

STATE OF WASHINGTON
OFFICE OF THE INSURANCE COMMISSIONER



FINANCIAL EXAMINATION
OF
KPS HEALTH PLANS
BREMERTON, WASHINGTON

NAIC CODE 53872
December 31, 2013

Order No. 15-155
KPS Health Plans
Exhibit A

SALUTATION

Seattle, Washington
April 16, 2015

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 corporate affairs and financial records of

**KPS Health Plans
of
Bremerton, Washington**

hereinafter referred to as "KPS" or the "Company" at the location of its home office 400 Warren Avenue, Bremerton, WA 98337. This report is respectfully submitted showing the financial condition and related corporate matters of the Company as of December 31, 2013.

CHIEF EXAMINER'S AFFIDAVIT

I hereby certify I have read the attached Report of the Financial Examination of KPS Health Plans of Bremerton, Washington. This report shows the financial condition and related corporate matters as of December 31, 2013.



Patrick H. McNaughton
Chief Examiner

6-29-15

Date

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SCOPE OF THE EXAMINATION

This examination covers the period January 1, 2012 through December 31, 2013 and comprises a risk focused review of the books and records of the Company. 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, 2015.

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 section of this report. In addition, the Company's Certified Public Accountants' (CPA's) work papers were reviewed and utilized, where possible, to facilitate efficiency in the examination.

This examination was performed in compliance with the 2013 NAIC FCEH which requires the examiners to consider the Company's risk management process, corporate governance structure, and control environment, as well as ten critical risk areas. The examiners utilized the information obtained during the examination to assess the Company's overall potential risks both currently and on an on-going basis, allowing the examiners to focus on the Company's greatest areas of risk, and providing assurance on the Company's financial statements as of the examination date.

INSTRUCTIONS

None

COMMENTS AND RECOMMENDATIONS

1. Adequate Review and Approval of Board Committee Meeting Minutes

The February 13, 2013 KPS Audit Committee (AC) minutes reflected that a non-member of the committee made a motion that the Audit Committee review and approve its Charter. The minutes reflected that this motion was seconded and passed unanimously. The February 13, 2013 Audit Committee minutes were subsequently reviewed and approved at its June 12, 2013 meeting. Upon inquiry, the Company stated that the February 13, 2013 meeting minutes contained an error with regard to the person who actually made the motion. The Company discovered the error on April 4, 2014, and the AC minutes were amended on July 9, 2014. It is a good governance practice for board committee members to devote sufficient review to action items prior to taking action at meetings.

It is recommended that the Audit Committee members enhance their review of action items prior to taking action.

2. Premium Reconciliation Controls

The Company's process to reconcile billed premiums to amounts collected contained numerous errors and the control was determined to be ineffective. Out of the sample selected for testing, the following errors were noted:

- a) The reconciliation used the wrong month's invoice, which resulted in an inaccurate identification of a discrepancy;

- b) The reconciliation spreadsheet incorrectly documented that one item was "paid in full" when in fact the invoice was not paid in full. As a result, a formal reconciliation was not performed when it should have been;
- c) The reconciliation spreadsheet contained an incorrect date of payment;
- d) The reconciliation spreadsheet incorrectly identified one item as needing a formal reconciliation, when the payment received was actually for a payment made in advance, and payments made in advance do not require formal reconciliations; and
- e) Several items on the reconciliation spreadsheet were missing invoice information, causing the outstanding balance on the reconciliation spreadsheet to differ from the outstanding balance on the formal reconciliation.

The premium reconciliation is an important control to detect potential errors with premium income, premium receivable, and the billing function.

It is recommended that KPS enhance its controls over premium receipts by accurately and timely performing premium reconciliations.

3. Reconciliations of General Ledger Accounts

KPS's policy requires general ledger accounts to be prepared by the 25th of the following month and then reviewed within two weeks of that date. Several reconciliations that were selected for testing were not performed timely. The Company stated that its transition to the Blackline, a new system used for documenting and tracking the reconciliation process, was the reason for some of the delays.

It is recommended that KPS enhance its controls by timely preparing and approving the account reconciliations in accordance with the Company's General Ledger and Account Reconciliation Process policy.

COMPANY PROFILE

Company History

The Company was formed by the Kitsap County Medical-Dental Business Bureau. The Company was incorporated on June 8, 1948 as a Washington non-profit corporation under the name of Kitsap County Medical Service Bureau. On May 13, 1960, the Articles of Incorporation were amended to change its name to Kitsap Physicians Service. It received its original Certificate of Registration as a health care service contractor (HCSC) under Chapter 48.44 RCW from the OIC on January 14, 1975. The Company became KPS Health Plans in April of 1999.

On August 2, 1999, pursuant to Chapters 48.31 RCW and 48.99 RCW, KPS was placed into receivership for the purpose of rehabilitation by Order of the Thurston County Superior Court. On October 1, 2005, KPS emerged from receivership when Group Health Cooperative (GHC) contributed \$19 million in cash and became the sole voting member of KPS.

Capitalization

The Company met the minimum net worth requirements pursuant to RCW 48.44.037 with \$19,152,091 of capital and surplus as of December 31, 2013.

Territory and Plan of Operation

KPS is registered as a HCSC in the state of Washington. The Company markets fee-for-service (FFS) health plan coverage based on a Preferred Provider Organization (PPO) network in the state of Washington. The Company contracts directly with providers on the Olympic peninsula and utilized a leased network of providers for the remainder of the state. The Company's product line spans from comprehensive medical and pharmacy plans to consumer-directed high-deductible health plans.

Growth of Company

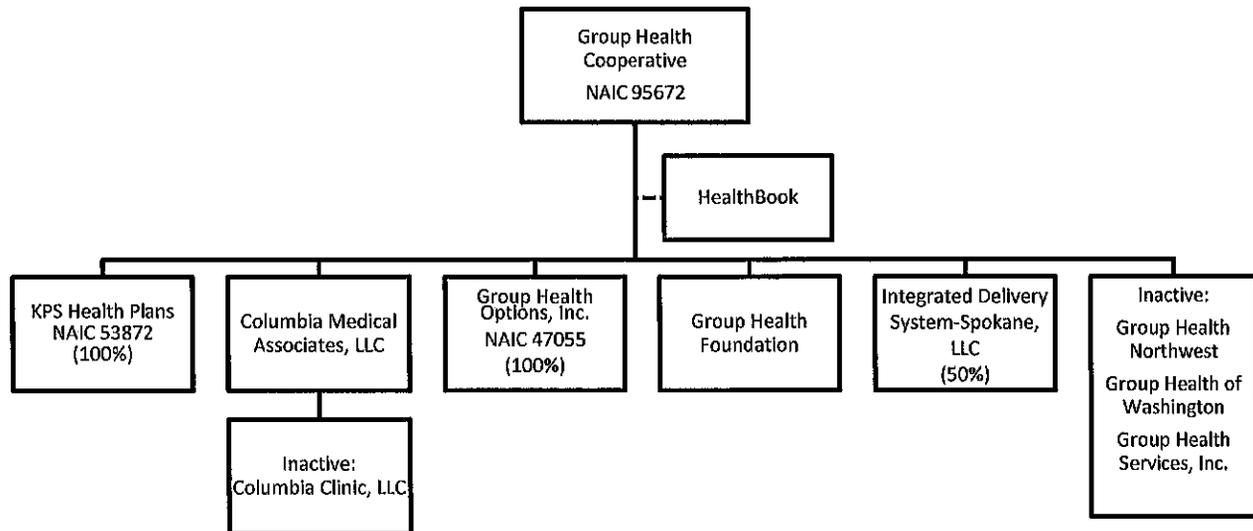
The following reflects the growth of the Company as reported in its filed NAIC Annual Statements for the two year period under examination:

<u>Year</u>	<u>Admitted Assets</u>	<u>Liabilities</u>	<u>Capital & Surplus</u>	
2013	\$40,798,021	\$21,645,930	\$19,152,091	
2012	53,824,635	39,227,895	14,596,740	

<u>Year</u>	<u>Total Revenue</u>	<u>Net Underwriting Gain (Loss)</u>	<u>Net Investment Gain (Loss)</u>	<u>Net Income</u>
2013	\$115,005,169	\$1,468,917	\$370,542	\$1,895,056
2012	123,220,612	508,596	2,865,133	3,430,313

Organizational Chart

The following is an organizational chart as of December 31, 2013:



Affiliated Companies

Group Health Cooperative (GHC)

GHC is a Washington non-profit corporation headquartered in Seattle, Washington. GHC offers comprehensive, coordinated health care to an enrolled membership for a fixed prepaid fee through its owned and leased facilities, employed providers, and contracted providers. In addition, GHC provides health care services on a fee-for-service basis to non-enrollees, as well as to enrollees that receive services from its internal delivery system that are not covered by their plan.

Group Health Options, Inc. (GHO)

GHO was incorporated in 1990 as a wholly owned subsidiary of GHC. GHO was issued a certificate of registration as a health care service contractor (HCSC) in the state of Washington on October 23, 1990. It offers a variety of health plans in Washington and Idaho. These plans range from a defined physician-network plan to point-of-service plans in which members can get care from outside network for higher out-of-pocket costs.

Group Health Foundation (GHF)

GHF is a Washington non-profit corporation organized under section 501(c)(3) of the Internal Revenue Code. GHF is registered in the state of Washington as a charitable gift annuity organization and is organized exclusively to benefit, to perform the functions of, and to carry out the purposes of GHC by securing, investing, and allocating charitable gifts in order to support research, health career training, health education, and other charitable programs that support the purpose of GHC. GHF is a membership corporation and has no capital stock. The membership of GHF consists of those persons elected as trustees of GHC.

Integrated Delivery System-Spokane, LLC (IDSS)

IDSS is a Washington limited liability company that was formed on July 31, 2012. GHC and Providence Health & Services-Washington, a corporation outside of the GHC holding company system, each own 50 percent of the membership interest in IDSS. The purpose of IDSS is to develop and operate an integrated healthcare delivery system in the greater Spokane area for GHC members.

Columbia Medical Associates, LLC (CMA)

CMA is a group of providers that delivers comprehensive medical care to families and individuals of all ages within the Spokane region. Effective July 31, 2011, GHC acquired 100 percent of CMA in order to provide a broader integrated system of medical care in the Spokane, Washington market. CMA owns 100 percent of Columbia Clinic, LLC.

HealthBook

CMA formed HealthBook as a Washington non-profit corporation without members on July 18, 2008. After GHC purchased CMA on August 1, 2011, HealthBook's Board of Directors was comprised entirely of GHC's employees and agents. Its purpose was to develop health information exchange platforms to facilitate the electronic exchange of health information among CMA primary care physicians and external specialists to be used in the treatment of patients. HealthBook was dissolved on December 12, 2014.

Intercompany Agreements

The Company is a party to various intercompany agreements with affiliates. Between January 1, 2012 to December 31, 2013, the Company had the following significant intercompany agreements in force:

Administrative Services Agreement between GHC and KPS

The agreement between GHC and KPS became effective January 1, 2007. Currently, GHC is to provide administrative services to KPS in the areas of legal services, risk management and insurance services, internal audit services, governance services, financial services, and marketing and communications. The agreement and its sixteen amendments were filed with the OIC on Form D's, and they were not disapproved. They were also disclosed on the Form B's.

Administrative Services Agreement between KPS and GHC

The agreement between KPS and GHC became effective September 1, 2011. The Agreement allows KPS to provide management of sales, account management, and contract administration services to or on behalf of GHC for GHC's FEHBP. The First Amendment effective June 11, 2012 adds actuarial services. The agreement and its amendment were filed with the OIC on Form D's, and they were not disapproved. They were also disclosed on the Form B's.

MANAGEMENT AND CONTROL

Ownership

The Company was organized under the Washington Non-profit Miscellaneous and Mutual Corporation Act, Chapter 24.06 RCW. The Company has one class of member. The membership is limited to a sole voting member, Group Health Cooperative.

Board of Directors (BOD)

Board of Directors as of December 31, 2013:

Rick Woods	Chair
Robert O'Brien, Jr.	Vice Chair
Scott Armstrong	Director
Breton Myers	Director
Sarah Yates	Director

Officers

Officers as of December 31, 2013:

Willis Page, Jr.	President
Robert O'Brien, Jr.	Vice President
Sarah Yates	Secretary
Breton Myers	Treasurer

Conflict of Interest

KPS's policy requires that upon hire, and annually thereafter, officers, directors and other key persons are required to submit a conflict of interest disclosure form. In addition, as conflicts of interest arise they must be disclosed to the GHC's Office of Compliance and Ethics or the executive director. No exceptions noted.

Fidelity Bond

KPS is a named insured on a commercial crime policy that includes employee fidelity coverage with \$10,000,000 coverage and a \$100,000 deductible. The coverage meets the NAIC recommended minimum guidelines.

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

Retirement Pension Plan

As of March 1, 2009, KPS curtailed its qualified defined benefit pension plan which was available to employees who were at least 21 years of age and worked a minimum of 1,000 hours per year. After March 1, 2009, no new benefits were accrued.

Defined Contribution Plan

KPS offers a 401(k) Savings Plan to eligible employees. Employees are eligible to participate upon hire. Employees may voluntarily defer from one percent to 100 percent of their pre-tax salary to this plan, up to the published Internal Revenue Service (IRS) annual maximum. KPS will match the employee's elective deferral to two percent, and the matching is vested immediately.

Executive Deferred Compensation Plan

KPS offers an unfunded deferred compensation plan to provide supplemental retirement benefits for a select group of management or highly compensated employees within the meaning of Section 201, 301, and 401 of the Employee Retirement Income Security Act of 1974 (ERISA). The participants may elect to defer up to 80 percent of their salary, and the Company may make discretionary contributions. There were four participants in the plan as of December 31, 2013.

CORPORATE RECORDS

The Articles of Incorporation, Bylaws, Certificate of Registration, and minutes of the BOD and its committees were reviewed for the period under examination. All BOD meetings were conducted with a quorum present. The Bylaws were amended on December 21, 2011 to specify the number of board members required to be as few as five and no more than nine.

ACTUARIAL REVIEW

The OIC actuary reviewed the Company's actuarial report, claims unpaid, and other claim liabilities as of December 31, 2013. The review included examining the Company's reserving philosophy and methodologies to determine the reasonableness of the claim liabilities, verifying that claim liabilities include provisions for all components noted in SSAP No. 55(7) and (8), and SSAP No. 54(12), (13), (18) and (19), reviewing historical paid claims and loss ratios, checking the consistency of the incurred-paid data from the Company's system with the figures reported in the 2013 NAIC Annual Statement, and estimating claims unpaid for the valuation date of December 31, 2013. The OIC actuary determined reserves were in compliance with statutory requirements, and the methods, assumptions, and methodologies used by the Company were appropriate.

REINSURANCE

KPS participates in a stop loss reinsurance agreement with American National Insurance Company. The reinsurance agreement complies with Washington State reinsurance statutes. The Company utilizes the services of a reinsurance intermediary, Axiom Re, LP, to solicit, negotiate, and place reinsurance cessions on its behalf.

INDEMNITY DEPOSITS

The Company maintained the following statutory deposit as of December 31, 2013:

<u>State</u>	<u>Type</u>	<u>Book Value</u>	<u>Fair Value</u>
Washington	Treasury Bill	<u>\$2,620,865</u>	<u>\$2,687,326</u>
Total		<u>\$2,620,865</u>	<u>\$2,687,326</u>

ACCOUNTING RECORDS AND INFORMATION SYSTEMS

The Company maintains its accounting records on a Generally Accepted Accounting Principles (GAAP) accrual basis of accounting and adjusts to Statutory Accounting Practices (SAP) basis for NAIC Annual Statement reporting. The Company is audited annually by the certified public accounting firm of KPMG LLP. The Company received an unqualified opinion for all years under review. The Company's accounting procedures, internal controls, and transaction cycles were reviewed during the planning and testing phase of the examination.

The Company'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:

- Align, Plan and Organize
- Build, Acquire and Implement
- Deliver, Service and Support
- Monitor, Evaluate and Assess

The IT systems 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. The Company 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

The Affordable Care Act (ACA) imposes an assessment on entities that issue health insurance for each calendar year beginning on or after January 1, 2014 (ACA Section 9010 Assessments). Assessments are based upon prior year net written premiums. Fees and assessments to the federal government are payable no later than September 30 of the applicable calendar year. KPS's estimated 2014 fee assessment payable is \$1 million, and its impact to RBC is 5.3 percent.

FINANCIAL STATEMENTS

The following financial statements show the financial condition of KPS as of December 31, 2013:

Assets, Liabilities, Capital and Surplus

Statement of Revenue and Expenses

Two Year Reconciliation of Surplus

KPS Health Plans
Assets, Liabilities, Capital and Surplus
December 31, 2013

	<u>BALANCE PER COMPANY</u>	<u>EXAMINATION ADJUSTMENTS</u>	<u>BALANCE PER EXAMINATION</u>
ASSETS			
Bonds	\$20,873,674	\$0	\$20,873,674
Cash, cash equivalents, and short-term	6,319,156		6,319,156
Investment income due and accrued	106,113		106,113
Premiums and considerations:			
Uncollected premiums and agents' balances			
In the course of collection	6,562,942		6,562,942
Amounts recoverable from reinsurers	30		30
Amounts receivable relating to uninsured plans	182,299		182,299
Current federal and foreign income tax recoverable and interest thereon	5,961		5,961
Net deferred tax asset	1,084,592		1,084,592
Health care and other amounts receivable	5,363,316		5,363,316
Aggregate write-ins for other than invested	299,939		299,939
Total assets	<u>\$40,798,021</u>	<u>\$0</u>	<u>\$40,798,021</u>
LIABILITIES, CAPITAL AND SURPLUS			
Claims unpaid	\$12,314,693	\$0	\$12,314,693
Unpaid claims adjustment expenses	256,903		256,903
Aggregate health policy reserves	6,274,946		6,274,946
Premiums received in advance	258,261		258,261
General expenses due or accrued	1,284,419		1,284,419
Amounts withheld or retained for the account of others	199,833		199,833
Amounts due to parent, subsidiaries and	292,042		292,042
Liability for amounts held under uninsured	54,701		54,701
Aggregate write-ins for other liabilities	710,132		710,132
Total liabilities	<u>21,645,930</u>	<u>0</u>	<u>21,645,930</u>
Gross paid in and contributed surplus	19,000,000		19,000,000
Unassigned funds (surplus)	152,091		152,091
Total capital and surplus	<u>19,152,091</u>	<u>0</u>	<u>19,152,091</u>
Total liabilities, capital and surplus	<u>\$40,798,021</u>	<u>\$0</u>	<u>\$40,798,021</u>

KPS Health Plans
Statement of Revenue and Expenses
For the Year Ended December 31, 2013

	<u>BALANCE PER COMPANY</u>	<u>EXAMINATION ADJUSTMENTS</u>	<u>BALANCE PER EXAMINATION</u>
Member months	257,485	0	257,485
Net premium income	\$115,005,169	\$0	\$115,005,169
Total revenues	<u>115,005,169</u>	<u>0</u>	<u>115,005,169</u>
Hospital and Medical:			
Hospital/medical benefits	74,756,146		74,756,146
Other professional services	3,491,829		3,491,829
Outside referrals	5,375,245		5,375,245
Emergency room and out-of-area	1,063,799		1,063,799
Prescription drugs	16,025,580		16,025,580
Aggregate write-ins for other hospital and medical	<u>1,349,880</u>		<u>1,349,880</u>
Subtotal	<u>102,062,479</u>	<u>0</u>	<u>102,062,479</u>
Less:			
Net reinsurance recoveries	<u>284,310</u>	<u>0</u>	<u>284,310</u>
Total hospital and medical	101,778,169	0	101,778,169
Claims adjustment expenses	3,327,959		3,327,959
General administrative expenses	<u>8,430,124</u>		<u>8,430,124</u>
Total underwriting deductions	<u>113,536,252</u>	<u>0</u>	<u>113,536,252</u>
Net underwriting gain or (loss)	<u>1,468,917</u>	<u>0</u>	<u>1,468,917</u>
Net investment income earned	311,331		311,331
Net realized capital gains or (losses) less capital gains tax	<u>59,211</u>		<u>59,211</u>
Net investment gains or (losses)	<u>370,542</u>	<u>0</u>	<u>370,542</u>
Aggregate write-ins for other income or expenses	<u>50,574</u>	<u>0</u>	<u>50,574</u>
Net income or (loss) after capital gains tax and before all other federal income taxes	1,890,033	0	1,890,033
Federal and foreign income taxes incurred	<u>(5,023)</u>	<u>0</u>	<u>(5,023)</u>
Net income or (loss)	<u>\$1,895,056</u>	<u>\$0</u>	<u>\$1,895,056</u>

KPS Health Plans
Statement of Revenue and Expenses (Continued)
For the Year Ended December 31, 2013

	BALANCE PER COMPANY	EXAMINATION ADJUSTMENTS	BALANCE PER EXAMINATION
<u>CAPITAL AND SURPLUS ACCOUNT</u>			
Capital and surplus prior reporting year	\$14,596,740	\$0	\$14,596,740
Net income or (loss)	1,895,056		1,895,056
Change in net deferred income tax	(1,641,921)		(1,641,921)
Change in nonadmitted assets	4,368,658		4,368,658
Aggregate write-ins for gains or (losses) in surplus	(66,440)		(66,440)
Net change in capital & surplus	4,555,351	0	4,555,351
Capital and surplus end of reporting year	<u>\$19,152,091</u>	<u>\$0</u>	<u>\$19,152,091</u>

KPS Health Plans
Two Year Reconciliation of Surplus
For the Years Ended December 31,

	2013	2012
Capital and surplus prior reporting year	\$14,596,740	\$11,033,612
Net income or (loss)	1,895,056	3,430,313
Change in net deferred income tax	(1,641,921)	5,672,344
Change in nonadmitted assets	4,368,658	(808,406)
Change in surplus notes	0	(4,637)
Aggregate write-ins for gains or (losses) in surplus	(66,440)	(4,726,486)
Net change in capital and surplus	4,555,351	3,563,128
Capital and surplus end of reporting year	<u>\$19,152,091</u>	<u>\$14,596,740</u>

ACKNOWLEDGMENT

Acknowledgment is hereby made of the cooperation extended to the examiners by the officers and employees of KPS Health Plans and its affiliates 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; Timothy F. Hays, CPA, JD, Investment Specialist; Susan Campbell, CPA, CFE, FLMI, ARA, Reinsurance Specialist; Scott Fitzpatrick, FSA, MAAA, Actuary; Adrienne Sulaiman, CPA, CFE, MHP, FLMI, Health Field Supervising Examiner; Christine Berch, CPA, Financial Examiner; Cynthia Clark, CPA, Financial Examiner; Edsel Dino, AFE, Financial Examiner, Keith Henderson, CPA, Financial Examiner; Tony Quach, AFE, Financial Examiner; Zairina Othman, Financial Examiner; 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,



Kathy Hicks, CPA, CFE
Examiner-in-Charge
State of Washington

