

Statutory Financial Examination of
ALASKA VISION SERVICES, INC.

FE 12-02

as of December 31, 2012

Issued by
STATE OF ALASKA
DEPARTMENT OF COMMERCE, COMMUNITY, AND
ECONOMIC DEVELOPMENT
DIVISION OF INSURANCE

NAIC Company Code: 47201
NAIC Group Code: 1189

FINAL REPORT:
June 30, 2014

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THE STATE
of **ALASKA**
GOVERNOR BILL WALKER

Department of Commerce, Community,
and Economic Development

DIVISION OF INSURANCE

550 West Seventh Avenue, Suite 1560
Anchorage, AK 99501-3567
Main: 907.269.7900
Fax: 907.269.7910

December 29, 2015

Ms. Lori Wing-Heier, Director
Division of Insurance
Department of Commerce, Community
and Economic Development
State of Alaska
550 West 7th Avenue, Suite 1560
Anchorage, AK 99501-3567

Dear Director Wing-Heier:

In accordance with your instructions and authorizations, and in accordance with statutory requirements, an examination has been made of the financial condition and business affairs of:

Alaska Vision Services, Inc.
530 7th Avenue
Fairbanks, AK 99701

(NAIC CoCode 47201; Group Code 1189)

SCOPE OF EXAMINATION

The full-scope examination covered the period of January 1, 2009, through December 31, 2011, with a rollforward of the examination covering the period December 31, 2011, through December 31, 2012. Transactions subsequent to the initial full-scope examination period were reviewed where deemed appropriate. The most recent prior full-scope examination of the Company covered the period from January 1, 2006 through December 31, 2008.

We conducted our examination in accordance with the NAIC *Financial Condition Examiners Handbook*. The Handbook requires that we plan and perform the 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. An examination also includes assessing the principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation, 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 examination was conducted in accordance with the guidelines and procedures recommended by the Financial Condition (E) Committee of the NAIC and the rules, regulations, and directives of the Division of Insurance, State of Alaska. The work papers of the independent certified public accountants, PricewaterhouseCoopers, were reviewed and used where it was determined to be appropriate. The appropriate PricewaterhouseCoopers work papers have been incorporated into the exam work paper file.

The Company's assets were evaluated and verified, and liabilities were analyzed to determine its financial condition as of December 31, 2012. Also, an actuarial evaluation of the reserves as of December 31, 2011, was performed by Katie Campbell, FSA, MAAA, Life/Health Actuary for the Division of Insurance, State of Alaska, as part of the full-scope examination.

SUMMARY OF EXAMINATION FINDINGS

Significant Findings

The Company was found to be out of compliance with the following items:

- Finding 1 – Authorization of Investment Transactions and Written Plan
- Finding 2 – Member Annual Meetings and Appointments of Directors

DESCRIPTION OF COMPANY

Company History

Alaska Vision Services, Inc. (AVS) is an Alaska-domiciled medical service corporation organized pursuant to Title 21, Chapter 87 (Hospital and Medical Service Corporations), of the Alaska Statutes. AVS was organized as a not-for-profit corporation on April 27, 1965, per its Articles of Incorporation "exclusively for the promotion of social welfare within the meaning of Section 501(c)(4) of the Internal Revenue Service." AVS received a Certificate of Authority from the State of Alaska, Division of Insurance, effective June 3, 1982, (D 1411) authorizing the Company to transact the business of a medical service corporation, (ophthalmology and optometry).

In 1988, AVS contracted with California Vision Service Plan of Sacramento, California (VSP) for plan administration and VSP became the controlling member. VSP is a non-stock, not-for-profit corporation operating in the State of California which controls several vision service plans in the United States.

The tax exempt status of VSP (California) and other subsidiaries, including Alaska Vision Services, Inc., was revoked by the IRS effective January 1, 2003. VSP filed a lawsuit with the U.S. District Court in Sacramento in 2005, a case it lost, subsequently filing an appeal of the decision to the U.S. Court of Appeals for the Ninth Circuit which ruled in January, 2008, that VSP does not qualify for exemption under IRS 501(c)(4). VSP appealed to the U.S. Supreme Court which denied a hearing of the case in 2010, effectively ending the appeal process and letting stand the IRS revocation of the group's tax exempt status. During the appeal period and subsequent, AVS, licensed as a Medical Service Corporation under AS 21.87, continued to operate as a not-for-profit corporation under the laws of the state of Alaska – Title 10, Chapter 20 (Nonprofit Corporations Act) of the Alaska Statutes – even while paying federal taxes.

Corporate Records

AVS has agreed to operate under a Consent Judgment and Order (Judgment) entered in the Superior Court for the State of Alaska, Third Judicial District, at Anchorage dated January 21, 1981. This Judgment included orders as follows.

- a) The amended bylaws of AVS shall provide that the Board of Directors would be composed of three members who are licensed optometrists and ophthalmologists, and four consumer representatives who are not licensed optometrists or ophthalmologists.
- b) The Board of Directors shall have exclusive authority to determine the fees paid to providing doctors in consideration for vision services rendered to subscribing members.
- c) In determining the fees paid to providing doctors, the board shall adopt a fee schedule based on usual and customary fees charged by optometrists and ophthalmologists in the community for similar vision services rendered to subscribing and non-subscribing members.
- d) Fee information collected by the board is limited for use solely in determining usual and customary fees.
- e) AVS is permanently enjoined and restrained from, in any manner, directly or indirectly engaging in any other contract, combination, agreement, understanding or concert of action in restraint of trade or commerce.

The Articles of Incorporation and Bylaws were reviewed during this examination. Bylaws in effect during the examination years were the Amended Bylaws, effective April 8, 1999. There were no amendments to the Company's Articles of Incorporation during the period under examination. Annual Board of Director meetings and elections were held each year as required by the Articles and Bylaws.

Management and Control

VSP, a not-for-profit California corporation, is AVS's sole voting and controlling member with one vote that can be exercised in person or by proxy. AVS has arranged for use of the VSP federally registered and common law service marks through an Administration and Marketing Agreement dated August 25, 1997. VSP also started providing administrative and managerial services to AVS through an Administration and Marketing Agreement dated February 10, 1998, amended September 30, 2003 and most recently amended effective January 1, 2008.

No significant management control changes have occurred since the previous examination. There have been no significant changes in executive management of AVS during the period covered by this examination.

AVS is party to an inter-company tax allocation agreement with the Vision Service Plan whereby the federal income tax return is filed on a consolidated basis. Additionally, Vision Service Plan provides administrative and marketing services for AVS as detailed in an administration and marketing agreement. Allocation of cost is based on percentage of written premiums among the entities within the VSP group.

Fidelity Bonds and Other Insurance

AVS is a named joint-insured on a fidelity bond underwritten by Travelers Casualty and Surety Company of America for the examination period. The bond provides for \$2,000,000, single loss limit of liability with a single loss retention of \$75,000, and aggregate limit of \$4,000,000. However, as AVS does not have any employees or fixed assets, with all administrative services provided by VSP, the bonding requirements of AS 21.87.310 and the NAIC minimum recommended fidelity coverage do not apply. Further, all officers of AVS are officers and employees of VSP and are thereby covered by the fidelity bond described above.

The Company is also a named joint-insured on various other insurance policies, which provide coverage for commercial liability, managed care liability, umbrella and excess liability, and directors and officers liability. All policies except for the commercial liability and the umbrella and excess liability policies, specify retentions of at least \$75,000. Because AVS owns no fixed assets, insurance coverage providing protection for fixed assets is not necessary.

Territory and Plan of Operation

AVS is an Alaska-domiciled medical-service corporation. Its primary purpose is to provide prepaid vision services to individuals residing and working in the State of Alaska.

Under the Administration and Marketing Agreement described above, VSP provides all marketing services to AVS and markets AVS plans to non-subscriber beneficiary groups in Alaska. These marketing services include, but are not limited to, providing all sales and marketing personnel with needed support to maximize sales, provide marketing training to the sales personnel of AVS, and paying all of AVS's normal operating expenses.

Growth of Company

The following schedule shows the annual results of the Company's operations for the years ended December 31, 2009 through December 31, 2011. The figures are as reported in the Company's annual statements for the years 2008 through 2011.

<u>Year</u>	<u>Admitted Assets</u>	<u>Liabilities</u>	<u>Surplus</u>
2008	5,931,446	1,251,739	4,679,707
2009	6,900,890	1,592,508	5,308,382
2010	6,961,478	1,029,407	5,932,071
2011	7,720,222	1,235,737	6,484,485
2012	8,430,078	654,913	7,775,165

Loss Experience

The following schedule shows the loss experience of the Company during the period of examination.

<u>Year</u>	<u>Premiums Earned</u>	<u>Claims Incurred</u>	<u>Percent of Premiums Earned</u>	<u>Claims Expenses Incurred</u>	<u>Percent of Premiums Earned</u>
2009	3,531,588	2,522,328	71.4	12,593	0.36
2010	3,236,595	2,483,637	76.7	2,383	0.07
2011	2,713,674	2,211,197	81.5	(869)	(0.03)
2012	2,631,789	1,934,733	73.5	(1,574)	(0.06)

Reinsurance

During the fiscal years ending December 31, 2009 thru 2012, AVS had no reinsurance arrangements.

Accounts and Records

The AVS books and records are maintained on various data processing software systems maintained by VSP under the terms of the Administration and Marketing Agreement. VSP's data processing systems and software are located at VSP's home offices in Rancho Cordova, California.

Statutory Deposits

Medical Service Corporations are not required to maintain statutory deposits in Alaska. Instead, they are required by AS 21.87.210 to maintain a special surplus fund of not less than \$50,000. The fund can be increased, however, AVS has maintained this amount for each year covered by this examination.

SUMMARY OF ACTUARIAL REVIEW

Katie Campbell, FSA, MAAA, Life/Health Actuary for the Alaska Division of Insurance, reviewed the adequacy of the loss and loss adjustment expense reserves as of December 31, 2011. The review relied upon information provided by the Company of which the underlying claim and premium data was examined by the division examination team. She also reviewed the actuarial opinion and memorandums supporting the opinions prepared by the independent appointed actuary, Frederick Kilbourne of The Kilbourne Company, for each year 2009, 2010 and 2011. Additionally, she reviewed the reserve estimate prepared by the independent auditor, PricewaterhouseCoopers (PwC), for 2011. Ms. Campbell's review of the claim run-off experience showed that reserves were adequate in each year 2009 – 2011.

AVS held reserves that were conservative relative to the independent actuary and to PwC estimates. Ms. Campbell concluded that more conservative reserves are appropriate for small blocks of business such as Alaska's which are more volatile.

Alaska Vision Services, Inc.
As of December 31, 2012
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Due to low inherent risk following the conclusion of the full-scope examination as of December 31, 2011, the targeted limited-scope exam as of December 31, 2012, did not include an additional review of the reserves.

FINANCIAL STATEMENTS

The following pages contain statutory financial statements for the Company as of December 31, 2012 as reported to the division and as determined by the examiners.

FINANCIAL STATEMENTS
STATEMENT OF ASSETS, LIABILITIES AND SURPLUS
As of December 31, 2012

	<u>As Filed</u>	<u>Adjustments</u>	<u>Finding No.</u>	<u>As Adjusted</u>
<u>Assets</u>				
Bonds	\$ 6,497,017			\$ 6,497,017
Cash & short term investments	1,032,415			1,032,415
Investment income due and accrued	49,232			49,232
Uncollected premiums and agents' balances in course of collection	88,022			88,022
Amounts receivable relating to uninsured plans	727,171			727,171
Deferred Tax Asset	36,221			36,221
	<u>\$ 8,430,078</u>	<u>\$ 0</u>		<u>\$ 8,430,078</u>
 <u>Liabilities, Surplus and Other Funds</u>				
<u>Liabilities</u>				
Claims unpaid	\$ 113,898			\$ 113,898
Unpaid claims adjustment expenses	1,154			1,154
Premiums received in advance	9,476			9,476
General expenses due or accrued	78,133			78,133
Current federal income tax payable	246,444			246,444
Remittances and items not allocated	4,085			4,085
Amounts due to parent, subsidiaries and affiliates	167,231			167,231
Liability for amounts held under uninsured plans	7,975			7,975
Taxes, Licenses, and Fees Payable	17,737			17,737
Escheatable Checks	8,780			8,780
	<u>\$ 654,913</u>	<u></u>		<u>\$ 654,913</u>
 <u>Surplus</u>				
Aggregate write-ins for other than special surplus funds – Statutory Reserve	50,000			50,000
Unassigned funds (surplus)	7,725,165			7,725,165
	<u>\$ 7,775,165</u>	<u></u>		<u>\$ 7,775,165</u>
	<u>\$ 8,430,078</u>	<u>\$ 0</u>		<u>\$ 8,430,078</u>

FINANCIAL STATEMENTS
STATEMENT OF UNDERWRITING AND INVESTMENT
as of December 31, 2012

	As Filed	Examination Adjustments	Finding Number	As Adjusted
<u>Underwriting Income</u>				
<u>Revenue</u>				
Net premium income	\$ 2,631,789			\$ 2,631,789
Fee-for-service (net of \$713,768 medical expenses)	153,495			153,495
Total Revenue	\$ 2,785,284			\$ 2,785,284
<u>Deductions</u>				
Other professional services (claims expenses)	\$ 1,934,733			\$ 1,934,733
Claims adjustment expenses	(1,574)			(1,574)
General administrative expenses	(15,822)			(15,822)
Total underwriting deductions	\$ 1,917,337			\$ 1,917,337
Net underwriting gain or (loss)	\$ 867,947			\$ 867,947
<u>Investment Income</u>				
Net investment income earned	\$ 102,403			\$ 102,403
Net realized capital gains or (losses)	- 0 -			- 0 -
Net investment gain or (loss)	\$ 102,403			\$ 102,403
<u>Other Income</u>				
Net gain or (loss) from agents' or premium balances charged off	111			111
Total other income	\$ 111			\$ 111
Net income before federal income tax	\$ 970,461			\$ 970,461
Federal income tax incurred	(329,565)			(329,565)
Net income (loss)	\$ 1,300,026			\$ 1,300,026
<u>Surplus Account</u>				
Surplus, December 31, prior year	\$ 6,484,485			\$ 6,484,485
<u>Gains and (Losses) in Surplus</u>				
Net income (loss)	\$ 1,300,026			\$ 1,300,026
Change in net deferred income tax	(8,803)			(8,803)
Change in nonadmitted assets	(543)			(543)
Change in surplus as regards policyholders	\$ 1,290,680			\$ 1,290,680
Surplus for the period ended December 31, 2012	\$ 7,775,165	\$ 0		\$ 7,775,165

FINANCIAL STATEMENTS
STATEMENT OF CAPITAL AND SURPLUS ACCOUNT
As of December 31, 2012

	Statutory Reserve ⁽¹⁾	SURPLUS		TOTAL
		Paid-In	Unassigned	
Balance at December 31, 2008	\$ 50,000	\$ 0	\$ 4,629,707	\$ 4,679,707
Net income – 2009			653,608	653,608
Change in net deferred income tax			19,781	19,781
Change in nonadmitted assets			(44,714)	(44,714)
Balance at December 31, 2009	\$ 50,000	\$ 0	\$ 5,258,382	\$ 5,308,382
Net income – 2010			609,013	609,013
Change in net deferred income tax			(30,038)	(30,038)
Change in nonadmitted assets			44,714	44,714
Balance at December 31, 2010	\$ 50,000	\$ 0	\$ 5,882,071	\$ 5,932,071
Net income – 2011			547,220	547,220
Change in net deferred income tax			5,360	5,360
Change in nonadmitted assets			(166)	(166)
Balance at December 31, 2011	\$ 50,000	\$ 0	\$ 6,434,485	\$ 6,484,485
Net income – 2012			1,300,026	1,300,026
Change in net deferred income tax			(8,803)	(8,803)
Change in nonadmitted assets			(543)	(543)
Balance at December 31, 2012	\$ 50,000	\$ 0	\$ 7,725,165	\$ 7,775,165

**ANALYSIS OF CHANGES IN FINANCIAL STATEMENTS
RESULTING FROM THE EXAMINATION**

This examination did not result in findings that produced adjustments to the financial statements filed as of December 31, 2012.

**COMPLIANCE WITH RECOMMENDATIONS IN
PRIOR REPORT OF EXAMINATION**

The following prior findings were not resolved during the current examination:

Prior Finding 1 – Authorization of Investment Transactions and Written Plan

Pursuant to 3 AAC 21.211, the board of directors shall evidence by formal resolution, at least annually, that it has determined that each investment has been made in accordance with delegations, standards, limitations and investment objectives prescribed by the board of directors or a committee of the board of directors that is charged with the responsibility to direct its investments.

Also, on at least a quarterly basis, an insurer's board of directors, or committee of the board, shall receive and review a summary report on the investment portfolio, the insurer's activities, and the insurer's investment practices engaged in under delegated authority to determine whether the portfolio activities and practices are consistent with the insurer's written plan and, review and revise the written plan as appropriate.

The AVS board of directors does document in its annual meeting minutes that the investment transactions for the prior year were approved. However, it does not pass a formal resolution that states that the board has determined that each investment has been made in accordance with delegations, standards, limitations, and investment objectives prescribed by the board of directors. The VSP Finance Committee meets quarterly and is responsible for monitoring the investment activity of the entity and its affiliates. The minutes of the Finance committee do not document that it formally approves the investment transactions quarterly. Also, it does not review the written plan quarterly for consistency or for any revisions that may be appropriate.

Prior Recommendation: It is recommended that the AVS Board of Directors pass an annual resolution that approves investment transactions as required by 3 AAC 21.211(b); and, that the Finance Committee of VSP or the AVS Board of Directors conduct quarterly reviews of investment transactions and practices compared to the written plan as required by 3 AAC 21.211(c).

Current Status: The Finance Committee of VSP meets quarterly and monitors and reviews investments of VSP and its affiliates. The minutes of the quarterly finance committee meetings did not document that it performed a review of investment transactions for AVS including a review of the investment plan as required by 3 AAC 21.211(c). (See current Finding 1.)

Prior Finding 2 – Appointment of Directors and Annual Statement Reporting

The Bylaws, and a 1981 Consent Judgment, require that AVS has seven directors consisting of four consumer representatives and three licensed practitioners. The minutes of the annual meetings of AVS for 2007 and 2008 stated that only six directors (including only two licensed practitioners) were appointed at the annual meetings. Pursuant to the minutes maintained in the corporate records, the membership of the board did not comply with the requirements of the Bylaws or with the 1981 Consent Judgment. Also, based on the minutes of the annual meetings for 2007 and 2008, it appeared

that the licensed- practioner members of the board who attended the annual meetings were not the ones who were appointed in those years. Instead, the 2006 licensed-practioner directors attended the meetings and were reported as directors in the annual statements for 2007 and 2008.

After these discrepancies were noted during the examination, the Company stated that it had been the intention of the board of VSP to reappoint the 2006 directors for the years 2007 and 2008, not to appoint new directors. The Company has indicated that it is taking actions to correct errors where possible and to implement a process that will avoid such discrepancies in the future.

Prior Recommendation: It is recommended that the Company implement effective procedures for appointments of directors that complies with the bylaws and that the corporate record book documents board appointments accurately.

Current Status: During the annual meeting in 2009, the board of VSP appointed six directors; two were optometrists and four were consumer representatives. (See current Finding 2.)

CURRENT EXAMINATION FINDINGS AND RECOMMENDATIONS

Finding 1 – Authorization of Investment Transactions and Written Plan

A review of the annual board minutes does not reflect a "formal resolution" regarding each investment. The language in the annual minutes reflects the same language as noted in the previous exam. A review of the finance committee minutes do not appear to reflect that the board or appropriate committee review the investment transactions and compared to the written plan. Additionally, there appeared no approval of the 2009 Investment Policy while the 2011 Investment Policy was not approved until May, 2012.

Per AAC 21.211 (Authorization of investments by the board of directors),

(b) An investment acquired, held, and invested in under 3 AAC 21.201 -- 3 AAC 21.399 must be acquired and held under the supervision and direction of the board of directors of the insurer. The board of directors shall evidence by formal resolution, at least annually, that it has determined that each investment has been made in accordance with delegations, standards, limitations, and investment objectives prescribed by the board of directors or a committee of the board of directors charged with the responsibility to direct its investments.

(c) On at least a quarterly basis, and more often if considered appropriate, an insurer's board of directors or committee of the board of directors shall

(1) receive and review a summary report on the insurer's investment portfolio, the insurer's investment activities, and the insurer's investment practices engaged in under delegated authority to determine whether the portfolio, activities, and practices are consistent with the written plan; and Needs Review

(2) review and revise, as appropriate, the written plan.

Recommendation: It is recommended that the AVS Board of Directors pass an annual resolution that approves investment transactions as required by 3 AAC 21.211(b); and that the Finance Committee or the AVS Board of Directors conduct quarterly reviews of investment transactions and practices compared to the written plan as required by 3 AAC 21.211(c). Additionally, the annual resolution and the quarterly reviews should be documented in the Board of Directors' and committee meeting minutes to evidence compliance with AAC

21.211(b) and (c), and that the Finance Committee review and approve the the current investment policy on an annual basis.

Finding 2 – Member Annual Meetings and Appointments of Directors

During the review of the Member Meeting Minutes, it was noted there was no Annual Member meeting held in 2010 and 2011. Per Company's Bylaws a Member meeting is to be held annually under Article VIII, Section 1. During the review of the Board of Director meeting minutes, it was noted per the Bylaws, Article V, Section 4, an organizational meeting of the Board is to be held immediately following the annual Member meeting. An organizational meeting of the Board was not held immediately following the Annual Member meeting for any of the years under examination. Additionally, per the Bylaws, Article V, Section 1. the Company is to have a total of seven (7) Directors, three (3) optometrists/ophthalmologists and four (4) consumer representatives, not optometrists/ophthalmologists. The annual meeting of the sole member in 2009 appointed only six (6) Directors and only two (2) of those Directors were optometrists, the other four (4) Directors were consumer representatives. The Member meetings held were also in violation of Alaska Statute 21.69.310(c), which states that Member meetings are to be held within the first six (6) months of the calendar year. The annual Member meeting held in 2009 was on October 19; the 2012 annual meeting was not held until December. The Company failed compliance with this statute for all years under examination.

Recommendation: It is recommended that the Company implement effective procedures for the holding of annual member meetings and the appointments of directors that complies with the bylaws and that the corporate record book documents board appointments accurately. Also need to note noncompliance with statute.

CLOSING

This examination was conducted in accordance with practices and procedures promulgated by the NAIC. This examination also includes a compliance review of applicable Alaska Statutes.

In addition to the undersigned, the following examiners participated in the examination: Actuary Katie Campbell, FCAS, MCAA and Insurance Financial Examiner Douglas Hartman, AFE, all of the Division of Insurance and Supervisory Contractor Margaret C. Spencer, CFE, Contractor Cathie A. Stewart, CFE, Barbara A. Bartlett, CFE, and Mary R. Hartell of Risk and Regulatory Consulting, LLC.

We wish to express our appreciation for the courteous cooperation and assistance extended to us by the management and staff of Alaska Vision Services during the course of this examination.

This report is respectfully submitted,



Richard B. Foster, CFE
Examiner-in-Charge



Maxine L. Froemling, CFE
Chief Financial Examiner

AFFIDAVIT

Anchorage, Alaska)
December _____, 2015)
STATE OF ALASKA)
THIRD JUDICIAL DISTRICT)

We, the undersigned, being duly sworn, do verify that the report of examination as of December 31, 2012, of Alaska Vision Services, an Alaska domiciled company holding Certificate of Authority D-1411, is true to the best of our knowledge and belief.



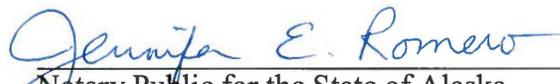
Richard B. Foster, CFE
Examiner-in-Charge



Maxine L. Froemling, CFE
Chief Financial Examiner

Subscribed and sworn to before me this 30th day of December, 2015.





Notary Public for the State of Alaska
My commission expires: With Office