# STATE OF WASHINGTON
# OFFICE OF THE INSURANCE COMMISSIONER

FINANCIAL EXAMINATION

of the Charitable Gift Annuity Business

of

**Fred Hutchinson Cancer Research Center**
**Seattle, Washington**

**DECEMBER 31, 2003**

**FRED HUTCHINSON CANCER**
**RESEARCH CENTER**
**ORDER G07-19**
**EXHIBIT A**

## SALUTATION

Seattle, Washington
March 1, 2007

The Honorable Mike Kreidler, Commissioner
Washington State Office of the Insurance Commissioner (OIC)
Insurance Building, Capitol Campus
302 14th Avenue SW
Olympia, WA 98504

Dear Commissioner Kreidler:

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

**Fred Hutchinson Cancer Research Center**

of

Seattle, Washington

hereinafter referred to as "FHCRC" at the location of its office, 823 Yale Avenue North, Seattle, WA 98109.

This report of examination is respectfully submitted showing the condition of FHCRC as of December 31, 2003.

CHIEF EXAMINER'S AFFIDAVIT

I hereby certify I have read the attached Report of the Financial Examination of the Charitable Gift Annuity Business of Fred Hutchinson Cancer Research Center of Seattle, Washington. This report shows the financial condition of the Charitable Gift Annuity Business and related corporate matters of Fred Hutchinson Cancer Research Center as of December 31, 2003.

Patrick H. McNaughton
Chief Examiner

3-1-2007
Date

## TABLE OF CONTENTS


SCOPE OF EXAMINATION ..... 1
INSTRUCTIONS ..... 1
COMMENTS AND RECOMMENDATIONS ..... 4
ORGANIZATION PROFILE ..... 4
AFFILIATED ORGANIZATIONS ..... 5
MANAGEMENT AND CONTROL ..... 5
- MANAGEMENT ..... 5
- BOARD OF TRUSTEES ..... 5
- OFFICERS ..... 6
- TAX STATUS ..... 6
- CONFLICT OF INTEREST ..... 6

CORPORATE RECORDS ..... 6
STATEMENT OF ACTUARIAL OPINION ..... 6
ANNUITY ASSETS CUSTODIAL FUNCTION ..... 7
SUBSEQUENT EVENTS ..... 7
ACCOUNTING RECORDS AND PROCEDURES ..... 7
FINANCIAL STATEMENTS ..... 7
ACKNOWLEDGMENT ..... 9
AFFIDAVIT ..... 10

## SCOPE OF THE EXAMINATION

This examination covers the period January 1, 1999 through December 31, 2003. The financial statements are presented on a consolidated basis, however, the scope of our examination focused only on the transactions and operations of the CGAB. FHCRC's records, along with various aspects of the organization's operating procedures and financial reports, were reviewed and tested during the course of this examination as necessary to substantiate CGAB reporting. The results of the examination are commented upon in the various sections of this report. In addition, FHCRC's 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 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 FHCRC by examiners from the state of Washington.

## INSTRUCTIONS

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

The following summarizes the exceptions noted while performing this review.

### 1. Reporting Requirements

The 2003 Annual Report contained certain missing account balances or balances that did not agree with FHCRC's accounting records:

- Balance Sheet – reported amounts for unrestricted net assets and temporarily restricted net assets disagreed due to misclassifications of balances between these two accounts. There was no effect on the reported total of the net assets. (See FINANCIAL STATEMENTS A1)
- Statement of Income and Expenses – disclosed only the unrestricted fund activities; but did not report the activities related to the temporarily and permanently restricted funds amounting to $$11,262,000 and $339,000, respectively. Also the statement did not report the changes in net assets from financing activities amounting to $14,735,000. The statement was incomplete. (See FINANCIAL STATEMENTS A2)
- Number of Annuity Contracts – the reported number of in-force contracts was inaccurate; the annuity contracts list included a contract that had been

closed and the list did not properly count and include all in-force contracts. The number of annuity contracts reported in the annual report was overstated. (See INSTRUCTION No. 3)

As a result, FHCRC was not in compliance with the OIC Annual Report Instructions.

RCW 48.38.010 states that: "The commissioner may grant a certificate of exemption to any insurer or educational, religious, charitable, or scientific institution conducting a charitable gift annuity business: (10) Which: (a) Files with the insurance commissioner on or before March 1 of each year a copy of its annual statement prepared pursuant to the laws of its state of domicile, as well as such other financial material as may be requested, . . ."

**To comply with RCW 48.38.010, FHCRC is instructed to:**

- **Develop and implement a system for the accounting and reporting of its charitable gift annuity business to ensure accuracy and compliance with the principles or practices prescribed or permitted by Chapter 48.38 RCW; and**

- **Develop and implement procedures for appropriate review, by staff other than the report preparer, to ensure completeness and accuracy of the Annual Report.**

## 2. Charitable Gift Annuities Fund Balance

The assets of the separate reserve fund stated in the 2003 Annual Report were inaccurate. The fund balance of $4,250,863 reported in the Charitable Gift Annuities Fund Balance did not agree with the total investments of $3,762,112 reported in the portfolio statement by Harris Bank as of December 31, 2003. The statutory reserve or liability amount was $4,250,863, which was greater than the total investments of $3,762,112. The annuity assets, therefore, were inadequate to meet payments under the charitable gift annuity contracts as of December 31, 2003. The OIC was not able to determine the inadequacy of the annuity assets because the 2003 Annual Report submitted by FHCRC did not appropriately disclose the actual annuity investments balance. As a result, FHCRC was not in compliance with RCW 48.38.010(10)(a) and RCW 48.38.020(1) and (2)(b).

No examination adjustment was made for the above discrepancies. On March 10, 2004, FHCRC funded the additional amount to bring the bank balance from $3,762,112 to $4,250,863.

RCW 48.38.020(1) and (2)(b) states that:

(1) "Upon granting to such insurer or institution under RCW 48.38.010 a certificate of exemption to conduct a charitable gift annuity business, the insurance commissioner shall require it to establish and maintain a separate reserve fund adequate to meet the future payments under its charitable gift annuity contracts."

(2) "The assets of the separate reserve fund: (b) Shall be invested in the same manner that persons of reasonable prudence, discretion, and intelligence exercise in the management of a like enterprise, not in regard to speculating but in regard to the permanent disposition of their funds, considering the probable income as well as the probable safety of their capital. Investments shall be of sufficient value, liquidity, and diversity to assure the insurer or institution's ability to meet its obligations."

**To comply with RCW 48.38.010 and RCW 48.38.020, FHCRC is instructed to:**

- **Maintain, at all times, annuity assets adequate to meet payments under its charitable gift annuity contracts;**

- **Develop and implement a system for accounting, investing, and reporting of its charitable gift annuity business to ensure accuracy and compliance with the principles or practices prescribed or permitted by Chapter 48.38 RCW; and**

- **Develop and implement procedures for appropriate review, by staff other than the report preparer, to ensure completeness and accuracy of the Annual Report.**

## 3. Annuity Reserves

The total annuity reserve amounts reported in the Annual Report were inaccurate because the in-force contract summary listings used by the actuary in calculating the annuity reserve amounts were incorrect. The listings, which were prepared and provided by FHCRC to the actuary, included a deceased annuitant and did not include two in-force contracts. (See INSTRUCTION No.1) FHCRC was not in compliance with RCW 48.38.010 and RCW 48.38.020. No examination adjustment could be made due to FHCRC's inability to supply an accurate actuarial report.

RCW 48.38.020 states that:

(1) "Upon granting to such insurer or institution under RCW 48.38.010 a certificate of exemption to conduct a charitable gift annuity business, the insurance commissioner shall require it to establish and maintain a separate reserve fund adequate to meet the future payments under its charitable gift annuity contracts."

(3) "The amount of the separate reserve fund shall be:

(a) For contracts issued prior to July 1, 1998, not less than an amount computed in accordance with the standard of valuation based on the 1971 individual annuity mortality table with six percent interest for single premium immediate annuity contracts and four percent interest for all other individual annuity contracts;

(b) For contracts issued on or after July 1, 1998, in an amount not less than the aggregate reserve calculated according to the standards set forth in RCW 48.74.030 for other annuities with no cash settlement options;

(c) Plus a surplus of ten percent of the combined amounts under (a) and (b) of this subsection."

**FHCRC is instructed, pursuant to Chapter 48.38 RCW, to correct its in-force contract summary listing, send a copy of the correct listing to the actuary, and notify the actuary to use the new corrected listing in the calculations of the annuity reserves. FHCRC should develop a recording and monitoring system to ensure the in-force contracts listing is proper and complete, and that the annuities reserve amounts are calculated correctly.**

## COMMENTS AND RECOMMENDATIONS

There were no comments or recommendations made in this examination report.

## ORGANIZATION PROFILE

**History:** Fred Hutchinson Cancer Research Center, organized on September 9, 1971, is an independent, nonprofit research institution for the development of lifesaving therapies through biomedical research. It is made up of four scientific divisions that conduct basic and applied research and provide clinical care to patients being treated. FHCRC's clinical and research partners are: University of Washington Medicine, Children's Hospital and Regional Medical Center, Seattle Cancer Care Alliance, and Cancer Consortium.

**Territory and Plan of Operation:** On August 19, 1981, the OIC granted FHCRC a Certificate of Exemption Number 7 to conduct a CGAB in the state of Washington. There were 106 in-force annuity contracts as of December 31, 2003. All of the 106 annuity contracts were issued by FHCRC to residents of the state of Washington.

**Total Net Assets:** FHCRC's total net assets as of December 31, 2003 were $120,585,000. This amount included an unrestricted net asset of $90,684,000. The minimum unrestricted net asset requirement pursuant to RCW 48.38.010(6) was satisfied as of December 31, 2003.

**Growth:** The growth of FHCRC for the past five years is reflected in the following exhibits. All information was compiled from FHCRC's consolidated financial statements as of fiscal years ending June 30. Please note that this information was provided based on FHCRC's fiscal year-end which was different than the examination as-of date as reflected in the examination report financial statements.

**Schedule 1 – Statement of Financial Position**

(In thousands)

| Fiscal Year | Assets | Liabilities | Total Net Assets | Total Net Assets Allocated Into: Unrestricted | Temporarily Restricted | Permanently Restricted |
|---|---|---|---|---|---|---|
| **2003** | $468,977 | $375,442 | $93,535 | $75,235 | $11,536 | $6,764 |
| **2002** | 471,773 | 364,539 | 107,234 | 96,349 | 5,046 | 5,839 |
| **2001** | 475,314 | 352,330 | 122,984 | 114,201 | 2,887 | 5,896 |
| **2000** | 453,323 | 329,516 | 123,807 | 117,662 | 3,011 | 3,134 |
| **1999** | 429,108 | 310,334 | 118,774 | 109,438 | 6,675 | 2,661 |

**Schedule 2 – Statement of Activities and Changes in Net Assets (NA)**

(In thousands)

| | 2003 | 2002 | 2001 | 2000 | 1999 |
|---|---|---|---|---|---|
| Revenues and gains | $248,962 | $238,232 | $232,588 | $223,665 | $201,166 |
| Expenses | (245,257) | (231,410) | (223,466) | (216,599) | (196,820) |
| Unrealized change in market value of investments | (17,404) | (22,572) | (9,945) | (2,033) | 2,230 |
| Increase (decrease) in NA | (13,699) | (15,750) | (823) | 5,033 | 6,576 |
| NA at beginning of period | 107,234 | 122,984 | 123,807 | 118,774 | 112,198 |
| **Net assets at end of year** | **$93,535** | **$107,234** | **$122,984** | **$123,807** | **$118,774** |
| Number of gift annuity contracts at end of year | 106 | 96 | 82 | 75 | 63 |

## AFFILIATED ORGANIZATIONS

Fred Hutchinson Cancer Research Center Foundation (the Foundation) is an affiliate of FHCRC. The Foundation was established as a separate organization to provide financial and other support to and for the benefit of FHCRC and to segregate fund-raising activities from the research, scientific and other activities of FHCRC. Contributions received by the Foundation for specific purposes are distributed to FHCRC as required to comply with the purposes specified by the donor.

The financial statements of FHCRC and Fred Hutchinson Cancer Research Center Foundation have been presented on a consolidated basis and transactions between these entities are eliminated upon consolidation.

## MANAGEMENT AND CONTROL

**Management:** Responsibility for governing the corporation is vested in a Board of Trustees elected by the Board at the annual meeting.

**Board of Trustees (BOT):** Members of the BOT as of Fiscal Year 2003 – 2004 are:

Carl Behnke
Phil Bussey
Jeremy Jaech
Skip Kotkins

Karl Ege
Joan Enticknap
Ed Fritzky
Bob Gerth
Chuck Hirsch
Henry James
J. Shan Mullin
Sally Narodick
Thurston Roach
Jon Runstad
Michael Stein
Bonnie Towne

**Officers:** The Bylaws of FHCRC (amended and restated as of February 6, 2003) state that the BOT appoints a president who serves as the chief executive officer (CEO) and director of FHCRC. The president appoints senior vice presidents, an executive vice president and chief operating officer, a secretary, a treasurer and other officers of FHCRC. The appointment of corporate officers by the president is subject to ratification by the BOT. Dr. Lee Hartwell was the President, CEO and Director as of December 31, 2003.

**Tax Status:** FHCRC is a Washington nonprofit research institution and is exempt from income tax under Section 501(c)(3) of the Internal Revenue Code.

**Conflict of Interest:** FHCRC requires its trustees, director, scientific staff and other employees of FHCRC to disclose any conflict of interest by signing a conflict of interest statement. The Executive Committee reviews all disclosures by trustees; the director reviews all disclosures by scientific staff and other employees. From a review of selected samples of the conflict of interest statements, it appeared the trustees and staff performed due diligence in disclosing potential conflicts of interest.

## CORPORATE RECORDS

The Board of Trustees meets at least four times a year to discuss any business which is pertinent to FHCRC. Minutes of meetings of the trustees documented the approval of FHCRC's transactions and events. No exceptions were noted.

## STATEMENT OF ACTUARIAL OPINION

A consulting actuary with eBenX, 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 FHCRC's annuity contract reserves as computed under RCW 48.38.020(3)(a) and (b) of the Washington Insurance Code should be $3,864,421. This amount plus the 10% surplus required by RCW 48.38.020(3)(c), was reported as CGAB liabilities in FHCRC financial statements. The total annuity reserve amount was inaccurate because of an incorrect in force summary listing supplied by FHCRC. (See INSTRUCTION No. 3)

## ANNUITY ASSETS CUSTODIAL FUNCTION

The separate reserve fund assets were held and physically segregated from the other assets of FHCRC as required by RCW 48.38.020(2). Investments were recorded at fair value and consisted of cash equivalents, bonds and stocks.

## SUBSEQUENT EVENTS

There were no material events which impacted FHCRC's CGAB between the examination date and the last day of our field work.

## ACCOUNTING RECORDS AND PROCEDURES

Except as noted in this report, 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 consolidated financial statements of FHCRC as of December 31, 2003:

**Statement of Financial Position**
(In thousands)

| | Balance Per Annual Report | Adj | Examination Adjustments | Adjusted Balance |
|---|---|---|---|---|
| **ASSETS** | | | | |
| Cash and cash equivalents | $12,863 | | | $12,863 |
| Investments | 94,954 | | | 94,954 |
| CGA assets | 4,251 | | | 4,251 |
| Other assets | 377,054 | | | 377,054 |
| **Total Assets** | **$489,122** | | **$0** | **$489,122** |
| **LIABILITIES** | | | | |
| Accounts payable | $19,320 | | | $19,320 |
| CGA reserves | 4,251 | | | 4,251 |
| Other liabilities | 344,966 | | | 344,966 |
| **Total Liabilities** | 368,537 | | 0 | 368,537 |
| **NET ASSETS** | | | | |
| Unrestricted | 98,213 | A 1 | (7,529) | 90,684 |
| Temporarily restricted | 15,269 | A 1 | 7,529 | 22,798 |
| Permanently restricted | 7,103 | | | 7,103 |
| **Total Net Assets** | 120,585 | | 0 | 120,585 |
| **Total Liabilities and Net Assets** | **$489,122** | | **$0** | **$489,122** |

**Statement of Financial Activity and Changes in Net Assets (NA)**
(In thousands)

| | Balance Per Annual Report | Adj | Examination Adjustments | Adjusted Balance |
|---|---|---|---|---|
| Changes in unrestricted NA | | | | |
| Revenues | $125,925 | | $0 | $125,925 |
| Expenses | (125,211) | | 0 | (125,211) |
| Other gains (losses) | | | | |
| Increase (decrease) in unrestricted NA | 714 | | 0 | 714 |
| Changes in temporarily restricted NA | | A 2 | 11,262 | 11,262 |
| Changes in permanently restricted NA | | A 2 | 339 | 339 |
| Unrealized change in market value of investments | | A 2 | 14,735 | 14,735 |
| Increase (decrease) in net assets | 714 | | 26,336 | 27,050 |
| Net assets at beginning of period | 93,535 | | | 93,535 |
| Net assets at end of year | **$94,249** | | **$26,336** | **$120,585** |

## Adjustment Notes:

A 1 – To adjust the reported unrestricted and temporarily restricted net assets to agree with FHCRC's balance sheet. (See INSTRUCTION No. 1)

A 2 – To adjust the annual report to agree with FHCRC's financial records. As stated in INSTRUCTION No. 1, the annual report's statement of income and expenses disclosed only the unrestricted fund activities; activities related to the temporarily restricted and permanently restricted funds were not disclosed. The $11,262,000 and $339,000 adjustments were made to recognize the unreported changes in temporarily and permanently restricted net assets, respectively. Also, the $14,735,000 adjustment was made to recognize the changes in net assets from financing activities.

## ACKNOWLEDGMENT

Acknowledgment is hereby made of the cooperation extended to the examiners by the officers and employees of FHCRC 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,

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

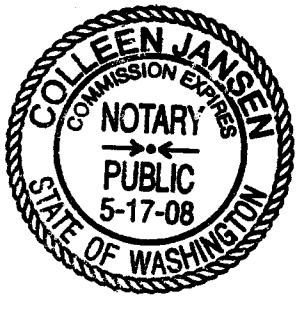
## AFFIDAVIT

**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 FHCRC's CGAB 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, AFE
Examiner-in-Charge
State of Washington

Subscribed and sworn to before me on this 1st day of March, 2007.

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