

**STATE OF WASHINGTON
OFFICE OF THE INSURANCE
COMMISSIONER**



FINANCIAL EXAMINATION

of

**Dental Health Services, Inc.
Seattle, Washington**

**NAIC CODE 47490
December 31, 2006**

Order No. 08-110
Dental Health Services
Exhibit A

SALUTATION

Seattle, Washington
August 11, 2008

The Honorable Mike Kreidler, Commissioner
Washington State Office of the Insurance Commissioner (OIC)
Insurance Building – Capitol Campus
302 Sid Snyder Avenue SW, Suite 200
Olympia, Washington 98504

Dear Commissioner Kreidler:

In accordance with your instructions, and in compliance with the statutory requirements of RCW 48.44.145 and RCW 48.03.010, an examination was made of the corporate affairs and financial records of

Dental Health Services, Inc.

of

Seattle, Washington

hereinafter referred to as “DHS-WA” or the “Company,” at the location of its home office, 936 North 34th Street, Suite 208, Seattle, Washington 98103. This report is respectfully submitted showing the condition of the Company as of December 31, 2006.

CHIEF EXAMINER'S AFFIDAVIT

I hereby certify I have read the attached Report of the Financial Examination of Dental Health Services, Inc., of Seattle, Washington. This report shows the financial condition and related corporate matters as of December 31, 2006.

A handwritten signature in black ink that reads "Patrick H. McNaughton". The signature is written in a cursive style with a horizontal line underneath it.

Patrick H. McNaughton
Chief Examiner

8-11-08

Date

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SCOPE OF THE EXAMINATION

This examination covers the period beginning January 1, 2003 through December 31, 2006 and comprises a comprehensive review of the books and records of the Company. The examination followed the statutory requirements contained in the Washington Administration Code (WAC), the Revised Code of Washington (RCW), and the guidelines recommended by the National Association of Insurance Commissioners (NAIC) Financial Condition Examiners Handbook. The examination included identification and disposition of material transactions and events occurring subsequent to the date of examination that were noted during the examination.

Corporate records, external reference materials, and various aspects of the Company's operating procedures and financial records were reviewed and tested during the course of this examination and are commented upon in the following sections of this report. In addition, the Company's certified public accountant's (CPA's) work papers were reviewed and utilized, where possible, to facilitate efficiency in the examination.

INSTRUCTIONS

The examiners reviewed the Company's filed 2006 NAIC Annual Statement as part of the statutory examination. This review was performed to determine if the Company completed the NAIC Annual Statement in accordance with the NAIC Annual Statement Instructions and to determine if the Company's accounts and records were prepared and maintained in accordance with Title 48 RCW, Title 284 WAC, and the NAIC Statements of Statutory Accounting Principles (SSAP) as contained in the NAIC Accounting Practices and Procedures Manual (AP&P).

1. NAIC Annual Statement Errors and Misclassifications

The results of the examination disclosed several instances in which the Company's filing of the 2006 NAIC Annual Statement did not conform to the NAIC Accounting Practices and Procedures Manual and the NAIC Annual Statement Instructions.

a. Reserve for an expected premium deficiency for the year 2007 not reported in the 2006 NAIC Annual Statement

The Company did not report premium deficiency reserves in the 2006 NAIC Annual Statement as required by SSAP No. 54, paragraph No. 18, which says in part, "...when the expected claims payments or incurred costs, claim adjustment expenses and administration costs exceed the premiums to be collected for the remainder of a contract period, a premium deficiency reserve shall be recognized by recording an additional liability for the deficiency, with a corresponding charge to operations." A new large employer group contracted with DHS-WA effective January 1, 2006. The contract included a two-year rate guarantee through December 31, 2007. Heavy utilization throughout 2006 resulted in high losses on the contract. A late open enrollment in 2006 resulted in high utilization lasting into 2007. Considering the two-year rate guarantee, the Company should have recognized a premium deficiency reserve. (See examination adjustment No. 3, debiting "Unassigned funds (Other

professional services)” and crediting “Aggregate health policy reserves” in the amount of \$2,604,961.)

b. Claims unpaid reported incorrectly in the 2006 NAIC Annual Statement

Claim data provided by the Company to the examiners and its opining actuary was not consistent with the claim data reported in the 2006 NAIC Annual Statement, Underwriting and Investment Exhibit, Part 2B. The opining actuary utilizes this information to estimate the Claims unpaid liability in the NAIC Annual Statement, Page 3, Line 1. When claim data is incorrect, this could result in the opining actuary projecting incorrect liability estimates. The Company reported claims unpaid in the amount of \$172,270 in the 2006 NAIC Annual Statement, but could not provide support for that amount.

The Company and the OIC actuary calculated a \$331,065 deficiency for unpaid claims. An examination adjustment as of December 31, 2006 for an additional claims unpaid reserve is required. (See examination adjustment No. 1, debiting “Other professional services” and crediting “Claims unpaid” in the amount of \$331,065.)

c. Unpaid claims adjustment expenses reported incorrectly in the 2006 NAIC Annual Statement

Unpaid claims adjustment expenses were reported incorrectly in the 2006 NAIC Annual Statement for the same reasons noted in Instruction No. 1b.

The Company used a factor of 5.3% of claims unpaid to determine the unpaid claims adjustment expenses. This amount as of December 31, 2006, was estimated at \$15,798. The amount reported for unpaid claims adjustment expenses in the 2006 NAIC Annual Statement, Page 3, Line 3, as of December 31, 2006 was \$9,830. An examination adjustment as of December 31, 2006 for additional unpaid claims adjustment expenses is required. (See examination adjustment No. 2, debiting “Claims adjustment expenses” and crediting “Unpaid claims adjustment expenses” in the amount of \$5,968.)

d. Uncollected premiums and agents’ balances incorrectly reported in the 2006 NAIC Annual Statement

The Company incorrectly reported \$16,596 as a non-admitted asset for “Uncollected premiums and agents’ balances in the course of collection” in the 2006 NAIC Annual Statement. (See examination adjustment No. 4, debiting “Uncollected premiums and agents’ balances in the course of collection”, and crediting “Net premium income” in the amount of \$16,596.)

e. General expenses due or accrued incorrectly reported in the 2006 NAIC Annual Statement

General expenses due or accrued were reported incorrectly in the 2006 NAIC Annual Statement. The Company reported \$16,000 in commissions payable for external brokers, but failed to include an accrual for commissions payable to internal sales staff. (See examination adjustment No. 5, debiting “General administrative expenses” and crediting “General expenses due or accrued” in the amount of \$20,000.)

f. Notes to Financial Statements not completed according to NAIC Annual Statement Instructions

The Company reported different amounts for “Cash, cash equivalents, and short-term investments” in Note 1 of the Notes to Financial Statements than it reported on the Asset page of the 2006 NAIC Annual Statement.

g. Dental health benefits reported on the incorrect line in the 2006 NAIC Annual Statement

The Company incorrectly reported dental health benefits in the 2006 NAIC Annual Statement, Statement of Revenue and Expenses, Page 4, on Line 9, “Hospital/medical benefits”. The 2006 NAIC Annual Statement Instructions requires that these benefits be included on Page 4, Line 10, “Other professional services”. (See examination adjustment No. 6, debiting “Other professional services” and crediting “Hospital/medical benefits” in the amount of \$3,328,089.)

The Company is instructed to comply with RCW 48.44.100 and file an accurate statement of its financial condition, transactions, and affairs; with RCW 48.43.097 which requires the filing of its financial statements in accordance with the AP&P; and with WAC 284-07-050(2) which requires adherence to the NAIC Annual Statement Instructions and the AP&P.

2. Minimum Net Worth Requirements Not Met

The foregoing examination adjustments reduce capital and surplus to a negative \$2,036,828 which places the Company in a state of insolvency. Minimum net worth requirements are not being met and the deficiency needs to be cured.

The Company is instructed to comply with RCW 48.44.037 and RCW 48.44.039 and cure the deficiency. (See Subsequent Events.)

3. Statement of Actuarial Opinion (SAO) Did Not Include a Data Certification Statement

The original SAO did not include a data certification statement from an officer of DHS-WA as required by the 2006 NAIC Annual Statement Instructions, Page 10, Paragraph 11. A subsequent SAO was filed correcting this deficiency.

The Company is instructed to comply with RCW 48.43.097 which requires the filing of its financial statements in accordance with the AP&P; WAC 284-07-050(2) which requires adherence to the NAIC Annual Statement Instructions and the AP&P; and WAC 284-07-060(2)(a) which requires each health carrier to include with its annual statement an SAO setting forth the actuary’s opinion related to the insurer’s reserves and other actuarial items, that is prepared in accordance with the NAIC Annual Statement Instructions and the AP&P.

4. Services Exchanged Between Affiliated Companies Without an Agreement

a. **There is no written marketing services agreement**

DHS-WA provides marketing services to an affiliate, Dental Health Services (DHS-CA), without a written agreement which is in violation of RCW 48.31C.050(2)(d).

b. **There is no written service agreement with Custom Benefits Advisors, Inc. (CBA)**

CBA, an affiliate through the parent, Dental Health Services of America, Inc. (DHS-AM), provides services as an outside sales agent to DHS-WA without a written agreement, which is in violation of RCW 48.31C.050(2)(d).

The Health Carrier Holding Company Act requires that cost sharing agreements between affiliates be in writing and on file with the commissioner. The Company is instructed to comply with RCW 48.31C.050(2)(d) and notify the commissioner in advance and in writing of its intention to enter into transactions and agreements with affiliated companies within the health carrier holding company system.

COMMENTS AND RECOMMENDATIONS

1. Business Continuity Plan

The Company does not have a formal, written business continuity plan based on a business impact analysis that has been tested, and that addresses all significant business activities, including financial functions, telecommunication services, and data processing and network services. (This finding was also reported in the previous Financial Examination Report of December 31, 2002.)

It is recommended that the Company prepare a formal, written business continuity plan that addresses the continuation of all significant business activities, including financial functions, telecommunication services and data processing services, in the event of a disruption of normal business activities, as recommended by the NAIC.

2. Disaster Recovery Plan

The Company does not have a formal, written, disaster recovery plan for the resumption of information systems (IS) operations in the event of a disruption of normal operations. (This finding was also reported in the previous Financial Examination Report of December 31, 2008.)

It is recommended that the Company write, test, and implement a disaster recovery plan that includes appropriate escalation procedures to resolve operational failures in a timely manner, as recommended by NAIC guidelines.

3. Statement of Actuarial Opinion (SAO) Recommended Content

The NAIC Annual Statement Instructions include recommended content for the SAO. Two recommended paragraphs of the recommended content found in the 2006 NAIC Health Annual

Statement Instructions, Page 9, Paragraph 8F, were not included in the DHS-WA 2006 SAO.

These paragraphs address the accuracy and completeness of the data reported in the 2006 NAIC Annual Statement, Underwriting and Investment Exhibit, Part – 2B. (See Instruction No. 1b.)

It is recommended that the Company utilize the recommended content for the SAO as written in the 2006 NAIC Annual Statement Instructions.

4. Conflict of Interest

The Company does not have a written policy for disclosure of potential conflicts of interest from the BOD members, officers, and key employees.

It is recommended the Company complete a written policy requiring BOD members, officers, and key employees to complete annual conflict of interest forms. It is also recommended that procedures be developed to review potential conflicts when disclosed.

COMPANY PROFILE

Company History

DHS-WA was incorporated in the state of Washington, June 15, 1984, and was originally registered as a health care service contractor on October 18, 1984. On May 30, 1991, the certificate of registration was amended to a limited health care service contractor. Dental Health Services of California (DHS-CA), organized in the state of California in May 1974, became 100% owner of DHS-WA on June 28, 1984. Dental Health Services of America, Inc. (DHS-AM or the Parent) purchased 100% of DHS-WA from DHS-CA in April 1986.

Capitalization

The Company has 50,000 shares authorized and 10,000 shares issued and outstanding of \$1 par value common capital stock as of December 31, 2006. Additional paid in capital in the amount of \$1,518,442 has been contributed by the stockholders.

Territory and Plan of Operation

The Company administers prepaid dental health care services in the state of Washington. Under this type of plan, dental care is provided on a contractual basis for a basic monthly subscription fee (capitation payments) which is received without regard to frequency, extent, or kind of services provided. The basic subscription fee is supplemented upon occasion by additional co-payments for certain of the services offered. Co-payment amounts may vary with the services rendered, but are contractually agreed upon among the Company, participating providers, and group policyholders. Services are provided by dentists selected by the policyholder from a list of member dental professionals with whom the Company has entered into written service agreements.

Acquisitions, Mergers, Disposals, Dissolutions, Purchases, and Sales

There are no plans for acquisitions, mergers, disposals, dissolutions, purchases or sales.

Growth of Company

The following reflects the growth of the Company based on information filed in the NAIC Annual Statements for the five years ended December 31, 2006:

<u>Year</u>	<u>Premiums Earned</u>	<u>Net Underwriting Gain (Loss)</u>	<u>Net Investment Gain (Loss)</u>	<u>Net Income</u>
2006	\$4,864,324	(\$531,302)	\$44,002	(\$365,677)
2005	3,593,308	149,380	26,516	129,401
2004	3,468,161	161,729	13,804	136,521
2003	3,141,729	8,778	21,683	20,461
2002	3,082,505	265,090	29,261	203,051

AFFILIATED COMPANIES

Dental Health Services

DHS-CA, the first company organized by Godfrey Pernell, DDS, was organized in May 1974 to administer prepaid dental health care services in the state of California. DHS-CA organized DHS-WA in June 1984 to administer prepaid dental health care services in the state of Washington.

Dental Health Services of America

DHS-AM was organized in the state of California in February 1985 by Godfrey Pernell, DDS, to become the parent company of current and ensuing affiliated companies engaged in providing dental health care services.

DHS-AM purchased DHS-WA from DHS-CA in April 1986. Subsequent to that purchase, DHS-AM also purchased DHS-CA. During the years following, DHS-AM continued to organize new companies for potential entry into new marketplaces, and other companies for the purpose of providing services to the other affiliated companies. DHS-AM provides management services for all affiliated companies pursuant to a management services agreement. After its purchase by DHS-AM, DHS-CA continued providing administrative services to DHS-WA pursuant to an administrative services contract.

The following companies are 100% owed by the parent company, DHS-AM as of December 31, 2006:

Dental Health Services, Inc. (An Arizona Corporation)	Inactive
Dental Health Services (A California Corporation)	Active
Dental Health Services, Inc. (A Colorado Corporation)	Inactive

Dental Health Services, Inc. (A Washington Corporation)	Active
Dental Health Services, Inc. (An Oregon Corporation)	Inactive
Dental Management Services, Inc. (A Washington Corporation)	Active
Custom Benefit Advisors, Inc. (A Washington Corporation)	Active
DHS – Insurance Services, Inc. (A California Corporation)	Active
Dental Network Services (A California Corporation)	Active

Intercompany Agreements

Management Services Agreement, DHS-WA and DHS-AM

DHS-WA does not have its own dedicated management team. The management team of DHS-AM provides general management services in connection with the operation of DHS-WA's prepaid dental plans. This consists of general management over DHS-WA and insurance coverage where DHS-WA is a named insured on DHS-AM blanket policies.

Administrative Services Agreement, DHS-WA and DHS-CA

This agreement contains two different clauses regarding services to be provided. One is for administrative services provided by DHS-CA to DHS-WA and the other is for marketing services provided by DHS-WA to DHS-CA.

DHS-CA provides DHS-WA with administrative support that includes accounting, payroll, accounts payable, billing, accounts receivable, enrollment processing, capitation processing, membership services, computer and data processing, regulatory reporting, human resources, claims administration, and customer service.

The clause regarding marketing services makes reference to a separate marketing service agreement. No written agreement was provided by the Company because none existed as of December 31, 2006. DHS-WA provides marketing services to DHS-CA without a written agreement which is in violation of RCW 48.31C.050(2)(d). (See Instruction No. 4.) Fees and charges under the marketing service agreement are charged against fees and charges incurred under the administrative services agreement, and DHS-WA remits net charges monthly to DHS-CA.

Tax Allocation Agreement, DHS-WA and DHS-AM

DHS-AM and its subsidiaries use a fiscal year end of April 30 for federal income tax purposes. DHS-AM files a consolidated tax return with its subsidiaries, pursuant to a tax allocation agreement. Pursuant to the agreement, federal income tax expense or benefit is allocated between the parties annually in the ratio of their respective individual taxable income or net operating loss.

MANAGEMENT AND CONTROL

Ownership

The Company is controlled by DHS-AM, with management vested in a Board of Directors. Godfrey Pernell, DDS, originally owned 100% of DHS-AM. In May of 1988, an Employees Stock Ownership Plan (ESOP) was established by DHS-AM. At this time, ownership changed to 70% ownership by Godfrey Pernell, DDS and 30% ownership by the ESOP.

Board of Directors (BOD)

Management of the Company is vested in a BOD of two persons elected at each annual meeting by the shareholders. The following have been directors since the Company was organized:

Godfrey Pernell, DDS
Gary Pernell

Officers

The officers of the Company are elected annually by the BOD. Officers of the Company as of December 31, 2006 were:

Godfrey Pernell, DDS	President
Gary Pernell	Secretary, Treasurer, and CEO
Michael P. Fenton, CPA	Chief Financial Officer (as of January 15, 2007)

Conflict of Interest

The Company has a code of conduct as part of its employee handbook, but does not have a formal written policy wherein it requires an annual disclosure of potential conflicts of interest from the BOD members, officers, and key employees. (See Comments and Recommendation No. 4.)

Fidelity Bond and other Insurance

The Company and all affiliates are named insureds on a financial institution fidelity bond purchased by DHS-AM. An aggregate loss limit of coverage in the amount of \$1,600,000 is provided. The aggregate amount of coverage meets the NAIC recommended level for the Company.

The Company owns no real estate and reports only \$25,000 net of depreciation and amortization as furniture and equipment. DHS-AM has property insurance for the protection of corporate assets as well as assets for all affiliated companies.

Officers', Employees', and Agents' Welfare and Pension Plans

The Company is a participating employer in the DHS-AM's ESOP. An employee becomes a participant in the plan as of the first day of the plan year in which the employee first completes 1,000 hours of service, provided the employee has attained age 18. DHS-AM funding policy for the plan is to contribute annually not less than the minimum required or more than the maximum amount that can be deducted for federal income tax purposes. The Company's accrued contribution to the plan for the year ended December 31, 2006 was \$45,393.

CORPORATE RECORDS

The Articles of Incorporation, Bylaws, Certificate of Registration and minutes of the BOD were reviewed for the period under examination. No exceptions were noted and all BOD meetings were conducted with a quorum present.

ACTUARIAL REVIEW

The OIC health actuary reviewed the Company's actuarial report, claims unpaid, and other claim liabilities as of December 31, 2006. The review included examining the Company's reserving philosophy and methods to determine the reasonableness of the claim liabilities; verifying that claim liabilities included provisions for all components noted in SSAP No. 55, Paragraphs 7 and 8; reviewing historical paid claims and loss ratios; and estimating claims unpaid as of December 31, 2006.

The claim data provided to the examiners and to the opining actuary by DHS-WA was not consistent with the claim data reported in the 2006 NAIC Annual Statement, Underwriting and Investment Exhibit, Part 2B. The Company must reconcile and ensure that the actuary is provided all relevant information, and that a complete reconciliation exists among the general ledger, the incurred-paid loss triangles, and the NAIC Annual Statement. The OIC actuary's recalculation produced reserve values that were higher than those produced by the opining actuary. (See Instructions No. 1b and 1c, and Notes No. 1 and 2 in the Notes to the Financial Statements.)

The Company did not report a premium deficiency reserve in the 2006 NAIC Annual Statement as required by SSAP No. 54, Paragraph No. 18. The Company obtained a new large group policy effective January 1, 2006, that had a two year premium rate guarantee. As of December 31, 2006, the benefits paid on the new policy greatly exceeded premiums earned. Considering the two year rate guarantee, the Company should have recognized a premium deficiency reserve. (See Instruction No. 1a and Note No. 3 in Notes to the Financial Statements.)

The original Statement of Actuarial Opinion (SAO) did not have an attached certification statement from an officer of DHS-WA as required by the 2006 NAIC Annual Statement Instructions, page 10, Paragraph 11. A subsequent SAO was filed correcting this deficiency. (See Instruction No. 3.)

The NAIC Annual Statement Instructions also include recommended content for the SAO. Two recommended paragraphs were not included in the DHS-WA 2006 SAO accompanying the 2006 NAIC Annual Statement. (See Comments and Recommendations No. 3.)

REINSURANCE

The Company has no reinsurance program.

SPECIAL DEPOSITS

DHS-WA, as a registered limited health care service contractor, is subject to the minimum net worth requirements of RCW 48.44.035(6). Pursuant to this regulation, DHS-WA has on deposit with the state of Washington, \$1,053,513 in cash and US Treasury Bills. Of this amount, \$947,112 was considered as restricted by the state of Washington as of December 31, 2006.

ACCOUNTING RECORDS AND INFORMATION SYSTEMS

Accounting records are maintained by an affiliated company DHS-CA, pursuant to an administrative services agreement, and the Information Systems Department (IS) is owned and operated by DHS-CA.

Accounting records are maintained on a Generally Accepted Accounting Principles (GAAP) accrual basis of accounting and adjusted to Statutory Accounting Practices (SAP) basis for NAIC Annual Statement reporting. The Company is audited annually by the certified public accounting firm of Miller, Kaplan, Arase & Co., LLP. The Company received an unqualified opinion for all years under review. Accounting procedures, internal controls, and transaction cycles were reviewed during the planning and testing phase of the examination.

The IS department has only two members. The small size prevents the proper separation of duties and controls within the department. Some of the internal controls have been delegated to the chief financial officer and accounting manager. The IS department does not maintain proper written documentation for the System Development Life Cycle, Systems Design Standard Manual, Programming Standards Manual, and the Document Standards Manual. Many of its processes and internal controls are not properly documented. (See Comments and Recommendations No. 1 and No. 2.)

Operations and application controls were reviewed to determine the type of hardware installed; operating systems and proprietary software in use; back up and recovery facilities employed; and the internal controls exercised to maintain data security. DHS-CA has sufficient internal controls in place to monitor system activity and processes for a company the size of DHS-WA and the other affiliated companies that it provides services for.

There is no formal, written disaster recovery plan for the resumption of information systems operations in the event of a disruption of normal operations, nor is there a formal, written business continuity plan based on a business impact analysis that has been tested, and that addresses all significant business activities, including financial functions, telecommunication services, and data processing and network services in the event of a disruption of normal business activities. (See Comments and Recommendations No. 1 and 2.)

SUBSEQUENT EVENTS

Because of the decline in surplus during 2006, and the anticipation for continued adverse loss experience and additional decline in surplus during 2007, the Company obtained a solicitation permit from the state of Washington during the second quarter 2007 for additional financing in the amount of \$2,000,000. \$1,500,000 was deposited at the end of June 2007, and the balance of \$500,000 was deposited at the end of September 2007. These deposits are classified as Surplus Notes.

Additionally, during the third quarter 2007, the Company amended provider reimbursement methods which had the effect of reducing the overall benefits paid out and reducing the loss of surplus for the remainder of 2007.

DHS-AM made a permanent capital infusion of \$500,000 to DHS-WA in February 2008 which was classified as additional paid in capital.

A large group policy which had resulted in the need for a premium deficiency reserve was renegotiated to bring premium levels more into line with benefits and expenses paid. The new contract, effective January 1, 2008, called for a significant rate increase, greater capitation, and significantly less in co-payments to providers.

FOLLOW UP ON PREVIOUS EXAMINATION FINDINGS

The prior examination report of December 31, 2002 included comments and recommendations for the preparation of a disaster recovery plan and a business continuity plan, but written plans were never prepared. (See Comments and Recommendations No. 1 and No. 2.)

FINANCIAL STATEMENTS

The following examination financial statements show the financial condition of Dental Health Services, Inc., as of December 31, 2006:

- Assets, Liabilities, Capital and Surplus
- Statement of Revenue and Expenses
- Five Year Surplus Reconciliation
- Analysis of Changes in Financial Statements Resulting from the Examination

DENTAL HEALTH SERVICES, INC.
ASSETS, LIABILITIES, CAPITAL AND SURPLUS
December 31, 2006

	<u>BALANCE PER COMPANY</u>	<u>ref.</u>	<u>EXAMINATION ADJUSTMENTS</u>	<u>BALANCE PER EXAMINATION</u>
Assets				
Cash and short-term investments	\$1,842,375			\$1,842,375
Premiums and considerations:				
Uncollected premiums and agents' balances	8,117	4	16,596	24,713
Total Assets	<u>\$1,850,492</u>		<u>\$16,596</u>	<u>\$1,867,088</u>
 Liabilities, Capital, and Surplus				
Claims unpaid	\$172,270	1	\$331,065	\$503,335
Unpaid claims adjustment expenses	9,830	2	5,968	15,798
Aggregate health policy reserves		3	2,604,961	2,604,961
Premiums received in advance	569,159			569,159
General expenses due or accrued	80,196	5	20,000	100,196
Net deferred tax liability	102			102
Amounts due to parent, subsidiaries and affiliates	113,769			113,769
Total Liabilities	<u>945,326</u>		<u>2,961,994</u>	<u>3,907,320</u>
Common capital stock	10,000			10,000
Gross paid in and contributed surplus	1,518,442			1,518,442
Unassigned funds (surplus)	(623,276)	1,2,3,4,5	(2,945,398)	(3,568,674)
Total Capital and Surplus	<u>905,166</u>		<u>(2,945,398)</u>	<u>(2,040,232)</u>
Total Liabilities, Capital and Surplus	<u>\$1,850,492</u>		<u>\$16,596</u>	<u>\$1,867,088</u>

DENTAL HEALTH SERVICES, INC.
STATEMENT OF REVENUE AND EXPENSES
December 31, 2006

	<u>BALANCE PER COMPANY</u>	<u>ref.</u>	<u>EXAMINATION ADJUSTMENTS</u>	<u>BALANCE PER EXAMINATION</u>
Member months	261,488			261,488
Net premium income	\$4,864,324	4	\$16,596	\$4,880,920
Total revenues	4,864,324		16,596	4,880,920
<u>Hospital and Medical:</u>				
Hospital/medical benefits	3,328,089	6	(3,328,089)	0
Other professional services		1,3,6	6,264,115	6,264,115
Subtotal	3,328,089		2,936,026	6,264,115
<u>Less:</u>				
Claims adjustment expenses	170,449	2	5,968	176,417
General administrative expenses	1,897,088	5	20,000	1,917,088
Total underwriting deductions	5,395,626		2,961,994	8,357,620
Net underwriting gain or (loss)	(531,302)	1,2,3,4,5	(2,945,398)	(3,476,700)
Net investment income earned	44,002			44,002
Net investment gains or (losses)	44,002		0	44,002
Aggregate write-ins for other income or expenses				0
Loss on sale of property	712			712
Net income or (loss) before FTT	(486,588)		(2,945,398)	(3,431,986)
Federal and foreign income taxes incurred	(120,911)			(120,911)
Net Income (Loss)	(\$365,677)		(\$2,945,398)	(\$3,311,075)
<u>CAPITAL AND SURPLUS ACCOUNT</u>				
Capital and surplus prior reporting period	\$1,417,847		\$0	\$1,417,847
Net Income (Loss) from above	(365,677)		(2,945,398)	(3,311,075)
Change in net unrealized capital gains and losses	20,349			20,349
Change in nonadmitted assets	(167,353)			(167,353)
Net change in capital and surplus	(512,681)		(2,945,398)	(3,458,079)
Capital and surplus end of reporting period	\$905,166		(\$2,945,398)	(\$2,040,232)

**SURPLUS RECONCILIATION
FOR THE PERIODS ENDING**

	<u>12/31/2006</u>	<u>12/31/2005</u>	<u>12/31/2004</u>	<u>12/31/2003</u>	<u>12/31/2002</u>
Capital and surplus, prior reporting year	\$1,417,847	\$1,273,177	\$1,100,501	\$1,106,553	\$838,437
Net income or (loss)	(3,311,075)	129,401	136,521	20,461	203,051
Change in net unrealized capital gains and losses	20,349				
Change in nonadmitted assets	(167,353)	15,269	36,155	(26,513)	65,065
Net change in capital and surplus	(3,458,079)	144,670	172,676	(6,052)	268,116
Capital and surplus, end of reporting period	(\$2,040,232)	\$1,417,847	\$1,273,177	\$1,100,501	\$1,106,553

DENTAL HEALTH SERVICES, INC.
ANALYSIS OF CHANGES IN FINANCIAL STATEMENTS
RESULTING FROM THE EXAMINATION
FOR THE YEAR ENDED DECEMBER 31, 2006

	<u>BALANCE PER COMPANY</u>	<u>BALANCE PER EXAMINATION</u>	ref.	<u>INCREASE (DECREASE) IN SURPLUS</u>	<u>TOTAL</u>
Capital and Surplus, December 31, 2006 Per Annual Statement					\$905,166
<u>ASSETS</u>					
Premiums and considerations:					
Uncollected premiums and agents' balances	\$8,117	\$24,713	4	\$16,596	
<u>LIABILITIES</u>					
Claims unpaid	172,270	503,335	1	(331,065)	
Unpaid claims adjustment expenses	9,830	15,798	2	(5,968)	
Aggregate health policy reserves	0	2,604,961	3	(2,604,961)	
General expenses due or accrued	80,196	100,196	5	(20,000)	
<u>STATEMENT OF REVENUE AND EXPENSES</u>					
Hospital/medical benefits	3,328,089	(3,328,089)	6	3,328,089	
Other professional services		3,328,089	6	(3,328,089)	
Change in surplus			1,2,3,4,5		<u>(2,945,398)</u>
Capital and Surplus, December 31, 2006 Per Examination					<u><u>(\$2,040,232)</u></u>

NOTES TO THE FINANCIAL STATEMENTS

The Company has no special consents, permitted practices or orders from the state of Washington. There were six examination report adjustments.

1. The Company understated claims unpaid in the amount of \$331,065 in the 2006 NAIC Annual Statement. Claim data provided to the actuary by DHS-WA was not consistent with the claim data reported in the 2006 NAIC Annual Statement. The Company's opening actuary utilizes this information to estimate the claims unpaid liability that is reported in the NAIC Annual Statement on Line 1, Page 3. Incorrect claim data can result in the opening actuary projecting incorrect liability estimates. (An examination adjustment is reflected in the preceding financial statements, debiting "Unassigned funds" (other professional services) and crediting "Claims unpaid" in the amount of \$331,065.) (See Instruction No. 1b.)
2. The Company understated unpaid claims adjustment expense in the amount of \$5,968 in the 2006 NAIC Annual Statement. Claim data provided to the Company's opening actuary was not consistent with the claim data reported in the 2006 NAIC Annual Statement. The opening actuary utilizes this information to estimate the unpaid claims adjustment expense liability that is reported in the NAIC Annual Statement on Line 3, Page 3. Incorrect claim data can result in the opening actuary projecting incorrect liability estimates (An examination adjustment is reflected in the preceding financial statements, debiting "Unassigned funds" (claims adjustment expenses) and crediting "Unpaid claims adjustment expenses" in the amount of \$5,968.) (See Instruction No. 1c.)
3. The Company understated "Aggregate health policy reserves" (premium deficiency reserve) in the amount of \$2,604,961 in the 2006 NAIC Annual Statement. Claim data provided to the Company's opening actuary was insufficient for the opening actuary to consider that a premium deficiency reserve should have been recognized. (An examination adjustment is reflected in the preceding financial statements, debiting "Unassigned funds" (other professional services) and crediting "Aggregate health policy reserves" (premium deficiency reserve) in the amount of \$2,604,961.) (See Instruction No. 1a.)
4. The Company incorrectly reported \$16,596 as a non-admitted asset for "Uncollected premiums and agents' balances in the course of collection" in the 2006 NAIC Annual Statement. (An examination adjustment is reflected in the preceding financial statements, debiting "Uncollected premiums and agents' balances in the course of collection", and crediting "Net premium income" in the amount of \$16,596.) (See Instruction No. 1d.)
5. General expenses due or accrued were reported incorrectly in the 2006 NAIC Annual Statement. The Company reported \$16,000 in commissions payable for external brokers, but failed to include an accrual for commissions payable to internal sales staff. (An examination adjustment is reflected in the preceding financial statements, debiting "General administrative expenses" and crediting "General expenses due or accrued" in the amount of \$20,000.) (See Instruction No. 1e.)

6. The Company incorrectly reported dental health benefits in the 2006 NAIC Annual Statement, Statement of Revenue and Expenses, Page 4, on Line 9, "Hospital/medical benefits." The 2006 NAIC Annual Statement Instructions requires including these benefits on Page 4, Line 10, "Other professional services." (An examination adjustment is reflected in the preceding financial statements, debiting "Other professional services" and crediting "Hospital/medical benefits" in the amount of \$3,328,089.) (See Instruction No. 1g.)

ACKNOWLEDGMENT

Acknowledgment is hereby made of the cooperation extended to the examiners by the officers and staff of Dental Health Services, Inc., during the course of this examination.

In addition to the undersigned, Michael V. Jordan, CPA, CFE, MHP, Assistant Chief Examiner; Carl M. Baker, CPA, CFE, CISA, Health Field Supervisor; John R. Jacobson, AFE, CISA, AES, Automated Examination Specialist; Timothy F. Hays, CPA, JD, Investment Specialist; Shiraz Jetha, FSA, FCIA, MAAA, Health Actuary; Friday P. Enoye, Financial Examiner; Ann V. Kauffman, CPA, Financial Examiner; all from the Washington State Office of the Insurance Commissioner participated in the examination and the preparation of this report.

Respectfully submitted,



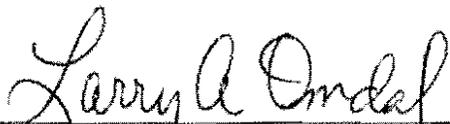
Larry A. Omdal, Examiner in Charge
State of Washington

AFFIDAVIT

STATE OF WASHINGTON }
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COUNTY OF KING } **ss**
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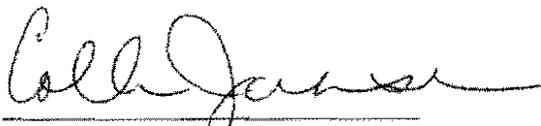
Larry A. Omdal, being duly sworn, deposes and says that the foregoing report subscribed is true to the best of his knowledge and belief.

He attests that the examination of Dental Health Services, Inc., was performed in a manner consistent with the standards and procedures required or prescribed by the Washington State Office of the Insurance Commissioner and the National Association of Insurance Commissioners (NAIC).



Larry A. Omdal, Examiner in Charge
State of Washington

Subscribed and sworn to before me this 11th day of August, 2008.



Notary Public in and for the
State of Washington