



Report of Independent Auditors  
in Accordance with OMB Circular A-133  
and Financial Statements  
with Supplementary Information for

Washington Health Benefit Exchange

December 31, 2012

**MOSS ADAMS** LLP

Certified Public Accountants | Business Consultants

*Acumen. Agility. Answers.*

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## REPORT OF INDEPENDENT AUDITORS

To the Board of Directors  
Washington Health Benefit Exchange

### Report on Financial Statements

We have audited the accompanying financial statements of the Washington Health Benefit Exchange (the Exchange), as of and for the period from inception through December 31, 2012, and the related notes to the financial statements, which collectively comprise the Exchange's basic financial statements as listed in the table of contents.

### *Management's Responsibility for the Financial Statements*

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

### *Auditor's Responsibility*

Our responsibility is to express opinions on these financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in Government Auditing Standards, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Exchange's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinions.

### ***Opinion***

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Washington Health Benefit Exchange, as of December 31, 2012, and the changes in financial position and, where applicable, cash flows thereof for the period then ended in accordance with accounting principles generally accepted in the United States of America.

### ***Other Matters***

#### *Required Supplementary Information*

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 4 through 8 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

#### *Supplementary Information*

Our audit was conducted for the purpose of forming opinions on the financial statements that comprise the Washington Health Benefit Exchange's basic financial statements. The schedule of expenditures of federal awards as required by Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations* is presented for purposes of additional analysis and is not a required part of the basic financial statements.

The schedule of expenditures of federal awards is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the basic financial statements or to the basic financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the schedule of expenditures of federal awards is fairly stated, in all material respects, in relation to the basic financial statements as a whole.

**Other Reporting Required by *Government Auditing Standards***

In accordance with *Government Auditing Standards*, we have also issued our report dated September 13, 2013, on our consideration of the Washington Health Benefit Exchange's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering Washington Health Benefit Exchange's internal control over financial reporting and compliance.

A handwritten signature in black ink that reads "Ross Adams LLP". The signature is written in a cursive, flowing style.

Everett, Washington  
September 13, 2013

# WASHINGTON HEALTH BENEFIT EXCHANGE MANAGEMENT'S DISCUSSION AND ANALYSIS

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## Washington Health Benefit Exchange Overview

The Washington Health Benefit Exchange (the Exchange) is a central marketplace for individuals, families, and small businesses to find, compare, and purchase qualified health insurance plans. Starting October 1, 2013, Washington Healthplanfinder (Healthplanfinder) will offer Washington State residents 1) simple and quick apples-to-apples comparisons of Qualified Health Plans (QHP); 2) immediate determination of eligibility for financial assistance and calculation of applicable Advance Premium Tax Credits (APTC); and 3) expert customer support online, by phone, or in person through its In-Person Assister Program (IPA).

The Exchange seeks to redefine people's experience with health care. Its mission is to radically improve how Washingtonians purchase health insurance through an innovative, easy-to-use online customer experience. Objectives include 1) increasing access to affordable health plan products; 2) organizing a transparent and accountable insurance market to facilitate consumer choice; 3) providing an efficient, accurate, and customer-friendly eligibility determination process; and 4) enhancing health plan competition on value, which includes price, access, quality, service, and innovation.

## Key Activities and Operations through December 31, 2012

**Establishment** - In April 2011, the Washington Legislature passed Substitute Senate Bill 5445 (SSB 5445), which created the Exchange as a "public-private partnership separate and distinct from the state." The legislation was passed for the purpose of implementing a central marketplace for individuals and small employers to shop for health insurance and access federal tax credits pursuant to the Federal Patient Protection and Affordable Care Act (ACA) of 2010. Subsequent to signing the legislation establishing the Exchange, Governor Christine Gregoire appointed a bipartisan 11-member Governing Board (including the Washington Insurance Commissioner and Executive Director of the Health Care Authority as ex-officio nonvoting members) for the Exchange in December 2011. In March 2012, the Exchange Board adopted bylaws and assumed authority for all Exchange functions. Also in March 2012, additional legislation was passed via House Bill 2319 (HB 2319) establishing market rules, requirements for Qualified Health Plans, essential health benefits, and other key Exchange responsibilities.

**Funding** - The Exchange is primarily financed through federal grants to cover start-up costs and provide funding through the first year of operations in 2014. Washington has received several federal grants to fund the implementation and operations of the Exchange as follows:

- Planning Grant, \$1 million, to the Washington Health Care Authority, from September 30, 2010, to September 29, 2012.
- Level 1 Establishment Grant, \$23 million, to the Washington Health Care Authority, from May 23, 2011, to May 22, 2013.
- Effective February 2013, the Level 1 Establishment Grant was transferred from the Washington State Health Care Authority (HCA) to the Exchange and an extension to December 22, 2013, was also subsequently approved.
- Level 2 Establishment Grant, \$128 million, to the Washington Health Benefit Exchange to develop the online insurance marketplace, from May 16, 2012, to December 31, 2014.

# WASHINGTON HEALTH BENEFIT EXCHANGE MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)

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## Key Activities and Operations through December 31, 2012 (continued)

Both the Level 1 and Level 2 grants are disbursed based on the Exchange's draw from the Payment Management System. Draw requests are based on costs incurred. As part of the grant funding, the Exchange provides two reports annually to the U.S. Department of Health and Human Services (HHS), Centers for Medicare and Medicaid Services (CMS), Center for Consumer Information and Insurance Oversight (CCIIO).

**Staffing and infrastructure** - The Exchange Board appointed Richard Onizuka as Chief Executive Officer on May 2, 2012. At that time, the Exchange began hiring key staff. Other steps to operationalize the organization included:

- Putting in place the necessary physical infrastructure, including leasing office space in Olympia, Washington, and employee productivity enhancement tools including, but not limited to, computers, communication systems, and office equipment.
- Contracting for the systems integrator role, which is responsible for the design, development, and implementation of the Healthplanfinder.
- Developing internal accounting controls and financial management reporting systems with established protocols.

As of December 31, 2012, the Exchange had 50 employees supporting operations, information technology, communications, outreach and marketing, financial management, policy, and legal. In addition, the Exchange contracted for a variety of specialized consulting services, such as actuarial, quality standards development, accounting, project management, and quality assurance and verification.

**Communications and transparency** - To keep the public and constituents informed relative to the ongoing progress of the Exchange, a separate webpage within the Health Care Authority's website was established in 2012. A new website specific to the Exchange, [wabhexchange.org](http://wabhexchange.org), was subsequently introduced and launched in January 2013. The Exchange complies with open public meetings and public disclosure requirements, but is not subject to other laws that govern state agencies.

**Legislative and state coordination** - Although the Exchange is a separate and distinct entity from the state of Washington, it works with the legislature and the state of Washington in the following ways:

- Legislation adopted in 2012 (Engrossed Second Substitute House Bill 2319) required the Exchange Board to submit to the state legislature recommendations to develop a methodology for financial sustainability by December 31, 2012. The 2013 Legislature enacted a bill (Engrossed Substitute House Bill 1947) that establishes a funding mechanism for the Exchange consisting of 1) premium taxes from plans sold through the Exchange and 2) an assessment on issuers offering plans through the Exchange, effective January 1, 2015. The bill also makes the Exchange budget subject to appropriation in the state budget, requires quarterly reports to the Legislature, and requires a performance audit of Exchange operations by July 1, 2016.

## **WASHINGTON HEALTH BENEFIT EXCHANGE MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)**

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### **Key Activities and Operations through December 31, 2012 (continued)**

- The Exchange works closely with state agencies in operating its Healthplanfinder enrollment function. The Exchange works closely with the Health Care Authority to develop and operate Healthplanfinder as an enrollment portal for both Medicaid and QHP. The Exchange collaborates with the Office of the Insurance Commissioner on the approval and certification of QHP and regulation of brokers and agents. The Department of Social and Health Services is working with the Exchange to build and operate the Eligibility Service that will verify income and other eligibility requirements.

### **Timeline of Key Activities**

#### **September 2010**

- Washington receives a \$1 million planning grant to assess the development of a state-based exchange.

#### **May 2011**

- The Washington Health Benefit Exchange is created in Washington State statute through SSB 5445.
- Washington receives a \$23 million Level 1 Establishment Grant to support Exchange development in Washington State.

#### **December 2011**

- Governor Gregoire appoints a bipartisan 11-member governing board for the Exchange.

#### **January 2012**

- Deloitte Consulting LLP is selected as the System Integrator to design, develop, and implement Washington State's Health Benefit Exchange Information Technology system and Healthplanfinder.

#### **May 2012**

- Exchange receives Level 2 Establishment Grant for \$128 million.

#### **December 2012**

- The Exchange board submits a sustainability plan recommendation to the Washington State Legislature.
- The Exchange receives conditional approval from the federal government to operate Washington Healthplanfinder.

#### **September 2013**

- Washington Healthplanfinder Call Center is scheduled to open.

#### **October 1, 2013**

- Open enrollment through Washington Healthplanfinder begins for Washingtonians for coverage effective January 1, 2014.

# WASHINGTON HEALTH BENEFIT EXCHANGE MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)

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## Financial Statements

The Washington Health Benefit Exchange financial statements—including the statement of net position, the statement of revenues, expenses, and changes in net position, and the statement of cash flows—are designed to provide an overview of the Exchange's financial position and activities. The financial statements are prepared in accordance with accounting principles generally accepted in the United States of America as promulgated by the Governmental Accounting Standards Board (GASB). Under this method of accounting, an economic resources measurement focus and an accrual basis of accounting is used, similar to private industry. Revenue is recorded when earned, and expenses are recorded when incurred. Management prepares this Discussion and Analysis to assist the reader of these financial statements.

In September 2010, the state of Washington received a \$1 million planning grant from the Department of Health and Human Services to begin development of a health insurance exchange per ACA under the direction of the Washington Health Care Authority. In May 2011, the HCA also received a \$23 million Level 1 Establishment Grant to support Exchange development in Washington State. Beginning in March 2012, the Exchange began operating as an entity separate and distinct from the Health Care Authority. Shortly thereafter, the Exchange received a \$128 million Level 2 grant to begin implementation of the Washington Healthplanfinder website. Effective February 2013, the Level 1 Establishment Grant was formally transferred from the HCA to the Exchange. At that time, approximately \$7.8 million of funding was still available under the Level 1 grant. Both the Level 1 and Level 2 grants are disbursed based on the Exchange's draw from the Payment Management System. Draw requests are based on costs incurred.

The statement of net position presents information on the Exchange's assets and liabilities, with the difference between the two reported as net position. Over time, increases or decreases in net position may serve as a useful indicator of whether the financial position of the Exchange is improving or deteriorating. The December 31, 2012, statement of net position for the Exchange reflects approximately \$41,000 in cash, \$7.2 million receivable from federal grants, and \$628,000 receivable from the HCA for Medicaid cost reimbursement. Accounts payable and accrued liabilities for incurred but unpaid operating expenses were \$4.9 million and \$3.0 million, respectively. The significant balances of federal grants receivable and accounts payable at period-end reflect the growing operational activity for the Exchange and reliance on federal funds for start-up and implementation activities. Capital assets, net of accumulated depreciation, totaled approximately \$10.1 million as of December 31, 2012.

## **WASHINGTON HEALTH BENEFIT EXCHANGE MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)**

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### **Financial Statements (continued)**

The statement of revenues, expenses, and changes in net position reports the operating revenues and expenses as well as the nonoperating revenues and expenses of the Exchange for the period. The difference—increase or decrease in net position—is presented as the change in net position for the period. The cumulative differences from inception forward are presented as the net position of the Exchange, reconciling to total net position on the statement of net position. As reflected in the attached statement of revenues, expenses, and changes in net position for the period ended December 31, 2012, the Exchange recognized approximately \$18.1 million in revenues from federal grants, approximately \$628,000 in matching revenues from the Medicaid program, and approximately \$2.8 million in revenues for assets transferred from the HCA. Operating expenses incurred by the Exchange for 2012 totaled approximately \$11.5 million for the period ended December 31, 2012. Systems development and professional services costs represented the two most significant expense categories, comprising 46% and 21% of operating expenses for 2012, respectively. These costs were primarily incurred during the development of the Washington Healthplanfinder website. In accordance with the development of the website, the Exchange had capital additions of approximately \$11.1 million of IT equipment and software (see the statement of cash flows and Note 2 to the financial statements).

The statement of cash flows presents information relative to how the Exchange's cash and cash equivalents position changed during the period. The statement of cash flows classifies cash receipts and cash payments as resulting from operating activities, capital and related financing activities, noncapital financing activities, and investing activities. The net result of those activities is reconciled to the cash balance reported at the end of the period. This statement is prepared using the direct method, which allows the reader to easily understand the amount of cash received and how much cash was used.

The notes attached to the financial statements provide the reader with several important disclosures, including a summary of the significant accounting practices used by the Exchange. A comparative analysis will be provided in future years when prior-year information is available for such purpose.

**WASHINGTON HEALTH BENEFIT EXCHANGE**  
**STATEMENT OF NET POSITION**  
**DECEMBER 31, 2012**

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**ASSETS**

CURRENT ASSETS

Cash and cash equivalents	\$ 41,357
Federal grants receivable	6,258,490
Medicaid program cost reimbursement receivable	571,260
Prepaid expenses	<u>40,384</u>
Total current assets	<u>6,911,491</u>

NONCURRENT ASSETS

Long-term portion of federal grants receivable	929,280
Long-term portion of Medicaid program cost reimbursement receivable	<u>56,798</u>
Total noncurrent assets	<u>986,078</u>

CAPITAL ASSETS

Software	8,509,182
Computers and network	<u>2,623,769</u>
	11,132,951
Less accumulated depreciation	(1,484,645)
Work in progress	<u>410,612</u>
Capital assets, net	<u>10,058,918</u>
Total assets	<u>\$ 17,956,487</u>

**LIABILITIES AND NET POSITION**

CURRENT LIABILITIES

Accounts payable	\$ 4,851,560
Accrued liabilities	1,804,242
Payroll liabilities	<u>255,689</u>
Total current liabilities	6,911,491

LONG-TERM LIABILITIES

Contracts holdback liability	<u>986,078</u>
Total liabilities	<u>7,897,569</u>

NET POSITION

Net invested in capital assets	10,058,918
Unrestricted	<u>-</u>
Total net position	<u>10,058,918</u>
Total liabilities and net position	<u>\$ 17,956,487</u>

**WASHINGTON HEALTH BENEFIT EXCHANGE**  
**STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN NET POSITION**  
**FOR THE PERIOD FROM INCEPTION THROUGH DECEMBER 31, 2012**

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OPERATING REVENUES	\$	-
OPERATING EXPENSES		
System development		5,293,800
Professional services		2,429,281
Salaries, payroll taxes, and benefits		1,644,803
Depreciation		1,484,645
Equipment and supplies		239,294
Call center development		222,000
Occupancy		119,063
Other		60,895
Total operating expenses		11,493,781
Operating loss		(11,493,781)
NONOPERATING REVENUES		
Federal grants		18,115,805
Medicaid program cost reimbursement		628,058
Total nonoperating revenues		18,743,863
GAIN BEFORE CAPITAL CONTRIBUTIONS		7,250,082
CAPITAL CONTRIBUTIONS		2,808,836
Increase in net position		10,058,918
NET POSITION, inception		-
NET POSITION, end of period	\$	10,058,918

**WASHINGTON HEALTH BENEFIT EXCHANGE**  
**STATEMENT OF CASH FLOWS**  
**FOR THE PERIOD FROM INCEPTION THROUGH DECEMBER 31, 2012**

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CASH FLOWS FROM OPERATING ACTIVITIES	
Cash payments to suppliers for goods and services	\$ (1,115,854)
Cash payments to employees for services	<u>(1,398,135)</u>
Net cash from operating activities	<u>(2,513,989)</u>
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES	
Federal grants received	<u>2,555,346</u>
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES	
Federal grants received	8,372,689
Acquisition of capital assets	<u>(8,372,689)</u>
Net cash from capital and related financing activities	<u>-</u>
NET INCREASE IN CASH AND CASH EQUIVALENTS	41,357
CASH AND CASH EQUIVALENTS, inception	<u>-</u>
CASH AND CASH EQUIVALENTS, end of period	<u><u>\$ 41,357</u></u>
RECONCILIATION OF INCREASE IN NET POSITION TO NET	
CASH FROM OPERATING ACTIVITIES	
Operating loss	\$ (11,493,781)
Adjustments to reconcile operating loss to net cash from operating activities	
Depreciation	1,484,645
Changes in assets and liabilities	
Prepaid expenses	(40,384)
Accounts payable	4,502,319
Accrued liabilities	1,804,242
Payroll liabilities	242,892
Contracts holdback	<u>986,078</u>
Net cash from operating activities	<u><u>\$ (2,513,989)</u></u>
NONCASH INVESTING, CAPITAL, AND FINANCING ACTIVITIES	
Change in capital assets included in accounts payable and payroll liabilities	<u><u>\$ 362,038</u></u>
Capital contribution from Health Care Authority	<u><u>\$ 2,808,836</u></u>

# WASHINGTON HEALTH BENEFIT EXCHANGE

## NOTES TO FINANCIAL STATEMENTS

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### **Note 1 - Summary of Significant Accounting Policies**

The Washington Health Benefit Exchange (the Exchange) was created in state statute as a “public-private partnership separate and distinct from the state” for the purpose of establishing a state health insurance exchange in compliance with the Patient Protection and Affordable Care Act (ACA) of 2010. The Exchange is responsible for the creation of Washington Healthplanfinder, an easily accessible online marketplace for individuals, families, and small businesses to find, compare, and enroll in Qualified Health Plans (QHP). Open enrollment will begin on October 1, 2013, for coverage effective January 2014.

Federal grant funding will finance the Exchange design, development, and implementation phases, as well as the first full year of operations during 2014. Beginning in 2015, the Exchange must be financially self-sustaining through state funding appropriation, premium tax assessments on QHP issuers, and administrative fee assessments on QHP issuers selling in the Exchange.

**Reporting entity and basis of presentation** - The accompanying financial statements have been prepared in conformity with U.S. generally accepted accounting principles (GAAP) and are presented on the economic resources measurement focus and the accrual basis of accounting. Accordingly, revenues are recorded when earned and expenses are recorded when a liability is incurred. The Exchange has adopted the pronouncements of the Governmental Accounting Standards Board (GASB), which is the accepted standard-setting body for establishing governmental accounting and financial reporting principles nationally. The Exchange has no relationship with other entities that could be considered component units.

**Cash and equivalents** - The Exchange considers all highly liquid investment securities purchased with an original maturity of three months or less to be cash equivalents. The Exchange maintains its cash in bank deposits that are insured by the Federal Deposit Insurance Corporation (FDIC) up to a limit of \$250,000 per depositor or in certain noninterest-bearing accounts that are fully insured by the FDIC. At December 31, 2012, the Exchange had no uninsured cash.

**Grants** - Grant revenue is recognized and recorded as related expenses are incurred. Direct costs reimbursed by United States government agencies are subject to review and audit by such agencies.

**Grants and Medicaid program cost reimbursement receivable** - Federal grants receivable represents unreimbursed federal grant funds as of December 31, 2012, for the Level 2 Establishment Grant. Medicaid program cost reimbursement receivable represents unreimbursed state funds as of December 31, 2012, for the Washington Health Care Authority (HCA) Medicaid cost reimbursement. Management believes these amounts are properly reimbursable and fully collectible as of period-end; as such, no allowance has been established.

# WASHINGTON HEALTH BENEFIT EXCHANGE

## NOTES TO FINANCIAL STATEMENTS

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### Note 1 - Summary of Significant Accounting Policies (continued)

**Capital assets** - Purchased capital assets are reported at cost. During 2012, hardware and software assets were purchased by the HCA under contract with Deloitte Consulting using Level 1 Establishment Grant funds. These assets were acquired on behalf of the Exchange, and were legally transferred from the HCA to the Exchange shortly after execution of Contract No. HBE001 with the HCA. Per Section 18 of the contract, the beginning date of performance under the agreement was established as March 15, 2012, regardless of the date of execution. As such, the transfer of hardware and software assets from the HCA to the Exchange was determined to be March 15, 2012. These assets are recorded at historical cost, as they had not been placed into service until transferred to the Exchange.

The Exchange's capitalization threshold is \$1,000 for tangible personal property and leasehold improvements. There were no acquisitions of land or other real property for the period ended December 31, 2012.

Costs of assets sold or retired (and related amounts of accumulated depreciation) are eliminated from the accounts in the period of sale or retirement, and the resulting gain or loss is included in operations. Other costs incurred for repairs and maintenance are expensed as incurred.

Depreciation on all assets is provided on the straight-line basis over the following estimated useful lives:

Computers and network	3 to 5 years
Software	3 to 5 years
Furniture and equipment	5 to 10 years
Leasehold improvements	5 to 10 years*

\*Leasehold improvements will be depreciated over the shorter of their estimated useful lives or the term of lease. The term of the lease may include the years in the lease renewals that are reasonably assured.

**Contracts holdback liability** - Effective April 19, 2012, Contract K521 with Deloitte Consulting LLP was executed for the purpose of purchasing systems integrator services to develop and implement a Health Benefits Exchange System. Under the contract, the Exchange is required to retain a holdback of 10% of the purchase price for each deliverable until six months after the acceptance of the Exchange system deliverable. As the delivery date of the Exchange system is expected to occur during 2014, the balance of contract holdbacks as of December 31, 2012, is reflected as a long-term liability.

**Net position** - Net position represents all assets, less liabilities. Net position is displayed in the statement of net position in the following categories:

**Net investment in capital assets** - Capital assets, net of accumulated depreciation and outstanding principal balances of debt attributable to the acquisition, construction, or improvement of those assets. There is no debt attributable to the capital assets as of December 31, 2012.

**Restricted** - Net position subject to externally imposed stipulations on their use. There are no restrictions as of December 31, 2012.

**Unrestricted** - All remaining net position that does not meet the definition of "net investment in capital assets" or "restricted."

# WASHINGTON HEALTH BENEFIT EXCHANGE

## NOTES TO FINANCIAL STATEMENTS

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### Note 1 - Summary of Significant Accounting Policies (continued)

When both restricted and unrestricted resources are available for the same purpose, restricted net position is considered to be used first over unrestricted net position.

**Operating revenue and expense** - The Exchange distinguishes operating revenues and expenses from nonoperating items. Operating expenses include all expenses directly and indirectly related to establishing and running a health insurance marketplace pursuant to the ACA. Non-operating items include Medicaid program cost reimbursement revenue and federal grant funds received or requested.

**Capital contributions** - Capital contributions include contributions of capital assets or resources required to be used to acquire or construct capital assets. The assets transferred from the HCA are included in the statement of revenues, expenses, and changes in net position as capital contributions.

**Risk management** - The Exchange is subject to the risk of loss from various events, including, but not limited to, natural disasters and destruction of assets. The Exchange is currently covered by a commercial insurance program that contains multiple individual policies to mitigate risk exposure.

**Use of estimates** - The preparation of financial statements in accordance with U.S. generally accepted accounting principles (GAAP) requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

**New accounting pronouncements** - In June 2012, the GASB issued Statement No. 68, *Accounting and Financial Reporting for Pensions—an amendment of GASB Statement No. 27*. This statement replaces the requirements of Statement No. 27, *Accounting for Pensions by State and Local Governmental Employers*, and Statement No. 50, *Pension Disclosures*. This statement revises and establishes new financial reporting requirements for entities participating in single-employer and multiple-employer defined benefit pension plans, cost-sharing plans, and defined contribution plans. This statement requires entities providing defined benefit pensions to recognize its long-term obligation for pension benefits as a liability for the first time, and to more comprehensively and comparably measure the annual costs of pension benefits. This includes changes in the methods and assumptions used to project pension payments, discount projected payments to their present values, and attribute those present values to periods of employee service. The statement also enhances accountability and transparency through revised and new note disclosures and required supplementary information. This statement is effective for periods beginning after June 15, 2014. The Exchange is currently evaluating the impact of the adoption of this standard on its financial statements.

**Subsequent events** - The Exchange has evaluated subsequent events through September 13, 2013, the date on which the financial statements were available to be issued.

Effective February 21, 2013, the Level 1 Establishment Grant was transferred from the HCA to the Exchange, at which point approximately \$7.8 million of unused federal funds were still available under the grant.

# WASHINGTON HEALTH BENEFIT EXCHANGE

## NOTES TO FINANCIAL STATEMENTS

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### Note 1 - Summary of Significant Accounting Policies (continued)

The federal funding under the original Level 2 Establishment Grant awarded May 15, 2012, totaled \$128 million and covered the period from May 15, 2012, to May 15, 2014. Subsequent to December 31, 2012, two additional amendments to the original Level 2 Establishment Grant were issued to the Exchange. Amendment 3, effective April 22, 2013, provided an additional \$8.4 million of federal funds for the In-Person Assister Program (IPA) under the activity of outreach, education, and marketing. Amendment 4, effective July 17, 2013, awarded \$21 million in supplemental funding for the 2013-2014 Level 2 Establishment Grant period. These two amendments effectively increased the total federal funding under the Level 2 grant to \$157 million, and left the project period unchanged.

Subsequent to December 31, 2012, the Exchange entered into several vendor contracts related to the continuing operations of the Exchange. Among these contracts executed by the Exchange during 2013, there are 22 individual vendor agreements that committed the Exchange to a total contract price of approximately \$39 million between 2013 and 2018.

### Note 2 - Capital Assets

Capital assets consist of the following at December 31, 2012:

	<u>Inception</u>	<u>Additions</u>	<u>Disposals</u>	<u>End of Period</u>
Software	\$ -	\$ 8,509,182	\$ -	\$ 8,509,182
Computers and network	-	2,623,769	-	2,623,769
	-	11,132,951	-	11,132,951
Accumulated depreciation	-	(1,484,645)	-	(1,484,645)
Work in progress	-	410,612	-	410,612
Total capital assets, net	<u>\$ -</u>	<u>\$ 10,058,918</u>	<u>\$ -</u>	<u>\$ 10,058,918</u>

### Note 3 - Online Marketplace Development

During 2012, the Exchange incurred \$410,612 in costs related to the development of the health benefit exchange online marketplace (Healthplanfinder) that are being capitalized. The online marketplace has not been placed into service yet; therefore, amortization expense was not recorded for the period ended December 31, 2012. The Exchange expects Healthplanfinder to be placed into service in October 2013. At the time Healthplanfinder is placed into service, amortization will begin to be recorded on these costs.

## WASHINGTON HEALTH BENEFIT EXCHANGE NOTES TO FINANCIAL STATEMENTS

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### **Note 4 - Medicaid Program Cost Reimbursement**

On August 10, 2011, the federal government announced a time-limited, specific exception to the cost allocation requirements set forth in OMB Circular A-87 (Section C.3) that requires benefitting programs to pay their share of the costs associated with building state-based information technology systems. This allowed the Exchange to allocate a portion of qualifying expenditures to Medicaid and the Children's Health Insurance Program (CHIP) at a pre-agreed-upon rate. Subsequently, the Exchange and HCA worked cooperatively to discuss, review, and determine the cost allocation methodology for any Medicaid/CHIP eligible expenditures. On April 18, 2012, the Center for Medicare and Medicaid Services (CMS) approved the Washington State Health Care Authority Implementation Advance Planning Document (I-APD) for the design, development, and implementation activities of the state's Health Insurance Exchange that provides a benefit to the state's Medicaid program.

Subsequent to December 31, 2012, the Exchange submitted an A19 invoice voucher to the HCA providing the total computable Medicaid/CHIP disbursements along with required backup documentation. The total amount owed from the HCA to the Exchange is reflected as Medicaid program cost reimbursement receivable in the statement of net position. As of December 31, 2012, the receivable totaled \$628,058, of which \$571,260 is classified as current and \$56,798 is classified as noncurrent. The related revenue of \$628,058 is recorded as Medicaid program cost reimbursement in the statement of revenues, expenses, and changes in net position.

### **Note 5 - Related Parties**

Prior to the Exchange Board adopting bylaws and assuming responsibility for all Exchange functions, operations relating to implementation of the Patient Protection and Affordable Care Act of 2010 were performed through the HCA. In December 2011, the Executive Director of the HCA was appointed as an ex-officio nonvoting member of the Exchange Board.

The \$23 million Level 1 Establishment Grant was initially awarded to the HCA in May 2011 to support the Exchange development. From July 1, 2011, through October 31, 2012, the HCA expended approximately \$15.2 million of Level 1 funds toward the development of the Exchange. During 2012, hardware and software assets were purchased by the HCA under contract with Deloitte Consulting using Level 1 Establishment Grant funds. These assets were acquired on behalf of the Exchange, and were legally transferred from the HCA to the Exchange shortly after execution of Contract No. HBE001 with the HCA. These transferred assets totaled \$2.8 million for the period ended December 31, 2012, and are reflected as assets transferred from the HCA on the statement of revenues, expenses, and changes in net position. Effective February 21, 2013, the Level 1 Establishment Grant was transferred from the HCA to the Exchange, at which point approximately \$7.8 million of unused federal funds were still available under the grant.

# WASHINGTON HEALTH BENEFIT EXCHANGE

## NOTES TO FINANCIAL STATEMENTS

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### Note 6 - Commitments

During 2012, the Exchange entered into numerous multi-year contract agreements relating to the development of an Exchange. Any agreements that exceed the Exchange's current grant period are contingent upon future grant approval and appropriated funding by the state government, which is dependent on premium tax and issuer assessment levels.

**Office lease** - Effective October 10, 2012, the Exchange entered into an agreement to lease approximately 30,679 square feet of office space located in Olympia, Washington, with the commencement date of the lease scheduled for eight calendar months from the effective date of the agreement. The lease term under the contract is a period of five years from the commencement date. The following is a schedule by year of future minimum lease payments as of December 31, 2012:

2013	\$ 244,000
2014	537,000
2015	537,000
2016	537,000
2017	537,000
2018	<u>292,000</u>
Total minimum lease payments	<u>\$ 2,684,000</u>

**Department of Social and Health Services** - Under the Level 2 Establishment Grant awarded to the Exchange, approximately \$14.9 million is earmarked for the Washington Department of Social and Health Services (DSHS) for upgrading the state's existing Medicaid eligibility system to support the operations of the Exchange. Of the amount earmarked for DSHS, approximately \$7.0 million was budgeted for the year ending December 31, 2013.

**Vendor contracts** - The Exchange has engaged in long-term contracts obligating it to material expenditures in future periods. Remaining obligations under noncancelable contracts total approximately \$34,913,000 as of December 31, 2012.

The Exchange has received federal financial assistance for specific purposes that are generally subject to review or audit by the grantor agencies. Entitlement to this assistance is generally conditional upon compliance with the terms and conditions of grant agreements and applicable federal regulations, including the expenditure of assistance for allowable purposes. Any disallowance resulting from a review or audit may become a liability of the Exchange.

### Note 7 - Employee Pension Plans

**Washington State Public Employees' Retirement System (PERS)** - Substantially all of the Exchange's full-time and qualifying part-time employees participate in PERS. This is a statewide local government retirement system administered by the Washington State Department of Retirement Systems (DRS), under cost-sharing, multiple-employer defined benefit public employee retirement plans. The PERS system includes three plans.

## WASHINGTON HEALTH BENEFIT EXCHANGE NOTES TO FINANCIAL STATEMENTS

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### **Note 7 - Employee Pension Plans (continued)**

Participants who joined the system by September 30, 1977, are PERS Plan 1 members. Those joining thereafter are enrolled in PERS Plan 2. In March 2000, Governor Gary Locke signed into law a new retirement plan option for members of the PERS Plan 2. The new plan, titled PERS Plan 3, provides members with a “two-part, hybrid retirement plan,” which includes a defined benefit component and a defined contribution component.

**PERS Plan 1** - Members are eligible for retirement at any age after 30 years of service, at age 60 with five years of service, or at age 55 with 25 years of service. The annual pension is 2% of the average final compensation per year of service, capped at 60%. The average final compensation is based on the greatest compensation earned during any 24 eligible consecutive compensation months.

**PERS Plan 2** - Members may retire at age 65 with five years of service or at age 55 with 20 years of service. The annual pension is 2% of the average final compensation per year of service. PERS Plan 2 retirements prior to 65 are actuarially reduced. On July 1 of each year following the first full year of retirement service, the benefit will be adjusted by the percentage change in the Consumer Price Index (CPI) of Seattle, capped at 3% annually.

**PERS Plan 3** - Members may retire at age 65 with five years of service or at age 55 with 10 years of service for the defined benefit allowance. PERS Plan 3 retirements prior to 65 are actuarially reduced. PERS Plan 3 is structured as a dual benefit program that will provide members with the following benefits:

A defined benefit allowance similar to PERS Plan 2 calculated as 1% of the average final compensation per year of service (versus a 2% formula) and funded entirely by employer contributions.

A defined contribution account consisting of member contributions plus the full investment return on those contributions.

Each biennium, the State Pension Funding Council adopts PERS Plan 1 employer contribution rates and PERS Plan 2 employer and employee contribution rates. Employee contribution rates for PERS Plan 1 are established by statute at 6% and do not vary from year to year. The employer and employee contribution rates for PERS Plan 2 are set by the Director of the DRS, based on recommendations by the Office of the State Actuary, to continue to fully fund PERS Plan 2. Unlike PERS Plan 2, which has a single contribution rate (which is currently 4.64%), with PERS Plan 3, the employee chooses how much to contribute from six contribution rate options. Once an option has been selected, the contribution rate choice is irrevocable unless the employee changes employers.

All employers are required to contribute at the level established by state law. The methods used to determine the contribution requirements are established under state statute in accordance with Chapters 41.40 and 41.26 RCW.

The Exchange’s covered payroll for PERS for the period ended December 31, 2012, was \$1,325,000.

# WASHINGTON HEALTH BENEFIT EXCHANGE

## NOTES TO FINANCIAL STATEMENTS

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### Note 7 - Employee Pension Plans (continued)

The Exchange's contribution rate during 2012 expressed as a percentage of covered payroll for employer was 7.08% for PERS Plan 1, PERS Plan 2, and PERS Plan 3. The employer rate does not include the employer administrative expense fee currently set at 0.16%.

Both the Exchange and its employees made the required contributions. The Exchange's required contributions for 2012 were as follows:

	<u>Plan 1</u>	<u>Plan 2</u>	<u>Plan 3</u>	<u>Total</u>
2012 employer contributions	\$ -	\$ 55,927	\$ 38,496	\$ 94,423

The pension obligation was calculated on a pension system basis and cannot be disclosed on a plan basis. PERS does not make separate measurements of assets and pension obligations for individual employers.

Historical trend information regarding all of these plans is presented in Washington State DRS's annual financial report. A copy of this report may be obtained at:

Department of Retirement Systems  
P.O. Box 48380  
Olympia, WA 98504-8380

Internet address: [www.drs.wa.gov](http://www.drs.wa.gov)

### Note 8 - Concentrations

During the period ended December 31, 2012, approximately 97% of the Exchange's revenue was from United States government agencies. In addition, at December 31, 2012, 92% of all receivables were due from United States government agencies. These funds are subject to the review and audit of the grantor. Loss of this funding could have a material effect on the Exchange; however, management of the Exchange does not anticipate a significant loss of such funding.

**REPORT OF INDEPENDENT AUDITORS ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH *GOVERNMENT AUDITING STANDARDS***

Board of Directors  
Washington Health Benefit Exchange

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of the Washington Health Benefit Exchange (the Exchange) as of and for the period ended December 31, 2012, and the related notes to the financial statements, which collectively comprise the Exchange's basic financial statements, and have issued our report thereon dated September 13, 2013.

**Internal Control over Financial Reporting**

In planning and performing our audit of the financial statements, we considered the Exchange's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Exchange's internal control. Accordingly, we do not express an opinion on the effectiveness of the Exchange's internal control.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, we did not identify any deficiencies in internal control during our audit that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

## **Compliance and Other Matters**

As part of obtaining reasonable assurance about whether the Exchange's financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

## **Purpose of this Report**

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the entity's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

A handwritten signature in black ink that reads "Ross Adams LLP". The signature is written in a cursive, flowing style.

Everett, Washington  
September 13, 2013

## **REPORT OF INDEPENDENT AUDITORS ON COMPLIANCE FOR EACH MAJOR FEDERAL PROGRAM AND REPORT ON INTERNAL CONTROL OVER COMPLIANCE**

Board of Directors  
Washington Health Benefit Exchange

### **Report on Compliance for Each Major Federal Program**

We have audited Washington Health Benefit Exchange's (the Exchange) compliance with the types of compliance requirements described in the *OMB Circular A-133 Compliance Supplement* that could have a direct and material effect on the Exchange's major federal program for the period ended December 31, 2012. The Exchange's major federal program is identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs.

#### ***Management's Responsibility***

Management is responsible for compliance with the requirements of laws, regulations, contracts, and grants applicable to its federal programs.

#### ***Auditor's Responsibility***

Our responsibility is to express an opinion on compliance for the Exchange's major federal program based on our audit of the types of compliance requirements referred to above. We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about the Exchange's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances.

We believe that our audit provides a reasonable basis for our opinion on compliance for the major federal program. However, our audit does not provide a legal determination of the Exchange's compliance.

### ***Opinion on Each Major Federal Program***

In our opinion, the Exchange complied, in all material respects, with the types of compliance requirements referred to above that could have a direct and material effect on its major federal program for the period ended December 31, 2012.

### **Report on Internal Control Over Compliance**

Management of the Exchange is responsible for establishing and maintaining effective internal control over compliance with the types of compliance requirements referred to above. In planning and performing our audit of compliance, we considered the Exchange's internal control over compliance with the types of requirements that could have a direct and material effect on its major federal program to determine the auditing procedures that are appropriate in the circumstances for the purpose of expressing an opinion on compliance for the major federal program and to test and report on internal control over compliance in accordance with OMB Circular A-133, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of the Exchange's internal control over compliance.

*A deficiency in internal control over compliance* exists when the design or operation of a control over compliance does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, noncompliance with a type of compliance requirement of a federal program on a timely basis. *A material weakness in internal control over compliance* is a deficiency, or combination of deficiencies, in internal control over compliance, such that there is a reasonable possibility that material noncompliance with a type of compliance requirement of a federal program will not be prevented, or detected and corrected on a timely basis. *A significant deficiency in internal control over compliance* is a deficiency, or a combination of deficiencies, in internal control over compliance with a type of compliance requirement of a federal program that is less severe than a material weakness in internal control over compliance, yet important enough to merit attention by those charged with governance.

Our consideration of internal control over compliance was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over compliance that might be material weaknesses or significant deficiencies. We did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

The purpose of this report on internal control over compliance is solely to describe the scope of our testing of internal control over compliance and the results of that testing based on the requirements of OMB Circular A-133. Accordingly, this report is not suitable for any other purpose.

A handwritten signature in black ink that reads "Ross Adams LLP". The signature is written in a cursive, flowing style.

Everett, Washington  
September 13, 2013

**WASHINGTON HEALTH BENEFIT EXCHANGE  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
PERIOD ENDED DECEMBER 31, 2012**

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**Section I - Summary of Auditor's Results**

**Financial Statements**

Type of auditor's report issued: Unmodified

Internal control over financial reporting:

Material weakness(es) identified?  Yes  No

Significant deficiency(ies) identified?  Yes  None reported

Noncompliance material to financial statements noted?  Yes  No

**Federal Awards**

Internal control over major programs:

Material weakness(es) identified?  Yes  No

Significant deficiency(ies) identified?  Yes  None reported

Any audit findings disclosed that are required to be reported in accordance with section 510(a) of Circular A-133?  Yes  No

**Identification of Major Programs**

CFDA Numbers	Name of Federal Program or Cluster	Type of Auditor's Report Issued
93.525	State Planning and Establishment Grants for the Affordable Care Act (ACA)'s Exchanges	Unmodified
Dollar threshold used to distinguish between type A and type B programs: \$543,474		
Auditee qualified as low-risk auditee? <input type="checkbox"/> Yes <input checked="" type="checkbox"/> No		

**Section II - Financial Statement Findings**

None reported

**Section III - Federal Award Findings and Questioned Costs**

None reported

**SUPPLEMENTARY INFORMATION**

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**WASHINGTON HEALTH BENEFIT EXCHANGE  
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS  
PERIOD ENDED DECEMBER 31, 2012**

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<u>Federal Grantor/Pass-Through Grant/Program Title</u>	<u>Federal Award Year</u>	<u>Federal CFDA Number</u>	<u>Pass-Through Number</u>	<u>Federal Expenditures</u>
U.S. Department of Health and Human Services				
State Planning and Establishment Grants for the Affordable Care Act (ACA) Exchanges	5/16/2012 - 05/15/2014	93.525	1 HBEIE120121-01-00	<u>\$ 18,115,805</u>
Total expenditures of federal awards				<u><u>\$ 18,115,805</u></u>

**WASHINGTON HEALTH BENEFIT EXCHANGE**  
**NOTES TO THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS**  
**PERIOD ENDED DECEMBER 31, 2012**

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**Note 1 - Basis of Presentation**

The schedule of expenditures of federal awards (Schedule) includes the federal grant activity of Washington Health Benefit Exchange (the Exchange) under programs of the federal government for the period from inception to December 31, 2012. The information in this Schedule is presented in accordance with the requirements of OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Because the Schedule presents only a selected portion of the operations of the Exchange, it is not intended to and does not present the financial position, changes in net position, or cash flows of the Exchange.

**Note 2 - Summary of Significant Accounting Policies**

Expenditures reported on the Schedule are reported on the accrual basis of accounting. Such expenditures are recognized following the cost principles contained in 2 CFR Part 225, *Cost Principles for State, Local, and Indian Tribal Governments* (previously OMB Circular A-87), wherein certain types of expenditures are not allowable or are limited as to reimbursement.