STATE OF CONNECTICUT

AUDITORS' REPORT
INSURANCE DEPARTMENT
AND
OFFICE OF MANAGED CARE OMBUDSMAN
FOR THE FISCAL YEARS ENDED JUNE 30, 2004 AND 2005

AUDITORS OF PUBLIC ACCOUNTS
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October 25, 2006

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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, 2004 and 2005. 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.

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 03-169 – Effective October 1, 2003, the Insurance Commissioner is authorized to adopt regulations for preferred provider networks concerning establishing formal licensing procedures, enforcing its authority to investigate complaints, and broadening reporting responsibilities to the Governor and General Assembly committees.

Public Act 04-17 – Effective October 1, 2004, the Connecticut Life and Health Insurance Guaranty Association, which protects policyholders when an insurance company becomes insolvent, increased its maximum claim coverage for life insurance death benefits from $300,000 to $500,0000 and net cash surrender and withdrawal values from life insurance and annuities from $100,000 to $500,000.

RÉSUMÉ OF OPERATIONS – INSURANCE DEPARTMENT:

General Fund Revenues and Receipts:

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

	2003-2004	2004-2005
Taxes	$ 10,992,727	$ 13,040,907
Licenses	19,210,192	5,454,118
Fees	12,778,099	12,241,337
Fines and costs	1,292,690	1,578,688
All other receipts	23,422	16,405
Totals	**$ 44,297,130**	**$ 32,331,455**

General Fund revenues for the fiscal year ended June 30, 2003 totaled $21,405,039, 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. The 18 percent increase in tax collections in the 2004-2005 fiscal year was primarily due to increases in insurance brokers' taxable premiums resulting from increased activity within the insurance business. Beginning in the 2003-2004 fiscal year, fee revenues included a new assessment of $7,100,000 to the insurance industry for purchasing vaccines to immunize children. Otherwise, fee revenues for applications and filings remained stable during the audited period. Even though the number of companies that were assessed fines decreased from 91 to 70 during the audited period, the increase

in fines and costs revenues, which exceeded 22 percent, was due to larger fine amounts being assessed 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, the Office of Managed Care Ombudsman, and also for the collection of license and external appeal fees for health care utilization reviews. Effective July 1, 2004, changes in the new Core-CT State accounting system transferred accounting for Utilization Review Fees restricted account activity from the Insurance Fund to a special revenue fund entitled "Grants and Restricted Accounts Fund." Further comments on this Fund are presented after the following section on Insurance Fund activities.

Insurance Fund revenues for the fiscal years ended June 30, 2004 and 2005 were as follows:

	2003-2004	2004-2005
Expenses Recovered from Insurance Companies	$15,984,413	$15,718,106
Licenses/Fees - Utilization Review Firms	317,500	0
Interest Income Credited	137,035	179,962
Other Receipts/Revenue	3,879	12,186
Total Insurance Fund Receipts	**$16,442,827**	**$15,910,254**

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

	2003-2004	2004-2005
Personal Services	$ 9,480,344	$10,144,060
Contractual Services	2,650,861	2,400,256
Commodities	69,113	61,269
Sundry Charges - Fringe Benefits	4,214,662	5,104,227
Sundry Charges - Other	448,493	578,603
Equipment	128,659	93,248
Total Expenditures	**$16,992,132**	**$18,381,663**

For comparative purposes, expenditures for the 2002-2003 fiscal year totaled $18,470,544. Decreases in expenditures during the 2003-2004 fiscal year were primarily due to personal services and fringe benefit costs from the implementation of budgetary constraints and measures that included a hiring freeze, layoffs, and a 2002-2003 fiscal year early retirement incentive. Increases in expenditures during the 2004-2005 fiscal year were primarily attributable to full-time positions eventually being filled replacing some of those who took early retirement and annual salary increases. Contractual services expenditures slightly decreased during the 2003-2004 fiscal year due to management consultant services for computer maintenance and support; and, further decreased during the 2004-2005 fiscal year due to the accounting for outside professional services for utilization reviews being transferred to a special revenue fund for restricted account activities as explained above.

Special Revenue Fund – Federal and Other Restricted Accounts:

As previously explained, effective July 1, 2004, Utilization Review Fees activity, previously recorded in the Insurance Fund, are accounted for in a special revenue fund entitled "Grants and Restricted Accounts Fund." Utilization Review Fees revenues and expenditures, for the 2004-2005 fiscal year totaled $377,500 and $289,468, 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, 2005, 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, 2005, the par value of these deposits amounted to $508,527,300.

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, 2005, the STIF account balances totaled $34,234,990 and consisted of assets from six insurance companies.

CONDITION OF RECORDS

Our review of the Insurance Department's records did not disclose any reportable conditions.

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. Maureen Smith served as Acting Managed Care Ombudsman until December 10, 2004, when Kevin P. Lembo was appointed Managed Care Ombudsman and continued to serve in that capacity throughout the audited period.

Pursuant to Public Act 05-102 of the January Session of the 2005 General Assembly, effective October 1, 2005, the name of the Office of Managed Care Ombudsman was changed to the Office of the Healthcare Advocate and under the direction of a Healthcare Advocate. Subsequent reports will be issued using the new Agency name.

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:

	2003-2004	2004-2005
Personal Services	$ 124,761	$ 179,971
Contractual Services	68,134	177,823
Commodities	10,282	11,637
Sundry Charges - Fringe Benefits	53,583	89,529
Sundry Charges - Other	514	38,691
Total Expenditures	**$ 257,274**	**$ 497,651**

For comparative purposes, expenditures during the 2002-2003 fiscal year totaled $499,803. Total expenditures decreased by $242,529, and then increased by $240,377 during the fiscal years 2003-2004 and 2004-2005, respectively.

A major factor for the fluctuations in expenditure levels during the audited period was due to personal services and fringe benefit costs. During the 2002-2003 fiscal year, the Office was staffed with three full-time employees until May 2003, when the Managed Care Ombudsman position became vacant. During the 2003-2004 fiscal year, the Office was staffed with two full-time employees and during the 2004-2005 fiscal year, staff levels were increased to three full-time employees due to the appointment of a new Managed Care Ombudsman. Decreases in contractual services expenditures in the 2003-2004 fiscal year were due to decreases in outside consulting

services for public and promotional outreach services. Increases in the 2004-2005 fiscal year contractual services were primarily due to increased advertising to re-educate the public on the Agency's mission.

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 decided to follow up on our prior recommendation and determine whether the Office of Managed Care Ombudsman has complied with Section 38a-1050 of the General Statutes, which requires the 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 requires that the Managed Care Ombudsman submit an annual 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 improvements were made in the maintenance of documentation to support the information being reported, however, statutory reporting deadlines for filing of the 2005 annual report were not met as noted in the recommendation below:

Late Annual Report Filing:

Criteria: Section 38a-1050 of the General Statutes, amended by Public Act 05-15 effective October 1, 2005, which changed the filing due date from January 1st to March 1st of each year, requires that the Healthcare Advocate (formerly the Managed Care Ombudsman) submit a report on activity levels and other pertinent information to the Governor and the General Assembly.

Condition: Our review noted that the 2004 report, due by January 1, 2005, was prepared and submitted in a timely manner. However, the 2005 report, due by March 1, 2006, was submitted in June 2006, a delay of over three months.

Effect: The requirements of the General Statutes were not fully met.

Cause: Inadequate staffing contributed to the reporting weakness.

Recommendation: The Healthcare Advocate should comply with the reporting deadlines as established by the Statutes for submitting its annual report. (See Recommendation 1.)

Agency Response: "The Office of the Healthcare Advocate shares the State Auditors' desire for compliance with the Connecticut General Statutes. We work, always, in a manner that affirms both the letter and the spirit of the law.

The Office of the Healthcare Advocate concurs with the Auditors' finding that the 2005 Annual Report, as required by CGS Section 38a-1050, was filed approximately 90 days after the statutory deadline of March 1st. This delay is directly related to the understaffing of the agency. The agency is approved for only four full time employees and has experienced explosive growth in the number of time-sensitive consumer complaints against health insurance carriers.

The Office of the Healthcare Advocate will continually seek to improve our operation and will more closely scrutinize work-planning in the first quarter of 2006 so as to avoid another late filing."

RECOMMENDATIONS

Status of Prior Audit Recommendations:

The following recommendation was made for the Insurance Department.

- *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*. Improvements were noted with equipment items being found in locations as recorded on agency inventory records. As a result, this recommendation is not being repeated.

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

- *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.* Improvements were noted in documenting information used to support the information reported; however, the annual report for the 2005 year was filed over three months late. Therefore, this recommendation will be repeated in modified form. (See Recommendation 1.)

Current Audit Recommendations:

Insurance Department:

No recommendations resulted from the current review.

Office of the Healthcare Advocate:

1. **The Healthcare Advocate should comply with the reporting deadlines established by the Statutes for submitting its annual report.**

   Comment:

   The required annual report for 2005 was submitted in June 2006, over three months after the statutory due date of March 1st.

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, 2004 and 2005. 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, 2004 and 2005, 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, 2004 and 2005, 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 "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.

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 material or significant weaknesses. 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 failure 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. We noted no matters involving internal control that we consider to be material or significant weaknesses.

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