

STATE OF WASHINGTON  
OFFICE OF THE INSURANCE COMMISSIONER



FINANCIAL EXAMINATION  
OF  
WASHINGTON STATE HEALTH INSURANCE POOL  
STANWOOD, WASHINGTON

December 31, 2012

Order No. 14-128  
Washington State Health Insurance Pool  
Exhibit A

**SALUTATION**

Seattle, Washington  
April 16, 2014

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:

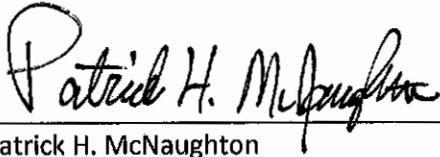
In accordance with your instructions, and in compliance with the statutory requirements of RCW 48.03.010, an examination was made of the financial records of

**Washington State Health Insurance Pool  
of  
Stanwood, Washington**

hereinafter referred to as "WSHIP" at the location of its third party administrator, Benefit Management Inc. (BMI) at 2015 16<sup>th</sup> Street, Great Bend, KS 67530. This report is respectfully submitted showing the condition and related matters of WSHIP as of December 31, 2012.

**CHIEF EXAMINER'S AFFIDAVIT**

I hereby certify I have read the attached Report of the Financial Examination of Washington State Health Insurance Pool of Stanwood, Washington. This report shows the financial condition and related matters as of December 31, 2012.



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Patrick H. McNaughton  
Chief Examiner

9-29-14

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Date

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## SCOPE OF THE EXAMINATION

This examination covers the period of January 1, 2008 through December 31, 2012 and comprises a risk focused review of the books and records of WSHIP. The examination followed 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). 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 April 16, 2014.

WSHIP's records, external reference materials, and various aspects of its 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. In addition, WSHIP's Certified Public Accountant's (CPA's) work papers were reviewed and utilized, where possible, to facilitate efficiency in the examination. Furthermore, BMI's external auditors completed an audit and issued an American Institute of Certified Public Accountants (AICPA) Statement on Standards for Attestation Engagements (SSAE) 16, type 2 report, which we placed reliance on to further facilitate efficiency in the examination.

RCW 48.41.070 requires that an annual financial report be submitted to the OIC in a form approved by the commissioner. WSHIP files a Health Annual Statement with the OIC, and it issues an Annual Report to its member companies and other interested parties. The examiners reviewed WSHIP's 2008 through 2012 Annual Reports as part of the statutory examination authorized under Chapters 48.41 and 48.03 RCW and Chapter 284-91 WAC, and reconciled the Annual Reports to the Health Annual Statements.

## INSTRUCTIONS

### **1. Paid Claims Accounting and Use in the Lag Triangle**

Prescription claims that had been reported to WSHIP that were Incurred But Not Paid (IBNP) were excluded from the actuarial reserves. The actuary indicated that these should have been accrued by WSHIP outside of the actuarial reserving process. There were no controls in place to ensure that the reported IBNP items the actuary excluded from the actuarial reserves were being communicated to WSHIP, and it was determined that the reported IBNP prescription claims had not been accrued in the financial statements. Because there were no reported IBNP prescription claims at year-end, there was no effect on the financial statements and no examination adjustment was necessary. In addition, the amounts used for the calculation of reserves for pharmacy claims were based on invoice dates and not on paid dates. The use of invoice date versus the paid date caused the data values to be inconsistent with other claim types. The inconsistency did not have a material impact on the December 31, 2012 financial statements and no examination adjustment was necessary.

RCW 48.41.060(1)(d) requires the Board to establish claim reserve formulas and any other actuarial functions appropriate to the operation of the pool.

**WSHIP is instructed to comply with RCW 48.41.060(1)(d) by establishing actuarial processes that ensure all IBNP claims are either included in the actuarial reserves, or if excluded from actuarial reserves, are adequately communicated to the financial accounting function and accrued in the financial statements. WSHIP is further instructed to establish an actuarial process that uses the paid date in the lag table for all claim types. The actuary should review the data used directly in the**

actuary's analysis for the purpose of identifying data values that are materially questionable or relationships that are materially inconsistent.

### **COMMENTS AND RECOMMENDATIONS**

#### **1. Cost Containment Expenses Improperly Included in Hospital and Medical Expense**

Premier Healthcare Exchange (PHX) has an agreement with BMI to perform bill review, claims audit, and out-of-network negotiations. When PHX identified any cost savings or was able to provide a discount through one of the many networks, WSHIP pays a fee to PHX equal to 25 percent of the total savings. PHX fees totaling \$898,510 were reported as 'Hospital and medical benefits' expenses in WSHIP's 2012 Annual Report in error. These fees are cost containment in nature and should have been reported as claim adjustment expenses in WSHIP's 2012 Annual Report. These expenses were also included in the claims database and lag table, which is used by the actuary to compute claim reserves. However, the error would not have materially affected the reserve calculation.

Similar cost containment expenses for other vendors totaling \$119,001 were reported as 'Hospital and medical benefits' in error. However, those expenses were excluded from the claims database and lag table.

The net effect of these errors was an overstatement of 'Hospital and medical benefits' and an understatement of 'Claim adjustment expenses' in the amount of \$1,017,511, which has been adjusted in the examination report. (See Examination Adjustment No. 1.)

**It is recommended that WSHIP properly report claim adjustment expenses in its Annual Report and exclude claim adjustment expenses from its lag table and claims database.**

#### **2. Executive Committee**

The Executive Committee of the Board of Directors (BOD) performs functions and approves transactions and reports that require members to have an understanding of accounting concepts and financial statements. The BOD does not have a policy requiring the Executive Committee to include a member who is considered a financial expert. It is a best practice to have at least one financial expert serving on committees whose functions include reviewing and approving accounting transactions, financial reports, and oversight of the independent auditors. Although the Executive Committee did have a financial expert serving on the Executive Committee for the period under examination, in the absence of a BOD requirement for such an expert, future Executive Committees may lack a financial expert.

**It is recommended that the BOD of WSHIP require a financial expert to serve on the Executive Committee at all times.**

#### **3. Controls over Account Reconciliations**

An electronic spreadsheet is maintained to document the date of who prepared and reviewed account reconciliations. The spreadsheet is not a strong control because it could be changed at any time without a record of what was changed, and one person could populate the entire excel spreadsheet. WSHIP could enhance this control by retaining a more permanent and reliable record of the control, for example an actual signature and date on the reconciliation, or in the form of a digital signature stamped and dated by the Information Technology (IT) system.

**It is recommended that WSHIP enhance its control over account reconciliations by retaining hardcopy or digital signatures of the preparer and reviewer of the account reconciliations with dates of the preparation and review.**

#### **4. General Ledger Accounting Controls**

The accounting software used does not contain adequate general ledger accounting controls. For example, it allows transactions to be:

- a) back-dated and posted to a prior period
- b) reversed and posted to a prior period
- c) deleted, and
- d) posted by the person who prepared the entry

Compensating controls have been implemented to monitor entries that have been posted to the general ledger. However, there is no policy or adequate controls to prevent or detect the other types of transactions.

**It is recommended that controls over general ledger transactions be enhanced by implementing a policy that restricts deleting, reversing, or back dating of entries to a prior period, and by monitoring these types of transactions. In addition, due to the complexity and volume of transactions that are processed, it is recommended that WSHIP consider using accounting software that contains these controls.**

#### **5. Reconciliation of Lag Table to General Ledger**

WSHIP did not reconcile the total paid claims amount per the lag table to the general ledger on a monthly basis. It is a sound actuarial practice to ensure that the lag table reconciles to the general ledger. This had no effect on the December 31, 2012 financial statements, and no examination adjustment was necessary.

**It is recommended that WSHIP implement a control to ensure that paid claims per the lag table are reconciled to the general ledger on a monthly basis.**

### **WSHIP PROFILE**

#### **WSHIP History**

WSHIP was established in 1987 by the state of Washington under Chapter 48.41 RCW, the Health Insurance Coverage Access Act, as a nonprofit, unincorporated entity. It was established to make health care coverage available for eligible persons in the state of Washington who have been rejected for individual coverage by licensed insurance carriers. WSHIP has the authority to assess insurance companies writing health premiums in the state of Washington for all losses of WSHIP. Assessments are made periodically throughout the year as funds are needed to pay benefits to insured persons and to maintain a positive surplus position.

#### **Organizational Funding and Structure**

Organizational funding and structure are obtained through assessments to insurer members. There are four classes of insurer members as defined in Article VI of the Articles of Organization. Assessments of the insurer members are determined and approved by the Board of Directors (BOD) and are recognized

as a contribution to accumulated surplus. Assessments receivable represent outstanding balances assessed to insurance companies, but not yet collected.

In addition to member assessments, WSHIP receives grant funds from the federal government, which are usually earmarked to be used in a specific way. These are accounted for as direct additions to "Unassigned surplus."

**Growth of WSHIP**

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

<u>Year</u>	<u>Admitted Assets</u>	<u>Liabilities</u>	<u>Unassigned Surplus</u>
2012	\$32,548,426	\$22,766,300	\$9,782,126
2011	29,088,206	19,971,341	\$9,116,865
2010	22,725,214	15,071,187	\$7,654,027
2009	18,534,239	13,208,426	\$5,325,813
2008	16,979,693	12,274,042	\$4,705,651

**Third Party Administrator**

Benefit Management Inc., the third party administrator for WSHIP, performs health plan enrollment, premium billing, claims processing, customer service, on-line information access, accounting, and financial reporting in accordance with the agreement terms. The agreement was extended on March 31, 2010 for an additional three year term and has been currently extended pending WSHIP's role based on legislative action to extend the program. Disputes are handled under the arbitration clause and termination of the agreement can be exercised by either party due to non-compliance to the agreement terms. Claims are required to be paid within 30 days of receipt, or 60 days if an investigation is required. Additionally, BMI works closely with WSHIP's other contractors who provide pharmacy, provider network, care management, and other services.

**MANAGEMENT AND CONTROL**

**Board of Directors (BOD)**

The BOD is composed of ten (10) directors, of which six are appointed by the governor of the state of Washington pursuant to the procedures specified in RCW 48.41.040(2). One director is elected by a vote of the Class A members (members that provide disability insurance or stop loss insurance), one director is elected by a vote of the Class B members (health care service contractors (HCSC)), one director is elected by a vote of the Class C members (health maintenance organizations (HMO)), and one director is elected by a vote by all members of WSHIP. No more than one director may be employed by the same member or an affiliate of the same member. In addition to the ten voting directors, the insurance commissioner of the state of Washington, or his designee, is a non-voting, ex-officio director. Directors serve a term of three years which may be adjusted as necessary to stagger the terms of all Directors.

Board of Directors as of December 31, 2012:

Shaun Koos, Chair	Confluence Health - Governor appointed, providers
Andrea Bailey	Alliance Nursing - Governor appointed, small business
Pete Cutler	Office of Insurance Commissioner - Ex Officio, Non-voting
James Grazko	Premera Blue Cross - Elected by HCSCs
Jill Harland	UnitedHealthcare Insurance Company - Elected by disability carriers
Rob Kuecker	Regence Blue Shield - Elected by all member plans
Lisa Matthews	DaVita Dialysis Center - Governor appointed, consumer
Scott Plack	Group Health Cooperative - Elected by HMOs
Mark Rose	The Partners Group - Governor appointed, insurance agents
Laura Treadway	Evergreen Health Insurance Program - Governor appointed, consumer
Mike Turner	Janicki Industries, Inc. - Governor appointed, large business

**Officers**

WSHIP officers are appointed annually by the Board of Directors to serve a one year term. Officers allowed by WSHIP Bylaws are a president, vice presidents, a secretary, and a treasurer.

The following were officers as of December 31, 2012:

Shaun Koos	President
Lisa Matthews	Vice President
Robert Kuecker	Secretary/Treasurer

**Executive Staff**

Kären Larson	Executive Director
Sharon Becker	Deputy Executive Director

**Conflict of Interest**

WSHIP's conflict of interest policy and procedure is stated in Article VIII of the Bylaws. Each director, principal officer, and committee member prepares an annual statement of compliance that is reviewed by the BOD. There were no exceptions noted during our review.

**Fidelity Bond and Other Insurance**

WSHIP does not have a fidelity bond. However, WSHIP does have a Director's and Officer's insurance policy that covers certain exposures of WHIP's directors and officers. This policy does not cover claims brought by, on behalf of, or against BMI, whether directly or derivatively. WSHIP's contract with BMI requires BMI to maintain its own liability coverage. BMI and WSHIP's insurance coverage meet the minimum amount recommended by the NAIC.

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

WSHIP has a Simple Individual Retirement Account (IRA) plan for its employees. WSHIP contributes matching funds up to a limit per employee. The Simple IRA plan is subject to Internal Revenue Service regulations pertaining to deposits and withdrawals.

**BUSINESS RECORDS**

The Articles of Organization, Bylaws, Operating Rules, and minutes of the BOD and committees were

reviewed for the period under examination. All BOD meetings were conducted with a quorum present.

### **ACTUARIAL REVIEW**

The OIC health actuary reviewed WSHIP's actuarial report, claims unpaid, and other claim liabilities as of December 31, 2012. The review included examining WSHIP's reserving philosophy and methods to determine the reasonableness of the claim liabilities, verifying that claim liabilities included provisions for all pertinent actuarial components, reviewing historical paid claims and loss ratios, and estimating claims unpaid as of December 31, 2012.

In addition, the examiners tested WSHIP's claims data by comparing source documents to data reported in the lag table, which is used by WSHIP's opening actuary to calculate unpaid claims. The examiner's testing determined that WSHIP's actuary used the invoice date instead of the paid date for pharmacy claims. While this had no effect on the actuarial reserves reported at December 31, 2012, the actuary should use the paid date for all claims, including pharmacy claims. (See Instruction No. 1.) Additionally, WSHIP's actuary excluded from the actuarial reserve, pharmacy claims that had been reported to WSHIP but had not yet been paid. WSHIP was not aware that these claims were excluded from actuarial reserves and did not accrue for these liabilities when they occurred at month-end. Pharmacy claims unpaid were therefore under reported for some months, however, the balances at December 31, 2012 were not impacted. (See Instruction No. 1.)

With the exception of the above, the claim data provided to the examiners and to the opening actuary by WSHIP was consistent with the claim data reported in the 2012 Annual Report, Statements of Operations and Unassigned Surplus, Hospital and Medical Benefits line.

Upon reviewing the opening actuary's assumptions, methodologies, and calculations for the actuarial liabilities, and re-performing the same functions using more current data, the OIC actuary determined that the opening actuary's method is more conservative. Based upon this review, the estimate for claim liabilities is satisfactory, and with the exception of using the invoice date instead of the paid date for pharmacy claims, the opening actuary's method is acceptable.

### **ACCOUNTING RECORDS AND INFORMATION SYSTEM**

WSHIP contracted with Benefit Management Inc., as its third-party administrator to handle all operating functions of WSHIP. WSHIP's accounting records are kept on a Generally Accepted Accounting Principles (GAAP) accrual basis of accounting. WSHIP is audited annually by the certified public accounting firm of Petrow Leemhuis Vincent and Kane. WSHIP 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. Several recommendations were made to strengthen accounting controls. (See Comments and Recommendations Nos. 3, 4, and 5.) In addition, BMI's Information

Technology (IT) environment was reviewed during the planning and testing phase of the examination, focusing on the following Control Objectives for Information and related Technology (COBIT) Framework domains:

- Plan and Organize
- Acquire and Implement
- Deliver and Support
- Monitor and Evaluate

The IT system and controls were evaluated to gain an understanding of the IT general control risks and assess the effectiveness of these controls to determine if appropriate mitigating and internal controls have been implemented. Appropriate mitigating and internal controls have been implemented to reduce residual risk to appropriate levels. WSHIP has an effective Business Continuity Plan and Disaster Recovery Plan, which has been tested on a regular basis and includes the availability of an alternate site.

### **SUBSEQUENT EVENTS**

On January 1, 2014, portions of the federal Affordable Care Act (ACA) became effective, including the elimination of health carriers' ability to deny coverage due to pre-existing conditions in the individual market and in medical underwriting. As a result, use of the Standard Health Questionnaire in the individual market to screen applicants was discontinued and new enrollment in WSHIP's non-Medicare products generally ended at that time. In 2013, the Washington legislature amended the Health Insurance Coverage Access Act to require termination of WSHIP's non-Medicare plans as of December 31, 2017. Until then, enrollees who were enrolled in WSHIP's non-Medicare plans as of December 31, 2013 can continue WSHIP coverage. WSHIP Medicare plans are not affected by the ACA.

WSHIP has been directed by the legislature to review populations needing coverage through WSHIP. Initially, a study was completed for the Board of Directors by Leif Associates in 2012. WSHIP has been directed to revisit the study and submit recommendations to the Governor by November 1, 2015.

### **FINANCIAL STATEMENTS**

The following financial statements show the financial condition of WSHIP as of December 31, 2012 as reported in its Annual Report. These financial statements were reconciled to the Health Annual Statement, as filed with the OIC.

Balance Sheet  
Statement of Operations and Unassigned Surplus  
Five Year Reconciliation of Unassigned Surplus

**WASHINGTON STATE HEALTH INSURANCE POOL**  
**Balance Sheet**  
**December 31, 2012**

	<u>BALANCE PER COMPANY</u>	<u>EXAMINATION ADJUSTMENTS</u>	<u>BALANCE PER EXAMINATION</u>
<b>Assets:</b>			
Cash and short-term investments	\$26,768,299	\$0	\$26,768,299
Assessment receivable	5,099,146		5,099,146
Uncollected premiums	57,238		57,238
Federal grant receivable	469,254		469,254
Other receivables	150,000		150,000
Due from PCIP-WA, LLC*	4,125		4,125
Prepaid expenses	364		364
<b>Total assets</b>	<b><u>\$32,548,426</u></b>	<b><u>\$0</u></b>	<b><u>\$32,548,426</u></b>
<b>Liabilities and Unassigned Surplus:</b>			
Claims unpaid	\$16,801,000		\$16,801,000
Unpaid claim adjustment expenses	408,000		408,000
Premiums received in advance	4,431,797		4,431,797
Assessment payable	771,509		771,509
Abandoned claims reserve	69,585		69,585
General expenses due or accrued	284,409		284,409
<b>Total liabilities</b>	<b><u>22,766,300</u></b>	<b><u>0</u></b>	<b><u>22,766,300</u></b>
<b>Unassigned surplus</b>	<b><u>9,782,126</u></b>	<b><u>0</u></b>	<b><u>9,782,126</u></b>
<b>Total liabilities and unassigned surplus</b>	<b><u>\$32,548,426</u></b>	<b><u>\$0</u></b>	<b><u>\$32,548,426</u></b>

\*-Pre-existing Condition Insurance Plan (PCIP)

**WASHINGTON STATE HEALTH INSURANCE POOL**  
**Statement of Operations and Unassigned Surplus**  
**For the Year Ended December 31, 2012**

	<u>BALANCE PER COMPANY</u>	<u>EXAMINATION ADJUSTMENTS</u>	<u>BALANCE PER EXAMINATION</u>	<u>NOTES</u>
<b>Operating Revenues:</b>				
Net premium income	\$31,629,551	\$0	\$31,629,551	
Total operating revenues	<u>31,629,551</u>	<u>0</u>	<u>31,629,551</u>	
<b>Operating Expenses:</b>				
Hospital/medical benefits	103,493,291	(1,017,511)	102,475,780	1
Claims adjustment expenses	838,320	1,017,511	1,855,831	1
General and administrative expenses	2,179,790		2,179,790	
Subtotal	<u>106,511,401</u>	<u>0</u>	<u>106,511,401</u>	
<b>Operating loss</b>	<b>(74,881,850)</b>	<b>0</b>	<b>(74,881,850)</b>	
<b>Non-Operating Revenues:</b>				
Investment and other income	168,342		168,342	
Federal grant awards	1,346,790		1,346,790	
Total underwriting deductions	1,515,132	0	1,515,132	
<b>Net income (loss) before assessments</b>	<b><u>(\$73,366,718)</u></b>	<b><u>\$0</u></b>	<b><u>(\$73,366,718)</u></b>	
<b>Assessments</b>	<b><u>\$74,031,979</u></b>	<b><u>\$0</u></b>	<b><u>\$74,031,979</u></b>	
<b>Change in Unassigned Surplus</b>	<b><u>\$665,261</u></b>	<b><u>\$0</u></b>	<b><u>\$665,261</u></b>	
<b>Unassigned Surplus Account:</b>				
Unassigned surplus prior reporting year	\$9,116,865	\$0	\$9,116,865	
Net income or (loss)	(73,366,718)		(73,366,718)	
Assessment levied	74,031,979		74,031,979	
Net change in unassigned surplus	665,261		665,261	
<b>Unassigned surplus end of reporting period</b>	<b><u>\$9,782,126</u></b>	<b><u>\$0</u></b>	<b><u>\$9,782,126</u></b>	

**WASHINGTON STATE HEALTH INSURANCE POOL**  
**Five Year Reconciliation of Unassigned Surplus**  
**For the Years Ended December 31,**

	<u>2012</u>	<u>2011</u>	<u>2010</u>	<u>2009</u>	<u>2008</u>
Unassigned surplus, prior reporting year	\$9,116,865	\$7,654,027	\$5,325,813	\$4,705,651	\$1,277,312
Net Income or (loss)	(73,366,718)	(62,590,689)	(50,759,377)	(43,938,738)	(37,271,661)
Assessment Levied	74,031,979	64,053,527	53,087,591	44,558,900	40,700,000
Net change in unassigned surplus	665,261	1,462,838	2,328,214	620,162	3,428,339
<b>Unassigned surplus, end of reporting year</b>	<b><u>\$9,782,126</u></b>	<b><u>\$9,116,865</u></b>	<b><u>\$7,654,027</u></b>	<b><u>\$5,325,813</u></b>	<b><u>\$4,705,651</u></b>

## **NOTES TO THE FINANCIAL STATEMENTS**

### **1. Cost Containment Expenses Improperly Included in Claims Expense**

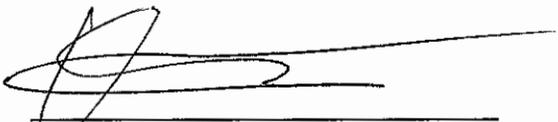
To reclassify vendor claim adjustment expenses, which were improperly reported as hospital and medical benefits: increase claim adjustment expenses by \$1,017,511 and decrease hospital and medical benefits by \$1,017,511. (See Comment and Recommendation No. 1.)

**ACKNOWLEDGMENT**

Acknowledgment is hereby made of the cooperation extended to the examiners by the officers and employees of Washington State Health Insurance Pool and BMI during the course of this examination.

In addition to the undersigned, Michael V. Jordan, CPA, CFE, MHP, Assistant Chief Examiner; Adrienne Sulaiman, CPA, CFE, FLMI, MHP, Health Field Supervising Examiner; John Jacobson, AFE, CISA, AES, Automated Examination Specialist; Scott L. Fitzpatrick, FSA, MAAA, Actuary; Terry Gates, CPA, 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,

A handwritten signature in black ink, appearing to read 'Friday Enoye', written over a horizontal line.

Friday Enoye, CFE  
Examiner-in-Charge  
State of Washington

