

STATE OF CONNECTICUT



***AUDITORS' REPORT
INSURANCE DEPARTMENT
AND
OFFICE OF THE HEALTHCARE ADVOCATE
FOR THE FISCAL YEARS ENDED JUNE 30, 2006 AND 2007***

AUDITORS OF PUBLIC ACCOUNTS

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Table of Contents

INTRODUCTION	1
Insurance Department:	
COMMENTS	1
Foreword.....	1
Significant New Legislation	2
Résumé of Operations – Insurance Department	2
General Fund Revenues and Receipts	2
Insurance Fund.....	3
Special Revenue Fund – Federal and Other Restricted Accounts	4
Brokered Transactions Guaranty Fund	4
Trust Deposits and Escrow Accounts Held by the State Treasurer	4
CONDITION OF RECORDS (Insurance Department)	5
Loss Reporting	5
Purchase Orders	6
Office of the Healthcare Advocate:	
COMMENTS	7
Foreword.....	7
Résumé of Operations – Office of the Healthcare Advocate.....	7
CONDITION OF RECORDS (Office of the Healthcare Advocate)	8
RECOMMENDATIONS	9
CERTIFICATION	10
CONCLUSION	12

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**AUDITORS' REPORT
INSURANCE DEPARTMENT
AND
OFFICE OF THE HEALTHCARE ADVOCATE
FOR THE FISCAL YEARS ENDED JUNE 30, 2006 AND 2007**

We have made an examination of the financial records of the Insurance Department and the Office of the Healthcare Advocate for the fiscal years ended June 30, 2006 and 2007. 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 the Healthcare Advocate. 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.

Auditors of Public Accounts

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.

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 until April 21, 2007, when Thomas R. Sullivan was appointed as Commissioner and continues to serve in that capacity.

Significant New Legislation:

Public Act 05-266 – Effective October 1, 2005, insurance producer license renewals, which are processed every two years, were changed from February 1st in even numbered years to the licensee's birthday; and, effective January 1, 2006, license renewal fees increased from \$40 every two years (\$20 per year) to \$40 per year.

Public Act 06-113 – Effective July 1, 2006, concerning assessments for immunization, this Act removed the 25 percent cap on the amount each Connecticut insurance company and HMO (Health Maintenance Organization) pays for immunization services that the Department of Public Health provides. Under this Act, each company pays a proportionate share of the total due from all insurers and HMOs; and, the proportion is based on the company's share of total tax and charges the State imposes on all insurers and HMOs for business conducted in Connecticut during the previous calendar year.

RÉSUMÉ OF OPERATIONS – INSURANCE DEPARTMENT:

General Fund Revenues and Receipts:

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

	<u>2005-2006</u>	<u>2006-2007</u>
Taxes	\$ 13,183,996	\$ 13,202,676
Licenses	19,988,408	5,687,054
Fees - Assessments	7,100,000	9,000,000
Fees	3,819,389	4,764,086
Fines and costs	932,372	1,136,052
All other receipts	14,154	268,871
Totals	<u>\$ 45,038,319</u>	<u>\$ 34,058,739</u>

General Fund revenues for the fiscal year ended June 30, 2005, totaled \$32,331,455, for comparative purposes. Revenues generated from licenses are dramatically higher in even years because both insurance agents' and producer licenses are renewed on a biennial basis. Tax collections slightly increased during the audited period primarily due to increases in insurance brokers' taxable premiums resulting from increased activity within the insurance business. Fee revenues from assessments increased from \$7,100,000 to \$9,000,000 during the respective audited years due to increases in assessing the insurance Industry for the purchasing of vaccines to immunize children from low income families. Fee revenues increased due to increases in the producer license fee from \$20 to \$40 per year, effective January 1, 2006. These increases were partially offset by decreases for applications and filings for Agent appointments due to statutory changes requiring reciprocity with other States that do not charge a fee for Agent appointments. 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. This Fund is used to assess insurance companies for the recovery of operating expenses of the Insurance Department and the Office of the Healthcare Advocate.

Insurance Fund revenues for the fiscal years ended June 30, 2006 and 2007, were as follows:

	<u>2005-2006</u>	<u>2006-2007</u>
Expenses Recovered from Insurance Companies	\$21,280,449	\$20,865,539
Interest Income Credited	265,644	369,562
Other Receipts/Revenue	<u>218,193</u>	<u>0</u>
Total Insurance Fund Receipts	<u>\$21,764,286</u>	<u>\$21,235,101</u>

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

	<u>2005-2006</u>	<u>2006-2007</u>
Personal Services	\$ 11,052,430	\$11,592,319
Contractual Services	2,455,565	2,622,080
Commodities	75,347	90,514
Sundry Charges - Fringe Benefits	6,012,765	6,300,464
Sundry Charges - Other	356,705	203,121
Equipment	<u>92,452</u>	<u>135,398</u>
Total Expenditures	<u>\$20,045,264</u>	<u>\$20,943,896</u>

For comparative purposes, expenditures for the 2004-2005 fiscal year totaled \$18,381,663. Total expenditures increased 14 percent during the audited fiscal years. Increases in expenditures were primarily due to increases in personal services and fringe benefit costs attributable to the filling of full-time positions that became vacant after the 2003 fiscal year early retirement incentive program, as well as annual salary increases negotiated by collective bargaining. Contractual services expenditures slightly increased during the audited period due to increases in postage and office supply costs for processing and mailing renewals for producer's licenses. Increases in equipment

expenditures were due to increased purchases of desktop and laptop computers.

Special Revenue Fund – Federal and Other Restricted Accounts:

Federal and Other Restricted Accounts receipts totaled \$380,500 and \$357,500 for the fiscal years ended June 30, 2006 and 2007, respectively. These receipts consisted of Utilization Review Fees resulting from the collection of license and external appeal fees from insurance companies involved with health care utilization reviews.

Utilization review expenditures totaled \$272,469 and \$344,897 for the fiscal years ended June 30, 2006 and 2007, respectively. The majority of expenditures were for personal services and outside professional services for arbitration and mediation 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. There was no financial activity in this Fund during the audited period. As of June 30, 2007, 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, 2007, the par value of these deposits amounted to \$333,793,000.

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, 2007, the STIF account balances totaled \$8,876,108 and consisted of assets from two insurance companies.

CONDITION OF RECORDS

Our review of the Insurance Department's records revealed the following areas that require improvement.

Loss Reporting:

Criteria: Section 4-33a of the General Statutes requires all State agencies to promptly notify the Auditors of Public Accounts and the State Comptroller of any unauthorized, illegal, irregular, or unsafe handling of State funds or breakdowns in the safekeeping of other State resources.

Condition: During the course of our audit, we found that an employee had used a State computer for personal use. This unauthorized use of State resources was resolved, in part, by having the employee reprimanded and later terminated when the problem persisted. However, the Insurance Department did not promptly notify the Auditors of Public Accounts and State Comptroller of the unauthorized use of State resources.

Effect: The Insurance Department did not comply with Section 4-33a of the General Statutes.

Cause: Management initially discovered the misuse and resolved this matter internally including union representation for the employee, and due to oversight, failed to report this matter as required to appropriate officials.

Recommendation: The Insurance Department should comply with Section 4-33a of the General Statutes which requires prompt notification to the Auditors of Public Accounts and the State Comptroller when there is a breakdown in the safekeeping of State resources. (See Recommendation 1.)

Agency Response: "The CT Insurance Department was unaware that the condition noted above was reportable under Section 4-33a of the C.G.S. Once notified of this requirement, we promptly submitted the proper reports to the appropriate officials. The Department will ensure that any other incidents in the future resembling this personnel matter will be reported as required."

Purchase Orders:

Criteria: Section 4-98, subsection (a), of the General Statutes states that no budgeted agency may incur any obligation except by the issuance of a purchase order transmitted to the State Comptroller to commit the agency's appropriations to ensure that funds are available for the payment of such obligations.

The State Accounting Manual requires that, "... commitments be submitted *at least five working days prior* to the submission of invoices to ensure commitments are posted to the system prior to payment. Payments will not be processed when a commitment is required but has not been submitted."

Condition: In our review of 13 purchase orders for committing funds for payments of goods and services, we noted that seven purchase orders (54 percent) were issued after the vendor invoices were received by the business office.

Effect: Expenditures were incurred for goods and services prior to funds being committed in violation of Section 4-98 of the General Statutes.

Cause: It appears that inadequate communications between the business office and other agency staff for the purchasing of goods and services contributed to the deficiency. Frequently, the business office was not informed of the purchases of goods received or services rendered until after the vendor invoice was received from agency staff.

Recommendation: The Insurance Department should improve purchasing procedures to ensure compliance with Section 4-98 of the General Statutes. (See Recommendation 2.)

Agency Response: "The CT Insurance Department will generate purchase orders in a manner that satisfies the requirements of Section 4-98 of the Connecticut General Statutes. The business office will communicate to the applicable departments the necessity of notifying the business office prior to incurring any obligation."

**OFFICE OF THE HEALTHCARE ADVOCATE
COMMENTS**

FOREWORD:

The duties, powers and responsibilities of the Office of the Healthcare Advocate 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 Healthcare Advocate, who is appointed by the Governor with the approval of the General Assembly. Kevin P. Lembo served as the Healthcare Advocate during the audited period.

RÉSUMÉ OF OPERATIONS – OFFICE OF THE HEALTHCARE ADVOCATE:

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

	<u>2005-2006</u>	<u>2006-2007</u>
Personal Services	\$ 246,289	\$ 336,073
Contractual Services	146,799	130,738
Commodities	1,570	4,578
Sundry Charges - Fringe Benefits	129,900	174,354
Sundry Charges - Other	<u>19,727</u>	<u>4,546</u>
Total Expenditures	<u>\$ 544,285</u>	<u>\$ 650,289</u>

For comparative purposes, expenditures during the 2004-2005 fiscal year totaled \$497,651. Total expenditures increased \$46,634 and \$106,004 during the 2005-2006 and 2006-2007 fiscal years, respectively.

A major factor for the increases in expenditure levels during the audited period was due to personal services and fringe benefit costs. During the 2004-2005 fiscal year, the Office was staffed with three full-time employees including the Healthcare Advocate. During the 2005-2006 fiscal year, staff levels increased to four full-time employees and during the 2006-2007 fiscal year, staff levels further increased to seven full-time employees. Decreases in contractual services expenditures during the audited period were due to decreases in advertising which was offset by increases in outside consulting services for public and promotional outreach programs.

CONDITION OF RECORDS

Our review of the Office of the Healthcare Advocate's records did not disclose any deficiencies.

RECOMMENDATIONS

Status of Prior Audit Recommendations:

No recommendations were made in the prior report for the Insurance Department.

The following recommendation was made for the Office of the Healthcare Advocate.

- *The Healthcare Advocate should comply with the reporting deadlines established by the Statutes for submitting its annual report.* Even though the 2006 annual report was filed over two months late, improvements were noted with the 2007 annual report being filed in a timely manner. As a result, this recommendation is not being repeated.

Current Audit Recommendations:

Insurance Department:

1. **The Insurance Department should comply with Section 4-33a of the General Statutes which requires prompt notification to the Auditors of Public Accounts and the State Comptroller when there is a breakdown in the safekeeping of State resources.**

Comment:

The Insurance Department did not report the unauthorized use of State equipment to the appropriate officials in a prompt manner.

2. **The Insurance Department should improve purchasing procedures to ensure compliance with Section 4-98 of the General Statutes.**

Comment:

Purchase orders for goods and services were not always prepared in a timely manner to properly commit funds prior to goods being received or services being rendered.

Office of the Healthcare Advocate:

No recommendations resulted from the current 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 the Healthcare Advocate for the fiscal years ended June 30, 2006 and 2007. 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 initiated, authorized, recorded, processed, and reported on consistent with management's direction, 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 the Healthcare Advocate for the fiscal years ended June 30, 2006 and 2007, 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 the Healthcare Advocate 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 controls to plan the audit and determine the nature, timing and extent of tests to be performed during the conduct of the audit.

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

In planning and performing our audit, we considered the Insurance Department and the Office of the Healthcare Advocate's internal control over its financial operations, safeguarding of assets, and compliance with requirements as a basis for designing our auditing procedures for the purpose of evaluating each Agency's financial operations, safeguarding of assets, and compliance with certain provisions of laws, regulations, and contracts, but not for the purpose of providing assurance on the effectiveness of each Agency's internal control over those control objectives.

Our consideration of internal control over financial operations, safeguarding of assets, and compliance requirements was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in internal control over financial operations, safeguarding of assets and compliance with requirements that might be significant deficiencies or material weaknesses. However as discussed below, we identified certain deficiencies in internal control over financial operations, safeguarding of assets, and compliance with requirements that we consider to be a significant deficiency.

A *control deficiency* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect on a timely basis unauthorized, illegal, or irregular transactions or the breakdown in the safekeeping of any asset or resource. A *significant deficiency* is a control deficiency, or combination of control deficiencies, that adversely affects each Agency's ability to properly initiate, authorize, record,

process, or report financial data reliably, consistent with management's direction, safeguard assets, and/or comply with certain provisions of laws, regulations and contracts such that there is more than a remote likelihood that a financial misstatement, unsafe treatment of assets, or noncompliance with laws, regulations and contracts that is more than inconsequential will not be prevented or detected by the each Agency's internal control. We consider the following deficiency, described in detail in the accompanying "Condition of Records" and "Recommendations" sections of this report for the Insurance Department, to be a significant deficiency in internal control over financial operations, safeguarding of assets and compliance with requirements: Recommendation 2 – the untimely preparation of purchase orders.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood 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, noncompliance which could result in significant unauthorized, illegal, irregular or unsafe transactions, and/or material financial misstatements by each Agency being audited will not be prevented or detected by each Agency's internal control.

Our consideration of the internal control over each Agency's financial operations, safeguarding of assets, and compliance with requirements, was for the limited purpose described in the first paragraph of this section and would not necessarily disclose all deficiencies in the internal control that might be significant deficiencies and, accordingly, would not necessarily disclose all significant deficiencies that are also considered to be material weaknesses. However, we believe that the significant deficiency described above is not a material weakness.

Compliance and Other Matters:

As part of obtaining reasonable assurance about whether the Insurance Department and the Office of the Healthcare Advocate 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, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion.

However, we noted certain matters which we reported to the Insurance Department's Management in the accompanying "Condition of Records" and "Recommendations" sections of this report.

The Insurance Department's response to the findings identified in our audit are described in the accompanying "Condition of Records" section of this report. We did not audit the Insurance Department's response and, accordingly, we express no opinion on it.

This report is intended for the information and use of each Agency's management, 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 the Healthcare Advocate 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