

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



**TARGET FINANCIAL EXAMINATION
OF
PUGET SOUND HEALTH PARTNERS, INC.
LAKEWOOD, WASHINGTON
NAIC CODE 12909
OCTOBER 31, 2008**

Order No. 09-93
Puget Sound Health Partners, Inc.
Exhibit A

SALUTATION

Seattle, Washington
July 27, 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 RCW 48.44.145 and RCW 48.03.010, a target examination was made of the corporate affairs and financial records of

Puget Sound Health Partners, Inc.

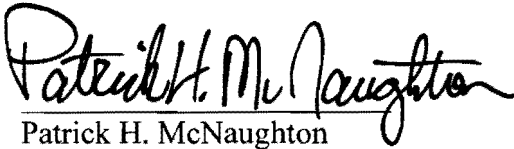
of

Lakewood, Washington

hereinafter referred to as "PSHP" or the "Company," at the location of its home office, 7502 Lakewood Drive, Suite A, Lakewood, Washington 98499. This report is respectfully submitted showing the condition of the Company as of October 31, 2008.

CHIEF EXAMINER'S AFFIDAVIT

I hereby certify I have read the attached Report of the Target Financial Examination of Puget Sound Health Partners, Inc., of Lakewood, Washington. This report shows the financial condition and related corporate matters as of October 31, 2008.



Patrick H. McNaughton
Chief Examiner

7-27-09
Date

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SCOPE OF THE EXAMINATION

A targeted, limited-scope examination was called on December 1, 2008 based on the financial results of the Company as of October 31, 2008. The primary objective of the examination was to review the Company's financial solvency by conducting a focused review of the books and records targeting the financial reporting accuracy of premium revenue, claim reserves, benefit and capitation payments, cash balances, Medicare contracted liabilities, review of investments, inter-company transactions and capital structure and subsequent events that could impact the Company's solvency.

This examination covers the period January 18, 2007 through October 31, 2008. The examination followed the statutory requirements contained in the Washington Administrative Code (WAC), Revised Code of Washington (RCW), and the guidelines recommended by the National Association of Insurance Commissioners (NAIC) Financial Condition Examiners Handbook. The examination included identification and disposition of material transactions and events occurring subsequent to the date of examination that were noted during the examination.

Corporate records, external reference materials, and various aspects of the Company's operating procedures and financial records were reviewed and tested during the course of this examination and are commented upon in the following sections of this report. In addition, the Company's certified public accountant's (CPA's) work papers were reviewed and utilized, where possible, to facilitate efficiency in the examination.

INSTRUCTIONS

The examiners reviewed the Company's filed 2007 Annual Statement and the October 31, 2008 OIC Monthly Statement as part of the statutory examination. This review was performed to determine if the Company completed the statements in accordance with Title 48 RCW, Title 284 WAC, and the NAIC Statements of Statutory Accounting Principles (SSAP) as contained in the NAIC Accounting Practices and Procedures Manual (AP&P).

1. Financial Statement Errors and Omissions

The results of the examination disclosed several instances where the Company's NAIC Annual Statement and the OIC Monthly Statement did not conform to the NAIC AP&P manual or the NAIC Annual Statement Instructions. While the Company needs to correct these practices, none of the following items in this instruction were material to the financial statements and no examination adjustments were necessary:

I. December 31, 2007 NAIC Annual Statement:

- A. In Schedule E, Part 3, the Company reported an indemnity deposit of \$0. It should have been reported as \$150,000.

- B. Note 10, of the Notes to Financial Statements, did not disclose all agreements with its shareholders; Northwest Physicians Network, LLC (NPN), Physicians of Southwest Washington (PSW), and Highline Medical Services Organization (HMSO), as required under SSAP No. 25, paragraphs 18-19. Not disclosed were the Administrative Services Agreements (ASA) with each shareholder and that each shareholder is a Medicare Advantage provider. While these agreements were filed on Form D with the OIC and were approved, they were not properly disclosed in the 2007 NAIC Annual Statement Notes to Financial Statements.

II. October 31, 2008 OIC Monthly Statement:

- A. Salaries and benefits payable were included as “General expenses due and accrued” instead of including them as “Amounts withheld or retained for the accounts of others”, in accordance with SSAP No. 67, paragraphs 7 and 8.
- B. Payables to HMSO, NPN, and PSW for marketing and credentialing services were improperly classified as “General expenses due and accrued” instead of “Amounts due to parent, subsidiaries and affiliates”.
- C. In the October 31, 2008 OIC Monthly Statement, the Company did not properly account for \$136,942 of uncollected premiums over 90 days past due as a nonadmitted asset as required by RCW 48.12.010(5) and SSAP No. 6, paragraph 9. The Company used Generally Accepted Accounting Principals (GAAP) accounting for uncollected premiums, as a result, the premiums were not shown as nonadmitted and flowed through the income statement instead of being a direct charge to surplus.
- D. Furniture and equipment was appropriately nonadmitted; however, depreciation related to nonadmitted furniture and equipment was also reversed as a GAAP to statutory adjustment. SSAP No. 19, paragraph 2, requires depreciation to flow through the income statement.

The Company is instructed to comply with RCW 48.43.097 and WAC 284-07-050(2),(6) and (7) in filing its NAIC Annual Statements, NAIC Quarterly Statements, and any interim statutory financial information requested by the OIC in accordance with the AP&P and the NAIC Annual Statement Instructions.

2. Reconciliations

Timely and accurate reconciliations are required to report full and adequate accounts and records of PSHP’s assets, obligations, transactions, and affairs. The following exceptions were noted in our review:

- A. PSHP did not provide an accurate bank reconciliation of its operating account. PSHP provided a printout from its general ledger system. However, the adjusted bank balance was \$15,857 lower than the ledger balance as of October 31, 2008.

- B. PSHP did not perform timely reconciliations between the financial supporting documents and the general ledger accounts of its premiums received from the members' monthly premium payment and Centers for Medicare and Medicaid Services (CMS) and the total net capitation payment for October 2008. PSHP performed the reconciliation at the request of the examination team in January 2009.

The Company is instructed to maintain and keep sufficient and timely detailed records and reconciliations in order to assist in complying with RCW 48.43.097.

3. Liability for Amounts Held Under Uninsured Plans

The Company failed to establish a Low Income Cost Subsidy (LICS) liability and a Reinsurance Payments (RP) liability as "Liability for amounts held under uninsured plans" in its NAIC 2008 Quarterly Statement filing as of September 30, 2008 and its October 31, 2008 monthly financial report to the OIC. The Company incorrectly recorded all amounts received for LICS and RP as premium income instead of a liability as required by SSAP No. 47, Paragraph 5.

The LICS is for low income Medicare patients using the Part D program for prescription drugs. LICS monies received by the Company should have been recorded as a liability and the liability should have been reduced by pharmacy benefits paid to eligible participants. Any unused portion of LICS monies received is required to be remitted back to CMS.

The RP paid by CMS should be treated as a liability for claim payments rather than as revenue to the Company, and the RP claims should not flow through PSHP's income statement. CMS prepays the RP on an estimated basis; RP received by PSHP should have been recorded as a liability and reduced by pharmacy benefits paid for eligible participants. Any unused portion is remitted back to CMS. Therefore, "Premium income" was overstated and "Liability for amounts held under uninsured plans" for LICS and PR from CMS was understated. Due to immateriality, no examination reclassification was necessary.

The Company is instructed to file an accurate statement of its financial condition, transactions, and affairs in compliance with RCW 48.43.097, which requires the filing of its financial statements in accordance with the AP&P, and WAC 284-07-050(2) which requires adherence to the NAIC Annual Statement Instructions and the AP&P manual; and with SSAP No. 47, Paragraph 5.

4. Custodial Agreement

The Company responded in its 2007 NAIC Annual Statement General Interrogatories 26.01 that its custodial agreement with US Bank complied with the FCEH. However, it did not contain several provisions required by the FCEH.

The Company is instructed to comply with RCW 48.43.097 by filing a true statement of its financial condition, transactions and affairs and to follow the NAIC Annual Statement Instructions and the AP&P, as required by WAC 284-07-050(2). The Company is also instructed to execute a revised or amended custodial agreement that complies with the FCEH.

5. Authorization of Investments

The investments bought or sold are not approved by the Board of Directors (BOD). PSHP's investment policy, which had not been approved by the BOD, requires that the Finance Committee or the BOD shall review for ratification all transactions made since prior ratification, as well as a detailed list of all current investments on a quarterly basis. PSHP is not in compliance with its investment policy or RCW 48.13.340 which requires all investments be authorized or approved by the BOD.

The Company is instructed to comply with RCW 48.13.340 which requires investment activity to be submitted to the BOD for approval.

6. Board and Committee Minutes

No issues were disclosed in any of the Company's furnished meeting minutes that would materially affect the Company's October 31, 2008 statutory financial statements. However, information that should have been included in the respective minutes during the examination period, such as clarification of explicit decisions and ratifications made by the BOD, was missing, incomplete, or not clearly stated.

Specific deficiencies in the PSHP's BOD minutes included the following:

- A. The minutes did not include approval of the Company's appointed actuary.

The Company is instructed to comply with WAC 284-07-350(2) by explicitly appointing an actuary and ratifying the approval of the actuary's reports in the BOD minutes.

- B. Not included in the minutes was information on the decision of the BOD to hire, elect or confirm officers such as chief executive officer, chief financial officer, and chief medical officer, or the resignation of said officers. (Company Bylaws, Section 3.1.3.)

The Company is instructed to comply with RCW 23B.08.300 and the Company's Bylaws, Section 3.1 by affirmatively and explicitly ratifying a potential officer of the Company.

- C. Decisions to not have a particular BOD meeting were not evidenced by

one or more consents describing the action taken, executed by each director either before or after the action taken, and delivered to the corporation for inclusion in the BOD minutes or filing with the corporate records, in accordance with both RCW 23B.08.210 and the Company's Bylaws, Section 3.6.

The Company is instructed to comply with RCW 23B.08.210 and the Company's Bylaws, Section 3.6 by having the Board of Directors' consent in writing, before or after the taken action, to not have a particular Board meeting, and include this written consent in the BOD minutes.

- D. The minutes for the Annual BOD meeting were not identified as the annual meeting as required by PSHP's Bylaws, Section 3.3, nor was the approval of PSHP's NAIC 2007 Annual Statement filing, audits, and regulatory reports as required by the Company's Bylaws, Section 3.1.10. In addition, the minutes did not document approval of contracts with affiliates and timely approval of the BOD minutes.

The Company is instructed to comply with RCW 23B.16.010 and the Company's Bylaws, Section 3.13 by keeping a record of all actions taken by the Company's Board of Directors without a meeting and/or a record of all actions taken by a committee of the Board of Directors exercising the authority of the Board of Directors, and to timely have the BOD minutes in writing, approved by the BOD, signed by the BOD secretary, and placed in the BOD minutes.

The Company is instructed to comply with RCW 48.43.097, Chapter 23B RCW, and WAC 284-07-050(2) in accordance with the NAIC Accounting Practices and Procedures Manual and the NAIC Annual Statement Instructions by keeping full and adequate accounts and records of transactions and affairs.

7. Intercompany Transaction Settlements

PSW, NPN, and HMSO provide administrative services, including credentialing and claims processing to the Company. The agreements for these services indicate that reimbursement of costs for these services require monthly settlement by PSHP, by the 10th day of the month, unless otherwise agreed to in writing. Both SSAP No. 25, paragraph 6, and SSAP No. 96, paragraph 2, require related party transactions to be in the form of a written agreement that provides for timely settlement of amounts owed and a specified due date. Any uncollected receivable over ninety days from the due date must be nonadmitted. The agreements comply with this requirement; however, monthly settlements were not made in 2008.

The Company is instructed to comply with RCW 48.43.097, SSAP No. 25, SSAP No. 96, in accordance with the Holding Company Act for Health Care

Service Contractors (RCW 48.31C.040(2) and RCW 48.31C.050), by timely settlement of its intercompany or related party transactions.

COMMENTS AND RECOMMENDATIONS

1. Accounting Staff and Controls

The Company's outside accounting firm for the 2007 audit recommended that PSHP's management design, document, and implement controls and processes in order to provide standards and guidelines for personnel regarding processes and procedures to follow and assess the operating effectiveness of internal controls. During our review of the October 31, 2008 statements, we noted the same weaknesses still existed.

Our review disclosed many of the external auditor's recommendations had not been implemented and it is recommended the Company document and implement controls and processes in order to provide standards and guidelines for personnel regarding processes and procedures to follow as cited by the external auditor. Also, this situation appears to be at least partially a function of not having enough staff resources, so it is recommended consideration be given to supplementing the existing accounting staff.

2. Conflict of Interest

PSHP did not follow its Conflict of Interest Policy procedures. PSHP's Bylaws, Section 12.4 requires PHSP to implement a conflict of interest (COI) policy for directors, officers, and key management employees. In our review of PSHP's records, we only found COI statements dated November and December of 2006 for the BOD. PSHP's BOD policy states that board directors must sign the COI statement annually. There were no COI statements for officers or key management employees since inception of the Company and no COI statements from the BOD for 2007 and 2008. As a result, the Company is not in compliance with its Bylaws or the BOD's Policy.

It is recommended that PSHP follow its conflict of interest policy requiring directors, officers, and key management employees to complete annual conflict of interest forms. In order to monitor compliance, it is also recommended the Company obtain and review conflict of interest declarations from directors, officers, and key management employees and to report the results to the Company's BOD, as required by the conflict of interest policy.

COMPANY PROFILE

Company History

The Company was incorporated in the state of Washington on January 18, 2007 as a for-profit company. The Company received its Certificate of Registration on February 9, 2007 as a health care service contractor. The Company offers Medicare Advantage plans through its contract with the Center for Medicare and Medicaid Services (CMS). The Company was formed through equal stock ownership by three local medical provider organizations; Northwest Physicians Network (NPN), Physicians of Southwest Washington (PSW) and Highline Medical Services Organization (HMSO).

Capitalization

As of October 31, 2008, the Company had 810,000 shares of common stock issued and outstanding with a \$10 par value. Minimum capital requirement pursuant to RCW 48.44.037 were met with \$8.4 million in capital and surplus as of October 31, 2008.

Territory and Plan of Operation

The Company writes Medicare Advantage coverage for parts A, B and D exclusively in Washington State specifically in King County, Pierce County, and Thurston County.

Growth of Company

The Company began writing business effective January 1, 2008. The Company's enrollment as of October 31, 2008 was 4,148 members. In the first ten months of operations ending October 31, 2008, the Company wrote \$37,009,358 in premiums and reported a net loss of \$(538,262).

AFFILIATED COMPANIES

Inter-company Agreements

PSHP has an Administrative Services Agreement (ASA) with each of its three shareholders HMSO, NPN, and PSW with similar provisions. All three administrative services agreements provide that the organizations will receive 85% of the Medicare Advantage premiums of its assigned members to provide benefits on a capitated basis for each member less a small deductible for uncovered services not provided by the organizations. In addition, the organizations receive 2.5% of premiums for claims processing of each assigned member.

MANAGEMENT AND CONTROL

Ownership

The Company was formed through stock ownership by three local provider organizations. Each organization owns a one-third interest in the capital stock of the Company as of October 31, 2008. As of October 31, 2008, the Company had 810,000 shares of common

stock issued and outstanding with a par value of ten dollars a share and total paid in capital of \$8,100,000.

Board of Directors (BOD)

The business and affairs of the Company are managed by its Board of Directors (BOD). According to Section 3.2 of its Bylaws, the number of directors shall be at least six (6) and not more than twelve (12).

Directors as of October 31, 2008:

Leonard B. Alenick, M.D.
John Van Bodegom, M.D.
Patricia C. Briggs
Mariella H. Cummings
Stanley Lalit Kumar Flemming, D.O.
Gary R. Goin, M.D.
Karen L. Lee
Lloyd R. Musselman
Laurence C. Schadt, M.D.

Officers

Officers as of October 31, 2008:

Lawrence Wing Sing Loo	Chief Executive Officer
Zachary A. Smulski	Chief Financial Officer
Corinne E. Jedynak-Bell, D.O.	Chief Medical Officer

Conflict of Interest

The Company's policy requires that members of the BOD and key management employees file a conflict of interest statement each year. The purpose of the statement is to detect any activities or participation on the part of an employee that could possibly be interpreted as a conflict of interest. As of October 31, 2008, the Company was not in compliance with its conflict of interest policy as stated in Section 12.4 of its Bylaws. (See Comments and Recommendations No. 2.)

CORPORATE RECORDS

No issues were disclosed in any of the Company's BOD minutes that would materially affect the Company's October 31, 2008 OIC Monthly Statement. However, information that should have been included in the respective minutes during the examination period, such as, clarification of explicit decisions and ratifications made by the BOD, was missing, incomplete, or not clearly stated. (See Instruction No. 6.)

ACTUARIAL REVIEW

The OIC actuary reviewed the Company's loss reserves as of October 31, 2008, and noted the Company failed to establish a Low Income Cost Subsidy liability and a Reinsurance Payments liability as "Liability for amounts held under uninsured plans" in its NAIC 2008 Quarterly Statement filing as of September 30, 2008 and its October 31, 2008 monthly financial reporting to OIC. (See Instruction No. 3.)

REINSURANCE

The Company has a stop-loss reinsurance agreement with Physicians Insurance A Mutual Company effective January 1, 2008. Based on discussions with management and our review of the October 31, 2008 statements, PSHP did not reach the attachment limit of the treaty or report any reinsurance amounts recoverable as of October 31, 2008.

SPECIAL DEPOSITS

As of October 31, 2008, the Company had a special deposit of \$150,000 in treasury obligations with U.S. Bank. (See Instruction No. 1.I.A.)

ACCOUNTING RECORDS AND INFORMATION SYSTEMS

The Company maintains its accounting records on a GAAP accrual basis of accounting and adjusts to Statutory Accounting Practices (SAP) basis for NAIC Annual Statement reporting. The Company was last audited in 2007 by the certified public accounting firm of Hagen, Kurth, Perman & Co., P.S. The Company received an unqualified opinion for the year ended 2007. The examination team did a limited review of the Company's accounting procedures, internal controls, and transaction cycles in connection with this target examination and relied on the CPA's review which identified significant deficiencies in internal controls in a letter dated April 28, 2008. (See Comments and Recommendations No. 1.)

SUBSEQUENT EVENTS

1. Lawrence Wing Sing Loo, Chief Executive Officer, resigned and was replaced by April Golenor on February 2, 2009.
2. On February 10, 2009, the Company issued an additional 100,000 shares of common stock. 50,000 shares were issued to PSW and another 50,000 shares were issued to NPN adding in total an additional \$1,000,000 to PSHP's surplus.

FINANCIAL STATEMENTS

The following examination financial statements show the financial condition of Puget Sound Health Partners, Inc., as of October 31, 2008:

Assets, Liabilities, Capital and Surplus
Statement of Revenue and Expenses

PUGET SOUND HEALTH PARTNERS, INC.
ASSETS, LIABILITIES, CAPITAL AND SURPLUS
October 31, 2008

	<u>Balance Per</u> <u>Company</u>	<u>Examination</u> <u>Adjustment</u>	<u>Balance Per</u> <u>Examination</u>
Assets			
Cash, cash equivalent, and short-term investments	\$7,930,518	\$0	\$7,930,518
Investment income due and accrued	555		555
Premiums and considerations:			
Uncollected premiums and agents' balances in the course of collection	139,373		139,373
Electronic data processing equipment and software	71,314		71,314
Receivables from parent, subsidiaries and affiliates	257,350		257,350
Total Assets	<u>\$ 8,399,110</u>	<u>\$0</u>	<u>\$ 8,399,110</u>
Liabilities, Capital, and Surplus			
Claims unpaid	\$ 515,556	\$0	\$ 515,556
Unpaid claims adjustment expenses	23,289		23,289
Premiums received in advance	3,340,113		3,340,113
General expenses due or accrued	828,190		828,190
Total Liabilities	<u>4,707,148</u>		<u>4,707,148</u>
Gross paid in and contributed surplus	8,100,000		8,100,000
Unassigned funds (surplus)	(4,408,038)		(4,408,038)
Total Capital and Surplus	<u>3,691,962</u>		<u>3,691,962</u>
Total Liabilities, Capital and Surplus	<u>\$ 8,399,110</u>	<u>\$0</u>	<u>\$ 8,399,110</u>

PUGET SOUND HEALTH PARTNERS, INC.
STATEMENT OF REVENUE AND EXPENSES
For the Ten Month Period Ending October 31, 2008

	<u>Balance Per Company</u>	<u>Examination Adjustment</u>	<u>Balance Per Examination</u>
Net premium income	\$ 37,009,358	\$0	\$ 37,009,358
<u>Hospital and Medical:</u>			
Hospital/medical benefits	31,734,341		31,734,341
CAE, including \$0 cost containment expenses	899,490		899,490
General administrative expenses	5,005,900		5,005,900
Total underwriting deductions	<u>37,639,731</u>		<u>37,639,731</u>
Net underwriting gain or (loss)	<u>(630,373)</u>		<u>(630,373)</u>
Net investment income earned	92,111		92,111
Net income or (loss) after capital gains tax and before FIT	<u>(538,262)</u>		<u>(538,262)</u>
Net income (loss)	<u>\$ (538,262)</u>	\$0	<u>\$ (538,262)</u>
<u>CAPITAL AND SURPLUS ACCOUNTS</u>			
Capital and surplus prior-reporting period	\$ 3,839,146	\$0	\$ 3,839,146
Net income(loss) from above	(538,262)		(538,262)
Change in deferred income tax	202,912		202,912
Change in nonadmitted assets	(111,834)		(111,834)
Paid in capital or common stock	300,000		300,000
Net change in capital and surplus	<u>(147,184)</u>		<u>(147,184)</u>
Capital and surplus end of reporting period	<u>\$ 3,691,962</u>	\$0	<u>\$ 3,691,962</u>

NOTES TO THE FINANCIAL STATEMENTS

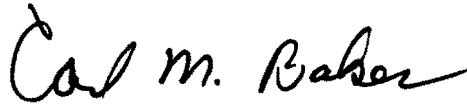
None

ACKNOWLEDGMENT

Acknowledgment is hereby made of the cooperation extended to the examiners by the officers of Puget Sound Health Partners, Inc., during the course of this examination.

In addition to the undersigned, Michael V. Jordan, CPA, CFE, MHP, Assistant Chief Examiner; Timothy F. Hays, CPA, JD, Investment Specialist; Shiraz Jetha, FSA, FCIA, MAAA, Health Actuary; Tony T. Quach, Financial Examiner, and Randy E. Fong, AFE, 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,



Carl M. Baker, CPA, CFE, CISA
Health Field Supervisor
Examiner-in-Charge
State of Washington

AFFIDAVIT

STATE OF WASHINGTON }
 } ss
 COUNTY OF KING }

Carl M. Baker, CPA, CFE, CISA, being duly sworn, deposes and says that the foregoing report subscribed is true to the best of his knowledge and belief.

He attests that the examination of Puget Sound Health Partners, Inc., 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).

Carl M. Baker

Carl M. Baker, CPA, CFE, CISA
 Health Field Supervisor
 Examiner-in-Charge
 State of Washington

Subscribed and sworn to before me this 27th day of July, 2009.

Colleen Jansen
 Notary Public in and for the
 State of Washington.

