

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



**FINANCIAL EXAMINATION
of the Charitable Gift Annuity Business**

of

**PeaceHealth
Bellevue, Washington**

June 30, 2007

Order No. 09-141
PeaceHealth
Exhibit A

SALUTATION

Seattle, Washington
November 16, 2009

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, WA 98504

Dear Commissioner Kreidler:

In accordance with your instructions and in compliance with the statutory requirements of Chapter 48.38 RCW, Charitable Gift Annuity Business, an examination was made of the corporate affairs and financial records pertaining to the charitable gift annuity (CGA) business of

PeaceHealth

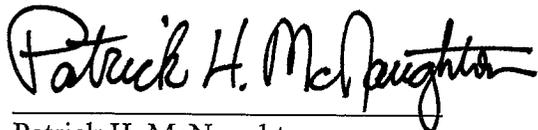
of

Bellevue, Washington

hereinafter referred to as "PH" at its office, 14432 SE Eastgate Way, Bellevue, Washington 98007. This report of examination is respectfully submitted showing the condition of the CGA business of PH as of June 30, 2007.

CHIEF EXAMINER'S AFFIDAVIT

I hereby certify I have read the attached Report of the Financial Examination of the Charitable Gift Annuity business of PeaceHealth of Bellevue, Washington. This report shows the financial condition of the CGA business and related corporate matters of PeaceHealth as of June 30, 2007.



Patrick H. McNaughton
Chief Examiner

11-16-09

Date

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SCOPE OF THE EXAMINATION

This examination covers the period January 1, 2003 through December 31, 2007. The 2007 Annual Report reflected the balance sheet and statement of revenue and expenses of PH as of June 30, 2007. The OIC granted permission to PH to present its CGA Annual Report as of its fiscal year ended June 30, 2007. The examination of the 2007 Annual Report, therefore, covers the period ending June 30, 2007 for the balance sheet and statement of revenue and expenses sections, and the period ending December 31, 2007 for the general interrogatories and charitable gift annuities reserve fund, and other applicable financial activities as deemed necessary. The financial statements are presented on a consolidated basis for PH and its affiliates. However, the scope of our examination focused only on the transactions and operations of the CGA business.

PH's records, along with various aspects of its operating procedures and financial reports, were reviewed and tested during the course of this examination as necessary to substantiate CGA business reporting. The results of the examination are commented upon in the various sections of this report. In addition, PH's certified public accountant's (CPA's) reports were reviewed and utilized, where possible, to facilitate efficiency in the examination.

The examination was conducted in accordance with the statutory requirements contained in the Revised Code of Washington (RCW) and the guidelines recommended by the National Association of Insurance Commissioners (NAIC) Financial Condition Examiners Handbook (FCEH). The examination was conducted at the Bellevue office of PH by examiners from the state of Washington.

INSTRUCTIONS

The examiners reviewed PH's CGA Annual Reports as part of the statutory examination. This review was performed to determine if PH completed the Annual Reports in accordance with the Annual Report Instructions published by the OIC and to verify that PH's accounts and records were prepared and maintained in accordance with Chapter 48.38 RCW.

The following summarizes the exceptions noted while performing this review.

1. Reporting Requirements

The filing of the Annual Reports by PH did not conform to Chapter 48.38 RCW and the OIC Annual Report Instructions during the examination periods 2003 through 2007.

- A. Balances reported included the accounts of PH, its subsidiary and related foundations. Included in the interest in net assets of related foundations were the net assets of St. John Medical Center Foundation (SJMCF). SJMCF is a separate

legal entity, a holder of Certificate of Exemption No. 80, and submits an annual report to the OIC.

- B. Although there were no exceptions noted in the forms and contents of the annuity contracts issued by PH, we noted that the transactions, investments and liability balances of six annuity contracts were maintained in the books of St. Joseph Hospital Foundation in error.

The OIC Annual Report Instructions specifically require that the Annual Report must be submitted only for the organization holding the certificate of exemption to issue annuities. Examination adjustments were made to remove account balances belonging to the subsidiary and interest in net assets of SJMCF, thereby, reflecting only the financial statements of PH in accordance with the OIC Annual Report Instructions. Adjustments to the 2007 Annual Report resulted in aggregate decreases in total assets of \$44,756,942, total liabilities of \$22,886,891, and total net assets of \$21,870,051. (See Financial Statements.)

PH is instructed to comply with reporting requirements in accordance with RCW 48.38.010(10)(a) and the OIC Annual Report Instructions.

2. CGA Liabilities - Reserves

RCW 48.38.020 requires PH to establish and maintain a separate reserve fund adequate to meet the future payments under its charitable gift annuity contracts. PH maintained a separate annuities reserve or payable of \$412,001 which did not agree to the actuary's calculated reserve amount of \$655,602. The amount of the separate reserve fund is also required to include a surplus of ten percent (10%) per RCW 48.38.020(3)(c). Pursuant to RCW 48.38.020(3)(c), the statutory aggregate reserves should be \$721,162. As a result, the reported annuities payable was understated by \$309,161 on December 31, 2007.

PH is instructed to report the statutory reserve calculated by the actuary pursuant to RCW 48.38.010(10)(c), plus an additional 10% as required by RCW 48.38.020(1) and (3)(c). No examination adjustment was made for June 30, 2007 reserves due to immateriality in relation to net assets and unrestricted assets available to back up the reserves.

COMMENTS AND RECOMMENDATIONS

There were no comments or recommendations made in this examination report.

ORGANIZATION PROFILE

History: PH is a not-for-profit corporation organized under the laws of the state of Washington. The corporation is organized and operated exclusively for charitable,

religious, scientific, and educational purposes. PH is a community ministry providing health care in Washington, Oregon, and Alaska. PH is sponsored by the Sisters of St. Joseph of Peace.

Territory and Plan of Operation: On December 16, 1994, the OIC granted PH a Certificate of Exemption No. 69 to conduct a CGA business in the state of Washington.

Total Net Assets: PH's total adjusted net assets as of June 30, 2007 were \$904,239,176. This amount included an unrestricted net asset of \$872,295,255. The minimum unrestricted net assets requirement was satisfied pursuant to RCW 48.38.010(6).

Growth: The growth of PH for the past five years is reflected in the following schedules. All information was compiled from PH's audited financial statements as of fiscal year ending June 30:

Schedule 1 – Statement of Financial Position

<u>Fiscal Year</u>	<u>Assets</u>	<u>Liabilities</u>	<u>Total Net Assets</u>	<u>Total Net Assets Allocated Into:</u>		
				<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>
*2007	\$1,687,572,968	\$783,333,792	\$904,239,176	\$872,295,255	\$29,351,317	\$2,592,604
2006	1,612,404,034	827,796,167	784,607,867	751,761,148	30,404,281	2,442,438
2005	1,509,078,150	833,555,551	675,522,599	648,936,318	24,353,323	2,232,958
2004	1,221,272,665	591,128,032	630,144,633	608,013,074	20,049,135	2,082,424
2003	1,069,862,688	524,842,532	545,020,156	531,301,096	10,836,536	2,882,524

Schedule 2 – Statement of Activities and Changes in Net Assets

	<u>*2007</u>	<u>2006</u>	<u>2005</u>	<u>2004</u>	<u>2003</u>
Total revenue and other income	\$1,163,108,792	\$1,092,577,104	\$996,732,832	\$900,172,764	\$845,948,896
Total expenses	1,068,975,977	999,426,050	954,853,428	850,288,686	792,692,608
Increase (decrease) in net assets	94,132,815	93,151,054	41,879,404	49,884,078	53,256,288
Other changes in net assets	49,804,628	15,934,214	3,498,562	35,240,399	(5,255,761)
Interest in net assets of SJMCF	(6,609,703)				
Net assets at beginning of year	766,911,436	675,522,599	630,144,633	545,020,156	497,019,629
Net assets at end of year	\$904,239,176	\$784,607,867	\$675,522,599	\$630,144,633	\$545,020,156
Number of gift annuity contracts at end of year	7	6	5	5	2

*The 2007 balances included examination adjustments. (See Financial Statements.) The net assets at the beginning of the year, \$766,911,436, included PH's consolidating journal entries of \$16,696,431 for prior years' fund balance adjustment (\$784,607,867 less \$17,696,431 equals \$766,911,436).

AFFILIATED ORGANIZATIONS

The consolidated financial statements include the accounts of PH, its subsidiary and related foundations. The following operating divisions are components of PH: Sacred Heart Medical Center – Oregon Region, Peace Harbor Hospital – Siuslaw Region, St. John Medical Center – Lower Columbia Region, St. Joseph Hospital – Whatcom Region, Ketchikan General Hospital – Alaska Region, and Oregon Medical Laboratories.

Health Ventures (HV) is a wholly owned subsidiary of PH which is engaged in several healthcare joint ventures. SJMCF, PH's affiliated foundation, operates for the exclusive benefit of the PeaceHealth St. John Medical Center in Longview, Washington and has maintained a separate charitable gift annuity exemption.

MANAGEMENT AND CONTROL

Management: PH's business and affairs are managed under the direction of a Board of Directors (BOD) of no less than thirteen or more than sixteen persons.

Board of Directors: The BOD as of June 30, 2008:

Terry Brandon
Norah Clarke
Margaret Dimond
Eleanor Gilmore
Joe Gonyea, II
Thomas Grove
Anne Hayes
Monica Heeran

Dieter Morich, M.D.
Andrea Nenzel
Catherine Potts, M.D.
Kathleen Pruitt
Curt Roberts
Carol Sheridan
Roland Trenouth, M.D.

Officers: The officers as of June 30, 2008:

Alan Yordy, President
Andrea Nenzel, First Vice President/Provincial Leader
Monica Heeran, Secretary
Terry Brandon, Treasurer

Tax Status: PH is a tax-exempt charitable organization under Section 501(c)(3) of the Internal Revenue Code.

Conflict of Interest: The BOD establishes a general policy statement concerning conflicts of interest, together with guidelines for observing the policy. Persons who serve on the BOD are required to furnish annually a signed statement certifying that they have received and agreed to comply with the Conflict of Interest Policy and disclosing any possible or apparent conflicts of interest on the Conflict of Interest Disclosure Questionnaire. The BOD reviews and decides whether a conflict of interest exists or not.

The BOD discussions and decisions are recorded in the minutes of the BOD meetings. There were no exceptions noted.

ORGANIZATION RECORDS

The BOD meets six times a year to discuss any business which is pertinent to PH. BOD meeting minutes documented the approval of PH's transactions and events. No exceptions were noted.

STATEMENT OF ACTUARIAL OPINION

A consulting actuary with Milliman, Inc., reviewed the adequacy of the annuity reserves and issued a Statement of Actuarial Opinion (SAO) which stated that he is a member of the American Academy of Actuaries. The SAO indicated that PH's annuity contract reserves as computed under RCW 48.38.020(3)(a) and (b) should be \$655,602 as of December 31, 2007. This amount, plus an additional 10% as required by RCW 48.38.020(3)(c), was not properly reported as annuity liabilities in PH's financial statements. (See Instruction No. 2.)

ANNUITY ASSETS CUSTODIAL FUNCTION

The separate reserve fund assets were held legally and physically segregated from the other assets of PH as required by RCW 48.38.020(2). The market values of the annuity investments as of December 31, 2007 were \$930,527 and consisted of cash equivalents and mutual funds. The annuity investments were properly reported in the financial statements at market value.

SUBSEQUENT EVENTS

There were no material events which impacted PH's CGA business between the examination date and the last day of our field work.

ACCOUNTING RECORDS AND PROCEDURES

The records and source documentation supported the data and amounts presented in the annual reports and financial statements.

FINANCIAL STATEMENTS

The following financial information summarizes the financial statements of PH:

PEACEHEALTH STATEMENT OF FINANCIAL POSITION June 30, 2007

	<u>Balance per Annual</u> <u>Report</u>	Reference	<u>Examination</u> <u>Adjustments</u>	<u>Balance Per</u> <u>Examination</u>
<u>ASSETS</u>				
Cash and cash equivalents	\$58,659,150	1	(\$3,613,340)	\$55,045,810
Short-term investments	115,822,215		0	115,822,215
CGA investments	875,094		0	875,094
Other current assets	247,627,613	1	(84,034)	247,543,579
Assets whose use is limited - cash and investments	395,812,848	1	(12,709,180)	383,103,668
Property, plant & equipment, net	842,098,513	1	(21,628,768)	820,469,745
Deferred financing costs, net	12,318,636		0	12,318,636
Interest in net assets of SJMCF	6,609,703	1	(6,609,703)	0
Interest in net assets of related foundations-Others**	26,748,345		0	26,748,345
Other assets	25,757,793	1	(111,917)	25,645,876
Total Assets	\$1,732,329,910		(\$44,756,942)	\$1,687,572,968
<u>LIABILITIES</u>				
Current liabilities	\$237,556,439	1	(\$140,518)	\$237,415,921
Other liabilities and deferred revenues	81,744,114	1	(608,993)	81,135,121
CGA reserves	411,627			411,627
Long-term debt and other liabilities	486,508,503	1	(22,137,380)	464,371,123
Total Liabilities	806,220,683		(22,886,891)	783,333,792
<u>NET ASSETS</u>				
Unrestricted	894,165,306	1	(21,870,051)	872,295,255
Temporarily restricted	29,351,317		0	29,351,317
Permanently restricted	2,592,604		0	2,592,604
Total Net Assets	926,109,227		(21,870,051)	904,239,176
Total Liabilities and Net Assets	\$1,732,329,910		(\$44,756,942)	\$1,687,572,968

**PH is required to recognize its interests in the net assets of its related foundations under Financial Accounting Standards No. 136, "Transfers of Assets to a Not-For-Profit Organization or Charitable Trust That Raises or Holds Contributions for Others." The related foundations' sole purpose is engage in fund raising activities for the exclusive benefit of PH.

STATEMENT OF ACTIVITIES AND CHANGES IN NET ASSETS
For Fiscal Year Ended June 30, 2007

	<u>Balance Per Annual Report</u>	<u>Reference</u>	<u>Examination Adjustments</u>	<u>Balance Per Examination</u>
Total revenues	\$1,175,328,560	1	(\$12,219,768)	\$1,163,108,792
Total expenses	<u>1,072,516,937</u>	1	<u>(3,540,960)</u>	<u>1,068,975,977</u>
Increase (decrease) in net assets	102,811,623		(8,678,808)	94,132,815
Other changes in net assets	38,228,610	1	11,576,018	49,804,628
Interest in net assets of SJMCF		1	(6,609,703)	(6,609,703)
Net assets at beginning of year	<u>785,068,994</u>	1	<u>(18,157,558)</u>	<u>766,911,436</u>
Net assets at end of year	<u><u>\$926,109,227</u></u>		<u><u>(\$21,870,051)</u></u>	<u><u>\$904,239,176</u></u>

Reference:

1. Assets, liabilities, revenues, expenses, and net assets of HV and SJMCF were eliminated in order to present PH's financial statements in accordance with the OIC Annual Report Instructions. (See Instruction No. 1.)

Please note that no adjustment was made for June 30, 2007 reserves due to immateriality in relation to net assets.

ACKNOWLEDGMENT

Acknowledgment is hereby made of the cooperation extended to the examiners by the officers and employees of PH's during the course of this examination.

In addition to the undersigned, Michael V. Jordan, CPA, CFE, MHP, Assistant Chief Examiner and Susan Campbell, CPA, CFE, FLMI, Life and Disability Field Supervising Examiner, both from the Washington State Office of the Insurance Commissioner, participated in the examination and the preparation of this report.

Respectfully submitted,



Orlando R. Gabriel, AFE
Examiner-in-Charge
State of Washington

November 2, 2009

James T. Odiorne
Deputy Insurance Commissioner
Company Supervision
5000 Capitol Blvd.
Tumwater, WA 98501

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**INSURANCE COMMISSIONER
COMPANY SUPERVISION**

Dear Mr. Odiorne,

Thank you for the opportunity to provide the following comments on the draft findings of your recent CGA examination of PeaceHealth. We appreciate your consideration of the following information:

1. Reporting Requirements:

- a. i. The balances reported for PeaceHealth included only PeaceHealth's ownership share of the joint ventures and excluded other partners' shares in the joint ventures. We are excluding PeaceHealth's investment in such entities on future annual reports since the exclusion of these balances does not materially affect the overall financial position and performance of PeaceHealth.
- ii. The report included the net assets of affiliated Foundations' since it is their sole purpose to engage in fund raising activities for the exclusive benefit of PeaceHealth. Under agreements with the Foundations PeaceHealth has turned over all its fund-raising activities to the Foundations and the net assets of the Foundations included on the PeaceHealth balance sheet are funds secured by the Foundations, which have not as yet been transferred to PeaceHealth but are still held by the Foundation for the exclusive benefit of PeaceHealth. However, since the St. John Medical Center Foundation (which also operates for the exclusive benefit of the PeaceHealth St. John Medical Center in Longview) has maintained a separate Charitable Gift Annuity license, we will exclude its net assets from reports PeaceHealth since those net assets are being reported to you in connection with the St. John Medical Center Foundation Annual Report.
- b. We also deem it is appropriate to report the Charitable Gift Annuities obtained from donors for the benefit of PeaceHealth's St. Joseph Hospital in Bellingham to be reported on the St. Joseph Hospital Foundation's books since PeaceHealth has turned over all fund raising activities for St. Joseph Hospital to its affiliated Foundation (as explained in "ii" above) and since the net assets of the St. Joseph Hospital Foundation were included in the annual report.

*Dedicated to Exceptional Medicine
and Compassionate Care*

2. CGA Liabilities – Reserves

RCW 48.38.020 requires PeaceHealth to establish and maintain a separate reserve fund adequate to meet the future payments under its charitable gift annuity contracts. We do not understand your conclusion that the separately maintained reserve fund as of December 31, 2007 only contained \$412,002. As of December 31, 2007 the balance in the separately maintained reserve fund was \$930,527--as confirmed on Page 5 of your draft findings—which exceeds the aggregate reserve requirement of \$721,162 (representing the actuarially calculated reserve plus 10%) by more than \$200,000. We monitor the reserve funding requirement on a monthly basis to assure that it is always funded by at least 110% of the last actuarial evaluation plus any new gifts received.

It is true that the financial statements of the St. Joseph Hospital Foundation only reflected annuities payable of \$412,001. That amount was determined in conformance with Generally Accepted Accounting Principles and was based on the IRS methodology of calculating the present value of gift annuity obligations, as recommended by our auditors. Since the actuarially calculated reserve under RCW 48.38 results in a more conservative valuation of future payment obligations to CGA donors, we are now using the actuarially calculated reserve to report annuities payable on our financial statements.

Please be assured of our sincere interest in complying with all aspects of Chapter 48.38 RCW. We hope that this additional information will help to clarify our rationale for providing reports as submitted. I would be happy to answer any questions or provide further clarification.

And finally, we would also like to express our sincere appreciation for the courtesy and consideration shown by Mr. Orlando Gabriel and Ms. Susan Campbell of your Seattle office, who conducted this audit.

Sincerely,



Hermann A. Goeppeler, CPA
Vice President for Capital Development

cc. Mr. Orlando Gabriel