

STATE OF CONNECTICUT

**AUDITORS' REPORT
INSURANCE DEPARTMENT
AND
OFFICE OF MANAGED CARE OMBUDSMAN
FOR THE FISCAL YEARS ENDED JUNE 30, 2002 AND 2003**

**AUDITORS OF PUBLIC ACCOUNTS
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January 19, 2005

**AUDITORS' REPORT
INSURANCE DEPARTMENT
AND
OFFICE OF MANAGED CARE OMBUDSMAN
FOR THE FISCAL YEARS ENDED JUNE 30, 2002 AND 2003**

We have made an examination of the financial records of the Insurance Department and the Office of Managed Care Ombudsman for the fiscal years ended June 30, 2002 and 2003. This report on that examination consists of the Comments, Recommendations and Certification that follow.

Financial statement presentation and auditing of the books and accounts of the State are done on a Statewide Single Audit basis to include all State agencies including the Insurance Department and the Office of Managed Care Ombudsman. This audit examination has been limited to assessing compliance with certain provisions of financial related laws, regulations, contracts, and evaluating both Agencies' internal control policies and procedures established to ensure such compliance.

**INSURANCE 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 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 of the General Statutes, the Department, in certain instances, is also responsible, in conjunction with the Department of Banking, for the oversight 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 oversight responsibilities for Workers' Compensation under the following sections of the General Statutes:

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

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

Susan F. Cogswell served as the Insurance Department Commissioner during the audited period.

Significant New Legislation:

Public Act 01-09, Section 66 (June Special Session) – Effective July 1, 2001, reimbursement of operating costs of the Managed Care Ombudsman's Office is required to be included in payments made by domestic insurance companies and hospital and medical service corporations to the Insurance Fund as part of the reimbursement of Insurance Department operations.

Public Act 02-40 – Effective May 6, 2002, the Insurance Commissioner is authorized to adopt regulations establishing security and privacy standards for consumer information that are consistent with Federal and State laws.

RÉSUMÉ OF OPERATIONS – INSURANCE DEPARTMENT:

General Fund Revenues and Receipts:

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

	<u>2001-2002</u>	<u>2002-2003</u>
Taxes	\$ 6,121,224	\$ 9,874,107
Licenses	17,077,892	4,796,053
Fees	5,996,120	5,476,924
Fines and costs	1,322,129	1,204,695
All other receipts	<u>47,033</u>	<u>53,260</u>
Totals	<u>\$ 30,564,398</u>	<u>\$ 21,405,039</u>

General Fund revenues for the fiscal year ended June 30, 2001 totaled \$15,830,295, for comparative purposes. Revenues generated from licenses are dramatically higher in even years because both insurance agents' and producer licenses are on a biennial renewal basis. The sixty percent increase in tax collections in fiscal year 2002-2003 was due primarily to increases in insurance brokers' taxable premiums resulting from increased activity within the insurance business. Fee revenues increased in fiscal year 2001-2002 based on a large number of new applications due to an increase in interstate commerce. A slight decrease in fee revenues occurred in fiscal year 2002-2003 due to a change in assessing only one application fee for one insurance company and its operations under different names rather than additional fees for each different name. Fines and costs

revenues remained stable during the audited period in both the dollar value and the number of companies, which were assessed fines by the Market Conduct Division.

Insurance Fund:

Section 38a-52a of the General Statutes established the Insurance Fund for assessments made to insurance companies for the recovery of operating expenses of the Insurance Department, the Office of Managed Care Ombudsman, and for license and external appeal fees relating to health care utilization reviews. Insurance Fund revenues deposited for the fiscal years ended June 30, 2002 and 2003 were as follows:

	<u>2001-2002</u>	<u>2002-2003</u>
Expenses Recovered from Insurance Companies	\$19,562,072	\$23,008,599
Licenses/Fees - Utilization Review Firms	317,500	312,500
Interest Income Credited	125,460	88,216
Other Receipts/Revenue	<u>76,861</u>	<u>88,034</u>
Total Insurance Fund Receipts	<u>\$20,081,893</u>	<u>\$23,497,349</u>

A summary of Insurance Department expenditures from the Insurance Fund for the two audited fiscal years, were as follows:

	<u>2001-2002</u>	<u>2002-2003</u>
Personal Services	\$11,238,695	\$10,575,626
Contractual Services	3,174,789	2,769,905
Commodities	206,483	107,033
Revenue Refunds	239,937	65,471
Sundry Charges - Fringe Benefits	4,799,209	4,289,474
Sundry Charges - Other	508,318	607,231
Equipment	<u>175,060</u>	<u>55,804</u>
Total Expenditures	<u>\$20,342,491</u>	<u>\$18,470,544</u>

For comparative purposes, expenditures for the 2000-2001 fiscal year totaled \$19,352,064. Decreases in expenditures during the audited period were due primarily to personal services and fringe benefit costs, which decreased as a result of budgetary restraints consisting of a hiring freeze, layoffs, and an early retirement incentive for employees. Contractual services expenditures increased during the 2001-2002 fiscal year due to an increase in rents and storage for the Insurance Department's new location and decreased during the 2002-2003 fiscal year due to a decrease in outside consulting services.

Brokered Transactions Guaranty Fund:

The Brokered Transactions Guaranty Fund operates under Sections 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 are credited to the Fund as long as the Fund balance is below \$500,000. Any amounts in excess of this level are deposited to the General Fund. Receipts of \$40 were deposited and no disbursements were made from this Fund during the audited period. As of June 30, 2003, the Fund's cash balance was \$500,000.

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 deposits include:

1. Retaliatory deposits made under the provisions of Section 38a-83 of the General Statutes, which require companies, that are domiciled in States that require deposits of Connecticut companies, to make equivalent deposits in Connecticut.
2. Deposits made under Section 38a-371 of the General Statutes for companies desiring to be self-insured for their automobile coverage.
3. Other deposits required by the Commissioner determined to be necessary for the protection of Connecticut policyholders.

As of June 30, 2003, the par value of these deposits amounted to \$504,419,000.

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, 2003, the STIF account balances totaled \$45,250,642 and consisted of assets from seven insurance companies.

CONDITION OF RECORDS

Our review of the Insurance Department's records revealed the following area that requires improvement:

Property Control:

Criteria: The State of Connecticut's *Property Control Manual* establishes criteria for maintaining an equipment inventory system. The criteria include the need for the proper recording, accountability, and safeguarding of equipment.

Condition: Our review noted that 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 inventory control records.

Effect: The lack of properly updated inventory control records can lead to the increased risk of loss and inadequate accountability of assets.

Cause: A breakdown in communication contributed to this weakness.

Recommendation: Equipment inventory control 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 Business Office will be implementing new controls and procedures regarding the Department's permanent inventory control records. The new policy and procedure will ensure that any change in location is communicated from the Computer Systems Support Unit to the Business Office. 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 the movement and reallocation of computers and related equipment within the Insurance Department in order to ensure proper recording of the location of the Department's computers and related equipment to comply with requirements established in the State of Connecticut Property Control Manual."

**OFFICE OF MANAGED CARE OMBUDSMAN
COMMENTS**

FOREWORD:

The duties, powers and responsibilities of the Office of Managed Care Ombudsman are set forth primarily by Title 38a, Chapter 706b of the General Statutes and, pursuant to these provisions, is placed within the Insurance Department for administrative purposes only. The Office acts as an advocate to assist consumers with health care issues through the establishment of effective outreach programs and the development of communications related to consumer rights and responsibilities as members of managed care plans. An Agency assigned to a department for “administrative purposes only” exercises its statutory authority independent of such department and without approval or control of the department as set forth under Section 4-38f of the General Statutes.

The Office is under the direction of a Managed Care Ombudsman, who is appointed by the Governor with the approval of the General Assembly. Gerald E. Martens served as Managed Care Ombudsman until May 2, 2003, when he was put on administrative leave for disciplinary purposes and subsequently terminated on January 8, 2004. In his absence, Maureen Smith served as Acting Managed Care Ombudsman until December 10, 2004, when Kevin P. Lembo was appointed Managed Care Ombudsman.

RÉSUMÉ OF OPERATIONS – OFFICE OF MANAGED CARE OMBUDSMAN (OMCO):

A summary of Agency expenditures from the Insurance Fund for the audited period were as follows:

	<u>2001-2002</u>	<u>2002-2003</u>
Personal Services	\$ 264,638	\$ 188,281
Contractual Services	274,413	226,555
Commodities	10,808	6,502
Sundry Charges - Fringe Benefits	112,810	76,865
Sundry Charges - Other	<u>1,129</u>	<u>1,600</u>
Total Expenditures	<u>\$ 663,798</u>	<u>\$ 499,803</u>

For comparative purposes, expenditures during the 2000-2001 fiscal year totaled \$352,818. Total expenditures increased by \$310,980, and then decreased by \$163,995 during the fiscal years 2001-2002 and 2002-2003, respectively.

The large increases in expenditures during the audited period were due primarily to increases in personal services and fringe benefit costs. During the 2001-2002 fiscal year, the office was fully staffed with four employees, however, at the end of the 2002-2003 fiscal year, staff was reduced to two full-time employees due to the retirement of one employee and the resignation of another. Contractual services expenditures increased and then decreased during the respective audited years, primarily as a result of outside consulting services. Outside consulting services increased as a result of hiring a consulting firm during the 2001-2002 fiscal year for specialized outreach and promotional services related to the start up of the Office as a separate agency.

Program Evaluation:

Section 2-90 of the General Statutes authorizes the Auditors of Public Accounts to conduct program evaluations as part of our routine audits of public agencies. We selected to review whether the Office of Managed Care Ombudsman has complied with Section 38a-1050 of the General Statutes, which requires a submission of an annual report, on the activities of the Managed Care Ombudsman, to the Governor and other appropriate officials.

Section 38a-1050 of the General Statutes, states that “The Managed Care Ombudsman shall submit, not later than January first of each year, a report to the Governor and the joint standing committees of the General Assembly having cognizance of matters relating to public health and insurance concerning the activities of the ombudsman. The report shall include, but not be limited to, information regarding: (1) The subject matter, disposition and number of consumer complaints processed by the ombudsman; (2) common problems and concerns discerned by the ombudsman from the consumer complaints and other relevant sources; (3) the need, if any, for administrative, legislative or executive remedies to assist consumers; and (4) the fiscal accounts of the Office of Managed Care Ombudsman.”

Our review noted deficiencies such as statutory reporting requirements not being fully met and information disclosed in the 2003 annual report not being completely supported or readily available for review as noted in the recommendation below:

Deficiencies in Reporting:

Criteria: Section 38a-1050 of the General Statutes requires that the Managed Care Ombudsman submit a report on activity levels and other pertinent information to the Governor and the General Assembly by January 1st of each year.

Sound business practice dictates that information included in the annual report be supported and that documentation be readily available for review.

Condition: Our review noted that the 2002 report, due by January 1, 2003, was not prepared or submitted. The 2003 report, due by January 1, 2004, was submitted on March 26, 2004, a delay of almost three months.

Our review of activity levels and other information included in the 2003 report, such as the total number of complaints processed, cases resolved, cases for nonpayment of claims or refusal to extend coverage, and cases involving mental health issues, showed that supporting documentation was lacking for certain of this information.

Effect: The requirements of the General Statutes were not fully met and some amounts disclosed in the 2003 report could not be substantiated.

Cause: Inadequate staffing and changes in personnel contributed to the reporting weaknesses.

Recommendation: The Managed Care Ombudsman should submit its report by January 1st of each year, as required by Section 38a-1050 of the General Statutes, and maintain documentation to support information reported. (See Recommendation 2.)

Agency Response: “The Office of Managed Care Ombudsman acknowledges that the Annual Report for 2002 was not submitted. Additionally, the Annual Report for the 2003 was submitted late. Significant resource issues have been and continue to require a daily prioritization of tasks needing to be accomplished. While a report identifying the number of cases received was not initially available, this report was subsequently generated and presented during the audit examination.

The Office of Managed Care Ombudsman will generate detailed case reports quarterly moving forward. These reports will be filed and readily available in the future....”

RECOMMENDATIONS

Status of Prior Audit Recommendations:

The following recommendations were made for the Insurance Department.

- *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.* Improvements were noted with the cost of computer upgrades being added to the equipment's cost and for data processing supplies being inventoried; however, equipment items were still found in locations different from those reflected on agency inventory records. Therefore, this recommendation will be repeated in a modified form. (See Recommendation 1.)
- *The Department should properly complete the State Comptroller's year-end closing forms.* The Department has properly completed the year-end closing forms. As a result, this recommendation is not being repeated.

Current Audit Recommendations:

Insurance Department:

- 1. Equipment inventory control 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 changes in equipment locations were not always communicated to the Business Office to ensure proper recording in the permanent records.

Office of Managed Care Ombudsman:

- 2. The Managed Care Ombudsman should submit its report by January 1st of each year, as required by Section 38a-1050 of the General Statutes, and maintain documentation to support information reported.**

Comment:

The required annual report for 2002 was not prepared or submitted and the report for 2003 was not submitted within the statutory time permitted. Also, support for some reported information was lacking and not readily available for review.

INDEPENDENT AUDITORS' CERTIFICATION

As required by Section 2-90 of the General Statutes we have audited the books and accounts of the Insurance Department and the Office of Managed Care Ombudsman for the fiscal years ended June 30, 2002 and 2003. 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 each Agency are complied with, (2) the financial transactions of each Agency are properly recorded, processed, summarized and reported on consistent with management's authorization, and (3) the assets of each Agency are safeguarded against loss or unauthorized use. The financial statement audits of the Insurance Department and the Office of Managed Care Ombudsman for the fiscal years ended June 30, 2002 and 2003, 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 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 and the Office of Managed Care Ombudsman 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 and the Office of Managed Care Ombudsman is the responsibility of the Insurance Department's management and the Office of Managed Care Ombudsman's management.

As part of obtaining reasonable assurance about whether each 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 each Agency's financial operations for the fiscal years ended June 30, 2002 and 2003, we performed tests of their 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 tests disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*. However, we noted certain immaterial or less than significant instances of noncompliance, which are described in the accompanying "Condition of Records", "Program Evaluation", and "Recommendations" sections of this report.

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

The management of the Insurance Department and the Office of Managed Care Ombudsman 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 each of their Agencies. In planning and performing our audit, we considered each Agency's internal control over its financial operations, safeguarding of assets, and compliance with requirements that could have a material or significant effect on each Agency's financial operations in order to determine our auditing procedures for the purpose of evaluating the Insurance Department and the Office of Managed Care Ombudsman'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 Insurance Department'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 inventory record keeping.

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 each Agency's financial operations or noncompliance which could result in significant unauthorized, illegal, irregular or unsafe transactions to each 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 each 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 that are described in the accompanying "Program Evaluation" 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 and the Office of Managed Care Ombudsman during the course of our examination.

William T. Zinn
Associate Auditor

Approved:

Kevin P. Johnston
Auditor of Public Accounts

Robert G. Jaekle
Auditor of Public Accounts

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