

STATE OF WASHINGTON
OFFICE OF THE INSURANCE COMMISSIONER



FINANCIAL EXAMINATION
OF THE
HEALTH CARE AUTHORITY
LACEY, WASHINGTON

JUNE 30, 2010

Order No. 11-224
Health Care Authority
Exhibit A

SALUTATION

Seattle, Washington
September 29, 2011

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:

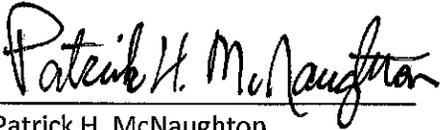
In accordance with your instructions, and in compliance with the statutory requirements of RCW 41.05.140(5) and RCW 48.03.010, an examination was made of the affairs and financial records of the

Health Care Authority
of
Lacey, Washington

hereinafter referred to as the "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 the 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 the HCA as of June 30, 2010.



Patrick H. McNaughton

Chief Examiner

9-29-11

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 the 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 the 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 the HCA to establish and maintain adequate reserves for payment of future claims. Part of the 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)

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.
- 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.

- 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.

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 PROFILE

History

The Health Care Authority was established by the Washington State Health Care Reform Act of 1988 (the Act). The Act authorizes the 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 & 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 the 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	<u>(30,292,838)</u>
Total Fund Balance Deficit as of June 30, 2010	<u>(\$101,913,014)</u>

STATUTORY DEPOSITS

None

ACCOUNTING RECORDS AND INFORMATION SYSTEMS

The HCA's accounts and records are maintained on accrual basis of accounting. Its 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

In 2010, the HCA received approval for additional funding from the State Legislature which included a 14.1% premium increase for fiscal year 2011. The additional funding is projected to fully fund the PSR and surplus deficits. The new funding rate per employee per month took effect on July 1, 2010. (See Instruction No. 1.)

Andy Cherullo was hired as the new Chief Financial Officer of the 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>
ASSETS			
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
Total Assets	<u>\$144,181,728</u>	<u>\$0</u>	<u>\$144,181,728</u>
LIABILITIES			
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
Total Liabilities	<u>174,474,566</u>	<u>0</u>	<u>174,474,566</u>
FUND BALANCE			
Beginning of Fiscal Year Fund Balance	39,067,564		39,067,564
Current Year Operation Excess (Deficit)	(69,360,402)		(69,360,402)
Total Fund Balance	<u>(30,292,838)</u>	<u>0</u>	<u>(30,292,838)</u>
Total Liabilities and Fund Balance	<u>\$144,181,728</u>	<u>\$0</u>	<u>\$144,181,728</u>

**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>
Revenue:			
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
Total Revenue	<u>1,598,664,343</u>	<u>0</u>	<u>1,598,664,343</u>
Expenses:			
Insured Benefits Administration			
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
Total Insured Expenses	<u>539,699,486</u>	<u>0</u>	<u>539,699,486</u>
Self-Insured Medical Benefits and Administration			
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
Total Self-Insured Medical Expense	<u>989,733,165</u>	<u>0</u>	<u>989,733,165</u>
Self-Insured Dental Benefits and Administration			
Incurred Dental Claims	116,354,672		116,354,672
Dental Claims Management	4,888,791		4,888,791
Total Self-Insured Dental Expenses	<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
Total Expenses	<u>1,668,024,745</u>	<u>0</u>	<u>1,668,024,745</u>
Excess (Deficit) of Current Year			
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	<u>(69,360,402)</u>	<u>(244,213,917)</u>	<u>28,753,250</u>	<u>48,190,980</u>	<u>66,328,886</u>
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 management and employees of the 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; Lichiou 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

