

STATE OF CONNECTICUT

**AUDITORS' REPORT
INSURANCE DEPARTMENT
FOR THE FISCAL YEARS ENDED JUNE 30, 2000 AND 2001**

AUDITORS OF PUBLIC ACCOUNTS
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April 12, 2002

**AUDITORS' REPORT
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We have made an examination of the financial records of the Insurance Department for the fiscal years ended June 30, 2000 and 2001. This report on that examination consists of the Comments, Recommendations and Certification, which follow.

Financial statement presentation and auditing are being done on a Statewide Single Audit basis to include all State agencies. This audit has been limited to assessing the Insurance Department's compliance with certain provisions of financial related laws, regulations, contracts, and evaluating the Insurance Department's internal control structure, policies and procedures established to ensure such compliance. In addition, we have conducted an evaluation of a program of the Department.

COMMENTS

FOREWORD:

The duties, powers and responsibilities of the Insurance Department are set forth primarily by Title 38a of the General Statutes. The responsibilities of the Department include the licensing and oversight of insurance business carried on within the State and for the collection of certain taxes and fees arising from such activities. Included within the scope of the term "insurance business" are the insurance activities related to fraternal benefit societies, coverage sometimes incident to credit transactions, public adjusters, casualty adjusters, motor vehicle physical damage adjusters, certified insurance consultants and health care centers.

Also, under Section 36a-285, the Department has responsibility, in certain specific instances jointly with the Department of Banking, for the supervision of the activities of insurance departments of mutual savings banks of the State, which engage in the marketing of savings bank life insurance.

Auditors of Public Accounts

The Department also has responsibilities under the following sections of the General Statutes dealing with Workers' Compensation:

Sections 31-328 through 31-339, concerning mutual associations of employers formed for purposes of insuring their liabilities to compensate employees for injuries sustained.

Sections 31-345 through 31-348a, concerning policies of insurance to be issued by either insurers or self-insureds, purporting to cover an employer's liabilities for workers' compensation.

George M. Reider, Jr. served as the Insurance Department Commissioner until his resignation on May 5, 2000. Deputy Commissioner William J. Gilligan was appointed Acting Commissioner, effective May 6, 2000 and served until June 21, 2000. Susan F. Cogswell was appointed Commissioner effective June 22, 2000 and continues to serve.

Significant New Legislation:

Public Act 99-284 established an Office of Managed Care Ombudsman that shall be within the Insurance Department for administrative purposes only. This Office is under the direction of the Managed Care Ombudsman who was appointed by the Governor, with the approval of the General Assembly. The Office will assist health insurance consumers with managed health care issues.

Public Act 00-211 requires the Public Safety Commissioner, the Workers' Compensation Fraud Unit and insurance companies to report actual or suspected incidents of insurance fraud involving arson, workers' compensation, and automobile insurance to the Insurance Commissioner. It also requires the Insurance Commissioner to annually report insurance fraud information to the Insurance and Real Estate Committee of the General Assembly.

RÉSUMÉ OF OPERATIONS:

General Fund Revenues and Receipts:

General Fund revenues for the past two fiscal years were as follows:

	<u>1999-2000</u>	<u>2000-2001</u>
Taxes	\$ 3,382,051	\$ 4,239,504
Licenses	13,049,286	4,703,624
Fees	4,851,438	5,424,122
Fines and costs	716,616	1,421,936
All other receipts	<u>37,725</u>	<u>41,109</u>
Totals	<u>\$ 22,037,116</u>	<u>\$ 15,830,295</u>

General Fund revenues for the fiscal year ended June 30, 1999 totaled \$12,915,216 for comparative purposes. Revenues generated from licenses are dramatically higher in even years because both insurance agents' and producer licenses are based on biennial renewals. The twenty percent increase in tax collections in fiscal year 2000-2001 is due to increases in insurance brokers'

taxable premiums which result from increased activity within the insurance business. Fee revenues increased based on a large number of new applications due to an increase in interstate commerce. The large increase in fines and costs was due to an increase in the dollar value and number of companies which were assessed fines by the Market Conduct Division.

Insurance Fund (1104):

Section 38a-52a of the General Statutes established the Insurance Fund. The Fund accounts for assessments made to insurance companies to recover the expenses of the Insurance Department and for license and external appeal fees relating to health care utilization reviews. Insurance Fund revenues deposited for the fiscal years ended June 30, 2000 and 2001 were as follows:

	<u>1999-2000</u>	<u>2000-2001</u>
Expenses Recovered from Insurance Companies	\$20,866,277	\$18,574,792
Licenses/Fees - Utilization Review Firms	307,500	325,000
Interest Income Credited	189,331	309,732
Other Receipts/Revenue	<u>47,492</u>	<u>25,430</u>
Total Insurance Fund Receipts	<u>\$21,410,600</u>	<u>\$19,234,954</u>

Insurance Fund expenditures by the Department, net of refunds of expenditures, for the two fiscal years, were as follows:

	<u>1999-2000</u>	<u>2000-2001</u>
Personal Services	\$ 10,405,777	\$ 11,177,151
Contractual Services	1,962,536	2,152,245
Commodities	114,761	374,279
Revenue Refunds	606,771	595,020
Sundry Charges	4,690,865	4,796,876
Equipment	<u>211,641</u>	<u>256,493</u>
Total Expenditures	<u>\$ 17,992,351</u>	<u>\$ 19,352,064</u>

For comparative purposes, expenditures for the 1998-1999 fiscal year totaled \$15,039,370. The largest increases in expenditures during the audited period were due primarily to an increase in personal service expenditures related to the normal and delayed payments of annual increments and cost of living increases to employees. Commodities increased primarily by non-capitalized equipment purchases made as part of the Insurance Department's move to a new location.

Brokered Transactions Guaranty Fund:

The Brokered Transactions Guaranty Fund operates under Section 38a-880 through 38a-889 of the General Statutes. The Fund compensates State residents aggrieved by various actions of insurance agents or brokers, including embezzlement and fraud. Newly licensed insurance agents and brokers are required to pay a \$10 fee to this Fund.

Pursuant to Section 38a-882, the Fund is to be maintained at a level not to exceed \$500,000.

Receipts shall be credited to the Fund as long as the Fund balance is below \$500,000. Any excess receipts are deposited to the General Fund. There was no receipt or disbursement activity to this Fund during the audited period. As of June 30, 2001, the Fund's cash balance was \$499,960.

Trust Deposits and Escrow Accounts Held by the State Treasurer:

Under various statutory provisions, certain insurance companies are required to deposit securities with the State Treasurer for the benefit of their policyholders. These would be: retaliatory deposits made under the provisions of Section 38a-83 of the General Statutes, which requires that companies domiciled in states requiring deposits of Connecticut companies, to make equivalent deposits in Connecticut; deposits made under Section 38a-371 of the General Statutes for those companies desiring to be self-insured for their automobile coverage; and, other deposits required by the Commissioner under various circumstances for the protection of Connecticut policyholders. The par value of these deposits amounted to \$500,882,100 as of June 30, 2001.

Under special circumstances, the Insurance Commissioner may take possession of the investment income or the deposits held by the Treasurer pending distribution to authorized parties. Cash on hand is temporarily held in the State Treasurer's Short Term Investment Fund (STIF) until it is needed. As of June 30, 2001, the STIF account balances totaled \$53,481,011 and consisted of assets from six insurance companies.

Program Evaluation:

Section 2-90 of the General Statutes authorizes the Auditors of Public Accounts to conduct program evaluations as part of its routine audits of public agencies. We selected to review whether the Insurance Department has taken steps to develop a public outreach program to educate health care consumers of the external appeal process, as required by Public Act 99-284.

Public Act 99-284, later codified as Section 38a-478n, subsection (e) of the General Statutes, states that "... not later than January 1, 2000, the Insurance Commissioner shall develop a comprehensive public education outreach program to educate health insurance consumers of the existence of the external appeals procedure (for enrollees who have exhausted the internal grievance mechanisms provided by a managed care organization or utilization review company) The program shall maximize public information concerning the appeals procedure... . The Managed Care Ombudsman shall coordinate the outreach program and oversee the education process."

In December 1999, the Insurance Department completed an outline for a multi-faceted approach to a public education outreach program to help alert consumers of the existence of the external appeals process. The outreach program was to be facilitated through the use of the Office of Managed Care Ombudsman (OMCO), which was also established through Public Act 99-284. The new program called for utilizing the media, press releases, consumer brochures, forums, and professional focus groups.

An Ombudsman was appointed by the Governor and assumed his duties in August 2000. The Office of Managed Care Ombudsman (OMCO) officially opened in May 2001 with a press

conference that included news releases and television coverage informing the public of this new resource. OMCO services include offering information and help to consumers who use the external appeals process for managed health care issues. Informational brochures and pamphlets, contact cards, magnets and other handout materials have been distributed to both consumers and managed health care providers and include a toll-free number and OMCO's website address. The website references the external appeal process and lists the related eligibility requirements that must be satisfied. Posters that inform consumers of their managed health care rights, including appeals, have been distributed to both employers and health care providers throughout the State.

Several consumer focus groups have been conducted to assess the consumer's level of awareness of managed health care plan rights. These focus groups offered suggestions for community outreach events. In addition, there have been meetings with several of the State's larger managed care providers to discuss OMCO's relationship with current consumer issues. Additional outreach activities include interaction with health related associations, health care executives and administrators, community workshops, health fairs, and community-based organizations through the use of informational presentations. Consumers can obtain information and be referred to the OMCO when they call the State's Infoline with managed health care questions. Data sheets and surveys forms are being created to evaluate the effectiveness of the overall services offered by the OMCO. An Advisory Board has also been established and will evaluate the effectiveness of the managed health care services that are being provided. The first evaluation is scheduled to take place in January 2002.

Our review indicates that the Department has taken positive action and is continuing its efforts in developing an effective educational outreach program to fully comply with Section 38a-478n, subsection (e) of the General Statutes.

CONDITION OF RECORDS

Our review of the Insurance Department's records revealed the following areas requiring improvement:

Property Control:

Criteria: The State of Connecticut's Property Control Manual establishes criteria for maintaining an equipment inventory system and sets up reporting requirements. The criteria includes the need for the proper recording, accountability and safeguarding of equipment and supplies, and the filing of Annual Fixed Assets/Property Inventory Reports that contain complete and accurate information.

Condition: Our review noted that component upgrades or enhancements made to computer hardware were not always added to the cost of the capital equipment listed on the Department's permanent inventory control record. Changes in the physical location of personal computers and computer-related equipment were not always communicated to the Business Office so that adjustments could be made to the permanent record. The Computer Systems Support Unit maintains a storage area with computer and printer supplies. The average total value of the supplies is more than \$1,000. These supplies were not properly inventoried and the value was not included on the Annual Fixed Assets/Property Inventory Report as of June 30, 2001.

Effect: The lack of properly updated inventory and supply records could lead to losses going undetected and the value of inventories being understated for insurance and reporting purposes.

Cause: The causes were not determined.

Recommendation: Equipment and supply inventory procedures should be strengthened to provide accurate information and to comply with requirements established in the State of Connecticut's Property Control Manual. (See Recommendation 1.)

Agency Response: " The Data Processing Manager will be implementing proper controls and procedures to adequately report computer component upgrades or enhancements to existing equipment. The Computer Systems Support Unit will provide the Business Office an inventory of computer and printer supplies at least annually so that these supplies appear on the Annual Fixed Assets/Property Report as of a fiscal year-end. In addition, in order to improve communication between the Business Office and the Computer Systems Support Unit, the Fiscal Administrative Manager and the Data Processing Manager will meet quarterly to discuss computer related issues (new purchases, upgrades, supplies...) in order to ensure

proper recording accountability and safeguarding of the Department's equipment and supplies and to comply with requirements established in the State of Connecticut's Property Control Manual."

Year-end Closing (GAAP package):

- Criteria:* The State Comptroller's year-end closing forms (GAAP package) include instructions that define the type of information required and the format used for reporting purposes. The GAAP package instructions relating to receivables require that the form be completed if the total amount of reportable receivables is greater than or equal to \$100,000. The GAAP instructions for reporting compensated absences requires the calculation of an average hourly salary for all employees who earn vacation and sick leave hours.
- Condition:* The total amount stated on the Department's GAAP closing package receivables form for the fiscal years ended June 30, 2000 and 2001 did not include \$18,767 and \$18,344, respectively, for various General Fund receivables that should have been reported. The GAAP form for reporting compensated balances did not accurately state the employee average hourly salary in both fiscal years. Part-time salaries were not included in the calculation for the fiscal years ended June 30, 2000 and 2001. Also, the number of employees used in the June 30, 2001 calculation did not include part-time or durational employees who earned leave time.
- Effect:* Inaccurate reporting could lead to misstatements on the State of Connecticut's annual financial reports.
- Cause:* The Department misinterpreted the GAAP closing package instructions for receivables and only reported the individual accounts receivable category that totaled over \$100,000 and not all receivables. The other causes were not determined.
- Recommendation:* The Department should properly complete the State Comptroller's year-end closing forms. (See Recommendation 2.)
- Agency Response:* "The Department shall report all of its receivables if the total amount of reportable receivables is greater than or equal to \$100,000. The GAAP form for compensated balances will include part-time and durational employees who earned leave time in order to accurately report employee average hourly salaries for a given fiscal year. Implementation of these reporting issues will enable the Department to properly complete the State Comptroller's year-end closing forms.

RECOMMENDATIONS

Status of Prior Audit Recommendations:

- Software inventory records should be maintained in compliance with the State's Property Control Manual guidelines. The Department has taken the appropriate steps to comply with the software guidelines. This recommendation will not be repeated.
- The Department should retain sufficient documentation of expenditures from contracted vendors. Documentation retention has been improved and the Department has increased its use of the on-line purchasing system. This recommendation will not be repeated.

Current Audit Recommendations:

- 1. Equipment and supply inventory procedures should be strengthened to provide accurate information and to comply with requirements established in the State of Connecticut's Property Control Manual.**

Comment:

Our review noted that the cost of computer hardware enhancements and upgrades was not always added to the equipment's cost. Changes in equipment locations were not always communicated to ensure proper recording in the permanent records. Also, data processing supplies were not properly inventoried.

- 2. The Department should properly complete the State Comptroller's year-end closing forms.**

Comment:

Year-end closing forms did not include all reportable accounts receivables. Also, the calculation of the employee's average hourly salary was incorrect.

INDEPENDENT AUDITORS' CERTIFICATION

As required by Section 2-90 of the General Statutes we have audited the books and accounts of the Insurance Department for the fiscal years ended June 30, 2000 and 2001. This audit was primarily limited to performing tests of the Agency's compliance with certain provisions of laws, regulations and contracts, and to understanding and evaluating the effectiveness of the Agency's internal control policies and procedures for ensuring that (1) the provisions of certain laws, regulations and contracts applicable to the Agency are complied with, (2) the financial transactions of the Agency are properly recorded, processed, summarized and reported on consistent with management's authorization, and (3) the assets of the Agency are safeguarded against loss or unauthorized use. The financial statement audits of the Insurance Department for the fiscal years ended June 30, 2000 and 2001, are included as part of our Statewide Single Audits of the State of Connecticut for those fiscal years.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial-related audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the Insurance Department complied in all material or significant respects with the provisions of certain laws, regulations and contracts and to obtain a sufficient understanding of the internal control to plan the audit and determine the nature, timing and extent of tests to be performed during the conduct of the audit.

Compliance:

Compliance with the requirements of laws, regulations, and contracts applicable to the Insurance Department is the responsibility of the Insurance Department's management.

As part of obtaining reasonable assurance about whether the Agency complied with laws, regulations and contracts, noncompliance with which could result in significant unauthorized, illegal, irregular or unsafe transactions or could have a direct and material effect on the results of the Agency's financial operations for the fiscal years ended June 30, 2000 and 2001, we performed tests of its compliance with certain provisions of laws, regulations and contracts. However, providing an opinion on compliance with these provisions was not an objective of our audit, and accordingly, we do not express such an opinion.

The results of our test disclosed no instances of noncompliance that are required to be reported herein under auditing standards generally accepted in the United States of America.

We did, however, note certain immaterial or less than significant instances of noncompliance that we have disclosed in the "Condition of Records" and "Recommendations" sections of this report. Such instances are contained in our comments on property control and year-end reporting.

Internal Control over Financial Operations, Safeguarding of Assets and Compliance:

The management of the Insurance Department is responsible for establishing and maintaining effective internal control over its financial operations, safeguarding of assets, and compliance with the requirements of laws, regulations, and contracts applicable to the Agency. In planning and performing our audit, we considered the Agency's internal control over its financial operations, safeguarding of assets, and compliance with requirements that could have a material or significant effect on the Agency's financial operations in order to determine our auditing procedures for the purpose of evaluating the Insurance Department's financial operations, safeguarding of assets, and compliance with certain provisions of laws, regulations and contracts, and not to provide assurance on the internal control over those control objectives.

However, we noted certain matters involving the internal control over the Agency's financial operations, safeguarding of assets, and/or compliance that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of internal control over the Agency's financial operations, safeguarding of assets, and/or compliance that, in our judgment, could adversely affect the Agency's ability to properly record, process, summarize and report financial data consistent with management's authorization, safeguard assets, and/or comply with certain provisions of laws, regulations and contracts. We believe that the following finding represents a reportable condition:

- The deficiencies in equipment and supply inventory recording and reporting.

A material or significant weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that noncompliance with certain provisions of laws, regulations and contracts, or the requirements to safeguard assets that would be material in relation to the Agency's financial operations or noncompliance which could result in significant unauthorized, illegal, irregular or unsafe transactions to the Agency being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over the Agency's financial operations and over compliance would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material or significant weaknesses. However, we believe that the reportable condition described above is not a material or significant weakness.

We also noted other matters involving internal control over the Agency's financial operations, safeguarding of assets, and/or compliance, which are described in the accompanying "Condition of Records" and "Recommendations" sections of this report.

This report is intended for the information of the Governor, the State Comptroller, the Appropriations Committee of the General Assembly and the Legislative Committee on Program Review and Investigations. However, this report is a matter of public record and its distribution is not limited.

CONCLUSION

In conclusion, we wish to express our appreciation for the courtesies and cooperation shown to our representatives by the personnel of the Insurance Department during the course of our examination.

Virginia A. Spencer
Principal Auditor

Approved:

Kevin P. Johnston
Auditor of Public Accounts

Robert G. Jaekle
Auditor of Public Accounts

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