STATE OF WASHINGTON
OFFICE OF THE INSURANCE COMMISSIONER

FINANCIAL EXAMINATION
of the Charitable Gift Annuity Business

of

Children’s Health Care System
Seattle, Washington

DECEMBER 31, 2005

Order No. G07-20
Children’s Health Care System
Exhibit A
The Honorable Mike Kreidler, Commissioner
Washington State Office of the Insurance Commissioner (OIC)
Insurance Building, Capitol Campus
302-14th Avenue SW
Olympia, WA 98505

Dear Commissioner Kreidler:

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

Children’s Health Care System

of

Seattle, Washington

hereinafter referred to as “CHCS” at the location of its office, 6901 Sand Point Way NE, Seattle, WA 98115.

This report of examination is respectfully submitted showing the condition of CHCS as of December 31, 2005.
CHIEF EXAMINER’S AFFIDAVIT


Patrick H. McNaughton
Chief Examiner

3-8-2007
Date
# TABLE OF CONTENTS

SCOPE OF EXAMINATION......................................................................................................... 1  
INSTRUCTIONS............................................................................................................................ 1  
COMMENTS AND RECOMMENDATIONS....................................................................................... 1  
ORGANIZATION PROFILE......................................................................................................... 2  
AFFILIATED ORGANIZATIONS................................................................................................. 3  
MANAGEMENT AND CONTROL.............................................................................................. 3  
  MANAGEMENT .......................................................................................................................... 3  
  BOARD OF TRUSTEES.............................................................................................................. 3  
  OFFICERS ................................................................................................................................ 4  
  TAX STATUS ............................................................................................................................ 4  
  CONFLICT OF INTEREST ....................................................................................................... 4  
CORPORATE RECORDS ........................................................................................................... 4  
STATEMENT OF ACTUARIAL OPINION ............................................................................... 4  
ANNUITY ASSETS CUSTODIAL FUNCTION ............................................................................. 4  
SUBSEQUENT EVENTS .......................................................................................................... 5  
ACCOUNTING RECORDS AND PROCEDURES ........................................................................ 5  
FINANCIAL STATEMENTS ....................................................................................................... 5  
ACKNOWLEDGMENT ............................................................................................................. 7  
AFFIDAVIT .................................................................................................................................. 8
SCOPE OF THE EXAMINATION

This examination covers the period January 1, 2001 through December 31, 2005. The 2005 Annual Report reflected the balance sheet and statement of revenue and expenses of CHCS as of September 30, 2005. The OIC granted permission to CHCS to present its CGA Annual Report as of its fiscal year ended September 30, 2005. The examination of the 2005 Annual Report, therefore, covers the period ending September 30, 2005 for the balance sheet and statement of revenue and expenses sections, and the period ending December 31, 2005 for the general interrogatories and charitable gift annuities reserve fund. The audited financial statements are presented on a consolidated basis for CHCS and its affiliates. However, the scope of our examination focused only on the transactions and operations of the CGA business. CHCS’ 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, CHCS’ 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 Seattle office of CHCS by examiners from the state of Washington.

INSTRUCTIONS

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

INSTRUCTIONS

No exceptions were noted and no instructions are included in this examination report.

COMMENTS AND RECOMMENDATIONS

Documentation of Closed Annuity Contracts

CHCS did not always obtain a death certificate to support the transfer of the remaining residuum funds of closed annuity contracts.

It is recommended that CHCS obtain death certificates in addition to any other relevant, important data currently gathered by or furnished to CHCS to fully
document an annuitant's death. All documentation should be kept in the
annuitant's file.

ORGANIZATION PROFILE

History: CHCS operates exclusively for charitable, scientific or educational purposes. It
is organized to provide health care services to infants, children and adolescents, and to
deliver those services through research, education, advocacy, and contributions to or for
the benefit of tax-exempt organizations.

Territory and Plan of Operation: On September 10, 1998, the OIC granted CHCS a
Certificate of Exemption to Issue Charitable Gift Annuities in the state of Washington.
There were 104 in-force annuity contracts as of December 31, 2005. Total annuity
contracts included all 36 contracts transferred from Children's Hospital and Regional
Medical Center (CHRMC) during 2005. CHCS and CHRMC combined the two groups
of annuities; therefore, there is only one certificate of exemption holder effective
December 31, 2005, which is CHCS. CHCS is now responsible for the administration
and payment of all CGA contracts issued originally by CHRMC and CHCS.

Total Net Assets: CHCS' total net assets as of September 30, 2005 were $404,799,000.
This amount included an unrestricted net asset of $319,375,000. The minimum
unrestricted net asset requirement pursuant to RCW 48.38.010(6) was satisfied as of
September 30, 2005.

Growth: The development of CHCS for the past five years is reflected in the following
schedules. The financial statements of CHCS and its affiliates have been presented on a
consolidated basis. The schedules below, however, show only the financial information
related to CHCS, as of fiscal years ending September 30, in accordance with the OIC
Annual Report Instructions.

Schedule 1 – Statement of Financial Position

<table>
<thead>
<tr>
<th>Fiscal Year</th>
<th>Assets (In thousands)</th>
<th>Liabilities (In thousands)</th>
<th>Total Net Assets (In thousands)</th>
<th>Unrestricted</th>
<th>Temporarily Restricted</th>
<th>Permanently Restricted</th>
</tr>
</thead>
<tbody>
<tr>
<td>2005</td>
<td>$428,183</td>
<td>$23,384</td>
<td>$404,799</td>
<td>$319,375</td>
<td>$14,875</td>
<td>$70,549</td>
</tr>
<tr>
<td>2004</td>
<td>$370,011</td>
<td>11,570</td>
<td>$358,441</td>
<td>279,696</td>
<td>13,667</td>
<td>65,078</td>
</tr>
<tr>
<td>2003</td>
<td>$332,365</td>
<td>9,164</td>
<td>$323,201</td>
<td>254,287</td>
<td>11,890</td>
<td>57,024</td>
</tr>
<tr>
<td>2002</td>
<td>$311,287</td>
<td>22,074</td>
<td>$289,213</td>
<td>217,237</td>
<td>10,297</td>
<td>61,679</td>
</tr>
<tr>
<td>2001</td>
<td>$298,870</td>
<td>11,179</td>
<td>$287,691</td>
<td>228,251</td>
<td>11,470</td>
<td>47,970</td>
</tr>
</tbody>
</table>
### Schedule 2 – Statement of Activities and Changes in Net Assets

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Revenues and gains (loss)</td>
<td>$51,412</td>
<td>$43,616</td>
<td>$40,201</td>
<td>$8,034</td>
<td>$(29,901)</td>
</tr>
<tr>
<td>Expenses</td>
<td>5,054</td>
<td>8,376</td>
<td>6,213</td>
<td>6,512</td>
<td>11,480</td>
</tr>
<tr>
<td>Increase (decrease) in net assets</td>
<td>46,358</td>
<td>35,240</td>
<td>33,988</td>
<td>1,522</td>
<td>(41,381)</td>
</tr>
<tr>
<td>Net assets at beginning of year</td>
<td>358,441</td>
<td>323,201</td>
<td>289,213</td>
<td>287,691</td>
<td>329,072</td>
</tr>
<tr>
<td>Net assets at end of year</td>
<td>$404,799</td>
<td>$358,441</td>
<td>$323,201</td>
<td>$289,213</td>
<td>$287,691</td>
</tr>
<tr>
<td>Number of gift annuity contracts at end of year</td>
<td>104</td>
<td>60</td>
<td>57</td>
<td>43</td>
<td>36</td>
</tr>
</tbody>
</table>

### AFFILIATED COMPANIES

CHCS is the parent organization of several affiliated Washington not-for-profit corporate entities which include the following: CHRMC, Children’s Hospital Foundation, Children’s Hospital Guild Association, Children’s Retail, Health Team Northwest, and Children’s Physicians.

### MANAGEMENT AND CONTROL

**Management:** Pursuant to CHCS’ Bylaws, the Board of Trustees (BOT) consists of voting trustees and non-voting trustees. Responsibility for governing CHCS is vested in the voting trustees who are elected by CHCS at its annual meeting. The voting members of CHCS include all CHCS trustees and honorary trustees of CHRMC. The sole voting member of CHRMC is CHCS.

**Board of Trustees:** There are 28 trustees; of these, 25 are voting trustees and three are non-voting trustees. The trustees are:

- Kathleen Randall, Chairman
- Peggy Walton, Vice Chairman
- Mary Ann Flynn, Recording Secretary
- Linda Stull, Corresponding Secretary
- Rhoda Altom, Treasurer
- Gloria Northcroft, Assistant Treasurer
- Sue Albrecht
- Prudence Baldwin
- Sherry-Lee Benaroya
- Jane Blair
- Julia Calhoun
- Nancy Daly
- Margaret Habegger
- Thomas Hansen, M.D.

- Catherine Heron
- Eugenia Higgins
- Laura Jennings
- Priscilla Joondeph
- James Ladd
- Mona Locke
- Cindy Masin
- Linda Mattox
- Richard Molteni, M.D.
- Teresa Moore
- Laurie Oki
- Robert Roskin, M.D.
- Janet Sinegal
- Didina Wells
Officers: Pursuant to the Bylaws, the officers of CHCS include a chief executive officer (CEO), who holds the title of president and CEO. The CEO is selected and employed by the BOT. According to the organizational chart, CHCS’ officers include, but are not limited to, the following: a president and CEO, a vice president general counsel, an executive vice president and chief operating officer (COO), and a vice president and chief financial officer (CFO).

Thomas Hansen, M.D., President and CEO  
Jeff Sconyers, Vice President General Counsel  
Pat Hagan, Executive Vice President COO  
Kelly Wallace, Vice President CFO

Tax Status: CHCS is a Washington not-for-profit corporation and is exempt from federal income taxes under Section 501(c)(3) of the Internal Revenue Code.

Conflict of Interest: The BOT adopted and implemented a written conflict of interest policy that includes guidelines for the resolution of any existing or apparent conflict of interest. The Audit and Corporate Responsibility Committees have general responsibility for oversight of the conflict of interest disclosure process. There were no exceptions noted.

CORPORATE RECORDS

The BOT met twelve times in 2005 to discuss business which is pertinent to CHCS. Minutes of the meetings of trustees documented the approval of CHCS’ 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 and meets its qualification standards. His SAO states that CHCS’ annuity contract reserves computed under RCW 48.38.020(3)(a) and (b) of the Washington Insurance Code should be $3,194,651. This amount, plus the 10% surplus required by RCW 48.38.020(3)(c), was reported as CGA liabilities in CHCS financial statements.

ANNUITY ASSETS CUSTODIAL FUNCTION

The separate reserve fund assets were held legally and physically segregated from the other assets of CHCS. Total annuity investments as of December 31, 2005 were $4,423,176, and consisted of money market funds, U.S. government obligations, corporate stocks and bonds, and mutual funds. Investments were recorded at fair value.
**SUBSEQUENT EVENTS**

There were no material events which impacted CHCS' 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 CHCS as of September 30, 2005:

**Balance Sheet**

<table>
<thead>
<tr>
<th></th>
<th>Balance Per</th>
<th>Examination</th>
<th>Adjusted</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>ASSETS</strong></td>
<td></td>
<td>Adj.</td>
<td>Balance</td>
</tr>
<tr>
<td>Cash and cash equivalents</td>
<td>$0</td>
<td>$0</td>
<td>$0</td>
</tr>
<tr>
<td>Receivables from affiliates, net</td>
<td>14,216,000</td>
<td>14,216,000</td>
<td></td>
</tr>
<tr>
<td>Investments</td>
<td>341,126,824</td>
<td>341,126,824</td>
<td></td>
</tr>
<tr>
<td>CGA assets*</td>
<td>4,423,176</td>
<td>4,423,176</td>
<td></td>
</tr>
<tr>
<td>Other assets</td>
<td>68,417,000</td>
<td>68,417,000</td>
<td></td>
</tr>
<tr>
<td><strong>Total Assets</strong></td>
<td>$428,183,000</td>
<td>$0</td>
<td>$428,183,000</td>
</tr>
</tbody>
</table>

| **LIABILITIES**      |             |             |          |
| Accounts payable     | $255,000    | $0          | $255,000 |
| Payables to affiliates| 12,527,000 | 12,527,000  |          |
| CGA reserves*        | 3,514,116   | 3,514,116   |          |
| Other liabilities    | 7,087,884   | 7,087,884   |          |
| **Total Liabilities**| 23,384,000  |             | 23,384,000 |

| **NET ASSETS**       |             |             |          |
| Unrestricted         | 319,375,000 |             | 319,375,000 |
| Temporarily restricted| 14,875,000 |             | 14,875,000 |
| Permanently restricted| 70,549,000 |             | 70,549,000 |
| **Total Net Assets** | 404,799,000 |             | 404,799,000 |

| **Total Liabilities and Net Assets** | $428,183,000 | $0 | $428,183,000 |

*The distribution of the annuity assets and statutory reserves are based on the Statement of Actuarial Opinion as of December 31, 2005.

**Statement of Financial Activity and Changes in Net Assets**
<table>
<thead>
<tr>
<th></th>
<th>Annual Report</th>
<th>Adj.</th>
<th>Examination Adjustments</th>
<th>Adjusted Balance</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total revenues</td>
<td>$51,412,000</td>
<td>$0</td>
<td>$0</td>
<td>$51,412,000</td>
</tr>
<tr>
<td>Total expenses</td>
<td>5,054,000</td>
<td>0</td>
<td>0</td>
<td>5,054,000</td>
</tr>
<tr>
<td>Increase (decrease) in net assets</td>
<td>46,358,000</td>
<td>0</td>
<td>0</td>
<td>46,358,000</td>
</tr>
<tr>
<td>Net assets at beginning of year</td>
<td>358,441,000</td>
<td>0</td>
<td>0</td>
<td>358,441,000</td>
</tr>
<tr>
<td>Changes in net assets per examination</td>
<td>0</td>
<td></td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Net assets at end of year</td>
<td>$404,799,000</td>
<td>$0</td>
<td>$0</td>
<td>$404,799,000</td>
</tr>
</tbody>
</table>
ACKNOWLEDGMENT

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

In addition to the undersigned, Michael V. Jordan, CPA, CFE, MHP, Assistant Chief Examiner, from the Washington State Office of the Insurance Commissioner, participated in the examination and the preparation of this report.

Respectfully submitted,

[Signature]
Orlando R. Gabriel, AFE
Examiner-in-Charge
State of Washington
AFFIDAVIT

STATE OF WASHINGTON } 
} ss 
COUNTY OF KING } 

Orlando R. Gabriel, being duly sworn, deposes and says that the foregoing report subscribed by him is true to the best of his knowledge and belief.

He attests that the examination of CHCS’ CGA business 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).

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

Subscribed and sworn to before me on this 8th day of March, 2007.

Notary Public in and for the
State of Washington,
Residing at Seattle.