



OFFICE OF  
INSURANCE COMMISSIONER

In the Matter of	)	No. 11-224
	)	
The Financial Examination of	)	FINDINGS, CONCLUSIONS,
<b>HEALTH CARE AUTHORITY</b>	)	AND ORDER ADOPTING REPORT
	)	OF EXAMINATION

**BACKGROUND**

An examination of the financial condition of the **HEALTH CARE AUTHORITY** (HCA) as of June 30, 2010 was conducted by examiners of the Washington State Office of the Insurance Commissioner (OIC). The Health Care Authority is an agency of the state of Washington created by Chapter 41.05 RCW. RCW 41.05.140(5) requires the Insurance Commissioner to perform periodic examinations of HCA. This examination was conducted in compliance with the laws and regulations of the state of Washington and in accordance with the procedures promulgated by the National Association of Insurance Commissioners and the OIC.

The examination report with the findings, instructions, and recommendations was transmitted to HCA for its comments on July 27, 2011. HCA's response to the report is attached to this order only for the purpose of a more convenient review of the response.

The Commissioner or a designee has considered the report, the relevant portions of the examiners' work papers, and the submissions by HCA.

Subject to the right of HCA to demand a hearing pursuant to Chapters 48.04 and 34.05 RCW, the Commissioner adopts the following findings, conclusions, and order.

## FINDINGS

Findings in Examination Report. The Commissioner adopts as findings the findings of the examiners as contained in pages 1 through 8 of the report.

## CONCLUSIONS

It is appropriate and in accordance with law to adopt the attached examination report as the final report of the financial examination of **HEALTH CARE AUTHORITY** and to order HCA to take the actions described in the Instructions and Comments and Recommendations sections of the report. The Commissioner acknowledges that HCA may have implemented some of the Instructions and Comments and Recommendations prior to the date of this order. The Instructions and Comments and Recommendations in the report are appropriate responses to the matters found in the examination.

## ORDER

The examination report as filed, attached hereto as Exhibit A, and incorporated by reference, is hereby ADOPTED as the final examination report.

HCA is ordered as follows, these being the Instructions and Comments and Recommendations contained in the examination report on pages 1- 2.

1. Pursuant to RCW 41.05.140(1) and (5), HCA is ordered to maintain the level of its fund balance at no less than the required PSR amount. Instruction 1, Examination Report, page 1.
2. Pursuant to RCW 41.05.140(6), HCA is ordered to keep full and adequate accounts and records of assets, obligations, transactions and affairs. Instruction 2, Examination Report, page 2.
3. It is ordered that HCA consider setting up receivables for pharmaceutical rebates that are specifically identified and billed in accordance with the pharmaceutical rebate contract provisions. In addition, the rebates should be accounted for in the appropriate accounting period. Comments and Recommendations 1, Examination Report, page 2.

IT IS FURTHER ORDERED THAT, HCA file with the Chief Examiner, within 90 days of the date of this order, a detailed report specifying how HCA has addressed each of the requirements of this order.

ENTERED at Olympia, Washington, this 3rd day of October, 2011.

A handwritten signature in black ink, appearing to read "Mike Kreidler". The signature is fluid and cursive, with the first name "Mike" being more prominent than the last name "Kreidler".

MIKE KREIDLER  
Insurance Commissioner



STATE OF WASHINGTON  
**HEALTH CARE AUTHORITY**

626 8th Avenue, SE • P.O. Box 45502 • Olympia, Washington 98504-5502

August 8, 2011

James T. Odiorne  
Deputy Insurance Commissioner  
Washington State  
Office of the Insurance Commissioner  
P.O. Box 40255  
Olympia, WA 98504-0255

Dear Deputy Commissioner Odiorne:

**SUBJECT: Financial Examination Report of the Health Care Authority as of  
June 30, 2010**

Please find the enclosed draft of the referenced report of examination with our responses to the exceptions noted and the comment and recommendations. If you have further questions regarding our responses or need additional information, please contact Annette Meyer, Deputy Chief, Financial Services, at (360) 923-2806 or via email at [Annette.meyer@hca.wa.gov](mailto:Annette.meyer@hca.wa.gov).

HCA staff appreciated working in a cooperative and transparent manner with OIC staff, and we look forward to working with you again in the future.

Sincerely,

A handwritten signature in black ink that reads "Doug Porter".

Doug Porter  
Director

Enclosure

cc: Annette Meyer, Deputy Chief Financial Officer, Financial Services, HCA

STATE OF WASHINGTON  
OFFICE OF THE INSURANCE COMMISSIONER



FINANCIAL EXAMINATION  
OF  
HEALTH CARE AUTHORITY  
LACEY, WASHINGTON

JUNE 30, 2010

**SALUTATION**

Seattle, Washington  
July 18, 2011

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

Dear Commissioner Kreidler:

In accordance with your instructions, and in compliance with the statutory requirements of RCW 41.05.140(5) and RCW 48.03.010, an examination was made of the affairs and financial records of

Health Care Authority  
of  
Lacey, Washington

hereinafter referred to as "HCA" at its home office located at 676 Woodland Square Loop SE, Lacey, Washington 98504-2682. This report is respectfully submitted showing the condition of HCA as of June 30, 2010.

**CHIEF EXAMINER'S AFFIDAVIT**

I hereby certify I have read the attached Report of the Financial Examination of the Health Care Authority of Lacey, Washington. This report shows the financial condition and related matters of HCA as of June 30, 2010.

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Patrick H. McNaughton  
Chief Examiner

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Date

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## SCOPE OF THE EXAMINATION

This examination covers the period July 1, 2006 through June 30, 2010 and comprises a comprehensive review of the books and records of HCA. The examination followed the applicable statutory requirements contained in the Washington Administrative Code (WAC), the Revised Code of Washington (RCW), and the guidelines recommended by the National Association of Insurance Commissioners (NAIC) Financial Condition Examiners Handbook (FCEH) and the NAIC Accounting Practices and Procedures Manual (AP&P). The examination included identification and disposition of material transactions and events occurring subsequent to the date of examination through the end of field work on May 16, 2011.

The records, external reference materials, and various aspects of HCA's operating procedures and financial records were reviewed and tested during the course of this examination and are commented upon in the following section of this report.

## INSTRUCTIONS

The following summarizes the exceptions noted while performing this review:

### **1. Premium Stabilization Reserves (PSR) and Surplus Deficiency**

RCW 41.05.140(1) and (5) require HCA to establish and maintain adequate reserves for payment of future claims. Part of HCA's fund balance is segregated as Premium Stabilization Reserves (PSR) which is the HCA's minimum total reserve level. As of June 30, 2010, the HCA's fund balance was negative and below the required PSR amount by \$101,913,014.

Pursuant to RCW 41.05.140(1) and (5), the HCA is instructed to maintain the level of its fund balance at no less than the required PSR amount. (See Page 4, PREMIUM STABILIZATION RESERVES AND SURPLUS DEFICIENCY)

Although the PEBB fund balance continues to experience challenges, the deficit has decreased from last year at this time. HCA received funding from the 2010 Legislature which included a 14.1% increase for fiscal year 2011. The new funding rate of \$850 per employee, per month took effect on July 1, 2010. We will continue to monitor the fund balance for significant changes.

### **2. Accounts and Records**

The following discrepancies were identified when auditing the HCA's accounts and records:

- a. The HCA could not explain or support a \$1,066,304 adjustment that was made to decrease Benefits Payable to Providers.

With the change in managers in July 2010, HCA identified the need for reconciliation of the Insurance general ledger accounts. We are actively working to define and work into our daily operations a process of reconciling the PAY1 Insurance transactions to the monthly OFM financial records (AFRS). As of May, 2011 staff have started and completed the accounts payable ledger (5111) analysis of the 09-11 biennium through February 2011. Our goal is to

have the outstanding payable balance of both payable ledgers (5111, 5115) identified and corrected by the biennial close of 09-11.

- b. The HCA reported changes in Incurred But Not Reported Reserves (IBNR) as Managed Care Organization (MCO) Premiums on the Statement of Revenue and Expenses, when it should have been reported as Incurred Medical Claims and Incurred Dental Claims on the Statement of Revenue and Expenses.

As discussed with OIC staff, the changes in the IBNR will be reported as Incurred Medical Claims and Incurred Dental Claims on the Statement of Revenue and Expenses on future reports.

- c. Two of the HCA's third party administrators (TPAs), who processed claims, recorded paid dates for some claims several days earlier than the actual check issue dates. This results in miscalculations when developing loss reserves and inaccurate paid claims reporting.

HCA will work with our TPAs to develop a process to reconcile the daily claims date to ensure accurate recording on a regular basis.

Pursuant to RCW 41.05.140(6), the HCA is instructed to keep full and adequate accounts and records of assets, obligations, transactions and affairs. No adjustments or reclassifications were necessary due to immateriality.

#### COMMENTS AND RECOMMENDATIONS

##### **1. Pharmacy Rebates**

The HCA does not receive estimates for future rebates from its pharmacy administrator as of the cutoff date of June 30, 2010. The HCA accounts for rebates as an offset to pharmacy claims when they come from the pharmacy administrator on a cash basis.

**It is recommended that the HCA set up receivables for pharmaceutical rebates that are specifically identified and billed in accordance with the pharmaceutical rebate contract provisions. In addition, the rebates should be accounted for in the appropriate accounting period.**

HCA accounting currently receives a quarterly report providing the estimated pharmaceutical rebates expected. We are working with staff to record the estimate and liquidate the receivable in the proper accounting periods.

## HCA PROFILE

### History

The Health Care Authority was established by the Washington State Health Care Reform Act of 1988 (the Act). The Act authorizes HCA to insure any type of loss under its jurisdiction except property and casualty risks. As an employer, it is the state's policy to provide comprehensive health care to state employees, officials, their dependents and those who depend upon the state for necessary medical care.

RCW 41.05.055 established the Public Employees Benefits Board (PEBB) to design and approve insurance benefit plans for state employees and school district employees. Effective 1993, RCW 70.47.040 placed the Basic Health Plan (BHP) within the HCA. The BHP is administered by the HCA and provides on a prepaid, capitated basis, reduced-cost health care coverage to Washington State residents whose gross family income is at or below 200 percent of the federal income guidelines.

### Territory and Plan of Operation

The HCA is authorized to provide medical and dental coverage in Washington State and is based in Lacey, Washington. The HCA indemnifies and provides the Uniform Medical and Dental Plan to eligible state employees, retirees, political subdivisions, and higher education facilities. In addition to the self-insured medical and dental plans, the HCA administers numerous insurance options with several carriers. Certain carriers are organized to deliver or arrange for the delivery of health care services while other carriers provide term life, accidental death and dismemberment, and long-term disability insurance.

### Growth of HCA

The following reflects the growth of the HCA as reported in its filed Annual Statements for the five year period under examination:

<u>Year</u>	<u>Admitted Assets</u>	<u>Liabilities</u>	<u>Capital &amp; Surplus</u>	
2010	\$144,181,728	\$174,474,566	(\$30,292,838)	
2009	182,392,036	143,324,472	39,067,564	
2008	429,351,048	146,069,567	283,281,481	
2007	375,550,981	121,022,750	254,528,231	
2006	309,402,028	103,064,777	206,337,251	

  

<u>Year</u>	<u>Premiums Earned</u>	<u>Interest and Misc Income</u>	<u>Total Expenses</u>	<u>Net Income (Deficit)</u>
2010	\$1,593,547,144	\$5,117,199	\$1,668,024,745	(\$69,360,402)
2009	1,333,606,924	11,555,481	1,595,781,322	(250,618,917)
2008	1,496,167,093	17,348,114	1,436,409,317	77,105,890
2007	1,418,131,837	16,074,936	1,336,015,793	98,190,980
2006	1,340,755,647	10,651,512	1,243,943,173	107,463,986

### MANAGEMENT AND CONTROL

The HCA was created within the Executive Branch of the state of Washington under RCW 41.05.021. With the consent of the Washington State Senate, the Governor appoints an administrator who may employ up to seven exempt staff members and any additional staff members necessary to administer the HCA.

#### **Administrator and Deputy Administrators as of June 30, 2010:**

<u>Name</u>	<u>Title</u>
Doug Porter	Administrator
John Williams	Deputy Administrator
Beth Dupre	Deputy Administrator

#### **Conflict of Interest**

RCW 42.52 – Ethics in Public Service establishes a single code of ethics that applies to all state officers and state employees in the executive, legislative, and judicial branches of government. RCW 42.52.200(1) allows each agency to adopt appropriate rules to protect against violations of this chapter. On June 30, 1995, the HCA Issued Administrative Policy No. 1-14 – Code of Personal Conduct, which addresses the personal conduct of all agency employees. No material conflicts of interest were noted in our review.

### INCURRED BUT NOT REPORTED RESERVES

The OIC actuary reviewed IBNR for the claims unpaid for the fiscal year ending June 30, 2010 for the Uniform Medical Plan (UMP) and the Uniform Dental Plan (UDP), the HCA's self-funded programs. The review included examining the reserving philosophy and methodologies to determine the reasonableness of liabilities recorded in the HCA's financial statements, and estimating IBNR for claims unpaid for the valuation date of June 30, 2010.

The HCA hired Milliman, Inc. (Milliman) to estimate IBNR for the claims unpaid. Milliman estimated \$109,293,000 of IBNR for the claims unpaid as of June 30, 2010. The OIC actuary reviewed Milliman's reserving methodology and concluded that the methodology appeared to be reasonable.

The OIC actuary estimated IBNR for the claims unpaid as of June 30, 2010 to be \$108,579,000 based on the paid incurred claim data provided by Milliman and a methodology prescribed by the American Academy of Actuaries. The OIC actuary concluded that HCA's reserves are within a reasonable range of estimates, therefore, no adjustment is recommended.

**PREMIUM STABILIZATION RESERVES AND SURPLUS DEFICIENCY**

The HCA maintains its Fund Balance in two separate funds, the PSR and surplus. The purpose of the PSR is to be the HCA's minimum reserve level. The PSR is based on incurred claims for the 12-month period ending June 30, 2010. The target level for PSR is equal to seven percent of the annual incurred claims for medical and prescription drug services incurred in 2010 and four percent of annual incurred dental claims incurred in 2010. The surplus is the remaining portion of the Fund Balance, exclusive of PSR. As of June 30, 2010, HCA did not have any surplus because the fund balance was negative. The fund balance was below its required PSR level by \$101,913,014. (See Instruction No. 1.)

**Calculation of PSR and Minimum Fund Balance as of June 30, 2010**

2010 Incurred Medical Claims	\$956,656,985
2010 Incurred Dental Claims	116,354,672
Target PSR Amount for Medical Claims (7%)	66,965,989
Target PSR Amount for Dental Claims (4%)	4,654,187
Target PSR and Minimum Fund Balance as of June 30, 2010	<u>\$71,620,176</u>

**Actual Fund Balance Deficiency as of June 30, 2010**

Current PSR Fund Balance	<u>\$0</u>
Current PSR Deficit	(71,620,176)
Current Fund Balance Deficit	(30,292,838)
Total Fund Balance Deficit as of June 30, 2010	<u>(\$101,913,014)</u>

**STATUTORY DEPOSITS**

None

**ACCOUNTING RECORDS AND INFORMATION SYSTEMS**

HCA's accounts and records are maintained on accrual basis of accounting. The HCA's Information System is administered by the state of Washington's Human Resources Information Systems Division (HRISD). All responsibility for the maintenance and update of the system resides with HRISD. The Invoicing system records the receivables, payables, expenses, and accrued revenues and then automatically interfaces with the Automated Financial Reporting System (AFRS) which is the main accounting system for the State of Washington. The Office of Financial Management (OFM) is responsible for maintaining and designing the AFRS system, which it uses to prepare annual financial statements for the state of Washington in accordance with Generally Accepted Accounting Principles (GAAP). The financial activities of the HCA are included in the OFM statements, which are audited by the Washington State Auditor's Office (SAO). Financial Statements filed with the OIC during the examination period were examined and found to be prepared in a manner consistent with the principles established by the OIC.

### **SUBSEQUENT EVENTS**

Andy Cherullo was hired as the new Chief Financial Officer of HCA, effective May 1, 2011. Annette Meyer was appointed Director of Financial Services, effective February 14, 2011.

### **FOLLOW UP ON PREVIOUS EXAMINATION FINDINGS**

The previous examination instruction was addressed.

### **FINANCIAL STATEMENTS**

The following financial statements show the financial condition of the Health Care Authority as of June 30, 2010:

Statement of Assets, Liabilities and Fund Balance  
Statement of Revenue and Expenses  
Five Year Reconciliation of Fund Balance

**Health Care Authority**  
**Statement of Assets, Liabilities and Fund Balance**  
**June 30, 2010**

	<u>BALANCE PER COMPANY</u>	<u>EXAMINATION ADJUSTMENTS</u>	<u>BALANCE PER EXAMINATION</u>
<b>ASSETS</b>			
Cash and Cash Equivalents	\$39,738,945	\$0	\$39,738,945
Investments	88,136,642		88,136,642
Interest Receivable	5,044		5,044
Premiums Due	15,593,149		15,593,149
Other Receivables	45,957		45,957
Admitted Assets	661,991		661,991
<b>Total Assets</b>	<b><u>\$144,181,728</u></b>	<b><u>\$0</u></b>	<b><u>\$144,181,728</u></b>
<b>LIABILITIES</b>			
Accounts Payable - Administration	\$2,363,735	\$0	\$2,363,735
Accounts Payable - Benefit Providers	62,516,390		62,516,390
Accounts Payable - Deferred Revenue	301,441		301,441
Incurred but Not Reported Reserves	109,293,000		109,293,000
<b>Total Liabilities</b>	<b><u>174,474,566</u></b>	<b><u>0</u></b>	<b><u>174,474,566</u></b>
<b>FUND BALANCE</b>			
Beginning of Fiscal Year Fund Balance	39,067,564		39,067,564
Current Year Operation Excess (Deficit)	(69,360,402)		(69,360,402)
<b>Total Fund Balance</b>	<b><u>(30,292,838)</u></b>	<b><u>0</u></b>	<b><u>(30,292,838)</u></b>
<b>Total Liabilities and Fund Balance</b>	<b><u>\$144,181,728</u></b>	<b><u>\$0</u></b>	<b><u>\$144,181,728</u></b>

**Health Care Authority  
Statement of Revenue and Expense  
For the Year Ended June 30, 2010**

	<u>BALANCE PER COMPANY</u>	<u>EXAMINATION ADJUSTMENTS</u>	<u>BALANCE PER EXAMINATION</u>
<b>Revenue:</b>			
Insurance premiums - Other Insured Benefits	\$546,586,670	\$0	\$546,586,670
Insurance Premiums - Self Insured Medical Benefits	879,638,024		879,638,024
Insurance Premiums - Self Insured Dental Benefits	167,322,450		167,322,450
Interest and Miscellaneous Income	5,117,199		5,117,199
<b>Total Revenue</b>	<u>1,598,664,343</u>	<u>0</u>	<u>1,598,664,343</u>
<b>Expenses:</b>			
<b>Insured Benefits Administration</b>			
Life Premiums	7,563,753		7,563,753
Long Term Disability Premiums	2,982,011		2,982,011
Managed Care Organizations Premiums	506,356,529		506,356,529
Dental Managed Care Premiums	22,797,193		22,797,193
<b>Total Insured Expenses</b>	<u>539,699,486</u>	<u>0</u>	<u>539,699,486</u>
<b>Self-Insured Medical Benefits and Administration</b>			
Incurred Medical Claims	956,656,985		956,656,985
Medical Claims Management	27,185,630		27,185,630
Uniform Medical Plan Benefits Administration	5,890,550		5,890,550
<b>Total Self-Insured Medical Expense</b>	<u>989,733,165</u>	<u>0</u>	<u>989,733,165</u>
<b>Self-Insured Dental Benefits and Administration</b>			
Incurred Dental Claims	116,354,672		116,354,672
Dental Claims Management	4,888,791		4,888,791
<b>Total Self-Insured Dental Expenses</b>	<u>121,243,463</u>	<u>0</u>	<u>121,243,463</u>
Risk Adjustment Administration Expenses	180,450		180,450
Agency Administration	17,168,181		17,168,181
<b>Total Expenses</b>	<u>1,668,024,745</u>	<u>0</u>	<u>1,668,024,745</u>
<b>Excess (Deficit) of Current Year</b>			
Revenues over Expenses	<u>(\$69,360,402)</u>	<u>\$0</u>	<u>(\$69,360,402)</u>

**Health Care Authority  
Five Year Reconciliation of Fund Balance  
For the Years Ended June 30,**

	<u>2010</u>	<u>2009</u>	<u>2008</u>	<u>2007</u>	<u>2006</u>
Fund Balance, June 30, Previous Year	\$39,067,564	\$283,281,481	\$254,528,231	\$206,337,251	\$140,008,365
Current Year Excess (Deficit)	(69,360,402)	(250,618,917)	77,105,890	98,190,980	107,463,886
Contributed Capital		6,405,000	(48,352,640)	(50,000,000)	(41,135,000)
Net change in capital and surplus for the year	(69,360,402)	(244,213,917)	28,753,250	48,190,980	66,328,886
Fund Balance, June 30, Current Year	<u>(\$30,292,838)</u>	<u>\$39,067,564</u>	<u>\$283,281,481</u>	<u>\$254,528,231</u>	<u>\$206,337,251</u>

**NOTES TO THE FINANCIAL STATEMENTS**

None

### ACKNOWLEDGMENT

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

In addition to the undersigned, Michael V. Jordan, CPA, CFE, MHP, Assistant Chief Examiner; John Jacobson, AFE, CISA, AES, Automated Examination Specialist; Susan Campbell, CPA, FLMI, CFE, ARA, Life Field Supervising Examiner; Lichlou Lee, ASA, MAAA, Actuary; Friday Enoye, AFE, Financial Examiner; and Richard Bologna, Financial Examiner; all from the Washington State Office of the Insurance Commissioner, participated in the examination and in the preparation of this report.

Respectfully submitted,

---

Constantine Arustamian, CPA, CFE, AIE, CPCU, ARC, ARM, ARe, AIS, AIAF  
Examiner-in-Charge  
State of Washington

