

STATE BOARD OF ACCOUNTS
302 West Washington Street
Room E418
INDIANAPOLIS, INDIANA 46204-2769

REVIEW REPORT
OF
INDIANA DEPARTMENT OF INSURANCE
STATE OF INDIANA
August 1, 2006 to May 31, 2008



FILED
12/30/2008

TABLE OF CONTENTS

<u>Description</u>	<u>Page</u>
Agency Officials	2
Independent Accountant's Report.....	3
Review Comments:	
Attendance Reports	4
Daily Deposits.....	4
Contract Form and Approval	4-5
Collection of Examination Fees	5
Reimbursement of Examiner Travel Expenses - State Employees	6
Lack of Subsidiary Ledgers	6
Duplicate Payments of Professional Services.....	7
Exit Conference.....	8
Official Response	9-14

AGENCY OFFICIALS

Office

Official

Term

Commissioner

Jim Atterholt

01-10-05 to 01-11-09



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INDEPENDENT ACCOUNTANT'S REPORT

TO: THE OFFICIALS OF INDIANA DEPARTMENT OF INSURANCE

We have reviewed the receipts, disbursements, and assets of the Indiana Department of Insurance for the period of August 1, 2006 to May 31, 2008. The Indiana Department of Insurance management is responsible for the receipts, disbursements, and assets.

Our review was conducted in accordance with attestation standards established by the American Institute of Certified Public Accountants. A review is substantially less in scope than an examination, the objective of which is the expression of an opinion on the receipts, disbursements, and assets. Accordingly, we do not express such an opinion.

Financial transactions of this office are included in the scope of our audits of the State of Indiana as reflected in the Indiana Comprehensive Annual Financial Reports.

Based on our review, nothing came to our attention that caused us to believe that the receipts, disbursements, and assets of the Indiana Department of Insurance are not in all material respects in conformity with the criteria set forth in the Accounting and Uniform Compliance Guidelines Manual for State Agencies and applicable laws and regulations, except as stated in the review comments.

STATE BOARD OF ACCOUNTS

August 21, 2008

INDIANA DEPARTMENT OF INSURANCE
REVIEW COMMENTS
May 31, 2008

ATTENDANCE REPORTS

We observed that the Indiana Department of Insurance (IDOI) employee attendance reports were frequently signed and/or dated prior to the last day worked by the employee and/or the supervisor.

Employee attendance reports should not be signed, dated or approved prior to the last day worked in a pay period. (Accounting and Uniform Compliance Guidelines Manual for State and Quasi Agencies, Chapter 9.)

DAILY DEPOSITS

The IDOI did not consistently deposit Patient's Compensation Fund revenue within the following business day. Twenty-eight of thirty items tested (93%) which included \$119,198,633.56 in receipts were not deposited timely.

Indiana Code 5-13-6-1(b) states in part: ". . . all public funds . . . shall be deposited with the treasurer of state, or approved depository selected by the treasurer of state not later than the business day following the receipt of the funds."

CONTRACT FORM AND APPROVAL

As stated in our prior Reports B29585 and B24471, the IDOI procured contractual services without obtaining the proper statutory signatory authorizations. Contractual services without properly executed contracts approved by the Department of Administration, State Budget Agency, and the Attorney General included:

1. Appointment agreements to designate the special deputy liquidator for insolvency estates.
2. Reinsurance agreements for insurance companies participating in the Mine Subsidence Fund.
3. Joint custodial agreements for custodial deposits maintained at banks by insurance companies on behalf of policy holders.
4. Attorneys' contract for the Patient's Compensation Fund.
5. Consultant contracts for examinations of insurers.

IDOI should consider requesting contract form approvals from the Office of the Attorney General. Such approvals are available to agencies with a considerable number of contracts for the same types of services and can speed up the contract approval process.

Indiana Code 4-13-2-14.1 and 14.2 require that a contract to which a state agency is a party must be properly approved by the Department of Administration, the Budget Agency, and the Attorney General's office.

INDIANA DEPARTMENT OF INSURANCE
REVIEW COMMENTS
May 31, 2008
(Continued)

Indiana Code 4-13-2-14.3 states that: ". . . the attorney general must review for form and legality contracts to which a state agency is a party."

The 2008 Professional Services Contract Manual issued by the Office of the Attorney General and Department of Administration states, in part, that "Once form approval is obtained, the individual contracts using the approved form do not have to be reviewed and signed by the Office of Attorney General . . . and can potentially save up to 45 days in the approval process."

COLLECTION OF EXAMINATION FEES

As stated in our prior reports (most recently B29585 and B24471), every insurance company that conducts business within the State of Indiana is subject to an examination at least once every three to five years. IDOI uses independent CPAs, other professionals, or agency staff to conduct examinations of insurance companies. For audit services performed by independent CPAs or other professionals, these firms invoice IDOI for all audit costs, invoices are "approved" by IDOI, and invoices are forwarded to the examined insurance company who makes payment directly to the retained firm. For audit services conducted by agency staff, IDOI will bill the insurance company for all audit costs other than the travel costs of the state employees. State employees issue travel expense invoices directly to, and receive payments from, the examined insurance companies.

To ensure proper internal controls and accountability over public funds, procedures would dictate that all payments for audit costs from the examined companies would be sent to the IDOI, deposited into state accounts, and then IDOI would pay employees, retained CPAs, or professionals.

According to Indiana Code 27-1-3.1-9(d), the Commissioner of the Indiana Department of Insurance (IDOI) is empowered to retain Independent CPAs, other professionals and specialists as examiners. The cost of retaining these examiners shall be borne by the company that is the subject of the examination.

In an Attorney General opinion issued to the State Board of Account's State Examiner on January 16, 2002, and subsequently forwarded to the Commissioner of the Department of Insurance, the Office of the Attorney General stated: "Although it may be expedient to have the company pay individuals directly, the statute does not contemplate such a process." The Attorney General also indicated that, because outside consultants function as agents of the IDOI, "consultants retained by the department should be compensated by the department even though it is the ultimate responsibility of the companies that are being examined to reimburse the department for those costs."

Each agency is responsible for compliance with applicable statutes, regulations, contract provisions, and state policies. Compliance is required, as applicable, with generally accepted accounting principles, and standards issued by the Governing Accounting Standards Board, Financial Accounting Standards Board, and other standard setting bodies and also with various accounting guides, manuals, and other publications. (Accounting and Uniform Compliance Guidelines Manual for State and Quasi Agencies, Chapter 1)

INDIANA DEPARTMENT OF INSURANCE
REVIEW COMMENTS
May 31, 2008
(Continued)

REIMBURSEMENT OF EXAMINER TRAVEL EXPENSES - STATE EMPLOYEES

As stated in our prior Reports B29585 and B24471, as noted in our finding entitled "Collection of Examination Fees," the IDOI allowed examiners that are state employees to directly bill insurance companies for reimbursement of their travel costs rather than IDOI reimburse the state employees for travel expenses and include those costs in the bill to the insurance companies.

In addition, we learned that state employees bill the insurance companies for travel costs based on the federal mileage rate. The federal mileage rate is higher than the state mileage rate established by State Budget Agency.

Insurance industry practices utilized by the IDOI must not conflict with state statute, policies or procedures.

In an Attorney General opinion issued to the Indiana State Board of Account's State Examiner on January 16, 2002, and subsequently forwarded to the Commissioner of the Department of Insurance, the Office of the Attorney General stated: "although it may be expedient to have the company pay individuals directly, the statute [IC 27-1-3.1-9(d)] does not contemplate such a process."

Financial Management Circular 2003-1, states in:

Section 2-6, "An Agency may develop internal policies and procedures relating to State Travel by State Travelers. Such policies and procedures may not be inconsistent with this Circular and must be approved by both the State Budget Director and the Commissioner [of the Indiana Department of Administration], or their respective designees."

Section 3-2, "Out-of-State Travel must be approved in advance in writing by the Commissioner, and the Agency Head, or their designees In-State Travel must be approved in advance by the Agency."

Section 4-7, "The rates of reimbursement for Travel Allowances shall be those established, in accordance with law, by the State Budget Director and adopted by the Commissioner."

40 IAC 2-1-9(3)(b) states: "A state officer or employee shall not solicit or accept compensation other than that provided for by law for such state officer or employee for the performance of official duties."

LACK OF SUBSIDIARY LEDGERS

As stated in our prior Reports B29585 and B24471, we observed that the IDOI did not have effective subsidiary ledgers for the Mine Subsidence Fund. IDOI still does not collect any detailed information from insurers regarding policies issued and effective dates that would allow it to maintain a subsidiary ledger to verify individual claims against prior premium payments.

Each agency has the following accounting responsibilities . . . [to] maintain an effective and accurate system for subsidiary and supplementary records. At all times, the agency's manual and computerized records, subsidiary ledgers, control ledger and reconciled bank or Auditor's balance should agree. (Accounting and Uniform Compliance Guidelines Manual for State and Quasi Agencies, Chapter 1)

INDIANA DEPARTMENT OF INSURANCE
REVIEW COMMENTS
May 31, 2008
(Continued)

DUPLICATE PAYMENTS OF PROFESSIONAL SERVICES

We found that the IDOI legal staff did not track payments of legal services for the Patient's Compensation Fund. We noted several instances where IDOI paid vendors twice for the same invoice. These vendors found the duplication and refunded IDOI \$132,681.44.

IDOI should adopt adequate monitoring procedures to ensure that Patient's Compensation Fund disbursements are properly paid.

Each agency, department, quasi, institution or office should have internal controls in effect which provide reasonable assurance regarding the reliability of financial information and records, effectiveness and efficiency of operations, proper execution of managements' objectives, and compliance with laws and regulations. Controls over the receipting, disbursing, recording, and accounting for the financial activities are necessary to avoid substantial risk of invalid transactions, inaccurate records and financial statements, and incorrect decision making. (Accounting and Uniform Compliance Guidelines Manual for State and Quasi Agencies, Chapter 1)

INDIANA DEPARTMENT OF INSURANCE
EXIT CONFERENCE

The contents of this report were discussed on October 23, 2008, with Jim Atterholt, Commissioner; and Barb Lohman, IDOI Controller. The official response has been made a part of this report and may be found on pages 9 through 14.



STATE OF INDIANA

MITCHELL E. DANIELS, JR., Governor

IDOI

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JAMES ATTERHOLT, Commissioner

November 7, 2008

Bruce Hartman, State Examiner
Indiana State Board of Accounts
302 West Washington Street, Room E418
Indianapolis, Indiana 46204-2738

Re: Indiana Department of Insurance ("IDOI") Official Response to SBA Review
Report for the Period August 1, 2006, to May 31, 2008

Dear Mr. Hartman:

This letter contains the Indiana Department of Insurance's Official Response to the State Board of Accounts Audit Results and Comments as presented to the Indiana Department of Insurance on October 23, 2008.

ATTENDANCE REPORTS

IDOI employee attendance reports were frequently signed and/or dated prior to the last day worked by the employee and/or the supervisor.

The PeopleSoft HR system implemented in July 2008 will dramatically reduce the time needed for processing payroll so that artificial deadlines set prior to the end of the pay period will no longer be utilized. In addition, the adoption of this program has allowed for the retraining of employees and supervisors on the submission of electronic payroll information on the last day worked in a pay period.

DAILY DEPOSITS

IDOI did not consistently deposit Patient's Compensation Fund revenue within the following business day.

An electronic filing system was implemented in January 2008 to specifically address this problem. IDOI personnel now can electronically deposit checks in an "approved depository selected by the treasurer of the state not later than the business day following the receipt of funds" per the directive of Ind. Code § 5-13-6-1(b).

ACCREDITED BY THE
NATIONAL ASSOCIATION OF INSURANCE COMMISSIONERS

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CONTRACT FORM AND APPROVAL

The IDOI contracted services without properly executed contracts approved by the Department of Administration, State Budget Agency, and the Attorney General. These contracts included:

1. Appointment agreements to designate the special deputy liquidator for insolvency estates

At the time of the last SBA audit, IDOI exclusively used Indiana Insolvency, Inc., to serve as special deputy liquidator for insolvencies. Since then, IDOI has engaged a new special deputy liquidator, which delayed the implementation of the previous plan to enter into a contract. IDOI will seek approval from the Attorney General's office and enter into contracts with liquidators.

2. Reinsurance agreements for insurance companies participating in the Mine Subsidence Fund

IDOI uses a common reinsurance contract, i.e., the "Indiana Mine Subsidence Reinsurance Agreement" between the Indiana Mine Subsidence Insurance Fund and each specific insurance company participating in the program. IDOI maintains copies of the contracts in file for all contracted insurance carriers. IDOI will resubmit the form contract for updated approval by the appropriate state agencies.

3. Joint custodial agreements for custodial deposits maintained at banks by insurance companies on behalf of policyholders

The joint custodial agreement form used by IDOI was previously approved by the Attorney General's office, but that approval has expired. IDOI will renew approval of the form.

4. Attorney contracts for the Patient's Compensation Fund

The Commissioner of IDOI is directed by Ind. Code § 34-18-6-2 to retain competent and experienced legal counsel to assist in litigation involving the Patient's Compensation Fund. Furthermore, Ind. Code § 34-18-6-7 exempts the Commissioner from Ind. Code 5-22 when retaining contractual personnel and services. Nevertheless, IDOI will work with the Attorney General's office to determine the feasibility of a form contract.

5. Consultant contracts for examinations of insurers

Currently, in both financial exams and market conduct exams the Insurance Commissioner *appoints* the examiners who sign engagement letters that outline the scope of the examination, the rate of pay, and agreement to payment by the subject being examined. Ind. Code § 27-1-3.1-9(a). The nature of an appointment is such that the appointee serves at the pleasure of the Commissioner. The appointment then is terminable by the Commissioner at will. If this relationship is memorialized by a written contract per the recommendation of the State Board of Accounts the legal status of the examiners is changed significantly.

The current system was developed to comply with the mandate of Ind. Code § 27-1-3.1-9(d) that *“the cost of retaining these examiners shall be borne by the company that is the subject of the examination.”* The suggested contracts could jeopardize IDOI’s compliance with this statutory directive. Recognizing however that the proposed form contracts do contain several sections designed to provide protection for the agency, IDOI proposes to work with the Attorney General’s office to determine the feasibility of a uniform engagement letter that will incorporate these provisions.

COLLECTION OF EXAMINATION FEES

For audit and examination services conducted by both state employees and contracted personnel, IDOI should make direct payments and seek reimbursement from the subject of the examination.

Domestic insurance companies are subject to a financial examination on a regular or emergency basis every three to five years. market conduct examinations are on an as needed basis to verify the behavior of the company in the marketplace as to unfair claims and unfair trade practices, and include domestic, foreign, and alien insurers doing business in the state. Both exams are accomplished pursuant to Ind. Code § 27-1-3.1 *et. seq.* and conducted in accordance with National Association of Insurance Commissioners (NAIC) Handbooks.

The examinations statute was developed via IDOI’s participation with the NAIC (*see* Ind. Code § 27-1-1-2) as a model law similarly adopted by the legislators of many states. The development of this model and its eventual adoption reflects the unique role of IDOI as a member of the NAIC and the public policy associated with the unfettered gathering of information via the use of an executed examination warrant. Insurance is a significant thread in the fabric of our economy and must be able to provide the protection contracted for when a peril arises. So, the Commissioner’s authority to **appoint** examiners must be preserved to facilitate the protection of Indiana citizens, even at times when internal budget restrictions may otherwise inhibit IDOI’s ability to confirm the solvency of an insurer or verify compliance with statutes designed to protect the industry and insuring public from harm. Those who designed the model and wisely adopted the model recognized three things when they crafted the following language:

“The cost of retaining these examiners shall be borne by the company that is the subject of the examination” Ind. Code § 27-1-3.1-9(d).

1) The appointment of examiners and others pursuant to an exam must be distinct from the other budgetary operations of IDOI so as not to adversely impact IDOI's operations. A 'subject' company's inability or chosen reluctance to pay an examination related bill would put a financial burden on IDOI and have an impact never anticipated by the legislature in its adoption of this model law.

2) The 'subject' company must not be able to impair IDOI's review or scrutiny, by delaying or withholding payment to examiners and adversely impacting IDOI's investigative authority or decision making. The use of the word '*shall*' by the legislature left no room for variation on the issue of costs.

3) The Commissioner must have the flexibility to act in an expedient manner.

The use of the appointment mechanism was purposeful and allows for an extension of the Commissioner's authority and flexibility of assignment of an examiner relative to a unique specialty or purpose.

Therefore, should IDOI, at any time pay an examiner directly, even anticipating next day reimbursement from the subject company IDOI has "borne the cost of the exam" and **done so in contravention of the statute.**

Implementing SBA's suggested interpretation of Ind. Code § 27-1-3.1 would put IDOI in violation of Indiana law and would make IDOI responsible for payment of the examiners' expenses. In the event of a slow payment or default on payment by the insurer, the suggested interpretation would result in IDOI being financially liable for payment, and then IDOI would need to seek repayment by the examined entity. Slow or no reimbursement would significantly inhibit IDOI's ability to perform its statutory audit and examination functions. A circumstance of slow payment is not unusual, especially with financially troubled companies. Under our current budget IDOI is unable to make payments to the examiner until receiving payment from the company. Our budget would need to be increased to allow for the possibility of default or delays. Under the current system, IDOI does not believe that it is responsible to the examiner if the insurer fails to pay. The examiner's remedy is with the company rather than IDOI. IDOI takes steps to ensure the examiner is aware of this fact and the examiner, in the engagement letter, acknowledges that IDOI is not responsible for payment of the expenses. All examination expenses are reviewed by IDOI and approved before being sent to the company for payment.

Outside examiners conduct 95% of IDOI's financial and market conduct examinations. IDOI's ability to perform examinations would be severely undercut by the recommended change. The potential consequences are significant, including but not limited to the loss of accreditation with the NAIC. Loss of accreditation results in our inability to fulfill our statutory obligations.

REIMBURSEMENT OF EXAMINER TRAVEL EXPENSES – STATE EMPLOYEES

IDOI should not allow examiners who are state employees to directly bill insurance companies for reimbursement of their travel cost. Rather, IDOI should reimburse the state employees for travel expenses and include those costs in the bill to the insurance companies.

State employees should not bill insurance companies for travel costs based on the federal mileage rate.

IDOI will bill the subject of the examination at state per diems, hotel costs, and mileage in a manner consistent with state guidelines going forward.

State employees, however, conducting or participating in an exam are appointed in the same manner as a non-state employee. The same issues discussed in the collection of examination fees section would apply here as well. If IDOI were to reimburse any of these expenses directly it would have 'borne the cost' in violation of Ind. Code § 27-1-3.1-9(d). Likewise, exams conducted by state employees are conducted in accordance with the NAIC examiners handbook, which includes provisions on travel expenses. It is fundamental that IDOI cannot adopt an expense reimbursement policy that threatens its NAIC accreditation.

LACK OF SUBSIDIARY LEDGERS

IDOI still does not collect any detailed information from insurers regarding policies issued and effective dates.

IDOI has contracted with Pinnacle Actuarial Resources, Inc., to provide an actuarial evaluation of the Mine Subsidence Insurance Fund. As a part of this report Pinnacle provided dwelling and non-dwelling mine subsidence policy counts, total property policy counts, market penetration, coverage in force, and gross written premiums primarily for the purpose of determining rate adequacy.

During the delivery of this report on August 12, 2008, Pinnacle was asked to search for a software system that would allow insurance companies to input key information including individual policy information, premiums generated, claims paid etc. and to streamline the input process to avoid IDOI from having to enter in the IDOI computer the same information that the submitting insurance companies had already put in electronic form. The goal is to download into the IDOI computer each insurance company's electronic submission directly without IDOI duplicating the company's key strokes. The information transmitted is to be the traditional information requested by the SBA Review.

DUPLICATE PAYMENTS OF PROFESSIONAL SERVICES

IDOI did not track payments of legal service for the Patient's Compensation Fund.

IDOI's controller has now implemented an invoice tracking system for the current fiscal year (beginning July 2008) in Excel to prevent duplicate payments of professional services. This system mandates a balance due review before an invoice is forwarded for final payment through PeopleSoft Accounts Payable.


James Atterholt, Commissioner
Indiana Department of Insurance