

Government of the District of Columbia
Department of Insurance, Securities and Banking



Thomas E. Hampton
Commissioner

BEFORE THE
INSURANCE COMMISSIONER OF
THE DISTRICT OF COLUMBIA

Re: Report on Examination - **AMERIGROUP Maryland, Inc.** as of December 31, 2005

ORDER

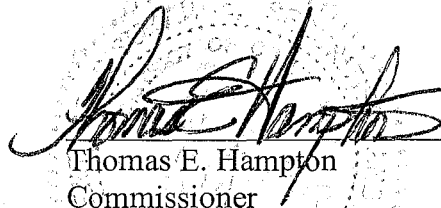
Pursuant to Examination Warrant 2006-3, an Organizational Examination of **AMERIGROUP Maryland, Inc.** as of December 31, 2005 has been conducted by the District of Columbia Department of Insurance, Securities and Banking (“the Department”).

It is hereby ordered on this 9th day of April, 2007, that the attached financial condition examination report be adopted and filed as an official record of this Department.

Pursuant to Section 31-1404(d)(1) of the D.C. Official Code, this Order is considered a final administrative decision and may be appealed pursuant to Section 31-4332 of the D.C. Official Code.

Pursuant to Section 31-1404(d)(1) of the D.C. Official Code, within 30 days of the issuance of the adopted report, the company shall file affidavits executed by each of its directors stating under oath that they have received a copy of the adopted report and related order.

Pursuant to Section 31-1404(e)(1) of the D.C. Official Code, the Department will continue to hold the content of the report as private and confidential information for a period of 10 days from the date of this Order.



Thomas E. Hampton
Commissioner

GOVERNMENT OF THE DISTRICT OF COLUMBIA

DEPARTMENT OF INSURANCE, SECURITIES AND
BANKING



REPORT ON EXAMINATION

AMERIGROUP MARYLAND, INC.
(*formerly* AMERIGROUP MARYLAND INC., A
MANAGED CARE ORGANIZATION)

AS OF

DECEMBER 31, 2005

NAIC NUMBER 95832

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Washington, D.C.
February 1, 2007

Honorable Thomas E. Hampton
Commissioner
Department of Insurance, Securities and Banking
Government of the District of Columbia
810 First Street, NE, Suite 701
Washington, D.C. 20002

Dear Sir:

In accordance with Section 31-1402 of the District of Columbia Official Code, we have examined the financial condition and activities of

AMERIGROUP Maryland, Inc.,

hereinafter referred to as the "Company" or "AMERIGROUP Maryland", at its main administrative offices located at 4425 Corporation Lane, Virginia Beach, Virginia 23462.

SCOPE OF EXAMINATION

This examination, covering the period January 1, 2003 through December 31, 2005, including any material transactions and/or events noted occurring subsequent to December 31, 2005, was conducted by examiners of the District of Columbia Department of Insurance, Securities and Banking (the Department).

Our examination was conducted in accordance with examination policies and standards established by the District of Columbia Department of Insurance, Securities and Banking and procedures recommended by the National Association of Insurance Commissioners and, accordingly, included such tests of the accounting records and such other examination procedures, as we considered necessary in the circumstances.

This examination was conducted in conjunction with the Texas, New Jersey and Ohio insurance department examinations of three affiliates of the Company domiciled in those respective states. These affiliates are AMERIGROUP Texas, Inc., AMERIGROUP New Jersey, Inc. and AMERIGROUP Ohio, Inc. The primary location of the books and records of the Company and of these affiliates is located at the offices of AMERIGROUP Corporation, the parent company of these companies. Many of the operational functions (e.g., underwriting, claims processing, investments, etc.) of the Company and of these affiliates have been partially, or wholly combined at the offices of AMERIGROUP Corporation. Because of this combination of operations, we determined that this financial examination of the Company would be more efficient if performed concurrently with examinations of the Texas, New Jersey and Ohio companies. The reports on examinations of the affiliated companies will be issued under separate cover by the respective insurance departments.

Our examination included a review of the Company's business policies and practices, management and corporate matters, a verification and evaluation of assets and a determination of the existence of liabilities. In addition, our examination included tests to provide reasonable assurance that the Company was in compliance with applicable laws, rules and regulations. In planning and conducting our examination, we gave consideration to the concepts of materiality and risk, and our examination efforts were directed accordingly.

The Company was audited annually by an independent public accounting firm. The firm expressed unqualified opinions on the Company's financial statements for the calendar years 2003 through 2005. We placed substantial reliance on the audited financial statements for calendar years 2003 and 2004, and consequently performed only minimal testing for those periods. We concentrated our examination efforts on the year ended December 31, 2005. We reviewed the working papers prepared by the independent public accounting firm related to the audit for the year ended December 31, 2005, and directed our efforts to the extent practical to those areas not covered by the firm's audit.

STATUS OF PRIOR EXAMINATION FINDINGS

Our examination included a review to determine the current status of the five exception conditions commented upon in our preceding Report on Examination, dated January 16, 2004, which covered the one-year period from January 1, 2002 through December 31, 2002. We determined that the Company had satisfactorily addressed four of those items. The fifth item is no longer considered an exception condition due to a change in Department policy.

HISTORY

General:

The Company was incorporated as AMERIGROUP Maryland Inc., a Managed Care Organization, under the laws of the state of Delaware on November 12, 1998.

During 1999, the Company was licensed by the Maryland Insurance Administration as a managed care organization, and was licensed by the District of Columbia Department of Insurance, Securities and Banking as a health maintenance organization. In June 1999, the Company's parent, AMERIGROUP Corporation, contributed to the Company certain intangible assets related to the Medicaid line of business in Maryland purchased from the Prudential Insurance Company of America and the Prudential Health Care Plan, Inc. (Prudential), including the right to provide managed care services to Prudential's Maryland Medicaid members and the assignment of Prudential's contracts with its Maryland healthcare providers. Thus the Company entered the Maryland Medicaid market through the acquisition of Prudential's Maryland Medicaid business. In

August 1999, AMERIGROUP Corporation acquired similar assets from Prudential with respect to the Medicaid lines of business in the District of Columbia. The Company began writing Medicaid business in Maryland and in the District of Columbia in 1999.

In March 2002, the Company executed an Asset Purchase Agreement with Capital Community Health Plan, Inc. (“CCHP”), a District of Columbia health maintenance organization, to purchase CCHP’s District of Columbia Medicaid business effective July 1, 2002.

In January 2003, the Company reincorporated in the District of Columbia from Delaware.

Effective in March 2006, the Company changed its license in the state of Maryland from a managed care organization license to a health maintenance organization license.

Effective June 8, 2006, the Company changed its name to AMERIGROUP Maryland, Inc. However, the Company did not file this name change with the Department. During our examination, we discussed this issue with management, and management indicated its intent to file the name change with the Department.

Capital Stock:

The Company's Articles of Incorporation authorize the Company to issue 1,000 shares of stock with no par value. According to the Company’s stock ledger, as of December 31, 2006, the Company had issued 1,000 shares to its parent, AMERIGROUP Corporation.

However, according to the Company’s stock ledger, the issued stock has a par value of \$.01 per share. During our examination, we discussed with management this discrepancy in the par value between the Company’s Articles of Incorporation (no par) and the stock ledger (\$.01 par). Management acknowledged this discrepancy and indicated the Articles of Incorporation would be changed to reflect an authorized par value of \$.01 per share.

In addition, we noted a discrepancy in the Company’s financial statements regarding the “Common capital stock” account. See NOTE 3. a. in the “Notes to Financial Statements” section of this Report for further comments regarding this discrepancy.

The stock of the Company is pledged to secure a line of credit issued to the Company’s parent. See NOTE 3. b. in the “Notes to Financial Statements” section of this Report for further comments regarding the pledge of the Company’s stock.

Dividends to Stockholder:

The Company declared and paid the following dividends to its sole stockholder, AMERIGROUP Corporation, during our examination period:

<u>Year</u>	<u>Type</u>	<u>Amount</u>
2004	Cash	\$23,436,604
2005	Cash	\$ 9,532,479

The dividends paid in 2004 are considered extraordinary and were approved by the board of directors of the Company and the District of Columbia Department of Insurance, Securities and Banking. The dividends paid in 2005 are considered ordinary dividends and were also approved by the board of directors of the Company and the District of Columbia Department of Insurance, Securities and Banking.

Management:

The following persons were serving as the Company's directors as of December 31, 2005:

<u>Name and Address</u>	<u>Principal Occupation</u>
Steven B. Larsen, Chairman Bethesda, Maryland	Executive Vice President, Health Plan Operations, AMERIGROUP Corporation
Stanley F. Baldwin Virginia Beach, Virginia	Executive Vice President, Secretary and General Counsel, AMERIGROUP Corporation
Sandra D. B. Nichols, MD North Potomac, Maryland	Vice President, Chief Executive Officer, District of Columbia Health Plan, AMERIGROUP Maryland, Inc.
Eric M. Yoder, MD Virginia Beach, Virginia	Executive Vice President, Chief Medical Officer, AMERIGROUP Corporation

The Composition of the board of directors at December 31, 2005 was not in compliance with District of Columbia Official Code, Section 31-706(c)(3), which requires that no less than 1/3 of the directors of the Company be persons who are not officers or employees of the Company, or of any entity controlling, controlled by, or under common control with the Company (i.e., 1/3 of the directors must be "independent"). See the "Comments and Recommendations" section of this Report, under the caption "Independent Directors" for further comments regarding this condition.

The following persons were serving as the Company's officers as of December 31, 2005:

<u>Name</u>	<u>Title</u>
Steven B. Larsen	Chairman, President, Chief Executive Officer of Health Plan - Maryland
Sandra D. B. Nichols, MD	Vice President, Chief Executive Officer of Health Plan - District of Columbia
Stanley F. Baldwin	Vice President, Secretary
James G. Carlson	Vice President, Assistant Secretary
E. Paul Dunn, Jr.	Vice President, Treasurer
Kathleen K. Toth	Vice President, Assistant Secretary
Shirley A. Grant, MD	Vice President, Medical Director
Catherine S. Callahan	Vice President
Margaret M. Roomsburg	Vice President
Scott W. Anglin	Vice President, Assistant Treasurer
Lori-Don Gregory	Assistant Treasurer

Committees:

The Company's by-laws allow for, but do not require committees. As of December 31, 2005, the Company did not have any committees. As a result, the Company was not in compliance with District of Columbia Official Code, Section 31-706(c)(4) which requires that the board establish one or more committees comprised of individuals who are not officers or employees of the Company, or of any entity controlling, controlled by or under common control with the Company. This committee or committees shall have responsibility for recommending the selection of independent certified public accountants, reviewing the Company's financial condition, nominating candidates for director, evaluating the performance of officers of the Company, and recommending to the board the selection and compensation of principal officers. See the "Comments and Recommendations" section of this Report, under the caption "Committees" for further comments regarding this condition.

Conflicts of Interest:

The Company has adopted the AMERIGROUP Corporation Compliance Program (the "Program"). Under provisions of the Program, officers and directors of the Company are required to complete conflict of interest questionnaires. However, conflict of interest questionnaires were not completed by directors and officers of the Company during the examination period. See the "Comments and Recommendations" section of this Report, under the caption "Conflicts of Interest" for further comments regarding this condition.

Corporate Records:

We reviewed the minutes of the meetings of the shareholder and board of directors for the period under examination. Based on our review, the Company's shareholder did not hold an "annual" meeting in 2004 or 2005 as required by the bylaws. In addition, the board of directors did not meet on a regular basis during the examination period and the minutes of

the meetings of the board of directors did not document approval of certain transactions. See the “Comments and Recommendations” section of this Report, under the caption “Corporate Records and Actions” for further comments regarding these conditions.

AFFILIATED COMPANIES

The Company is a wholly owned subsidiary of AMERIGROUP Corporation (“AMERIGROUP”), a publicly traded for profit Delaware Corporation. AMERIGROUP is a multi-state managed healthcare company, which through its health maintenance organization and insurer subsidiaries in numerous states, focuses on providing healthcare benefits to persons enrolled in publicly sponsored programs, primarily Medicaid. As of December 31, 2005, AMERIGROUP and its subsidiaries employed approximately 2,700 employees, and AMERIGROUP subsidiaries provided healthcare services to approximately 1.1 million enrollees in the District of Columbia, Illinois, Florida, Maryland, New Jersey, New York, Ohio, Texas and Virginia.

Persons or entities owning more than ten percent of AMERIGROUP Corporation’s outstanding shares as of December 31, 2005 are as follows:

Earnest Partners, LLC	10.6%
FMR Corp.	10.0%

The AMERIGROUP Corporation holding company structure as of December 31, 2005, is depicted in the following chart:

ORGANIZATIONAL CHART

	Domiciliary Jurisdiction
AMERIGROUP Corporation	Delaware
PHP Holdings, Inc.	Florida
AMERIGROUP Florida, Inc. (HMO) (NAIC # 95093)	Florida
AMERIGROUP Illinois, Inc. (HMO) (NAIC # 95372)	Illinois
AMERIGROUP, Maryland, Inc. (HMO) (NAIC # 95832)⁽¹⁾	District of Columbia
AMERIGROUP New Jersey, Inc. (HMO) (NAIC # 95373)	New Jersey
AMERIGROUP Texas, Inc. (HMO) (NAIC # 95314)	Texas
AMERIGROUP CarePlus, Inc.	New York
AMGP Georgia Managed Care Company, Inc. (HMO) (NAIC # 12229)	Georgia
AMERIGROUP Virginia, Inc. (HMO) (NAIC # 10153)	Virginia
AMERIGROUP Ohio, Inc. dba AMERIGROUP Community Care (HMO) (NAIC # 10767)	Ohio
AMERIGROUP New Mexico, Inc. (HMO) (NAIC # 12354) ⁽²⁾	New Mexico
AMERIGROUP Nevada, Inc. (HMO) (NAIC # 12586) ⁽²⁾	Nevada
AMERIVANTAGE, Inc.	Delaware
AMERIGROUP Charitable Foundation (controlled) ⁽³⁾	Delaware

All Companies are owned 100 percent unless otherwise indicated.

⁽¹⁾ AMERIGROUP, Maryland, Inc. also uses the registered trade name AMERIGROUP District of Columbia when doing business in the District of Columbia.

⁽²⁾ Obtained HMO certificate of authority in 2006.

⁽³⁾ The AMERIGROUP Charitable Foundation (the "Foundation"), a 501(c)(3) private foundation was established in 2000 by AMERIGROUP Corporation ("AMERIGROUP") and is controlled by AMERIGROUP through common directors and officers. The Foundation does not actively conduct or administer charitable programs, but funds other organizations that run their own programs. AMERIGROUP made contributions to the Foundation totaling \$2 million in 2004 and \$1 million in 2005. According to the Company's management, the policy of AMERIGROUP is not to allocate costs related to contributions to or expenses of the Foundation to the subsidiaries of AMERIGROUP. Our review of AMERIGROUP's 2005 contribution to the Foundation indicated the contribution was not allocated to the Company. However, the cost allocation policies and procedures of the Company and of AMERIGROUP Corporation did not specifically state that contributions from AMERIGROUP Corporation to the Foundation are excluded from the intercompany cost allocation. See the "Comments and Recommendations" section of this Report, under the caption "Intercompany Cost Allocation: Cost Allocation Policies and Procedures" for further comments regarding the Company's intercompany cost allocation.

INTERCOMPANY AGREEMENTS

Administrative and Support Services Agreement:

Administrative and other support services are provided to the Company by its parent, AMERIGROUP Corporation (“AMERIGROUP”), under an “Administrative and Support Services Agreement” (“Agreement”). Under terms of this Agreement, which has been approved by the Department, AMERIGROUP provides administrative support and services necessary for the operation of the Company, including finance, management information systems, claims administration, legal, regulatory, provider credentialing, and other necessary services. During 2005, the Company paid approximately \$34 million for services provided by AMERIGROUP under this agreement.

Under the terms of the Agreement, the Company pays AMERIGROUP, on a monthly basis, a fee defined in the Agreement as AMERIGROUP’s “cost, direct and indirect” for services provided. In addition, the Agreement provides for an additional administrative fee of 10 percent of the direct and indirect costs. The Agreement does not define direct and indirect costs. However, in correspondence with the Department during the examination period, the Company has clarified these costs as follows:

Direct costs are those costs incurred by AMERIGROUP directly related to providing services to the subsidiary health plans, including the Company. Examples of these costs are claims processing and the national call center. These costs are allocated to the various health plans based on various allocation bases. For example, the total costs of the AMERIGROUP claims department are allocated to the individual subsidiary health plans based on the number of claims processed for an individual health plan as a percentage of total claims processed for all health plans. Costs of the call center are allocated based on the number of calls handled for an individual health plan as a percentage of total calls handled by the call center for all health plans. Direct costs are also those costs incurred by AMERIGROUP that are specifically identifiable to a health plan, such as travel expenses of an AMERIGROUP employee to travel to a health plan, or outside legal or auditing fees procured by and paid by AMERIGROUP on behalf of a health plan.

Indirect costs are costs incurred by AMERIGROUP for the benefit of the health plans, but which cannot be specifically identified to a particular health plan. These costs are essentially AMERIGROUP Corporation “overhead” costs (legal department salaries and expenses, executive salaries, insurance, rent, etc.) and are allocated to the subsidiary health plans based on premium volume of each plan as a percentage of total premium volume for all plans.

As indicated above, the Agreement is not detailed regarding the definition of direct and indirect costs, and during the examination period, the Company submitted correspondence to the Department to clarify these costs and to describe other aspects of its cost allocation process. In addition, this correspondence from the Company also

included information justifying the additional 10 percent administrative fee which is added to all direct and indirect costs. The justification for the 10 percent fee was essentially that 10 percent is a typical profit margin charged by third party administrators (TPA) for similar services and the Company provided documentation to substantiate this. Approval of the company's cost allocation methodologies, including the 10 percent fee, was granted by the Department based upon this correspondence. The Department's approval instructed the Company to update the justification for the 10 percent fee on a tri-annual basis. This update is due to the Department in the second quarter of 2007.

During our examination, we reviewed the cost allocation process and the detailed costs allocated to the Company in 2005. Included in the costs allocated from AMERIGROUP to the Company were amounts totaling approximately \$1.2 million for "Cost of Capital" and approximately \$4 million for federal income tax expense incurred by AMERIGROUP. These amounts included the 10 percent administrative fee. We determined that these amounts should not be charged by AMERIGROUP to the Company. In addition, we noted that documentation of policies, procedures and certain controls over the cost allocation process could be improved. See the "Comments and Recommendations" section of this Report, under the caption "Intercompany Cost Allocation" for further comments regarding these conditions.

In addition, as a result of our detailed review during the examination of the cost allocation process, we noted a number of other issues and questions regarding the process that were not noted previously during the Department's aforementioned review and approval of the Company's cost allocation methodologies. Although these additional issues and questions did not result in examination adjustments or comments and recommendations for purposes of our Report, we indicated to Company management that in the near future, in conjunction with the Company's tri-annual update of the justification for the 10 percent administrative fee, the Department would undertake a comprehensive review of the Company's cost allocation policies, procedures and methodologies. Issues the Department will address in this review include:

1. The additional 10 percent administrative fee (versus allocating actual expenses incurred without the 10 percent fee; or charging a market rate for all services performed).
2. The application of the 10 percent administrative fee to certain expenses that are essentially pass-through expenses, such as legal or auditing services procured by and paid by AMERIGROUP on behalf of a health plan.
3. The logic of using a typical TPA profit margin (10 percent), to justify adding 10 percent to expenses charged to the Company by AMERIGROUP without performing a detailed review of the operational and expense structure of a TPA versus the operational and expense structure of AMERIGROUP.

Tax Sharing Methodology:

During the examination period, the Company, along with other affiliates, was party to consolidated federal income tax returns filed by its parent, AMERIGROUP Corporation, pursuant to a written "Tax Sharing Methodology" ("Methodology"), which had been adopted by the Company's board of directors. In addition, under terms of the Methodology, state tax returns are filed on a consolidated, combined, unitary, or stand-alone basis depending on applicable state law. The Methodology established methodologies for allocating the consolidated tax liability of the group among its members, for reimbursing the parent for payment of such tax liability, for compensating any member of the group for use of its tax losses or tax credits, and to provide for the allocation and payment of any refund arising from a carry back of losses or tax credits.

Under terms of the Methodology, the parent computes a separate tax liability for each member of the group as if a separate return had been filed by the member, and the member pays such amount to the parent. As indicated above, members are compensated for use of tax losses or tax credits.

During our examination, we discussed with management the requirements of Statement of Statutory Accounting Principles No. 10, "Income Taxes" (SSAP No. 10). Specifically, under the provisions of SSAP No. 10, in the case of a reporting entity (the Company in this case) that files a consolidated income tax return with one or more affiliates, income tax transactions between the affiliated parties shall be recognized if such transactions are pursuant to a written income tax allocation agreement. Therefore, since the Company's "Tax Sharing Methodology" is not a written agreement between the parties, the Company's income tax transactions during the examination period, as well as the Company's receivable from its parent totaling approximately \$1.3 million as of December 31, 2005 related to transactions under the Methodology, and its "Net deferred tax asset" totaling approximately \$1.3 million as of December 31, 2005, would not be recognized under the provisions of SSAP No. 10.

In response to this condition, prior to the completion of our examination, the Company executed a "Tax Allocation Agreement" with its parent. This agreement, effective as of December 15, 2006, had been submitted to and was under review by the Department as of the date of this report. Because the Company executed this agreement and submitted it to the Department prior to the completion of our examination, and, although the Company's Methodology in place during the examination period was not an agreement, it did demonstrate the Company had adopted a procedure for the intercompany tax allocation, the Company's income tax transactions during the examination period, as well as the Company's receivable from its parent and deferred tax asset as of December 31, 2005, were recognized for purposes of our examination. However, any future income tax transactions between the Company and affiliated parties will not be recognized unless the transactions are executed pursuant to a written income tax allocation agreement which has been approved by the Department.

FIDELITY BOND AND OTHER INSURANCE

The Company is a named insured on a fidelity crime policy, with coverage of \$100 million, issued to AMERIGROUP Corporation and certain of its other subsidiaries. The fidelity bond coverage exceeded the minimum amount recommended by the National Association of Insurance Commissioners on a consolidated basis.

In addition, the Company had other insurance policies (e.g., director's and officer's liability, etc.). Based upon our review, the Company's insurance coverage for these risks appears adequate.

PENSION, STOCK OWNERSHIP AND INSURANCE PLANS

401(k) Plan:

The Company's employees have the option to participate in the AMERIGROUP Corporation 401(k) deferred compensation plan. Eligible participants may defer a certain percentage of regular compensation subject to maximum federal and plan limits. AMERIGROUP Corporation may elect to match a certain percentage of each employee's contributions up to specified limits. For the year ended December 31, 2005, AMERIGROUP Corporation made matching contributions totaling approximately \$1.7 million to employees participating in the deferred compensation plan. This amount is allocated to AMERIGROUP Corporation's subsidiaries, including the Company.

AMERIGROUP Corporation also offers the following:

Executive Deferred Compensation Plan – Certain Employees are eligible and must be selected to participate in this plan. Employees can contribute a portion of their salaries and/or bonuses to the plan. The maximum deferral is 50 percent of salaries and 100 percent of bonuses. Investment options for participants are approved by the AMERIGROUP Savings Committee and each participant chooses where to invest deferrals. AMERIGROUP Corporation also has the option to make matching contributions to employees participating in the plan. However, no contributions were made to the plan by AMERIGROUP Corporation during the examination period.

Equity Incentive Plans (Employee Stock Option Plans) – Certain employees of the Company are eligible to participate in AMERIGROUP Corporation Equity Incentive Plans (employee stock option plans). During the examination period, shareholders of AMERIGROUP Corporation adopted and approved two such plans, one in 2003 and one in 2005. Costs incurred by AMERIGROUP Corporation related to the employee stock option plans are allocated to AMERIGROUP Corporation's subsidiaries, including the Company.

Health Insurance and Other Benefits – Employees of the Company and eligible dependents are eligible for health insurance and other benefits offered by

AMERIGROUP Corporation. These benefits include group medical, dental, vision, life, accidental death and dismemberment, and short-term and long-term disability insurance. AMERIGROUP Corporation also provides employee assistance programs for employees and their eligible dependents. Expenses incurred by AMERIGROUP Corporation related to providing health insurance and other benefits are allocated to AMERIGROUP Corporation's subsidiaries, including the Company.

STATUTORY DEPOSITS

As of December 31, 2005, in compliance with the provisions of the District of Columbia Official Code Section 31-3412(b), the Company had deposited, pursuant to a June 10, 1999 custodial agreement approved by the Department, United States Treasury Notes and money market funds with par and market values totaling \$307,783 and \$306,657, respectively.

In addition, the Company had deposited in trust with the Maryland State Treasurer, United States Treasury Notes with a market value of \$104,606 as of December 31, 2005.

The deposits in the District of Columbia and in Maryland were held for the protection of all policyholders.

In addition, as of December 31, 2005, the Company reported a trust deposit totaling \$1,945,000 with the District of Columbia Medical Assistance Administration.

TERRITORY AND PLAN OF OPERATION

As of December 31, 2005, the Company was licensed as a health maintenance organization in the District of Columbia and was also authorized to operate as a Managed Care Organization in Maryland. (During 2006, the Company became licensed in Maryland as a health maintenance organization.)

All of the Company's business is from the Medicaid program. During 2005, the Company wrote premiums totaling approximately \$99 million in the District of Columbia and \$403 million in Maryland. The Company receives a per member per month premium amount for District of Columbia and Maryland enrollees, and in return the Company arranges for a prescribed range of health care services to these enrollees. These services include physician, specialty, hospital and ancillary services. The monthly premium is generally a fixed-fee per member, also known as capitation, and is generally fixed regardless of the extent or nature of the services provided to the enrollees by the Company. As of December 31, 2005 the Company had approximately 41,000 members in the District of Columbia and 141,000 members in Maryland.

The Company's contract with the District of Columbia Department of Health, Medical Assistance Administration (MAA), to provide services to Medicaid enrollees,

ends July 31, 2007. In order to continue writing Medicaid business in the District of Columbia after July 31, 2007, the Company will have to respond to a request for proposals from the MAA to provide services to Medicaid enrollees, and will have to be awarded a new contract by the MAA. The Company's contract with the State of Maryland does not have a set term. The Company can choose to terminate the Maryland contract effective January 1 of any year.

The Company does not have its own health care facilities, but provides healthcare services to its enrollees through contracts with participating providers. As of December 31, 2005 the Company's participating providers consisted of 1,723 primary care physicians, 7,655 specialists, 50 hospitals, and 479 ancillary providers. The majority of the Company's provider contracts are fee-for-service.

The Company maintains offices in the District of Columbia, in Maryland, and in Virginia. Approximately 40 employees are located in the District of Columbia office. The Maryland and District of Columbia locations include the Chief Executive Officer for the Maryland and District of Columbia operations, respectively, as well as provider relations, case management and member outreach for the respective operations. The Virginia offices include the corporate offices of AMERIGROUP Corporation, including centralized operational functions (e.g., underwriting, claims processing, investments, finance, etc.) which provide support to the Company and other subsidiaries of AMERIGROUP Corporation.

INSURANCE PRODUCTS AND RELATED PRACTICES

The District of Columbia Department of Insurance, Securities and Banking's Market Conduct Unit has never conducted an examination of the market conduct affairs of the Company, and as of the date of this Report, the Unit was not planning to conduct a market conduct examination of the Company. A market conduct examination would include detailed reviews of the Company's sales and advertising, agent licensing, underwriting, and rating, claims processing and complaint handling practices and procedures.

The scope of our examination did not include market conduct procedures, including, but not limited to, market conduct procedures in the following areas:

- Policy Forms
- Fair Underwriting Practices
- Advertising and Sales Materials
- Treatment of Policyholders:
 - Claims Processing (Timeliness)
 - Complaints

REINSURANCE

Assumed Reinsurance:

The Company did not assume reinsurance during the examination period.

Ceded Reinsurance:

During the examination period, the Company maintained excess of loss reinsurance coverage. Under the terms of the policy in effect as of December 31, 2005, the Company retained the first \$300,000 of eligible expenses incurred per each member per policy year and the reinsurer assumed 90 percent of eligible expenses in excess of the retention level. (For eligible transplant expenses, the Company's retention is \$250,000 per member per policy year.) The maximum coverage per member is \$1,000,000 per contract year. There are no aggregate limits on the reinsurer's responsibility per policy year.

Therefore, the Company is responsible for the first \$300,000 in expenses per member, and the reinsurer is responsible for \$1 million of the next \$1,111,111, in any one policy year. The Company is responsible for 100 percent of any amounts above \$1,411,111.

During 2005, the Company ceded reinsurance premiums totaling approximately \$1.8 million, and reported reinsurance recovered on paid losses totaling approximately \$2.1 million. As of December 31, 2005, the Company reported reinsurance recoverable on paid losses totaling \$380,000, and had not reduced its claims unpaid liability for any anticipated reinsurance recoverable amounts.

ACCOUNTS AND RECORDS

As previously indicated in the "Territory and Plan of Operation" section of this report, the Company maintains offices in the District of Columbia, in Maryland, and in Virginia. In its December 31, 2005 annual statement, the Company indicated that its main administrative offices and the primary location of its books and records are in Virginia Beach, Virginia. In addition, the annual statement indicated that the location of the Company's statutory home office is in Linthicum, Maryland. The annual statement did not include the address of the Company's District of Columbia offices.

District of Columbia Official Code, Section 31-3431 requires that a domestic health maintenance organization maintain its principal office within the District and shall keep its books, records, and files therein, and shall not remove from the District either its principal office or its books, records, or files without the permission of the Commissioner. To maintain compliance with the requirement to keep its books, records, and files in the District, during 2003 the Company requested, and was granted permission by the Commissioner to maintain its books and records in Virginia Beach, Virginia.

During our examination, we discussed with management the fact that the Company's annual statement listed Linthicum, Maryland as the location of its statutory home office, and did not list the address of the Company's District of Columbia offices. According to management, the omission of the District of Columbia address was an oversight, and this address (750 1st Street, NE Suite 1120 Washington, DC 20002) should have been listed in the annual statement as the location of the Company's statutory home office. Management indicated its intent to accurately list the Company's statutory home office address in future annual and quarterly statement filings.

The Company's general accounting records consisted of an automated general ledger and various subsidiary ledgers (e.g., cash receipts, cash disbursements). Our review did not disclose any significant deficiencies in these records. However, we noted the Company's documentation of certain policies, procedures and controls regarding the intercompany cost allocation process could be improved. In addition, our review of the Company's electronic data processing system disclosed an area in which the electronic data processing controls could be improved. These conditions are further discussed in the "Comments and Recommendations" section of this Report, under the captions "Intercompany Cost Allocation", and "Management Information Systems General Controls", respectively.

FINANCIAL STATEMENTS

The following financial statements reflect the financial condition of the Company as of December 31, 2005, as determined by this examination:

<u>STATEMENT</u>	<u>PAGE(S)</u>
Balance Sheet:	17
Assets	17
Liabilities, Capital and Surplus	18
Statement of Revenue and Expenses	19
Capital and Surplus Account	20
Analysis of Examination Changes to Surplus	21
Comparative Financial Position of the Company	22

The accompanying Notes to Financial Statements are an integral part of these Financial Statements.

BALANCE SHEET

ASSETS

	<i>Assets</i>	<i>Nonadmitted Assets</i>	<i>Net Admitted Assets</i>	<i>Examination Adjustments Increase (Decrease)</i>	<i>Net Admitted Assets Per Examination</i>
Bonds	\$ 24,686,171	\$	\$ 24,686,171	\$	\$ 24,686,171
Cash (\$14,233,991), cash equivalents (\$42,860,528) and short-term investments (\$8,349,053)	65,443,572		65,443,572		65,443,572
Subtotals, cash and invested assets	\$ 90,129,743	\$	\$ 90,129,743	\$	\$ 90,129,743
Investment income due and accrued	184,655		184,655		184,655
Premiums and considerations:					
Uncollected premiums and agents' balances in the course of collection	12,115,252		12,115,252		12,115,252
Reinsurance:					
Amounts recoverable from reinsurers	381,346		381,346		381,346
Net deferred tax asset	1,268,808		1,268,808		1,268,808
Electronic data processing equipment and software	53,508		53,508		53,508
Furniture and equipment, including health care delivery assets	633,420	633,420			
Health care (\$151,969) and other amounts receivable	151,969	151,969			
Aggregate write-ins for other than invested assets (NOTE 1)	14,773,720	14,773,720			
Total	\$ 119,692,421	\$ 15,559,109	\$ 104,133,312	\$	\$ 104,133,312

LIABILITIES, CAPITAL AND SURPLUS

Claims unpaid (less \$0 reinsurance ceded) (NOTE 2)	\$ 58,237,042
Unpaid claims adjustment expenses (NOTE 2)	1,649,855
Premiums received in advance	59,679
General expenses due or accrued	152,027
Amounts due to parent, subsidiaries and affiliates	<u>1,572,389</u>
 Total liabilities	 \$ <u>61,670,992</u>
 Common capital stock (NOTE 3)	 \$ 1
Gross paid in and contributed surplus	29,415,565
Unassigned funds (surplus)	<u>13,046,754</u>
 Total capital and surplus	 \$ <u>42,462,320</u>
 Total liabilities, capital and surplus	 \$ <u><u>104,133,312</u></u>

STATEMENT OF REVENUE AND EXPENSES

Net premium income (including \$0 non-health premium income)	\$ <u>503,219,052</u>
Total revenues	\$ <u>503,219,052</u>
Hospital and Medical:	
Hospital/medical benefits	\$ 303,805,330
Other professional services	18,624,599
Emergency room and out-of-area	39,528,665
Prescription drugs	47,854,565
Aggregate write-ins for other hospital and medical	8,026,808
Total	\$ <u>417,839,967</u>
Less:	
Net reinsurance recoveries	\$ 2,311,706
Total hospital and medical	\$ <u>415,528,261</u>
Claims adjustment expenses, including \$10,299,693 cost containment expenses	12,033,827
General administrative expenses	50,034,192
Total underwriting deductions	\$ <u>477,596,280</u>
Net underwriting gain	\$ 25,622,772
Net investment income earned	<u>2,975,281</u>
Net income before federal income taxes	\$ 28,598,053
Federal income taxes incurred	<u>7,475,870</u>
Net income	\$ <u><u>21,122,183</u></u>

CAPITAL AND SURPLUS ACCOUNT

Capital and surplus December 31, 2002	\$	18,589,992
Net income, 2003	\$	19,282,804
Change in net deferred income tax		(29,408)
Change in non-admitted assets		2,144,984
Aggregate write-ins for (losses) in surplus		(1,732,317)
Net change in capital and surplus, 2003	\$	19,666,063
Capital and surplus, December 31, 2003	\$	38,256,055
Net income, 2004	\$	16,985,456
Change in net deferred income tax		(123,886)
Change in non-admitted assets		1,343,475
Dividends to stockholder		(23,436,604)
Net change in capital and surplus, 2004	\$	(5,231,559)
Capital and surplus, December 31, 2004	\$	33,024,496
Net income, 2005	\$	21,122,183
Change in net deferred income tax		(2,062,228)
Change in non-admitted assets		(89,652)
Dividends to stockholder		(9,532,479)
Net change in capital and surplus, 2005	\$	9,437,824
Capital and surplus, December 31, 2005	\$	42,462,320

ANALYSIS OF EXAMINATION CHANGES TO SURPLUS

There were no changes to the Company's surplus as a result of our examination.

COMPARATIVE FINANCIAL POSITION OF THE COMPANY

The comparative financial position of the Company for the five-year period ended December 31, 2005 is as follows:

	<u>2005</u>	<u>2004</u>	<u>2003</u>	<u>2002</u>	<u>2001</u>
Assets	\$ 104,133,312	\$ 95,079,124	\$ 114,158,871	\$ 103,535,488	\$ 79,600,770
Liabilities	61,670,992	62,054,628	75,902,816	84,945,496	57,835,165
Capital and surplus	42,462,320	33,024,496	38,256,055	18,589,992	21,765,605
Net premium income	503,219,052	430,917,207	409,966,704	346,261,827	282,976,705
Net investment income	2,975,281	1,631,854	1,303,442	1,768,758	3,203,435
Net income	21,122,183	16,985,456	19,282,804	2,607,523	1,440,793

Note: Amounts in the preceding financial statements for the years ended December 31, 2001, 2003 and 2004 were taken from the Company's Annual Statements as filed with the Department. Amounts for the years ended December 31, 2002 and December 31, 2005 are amounts per examination.

NOTES TO FINANCIAL STATEMENTS

1. Goodwill:

The Company reported “Aggregate write-ins for other than invested assets” totaling \$14,773,720, and nonadmitted the entire amount. This amount relates to goodwill, an intangible asset, created from the Company’s 1999 purchase of the Prudential Health Care Plan and the 2002 purchase of Capital Community Health Plan, Inc. (“CCHP”) as previously described in the “History” section of this Report. This goodwill is nonadmitted under applicable statutory accounting guidelines.

2. Unpaid Claims:

The Company reported “Claims unpaid” and “Unpaid claims adjustment expenses” totaling \$58,237,042 and \$1,649,855, respectively. These amounts represent management’s best estimate of the amounts necessary to pay all claims and related expenses that had been incurred but still unpaid as of December 31, 2005, and are not reduced for any estimated amounts recoverable under the Company’s reinsurance treaty.

The methodologies utilized by the Company to compute reserves, and the adequacy of the claims unpaid and unpaid claims adjustment expense reserves as of December 31, 2005, were reviewed as part of our examination. As part of our review, we relied on the Company’s independent actuary, who concluded that the methodologies and reserves appeared to be sufficient. In addition, the methodologies utilized by the Company to compute these reserves, and the adequacy of the reserves were reviewed by an independent actuary engaged as part of our examination. This independent actuary engaged as part of our examination also concluded that the methodologies and reserves appeared to be sufficient.

3. Capital Stock:

- a. The Company’s 2005 Annual Statement indicated the Company had issued 100 shares of common stock, and the Company reported “Common capital stock” totaling \$1 in its balance sheet. As previously noted in the “Capital Stock” section of this Report, according to the Company’s stock ledger, the Company had issued 1,000 shares of common stock with a par value of \$.01 per share to its parent, AMERIGROUP Corporation. Therefore, the number of shares issued should have been 1,000, and the Company’s “Common capital stock” account should have been \$10.

Due to immateriality, no adjustment is made to the Company’s financial statements for purposes of our financial examination. However, during our examination, we discussed these discrepancies with Company management, and management indicated future financial filings would accurately reflect the number of shares of common stock

issued and would accurately reflect the amount of “Common capital stock” reported in the balance sheet.

- b. As noted in the “Capital Stock” section of this report, as of December 31, 2005, all of the Company’s issued and outstanding shares of stock were pledged as collateral by the Company’s parent, AMERIGROUP Corporation, to secure a line of credit available to the parent for general operating purposes if and when needed. This pledge has no effect on the Company’s financial statements. However, in the event of default by AMERIGROUP Corporation, and subject to regulatory approval, ownership of the Company would be subject to change. The credit agreement terminates in 2010, and we were informed by management of the Company that as of December 31, 2005, there were no borrowings outstanding under the credit agreement. Our financial examination of AMERIGROUP Maryland did not include an examination of the financial condition of AMERIGROUP Corporation, nor of the credit agreement.

COMMENTS AND RECOMMENDATIONS

Independent Directors:

The Company is not in compliance with District of Columbia Official Code Section 31-706(c)(3) which states that no less than 1/3 of the directors of a domestic insurer (which is part of a holding company system) shall be persons who are not officers or employees of the insurer or of any entity controlling, controlled by, or under common control with the insurer. As of December 31, 2005, the Company had four directors and all were officers and employees of the Company, or of the Company's parent, AMERIGROUP Corporation. **We recommend that the Company comply with the above-mentioned requirement of the District of Columbia Code.**

Committees:

The Company is not in compliance with District of Columbia Official Code Section 31-706(c)(4) which requires that the board of directors of a domestic insurer (which is part of a holding company system) establish one or more committees comprised solely of directors who are not officers or employees of the insurer or of any entity controlling, controlled by, or under common control with the insurer. The committee or committees shall have responsibility for recommending the selection of independent certified public accountants, reviewing the insurer's financial condition, the scope and results of the independent audit and any internal audit, nominating candidates for director for election by shareholders or policyholders, evaluating the performance of officers deemed to be principal officers of the insurer, and recommending to the board of directors the selection and compensation of the principal officers. As of December 31, 2005, the Company did not have any board committees. **We recommend that the Company comply with the above-mentioned requirement of the District of Columbia Code.**

Conflicts of Interest:

The Company has adopted the AMERIGROUP Corporation Compliance Program (the "Program"). Under provisions of the Program, officers and directors of the Company are required to complete conflict of interest questionnaires. However, conflict of interest questionnaires were not completed by directors and officers of the Company during the examination period. **To ensure all potential conflicts of interest are properly disclosed, the Company should adhere to its own policy and ensure that annual questionnaires are completed for all persons required to complete them.**

Corporate Records and Actions:

During our examination, we noted the following:

1. The Company's shareholder did not hold an "annual" meeting in 2004 or 2005 as required by the bylaws.

2. The Company's board of directors did not meet on a regular basis during the examination period. Specifically, the Company's board did not meet in 2003 or 2004, and met two times in 2005. (All 2003 and 2004 documented actions by the board of directors, as well as the majority of 2005 documented actions by the board of directors, were accomplished via signed consents in lieu of meetings.)
3. The minutes of the meetings of the board of directors did not document approval of the Company's investment transactions, as required by Chapter 26, Section 3101.2 of the District of Columbia Municipal Regulations.

We recommend the following:

- 1. Management of the Company ensure the Company's shareholder holds an annual meeting as required by the Company's by-laws.**
- 2. The Company's board meet more frequently (e.g., at least quarterly).**
- 3. The minutes of the meetings of the board of directors document approval of the Company's investment transactions, as required by Chapter 26, Section 3101.2 of the District of Columbia Municipal Regulations.**

Intercompany Cost Allocation:

The Company pays a portion of its operating expenses directly ("local" costs), and pays its parent for "direct" and "indirect" costs incurred by the parent related to providing services and support to the Company. These direct and indirect costs are allocated by the parent to the parent's subsidiary companies. During our examination, we noted the following:

Cost Allocation Policies and Procedures:

In correspondence with the Department during the examination period, the Company outlined various aspects of its cost allocation process, including information regarding local and allocated costs. Approval of the company's cost allocation methodologies was granted by the Department based upon this correspondence. However, except for a brief procedure regarding the Company's indirect cost allocation, this cost allocation process as outlined in the company's correspondence is not contained in written policies and procedures. Such policies and procedures would include documentation of the allocation methodologies to be used to allocate various expenses (e.g., Company's percentage of premiums compared to premiums for all companies in the group, number of claims processed for the company compared to total claims processed for all companies, etc.), and other guidelines such as identification of specific expenses to be included in the allocation (e.g., corporate rent, insurance policies, etc.) or excluded from the allocation (e.g., charitable contributions, capital contributions, etc.). Without formal policies and procedures, there is a risk that the cost allocation process may be carried out in a manner inconsistent with management's objectives.

We recommend that the Company develop and maintain written policies and procedures with respect to the inter-company cost allocation process. These procedures should be submitted to the Department for review by September 30, 2007.

Cost of Capital and Federal Income Taxes:

Included in the 2005 costs allocated from the Company's parent to the Company were amounts totaling approximately \$1.2 million for "Cost of Capital" and approximately \$4 million for federal income tax expense incurred by AMERIGROUP Corporation. These amounts included a 10 percent administrative charge applied by the parent to expenses allocated to the Company.

According to Company management, the cost of capital charge is an imputed value related to the acquisition by the parent of capital assets that are purchased for the infrastructure it needs to provide services to its subsidiaries under the administrative services agreement. The parent pays cash for these assets (and the Company pays its parent the Company's share of the cost of them, as well as for its share of the costs of personnel and overhead to procure, administer and maintain them, plus the 10 percent administrative fee added to the cost of the assets, personnel and overhead). This imputed value is intended to approximate the costs of financing these purchases, if the parent had chosen to finance them, rather than pay cash. It is also intended to compensate the parent for potential returns on forgone investment opportunities, since the cash is not available for other investment considerations. Management states that there would be a financing cost if these assets were purchased by the Company, and management believes including the cost of capital charge is more representative of an arm's length transaction that the subsidiary would incur to receive the benefit of these assets.

Regarding federal income tax expense, the Company pays its parent for an allocated portion of the federal income tax expense incurred by its parent. This income tax expense incurred by the parent results from the parent's net operating revenues, including administrative fees and dividends paid by the Company and other affiliates to its parent. This federal income tax expense is separate and apart from the Company's federal income tax expense computed by AMERIGROUP Corporation for the Company as if a separate return had been filed by the Company. Management of the Company believes including the parent's income tax expense in the intercompany cost allocation is appropriate.

During our examination, the Department determined that the above amounts should not be charged by the parent to the Company. **We recommend that the company immediately cease paying its parent for "Cost of Capital" and for federal income tax expense incurred by its parent.**

Documentation of Spreadsheet Controls:

The Company's parent uses spreadsheets in the calculation of the allocation of direct and indirect expenses from the parent to its subsidiaries. These spreadsheets represent a key component in the Company's financial reporting and operational processes and are complex spreadsheets that support material transactions and accounts. During our examination, we noted that controls over these cost allocation spreadsheets were not documented. Such controls could include change control, verification of source numbers, and logic inspection. **We recommend that the Company ensure that the controls over these spreadsheets are documented.**

Management Information Systems General Controls:

The Company uses an electronic data processing system to process the majority of its critical applications (e.g., general ledger, premium processing, claims processing). The majority of these critical applications were processed by the Company's parent on the parent's computer systems. Our examination included a review and evaluation of the general and security access procedures and controls in place at the parent's data center and over the Company's systems. Our review of procedures and controls disclosed the following:

Changes to Code:

Code can be promoted from the test environment to production by data base administrators. Therefore, the possibility exists that code could be changed after the completion, testing and approval of changes, but prior to being moved to the production environment, As a result, unauthorized changes to programs and data could occur and go undetected. **To provide for adequate segregation of duties over the change process, we recommend that completed and approved changes to code be moved to the production environment either by an automated process or by non-programmers and non-data base administrators.**

Additional Comments and Recommendations:

In addition to the above Comments and Recommendations, during our examination, we made other suggestions and recommendations to the Company with regard to record keeping and other procedures relating to its operations.

SUBSEQUENT EVENTS

AMERIGROUP Illinois Lawsuit:

In 2002, a former employee of the Company's Illinois affiliate, AMERIGROUP Illinois, Inc. ("AMERIGROUP Illinois"), filed a federal and state whistleblower action against AMERIGROUP Illinois. The United States of America and the State of Illinois were also plaintiffs. The complaint was filed in the U.S. District Court for the Northern District of Illinois, Eastern Division, and it alleged that AMERIGROUP Illinois submitted false claims under the Medicaid program, and that AMERIGROUP Illinois maintained a scheme to discourage or avoid the enrollment into the health plan of pregnant women and other recipients with special needs. The suit sought statutory penalties and an unspecified amount of damages, which would be trebled under the False Claims Act.

In June 2005, the complaint was amended to add AMERIGROUP Corporation as a party. In the amended complaint, the plaintiffs alleged that AMERIGROUP Corporation was liable as the alter-ego of AMERIGROUP Illinois and that AMERIGROUP Corporation was liable for making false claims or causing false claims to be made.

Fact discovery concluded in August 2006 and the trial was held in October 2006. On October 30, 2006, the jury returned a verdict against AMERIGROUP Corporation and AMERIGROUP Illinois in the amount of \$48 million, which under applicable law could be trebled to \$144 million plus penalties. The jury also found that there were 18,130 false claims. The statutory penalties allowable under the False Claims Act range between \$5,500 and \$11,000 per false claim. The statutory penalties allowable under the Illinois Whistleblower Rewards and Protection Act range between \$5,000 and \$10,000 per false claim.

Upon rendering of the verdict, management of AMERIGROUP Corporation indicated it disagreed with the verdict and would seek to have it set aside and would appeal if necessary. As of the date of this report, AMERIGROUP Corporation has filed various motions, including motions to reduce or set aside the verdict, and for a new trial. Plaintiffs have also filed motions, asking the court to treble the verdict of \$48 million, impose penalties of \$199 million allowed under the False Claims Act and \$181 million allowed under the Illinois whistleblower law, and to include plaintiff's legal fees and expenses in the award. As of the date of this report, only the \$48 million verdict has been entered. The motion to treble has not been granted and no penalties or legal fees and expenses have been imposed. Upon the court's entering of the \$48 million verdict, AMERIGROUP Corporation was required to place security for this amount, and did so by posting a letter of credit.

As of the date of this report, post-trial motions are pending. Management of AMERIGROUP Corporation has indicated in the event its motions are denied, the judgment will be appealed to the U.S. Court of Appeals.

Management has indicated its belief that there is a basis for the jury verdict to be reversed, either resulting in a judgment in favor of AMERIGROUP Corporation, or in a new trial. Accordingly, management has indicated its belief that it is reasonably possible that damages

could range from zero to \$524,730,000 plus reasonable attorney's fees, expenses and costs of plaintiffs. In addition, the federal or a state government could move to exclude the company from future contracts as a result of a civil verdict under the False Claims Act. Management has indicated this is a discretionary step which it believes would not be commenced until all appeals had been exhausted. Further, prior to any exclusion taking effect, management believes it would have the right to a hearing before an administrative law judge, at which time management would have an opportunity to advocate that exclusion was not warranted. Management has indicated that while it believes the circumstances of this case do not appear to warrant such action, an exclusion from doing business with the federal and state governments could have a material adverse effect on the financial position, results of operations or liquidity of AMERIGROUP Corporation.

Management has acknowledged that although it is possible that the ultimate outcome of this case will not be favorable to AMERIGROUP Corporation, and could have a material adverse effect on AMERIGROUP Corporation's financial position, results of operations or liquidity, management has not concluded that it is probable that a loss has been incurred. Accordingly, AMERIGROUP Corporation has not recorded any amounts in its financial statements for unfavorable outcomes. Management has indicated that if significant losses were to incur in connection with the litigation, in addition to being liable for the amount of any final verdict, penalties and expenses, AMERIGROUP Corporation could fail to meet certain financial covenants and/or other provisions under a credit agreement which would render the Company in default under the credit agreement, thereby causing, among other things, any amounts borrowed, or otherwise owed, under the credit agreement to become due and payable.

As of December 31, 2005, there is no impact on the Company's financial statements as a result of this litigation. As of the date of this report, any future impact on AMERIGROUP Maryland, Inc. from this litigation is unknown. Future impacts on the Company could include an exclusion from doing business with the federal and state governments, and any impacts from adverse effects on AMERIGROUP Corporation's financial position. During our examination, management represented that no costs related to this litigation have been paid by or charged to AMERIGROUP Maryland, Inc., and no future costs and expenses related to this litigation will be charged to or paid by AMERIGROUP Maryland, Inc.

CONCLUSION

Our examination disclosed that as of December 31, 2003 the Company had:

Admitted Assets	<u>\$ 104,133,312</u>
Liabilities and Reserves	<u>\$ 61,670,992</u>
Common Capital Stock	\$ 1
Gross Paid In and Contributed Surplus	29,415,565
Unassigned Funds (Surplus)	<u>13,046,754</u>
Total Surplus	<u>\$ 42,462,320</u>
Total Liabilities, Capital and Surplus	<u>\$ 104,133,312</u>

Based on our examination, except as noted, the accompanying balance sheet properly presents the statutory financial position of the Company at December 31, 2005, and the accompanying statement of income properly presents the statutory results of operations for the period then ended. The supporting financial statements properly present the information prescribed by the District of Columbia Official Code and the National Association of Insurance Commissioners.

Chapters 20 (“RISK-BASED CAPITAL”) and 34 (“HEALTH MAINTENANCE ORGANIZATIONS”) of Title 31 (“Insurance and Securities”) of the District of Columbia Official Code specify the level of capital and surplus required for the Company. We concluded that the Company’s capital and surplus funds exceeded the minimum requirements during the period under examination.

SIGNATURES

In addition to the undersigned, the following examiners representing the District of Columbia Department of Insurance, Securities and Banking participated in certain phases of this examination:

Xiangchun (Jessie) Li, CFE, District of Columbia Department of
Insurance, Securities and Banking
Chidinma Ukaio, District of Columbia Department of Insurance,
Securities and Banking

As indicated in the "Scope of Examination" section of this report, this examination was conducted in conjunction with the Texas, New Jersey and Ohio insurance department examinations of three affiliates of the Company domiciled in those respective states. Certain portions of this examination were completed by examiners representing these states.

The electronic data processing review was performed by Jenny Jeffers, CISA, AES, of Bostick/Crawford Consulting Group.

The actuarial portion of this examination was completed by Donna Novak, FCA, ASA, MAAA, FLMI, of NovaRest, Inc.

Respectfully submitted,



Nathaniel Kevin Brown, CFE
Examiner-In-Charge
District of Columbia Department of Insurance,
Securities and Banking

Under the Supervision of,



P. Sean O'Donnell, CFE
Chief Examiner
District of Columbia Department of Insurance,
Securities and Banking

Government of the District of Columbia
Department of Insurance, Securities and Banking



Thomas E. Hampton
Commissioner

March 2, 2007

Steven B. Larsen
President
AMERIGROUP Maryland, Inc.
750 1st Street, NE, Suite 1120
Washington, DC 20002

Dear Mr. Larsen:

Pursuant to the provisions of Section 31-1404 of the D.C. Official Code, enclosed is a draft copy of the Report on Examination of the affairs and financial condition of **AMERIGROUP Maryland, Inc.** as of December 31, 2005.

Please call our attention to any errors or omissions. In addition, if this Report on Examination contains a section entitled "Comments and Recommendations" that discloses certain areas requiring action, the Company shall submit a statement covering the corrective measures which will be taken. If the Company's position on any of these points is contrary to the Examiner's findings, an explanation should be submitted covering each contested comment and/or recommendation.

If there are no errors or omissions to be brought to our attention, and there are no "Comments and Recommendations" requiring a response, please submit a statement that the Company accepts the Report.

All of your comments concerning these matters must be in writing and shall be furnished to this Department within **thirty (30) days from the date of this letter (April 2, 2007)**.

Sincerely,

A handwritten signature in black ink, appearing to read "Philip Barlow", is written over a solid black rectangular box. The signature is fluid and cursive.

Philip Barlow
Associate Commissioner for Insurance

Enclosure

AMERIGROUP[®]

C O R P O R A T I O N

April 2, 2007

Philip Barlow
Associate Commissioner for Insurance
Government of the District of Columbia
Department of Insurance, Securities and Banking
810 First Street, NE, Suite 701
Washington, DC 20002

RE: Examination Report of AMERIGROUP Maryland, Inc. as of December 31, 2005

Dear Mr. Barlow:

I have reviewed the examination report for AMERIGROUP Maryland, Inc. (the "Company") for the period as of December 31, 2005. Below are our comments on the draft report.

Corrections

Pension, Stock Ownership and Insurance Plans (page 11)

In the section labeled Executive Deferred Compensation, the Compensation Committee does not determine the rate of return for amounts deferred into the plan. Rather the investment alternatives that are available to the participants are approved by the AMERIGROUP Savings Committee but the investment selections are made by the participants. Therefore, the language should be changed to indicate the investment options available are approved by the AMERIGROUP Savings Committee and each participant chooses where to invest their deferrals.

Cash Incentive Plan

The cash incentive described in the report is one component of the cash incentive plan, specifically the long-term incentive plan. Below is the description of both components of the plan.

Cash Incentive Plan-The Company provides two cash incentive plans: the MJO Bonus and Long-Term Cash Incentive Awards (LTIP) under our Chairman's Bonus Plan. Participants can receive an award only if the Company meets or exceeds its financial and non-financial goals and the executive attains his or her major job objectives (MJOs).

The purpose of the MJO Bonus is to provide short-term incentive compensation tied to individual and Company annual performance. MJO Bonuses are measured over a one-year period and are paid prior to March 15th following the year for which the bonus is earned.

The purpose of the LTIP Award Program is to provide long-term cash incentive compensation tied to individual and Company annual performance through a deferred payment award structured to encourage executive retention. A cash incentive amount is determined for each eligible participant, and payment of this amount is deferred for three years. The target award amount is funded over the three-year period, with the funding being dependent upon the Company meeting its financial goals each year. A participant is eligible for payment of an amount funded in any one year that will be paid before March 15th of the first year following the end of the three-year cycle if the participant remains employed by the Company on the date the payment is made. AMERIGROUP Corporation did not contribute to this plan in 2005 as financial goals were not met. AMERIGROUP Corporation contributions to this plan for 2004 and 2003 totaled approximately \$1,754,000 and \$1,320,000 respectively. These amounts are allocated to AMERIGROUP Corporation's subsidiaries, including the Company.

The following are the details of the corrective actions that will be implemented for the "Comments and Recommendations" in the above examination report:

1. Independent Directors: The Company is not in compliance with District of Columbia Official Code Section 31-706(c)(3) which states that no less than 1/3 of the directors of a domestic insurer (which is part of a holding company system) shall be persons who are not officers or employees of the insurer or of any entity controlling, controlled by, or under common control with the insurer. As of December 31, 2005, the Company had four directors and all were officers and employees of the Company, or of the Company's parent, AMERIGROUP Corporation. **We recommend that the Company comply with the above-mentioned requirement of the District of Columbia Code.**

***Response:** The Company is in the process of changing the membership of the directors to be in compliance with the Code.*

2. Committees: The Company is not in compliance with District of Columbia Official Code Section 31-706(c)(4) which requires that the board of directors of a domestic insurer (which is part of a holding company system) establish one or more committees comprised solely of directors who are not officers or employees of the insurer or of any entity controlling, controlled by, or under common control with the insurer. The committee or committees shall have responsibility for recommending the selection of independent certified public accountants, reviewing the insurer's financial condition, the scope and results of the independent audit and any internal audit, nominating candidates for director for election by shareholders or policyholders, evaluating the performance of officers deemed to be principal officers of the insurer, and recommending to the board of directors the selection and compensation of the principal officers. As of December 31, 2005, the Company did not have any board

committees. We recommend that the Company comply with the above-mentioned requirement of the District of Columbia Code.

Response: The Company will review what committee(s) of the Board is appropriate and their responsibilities.

3. Conflicts of Interest: The Company has adopted the AMERIGROUP Corporation Compliance Program (the "Program"). Under provisions of the Program, officers and directors of the Company are required to complete conflict of interest questionnaires. However, conflict of interest questionnaires were not completed by directors and officers of the Company during the examination period. **To ensure all potential conflicts of interest are properly disclosed, the Company should adhere to its own policy and ensure that annual questionnaires are completed for all persons required to complete them.**

Response: The Company has strengthened its Compliance Program and the conflict of interest questionnaires remain a component of the program with enhanced controls over the completeness of this component.

4. Corporate Records and Actions:

During our examination, we noted the following:

- a. The Company's shareholder did not hold an "annual" meeting in 2004 or 2005 as required by the bylaws.
- b. The Company's board of directors did not meet on a regular basis during the examination period. Specifically, the Company's board did not meet in 2003 or 2004, and met two times in 2005. (All 2003 and 2004 documented actions by the board of directors, as well as the majority of 2005 documented actions by the board of directors, were accomplished via signed consents in lieu of meetings.)
- c. The minutes of the meetings of the board of directors did not document approval of the Company's investment transactions, as required by Chapter 26, Section 3101.2 of the District of Columbia Municipal Regulations.

We recommend the following:

1. **Management of the Company ensure the Company's shareholder holds an annual meeting as required by the Company's by-laws.**
2. **The Company's board meet more frequently (e.g., at least quarterly).**
3. **The minutes of the meetings of the board of directors document approval of the Company's investment transactions, as required by Chapter 26, Section 3101.2 of the District of Columbia Municipal Regulations.**

***Response:** The Company will hold an annual meeting as required by our by-laws. The Company's Board will review their meeting frequency to determine the periodicity. Effective in 2007, the Board will review investment transactions as required by the District of Columbia Municipal Regulations.*

Intercompany Cost Allocation:

The Company pays a portion of its operating expenses directly ("local" costs), and pays its parent for "direct" and "indirect" costs incurred by the parent related to providing services and support to the Company. These direct and indirect costs are allocated by the parent to the parent's subsidiary companies. During our examination, we noted the following:

5. Cost Allocation Policies and Procedures: In correspondence with the Department during the examination period, the Company outlined various aspects of its cost allocation process, including information regarding local and allocated costs. Approval of the company's cost allocation methodologies was granted by the Department based upon this correspondence. However, except for a brief procedure regarding the Company's indirect cost allocation, this cost allocation process as outlined in the company's correspondence is not contained in written policies and procedures. Such policies and procedures would include documentation of the allocation methodologies to be used to allocate various expenses (e.g., Company's percentage of premiums compared to premiums for all companies in the group, number of claims processed for the company compared to total claims processed for all companies, etc.), and other guidelines such as identification of specific expenses to be included in the allocation (e.g., corporate rent, insurance policies, etc.) or excluded from the allocation (e.g., charitable contributions, capital contributions, etc.). Without formal policies and procedures, there is a risk that the cost allocation process may be carried out in a manner inconsistent with management's objectives.

We recommend that the Company develop and maintain written policies and procedures with respect to the inter-company cost allocation process. These procedures should be submitted to the Department for review by September 30, 2007.

***Response:** AMERIGROUP Corporation, the parent of the Company, will enhance its intercompany management fee policy and submit the revised policy to the Department prior to September 30, 2007.*

6. Cost of Capital and Federal Income Taxes: Included in the 2005 costs allocated from the Company's parent to the Company were amounts totaling approximately \$1.2 million for "Cost of Capital" and approximately \$4 million for federal income tax expense incurred by AMERIGROUP Corporation. These amounts included a 10 percent administrative charge applied by the parent to expenses allocated to the Company.

According to Company management, the cost of capital charge is an imputed value related to the acquisition by the parent of capital assets that are purchased for the infrastructure it needs to provide services to its subsidiaries under the administrative services agreement. The parent pays cash for these assets (and the Company pays its

parent the Company's share of the cost of them, as well as for its share of the costs of personnel and overhead to procure, administer and maintain them, plus the 10 percent administrative fee added to the cost of the assets, personnel and overhead). This imputed value is intended to approximate the costs of financing these purchases, if the parent had chosen to finance them, rather than pay cash. It is also intended to compensate the parent for potential returns on forgone investment opportunities, since the cash is not available for other investment considerations. Management states that there would be a financing cost if these assets were purchased by the Company, and management believes including the cost of capital charge is more representative of an arm's length transaction that the subsidiary would incur to receive the benefit of these assets.

Regarding federal income tax expense, the Company pays its parent for an allocated portion of the federal income tax expense incurred by its parent. This income tax expense incurred by the parent results from the parent's net operating revenues, including administrative fees and dividends paid by the Company and other affiliates to its parent. This federal income tax expense is separate and apart from the Company's federal income tax expense computed by AMERIGROUP Corporation for the Company as if a separate return had been filed by the Company. Management of the Company believes including the parent's income tax expense in the intercompany cost allocation is appropriate.

During our examination, the Department determined that the above amounts should not be charged by the parent to the Company. **We recommend that the company immediately cease paying its parent for "Cost of Capital" and for federal income tax expense incurred by its parent.**

***Response:** AMERIGROUP Corporation provides a wide range of services to the Company as prescribed in the Administrative Services Agreement. We believe the Company is paying a reasonable fee for the services received. We believe that the above costs are valid to be included because they represent reasonable, arms-length pricing considerations for the aggregate value of services that the AMERIGROUP Corporation is providing to the Company.*

7. Documentation of Spreadsheet Controls: The Company's parent uses spreadsheets in the calculation of the allocation of direct and indirect expenses from the parent to its subsidiaries. These spreadsheets represent a key component in the Company's financial reporting and operational processes and are complex spreadsheets that support material transactions and accounts. During our examination, we noted that controls over these cost allocation spreadsheets were not documented. Such controls could include change control, verification of source numbers, and logic inspection. **We recommend that the Company ensure that the controls over these spreadsheets are documented.**

***Response:** Our spreadsheet controls are documented within our Sarbanes-Oxley risk assessment within our Financial Statement Close process. We are in the process of evaluating this control to further enhance it and we will elaborate our documentation regarding spreadsheet controls.*

Management Information Systems General Controls:

The Company uses an electronic data processing system to process the majority of its critical applications (e.g., general ledger, premium processing, claims processing). The majority of these critical applications were processed by the Company's parent on the parent's computer systems. Our examination included a review and evaluation of the general and security access procedures and controls in place at the parent's data center and over the Company's systems. Our review of procedures and controls disclosed the following:

8. Changes to Code:

Code can be promoted from the test environment to production by data base administrators. Therefore, the possibility exists that code could be changed after the completion, testing and approval of changes, but prior to being moved to the production environment, As a result, unauthorized changes to programs and data could occur and go undetected. **To provide for adequate segregation of duties over the change process, we recommend that completed and approved changes to code be moved to the production environment either by an automated process or by non-programmers and non-data base administrators.**

***Response:** We believe that our process to move code from the test environment to the production environment is secure with appropriate audit controls. The code that is promoted to the production environment is promoted by DBAs that are responsible for the administration of the production systems. The code that is promoted as part of our Change Management process is code that is locked down and it is promoted from secure area that is restricted by security controls. It is true that these production DBAs have the ability to institute changes to the production environment based on their security profiles. System Administrators as well as DBAs are granted these privileges based on their roles to the organization and with this, are given the trust of organization that they will adhere to policy. However, there are also audit controls in place to track any unauthorized access or changes to these systems. We believe these audit controls would identify inappropriate changes. Additionally, the DBAs also report into different reporting managers and not the development manager to enhance their separation of duties. This process has been reviewed and approved by our Internal Audit department and external auditor on an annual basis as part of IT general controls and Sarbanes-Oxley.*

If you have any questions, please do not hesitate to call me at (757) 473-2721.

Sincerely,



Margaret M. Roomsburg
Senior Vice President & Chief Accounting Officer
AMERIGROUP Corporation

Government of the District of Columbia
Department of Insurance, Securities and Banking



Thomas E. Hampton
Commissioner

April 9, 2007

Vincent M. Ancona
Interim Chief Executive Officer
AMERIGROUP Maryland, Inc.
750 1st Street, NE Suite 1120
Washington, DC 20002

Dear Mr. Ancona:

We are in receipt of a response, dated April 2, 2007, from Margaret M. Roomsburg, Senior Vice President and Chief Accounting Officer of AMERIGROUP Corporation, which addresses the corrective actions taken by AMERIGROUP Maryland, Inc. to comply with the recommendations made in the Report on Examination as of December 31, 2005, dated February 1, 2007. Except for the following, the response adequately addresses the recommendations made in the Report.

Intercompany Cost Allocation:

Cost of Capital and Federal Income Taxes:

We recommended that the company immediately cease paying its parent for "Cost of Capital" and for federal income tax expense incurred by its parent.

The response indicated that AMERIGROUP Corporation believes that fees paid by the Company to AMERIGROUP Corporation for "Cost of Capital" and for federal income tax expense are valid intercompany fees.

As stated in our report, the company should immediately cease paying its parent for "Cost of Capital" and for federal income tax expense incurred by its parent.

During our next examination of the Company, we will review the implementation of the corrective actions taken.

In addition, we have made the editorial changes to the "Pension, Stock Ownership and Insurance Plans" section as indicated by Ms. Roomsburg. The section entitled "Cash Incentive Plan" has been eliminated from the Report, as it is not a pension, stock ownership or insurance plan.

Vincent M. Ancona
AMERIGROUP Maryland, Inc.
April 9, 2007
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The adopted Report (which includes a copy of this letter), and the Order evidencing such adoption are enclosed. Pursuant to Section 31-1404(e)(1) of the D.C. Official Code, the adopted Report will be held private and confidential for a period of 10 days from the date of the Order evidencing such adoption. After this 10 day period has passed, the Report will be publicly available, and will be forwarded electronically to each Commissioner whose name is set forth on Page 1 of the Report, as well as to each of the participating zone examiners, to the National Association of Insurance Commissioners, and to each state in which the Company is licensed, according to your Annual Statement.

Pursuant to Section 31-1404(d)(1) of the D.C. Official Code, within 30 days of the date of the above-mentioned Order, affidavits executed by each Company director stating under oath that he or she has received a copy of the adopted examination Report and related Order shall be filed with this Department. Please send these affidavits to my attention here at the Department.

Please contact me at 202-442-7785 if you have any questions.

Sincerely,

A handwritten signature in black ink that reads "P. Sean O'Donnell". The signature is written in a cursive style with a long horizontal flourish at the end.

P. Sean O'Donnell
Chief Financial Examiner

Enclosures