

Report on Examination

of

Avahealth, Inc.

Tampa, Florida

as of

December 31, 2008

By The

Florida Office of Insurance Regulation

Kevin M. McCarty, Commissioner
Florida Office of Insurance Regulation
200 E. Gaines Street, Room 101
Tallahassee, Florida 32399-0301

Dear Sir:

Pursuant to Section 624.316, Florida Statutes, and the *Financial Condition Examiners Handbook* of the National Association of Insurance Commissioners, we have completed a financial condition examination of Avahealth, Inc. as of December 31, 2008. Our report on the examination follows.

Florida Office of Insurance Regulation
August 11, 2009

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SCOPE OF EXAMINATION

We have completed a financial condition examination as of December 31, 2008 of Avahealth, Inc. (the "Company"), a single-state insurer domiciled in Florida. The last financial condition examination of the Company by the Florida Office of Insurance Regulation (the "Office") was as of December 31, 2007.

This examination covered the period of January 1, 2008 through December 31, 2008. We conducted our examination in accordance with the National Association of Insurance Commissioners (NAIC) *Financial Condition Examiners Handbook*. The Handbook required that we plan and perform our examination to evaluate the financial condition and identify prospective risks of the Company by obtaining information about the Company including corporate governance, identifying and assessing inherent risks within the Company, and evaluating system controls and procedures used to mitigate those risks. Our examination included assessing the principles used and significant estimates made by management. It also included evaluating overall financial statement presentation and management's compliance with statutory accounting principles and annual statement instructions when applicable to domestic state regulations. All accounts and activities of the Company were considered in accordance with the risk-focused examination process.

The Company's main administrative office was located in Tampa, Florida, where this examination was conducted.

MATERIAL PROSPECTIVE RISKS

During this financial condition examination, we assessed the adequacy of the Company's management controls and the extent to which the Company's current business processes might negatively affect its future solvency. Since commencing insurance operations in 2006, the Company's premium revenues have increased; however, its operations have resulted in a cumulative net loss. At December 31, 2008, its required minimum capital and surplus was \$1,500,000 and its actual capital and surplus was \$1,822,107 including an accrued capital contribution of \$975,000 collected in 2009 (as further discussed on page 13). The prospective risk exists that the Company will not generate premium revenues and earnings sufficient to assure its future solvency and long-term success.

COMPANY HISTORY

The Company was incorporated in Florida on July 8, 2005 and commenced insurance operations on April 1, 2006. It was authorized by the State of Florida to operate as an accident and health insurer in accordance with Section 624.401, Florida Statutes (F.S.).

In February of 2008, the Company filed amended articles of incorporation to change its name from Avalon Healthcare, Inc. to Avahealth, Inc. and registered the fictitious name Avalon Healthcare, Inc. with the Florida Department of State.

Dividends and Capital Contributions

No dividends were distributed by the Company during 2008. The Company reported capital contributions from its parent in the total amount of \$2,207,000 during 2008.

CORPORATE RECORDS

The recorded minutes of the meetings of the shareholder and Board of Directors were reviewed for the period examined. The recorded minutes of the Board adequately documented its meetings and approval of Company transactions in accordance with Section 607.1601(1), F.S. However, the Company was unable to demonstrate that it held an annual shareholder meeting for the election of directors as required by Section 607.0701(1), F.S.

MANAGEMENT AND CONTROL

As of December 31, 2008, the Company was wholly-owned by Avalon Healthcare Holdings, Inc.

The Company's senior officers, directors and Executive Committee members were as shown below.

Senior Officers

<u>Name</u>	<u>Title</u>
Charles T. O'Neill	President and Chief Executive Officer
Andrew B. Cassidy	Chief Financial Officer and Treasurer
Henry H. Neely	Vice President and Secretary

Board of Directors

<u>Name</u>	<u>Location</u>
Joseph Gauta, M.D.	Naples, Florida
Richard W. Haydon	Tampa, Florida
Paul W. Kowalski	Tampa, Florida
Judith A. Lyons	Tampa, Florida
Henry H. Neely	Tampa, Florida
Charles T. O'Neill	Tampa, Florida

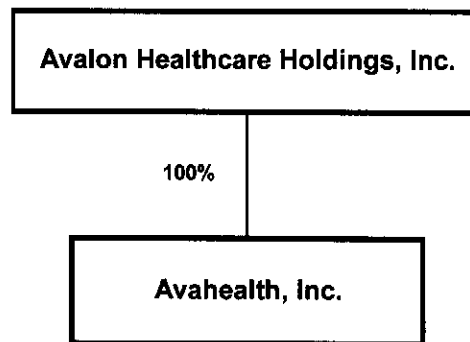
Executive Committee

Charles T. O'Neill
Henry H. Neely

The Company was a member of an insurance holding company system as defined by Rule 69O-143.045(3), Florida Administrative Code (F.A.C.). Its latest holding company registration statement was filed with the State of Florida as required by Section 628.801, F.S., and Rule 69O-143.046, F.A.C., on April 1, 2009.

An organizational chart as of December 31, 2008 reflecting the holding company system is shown below.

**Avahealth, Inc.
Organizational Chart
December 31, 2008**



Avalon Healthcare Holdings, Inc. provided management services to the Company pursuant to a January 1, 2008 agreement. In 2008, executive management and administration, marketing, accounting and financial support, claims processing and administration, claims analysis and statistical reporting, utilization management, provider and member relations and personnel management services were provided in return for fees of \$6.3 million.

FIDELITY BONDS AND OTHER INSURANCE

The Company maintained fidelity bond coverage of up to \$250,000 with a deductible of \$5,000 which adequately covered the suggested minimum amount of coverage for the Company as recommended by the NAIC of \$150,000.

PENSION, STOCK OWNERSHIP AND INSURANCE PLANS

The Company offered to eligible employees participation in a Section 401(k) retirement plan sponsored by Avalon Healthcare Holdings, Inc.

TERRITORY AND PLAN OF OPERATION

At December 31, 2008, the Company was authorized to transact insurance solely in the State of Florida.

COMPANY GROWTH

The Company reported the following for years 2006, 2007 and 2008:

	<u>2006</u>	<u>2007</u>	<u>2008</u>
In thousands:			
Net premiums	\$659.9	\$3,415.1	\$9,191.9
Total revenues	\$667.6	\$3,431.0	\$9,204.5
Net income (loss)	(\$2,549.7)	\$145.8	(\$2,479.4)
Total capital and surplus	\$1,655.7	\$2,130.8	\$1,859.1

REINSURANCE

The Company maintained excess of loss reinsurance coverage with HCC Life Insurance Company. Coverage was on a loss-occurring basis with an aggregate loss limit of \$5 million on covered policies in excess of \$200,000 for individual policies and \$150,000 for group policies. The Company did not assume insurance during the period examined.

STATUTORY DEPOSITS

The Company maintained a cash deposit of \$100,000 with the State of Florida as required by Section 624.411, F.S.

Avahealth, Inc.
Assets
December 31, 2008

	Per Company	Examination Adjustments	Per Examination
Cash, cash equivalents and short-term investments	\$2,233,494	\$0	\$2,233,494
Investment income due and accrued	570	0	570
Amounts recoverable from reinsurers	365,741	0	365,741
Other amounts receivable under reinsurance contracts	833	0	833
Current federal and foreign income tax recoverable	75,033	0	75,033
Receivables from parent, subsidiaries and affiliates	1,195,192	0	1,195,192
Health care and other amounts receivable	48,081	(36,990)	11,091
Total assets	\$3,918,944	(\$36,990)	\$3,881,954

Avahealth, Inc.
Liabilities, Capital and Surplus
December 31, 2008

Liabilities	Per Company	Examination Adjustments	Per Examination
Claims unpaid	\$1,019,005	\$0	\$1,019,005
Unpaid claims adjustment expenses	19,904	0	19,904
Aggregate health policy reserves	28,735	0	28,735
Premiums received in advance	911,240	0	911,240
General expenses due or accrued	80,963	0	80,963
Total liabilities	2,059,847	0	2,059,847
Capital and Surplus			
Common capital stock	1,500,000	0	1,500,000
Gross paid in and contributed surplus	5,807,000	0	5,807,000
Unassigned funds	(5,447,903)	(36,990)	(5,484,893)
Total capital and surplus	1,859,097	(36,990)	1,822,107
Total liabilities, capital and surplus	\$3,918,944	(\$36,990)	\$3,881,954

Avahealth, Inc.
Statement of Revenue and Expenses
(As reported by the Company)
For The Year Ended December 31, 2008

Net premium income	\$9,191,923
Aggregate write-ins for other non-health revenues	12,540
<u>Total revenues</u>	<u>9,204,463</u>
Hospital and medical benefits	4,377,655
Other professional services	1,911
Outside referrals	29,800
Emergency room and out-of-area	272,483
Prescription drugs	377,975
<u>Total hospital and medical</u>	<u>5,059,824</u>
General administrative expenses	6,673,613
<u>Total underwriting deductions</u>	<u>11,733,437</u>
Net underwriting gain (loss)	(2,528,974)
Net investment income	49,600
<u>Net income (loss)</u>	<u>(\$2,479,374)</u>

Avahealth, Inc.
Statement of Changes in Capital and Surplus
For The Year Ended December 31, 2008

Capital and surplus - December 31, 2007	\$2,130,846
Net income (loss)	(2,479,374)
Change in nonadmitted assets	625
Paid in capital	2,207,000
	<hr/> 1,859,097
Examination adjustments	(36,990)
	<hr/> Capital and surplus - December 31, 2008
	<hr/> <hr/> \$1,822,107

Avahealth, Inc.
Comparative Analysis of Changes in Capital and Surplus
December 31, 2008

The following is a reconciliation of capital and surplus between that reported by the Company and as determined by the examination.

Capital and surplus, December 31, 2008 - per annual statement			\$1,859,097
	<u>Per</u> <u>Company</u>	<u>Per</u> <u>Examination</u>	<u>Increase</u> <u>(Decrease)</u> <u>In Capital</u> <u>& Surplus</u>
Health care and other amounts receivable	\$48,081	\$11,091	(\$36,990)
Net change in capital and surplus			<u>(36,990)</u>
Capital and surplus, December 31, 2008 - per examination			<u><u>\$1,822,107</u></u>

COMMENTS ON FINANCIAL STATEMENTS

Receivables From Parent, Subsidiaries and Affiliates	\$1,195,192
Gross Paid In and Contributed Surplus	\$5,807,000

The amount reported by the Company in its 2008 annual statement as 'gross paid in and contributed surplus' included an accrued capital contribution of \$975,000 collected in 2009 and reported as a receivable at December 31, 2008 without the approval of the Office. Pursuant to paragraph 8 of Statement of Statutory Accounting Principles (SSAP) No. 72, such receivables may be considered as admitted assets with the approval of the domiciliary commissioner.

Health Care and Other Amounts Receivable	\$11,091
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The \$48,081 reported by the Company has been decreased by \$36,990. In its 2008 annual statement, the Company reported an asset consisting of amounts due from certain of its policyholders. The policyholder receivables were reported as 'health care and other amounts receivable' in the amount of \$36,990, and resulted from the Company's payments to provider hospitals of the full amounts of covered claims, including the portions for which the policyholders were obligated. Upon examination, the asset was nonadmitted on the basis that it was not allowable as an admitted asset under Part I of Chapter 625, F.S.

SUMMARY OF RECOMMENDATIONS

Material Prospective Risk

As reported on page 2, the prospective risk exists that the Company will not generate premium revenues and earnings sufficient to assure its future solvency and long-term success. **We recommend that the Company develop controls and business processes sufficient to mitigate this risk.**

Annual Shareholder Meeting

As reported on page 3, the Company was unable to demonstrate that it held an annual shareholder meeting for the election of directors. **We recommend that the Company comply with Section 607.0701(1), F.S.**

Accrued Capital Contribution

As reported on page 13, the amount reported by the Company in its 2008 annual statement as 'gross paid in and contributed surplus' included an accrued capital contribution of \$975,000 collected in 2009 and reported as a receivable at December 31, 2008 without the approval of the Office. **We recommend that, in accordance with paragraph 8 of SSAP No. 72, the Company admit such receivables in future statements only with the approval of the Office.**

Health Care and Other Amounts Receivable

As reported on page 13, the Company incorrectly reported an asset, consisting of policyholder receivables in the total amount of \$36,990, which was not allowable as an admitted asset under Part I of Chapter 625, F.S. **We recommend that the Company not admit the policyholder receivables in future statements filed with the Office.**

SUBSEQUENT EVENTS

Richard W. Haydon resigned from the Company's board of directors effective July 31, 2009.

CONCLUSION

The customary insurance examination practices and procedures as promulgated by the NAIC have been followed in ascertaining the financial condition of Avahealth, Inc. as of December 31, 2008, consistent with the insurance laws of the State of Florida.

The Company's total capital and surplus at December 31, 2008 was determined to be \$1,822,107, which was in compliance with Section 624.408, F.S. Its required minimum capital and surplus at December 31, 2008 was \$1,500,000.

In addition to the undersigned, the following participated in this examination: Cathy S. Jones, CPA, Financial Examiner/Analyst Supervisor; Russell K. Judge, Financial Examiner/Analyst; and Kerry A. Krantz, Actuary.

Respectfully submitted,


Darlene L. Lenhart-Schaeffer, AFE
Florida Office of Insurance Regulation