



STATE OF ILLINOIS
**OFFICE OF THE
 AUDITOR GENERAL**

Frank J. Mautino, Auditor General

SUMMARY REPORT DIGEST

DEPARTMENT OF INSURANCE

Compliance Examination
 For the Two Years Ended June 30, 2018

Release Date: April 18, 2019

FINDINGS THIS AUDIT: 11	AGING SCHEDULE OF REPEATED FINDINGS			
	Repeated Since	Category 1	Category 2	Category 3
Category 1:	2014		18-7	
Category 2:	2012	18-1	18-6	
Category 3:				
TOTAL				

	New	Repeat	Total
Category 1:	3	1	4
Category 2:	5	2	7
Category 3:	0	0	0
TOTAL	8	3	11

FINDINGS LAST AUDIT: 5

SYNOPSIS

- (18-01) The Department’s Public Pension Division did not perform required examinations of police and firefighters pension funds once every three years as required by the Illinois Pension Code.
- (18-02) The Department did not maintain adequate controls over the timeliness of approving and denying insurance and Health Maintenance Organization (HMO) company policy forms.
- (18-04) The Department failed to adhere to provisions in the Fiscal Control and Internal Auditing Act.

Category 1: Findings that are **material weaknesses** in internal control and/or a **qualification** on compliance with State laws and regulations (material noncompliance).

Category 2: Findings that are **significant deficiencies** in internal control and **noncompliance** with State laws and regulations.

Category 3: Findings that have **no internal control issues but are in noncompliance** with State laws and regulations.

{Expenditures and Activity Measures are summarized on next page.}

**DEPARTMENT OF INSURANCE
COMPLIANCE EXAMINATION
For the Two Years Ended June 30, 2018**

EXPENDITURE STATISTICS	2018	2017	2016
Total Expenditures.....	\$ 39,741,187	\$ 44,980,430	\$ 53,535,506
OPERATIONS TOTAL.....	\$ 36,322,521	\$ 42,222,386	\$ 51,170,610
% of Total Expenditures.....	91.4%	93.9%	95.6%
Personal Services.....	17,569,921	18,224,294	19,372,179
Other Payroll Costs (FICA, Retirement).....	14,283,270	14,907,792	16,224,680
All Other Operating Expenditures.....	4,469,330	9,090,300	15,573,751
AWARDS AND GRANTS.....	565,458	61,375	16,050
% of Total Expenditures.....	1.4%	0.1%	0.0%
REFUNDS.....	\$ 2,853,208	\$ 2,696,669	\$ 2,348,846
% of Total Expenditures.....	7.2%	6.0%	4.4%
Total Receipts.....	\$ 539,158,257	\$ 544,898,309	\$ 526,872,732
Average Number of Employees (Not Examined)....	243	257	249
SELECTED ACTIVITY MEASURES (Not Examined)	2018	2017	2016
Consumer Market Activities			
New/Renewal Licenses Processed.....	118,575	111,273	107,266
Market Conduct Examinations completed.....	61	61	48
Closed Consumer Complaint Files.....	13,688	13,111	9,785
Financial-Corporate Regulatory Division			
Financial Statement Annual Review.....	340	349	349
Financial Examinations Started.....	77	84	59
Pension Fund Examinations completed.....	23	37	81
AGENCY DIRECTOR			
During Examination Period: Anne Melissa Dowling, Acting (through 1/16/17), Jennifer Hammer (1/17/17 - 12/12/18)			
Currently: Robert Muriel, Acting (effective 3/11/19)			

FINDINGS, CONCLUSIONS, AND RECOMMENDATIONS

FAILURE TO PERFORM REQUIRED EXAMINATIONS OF POLICE AND FIREFIGHTER PENSION FUNDS

Required examinations of police and firefighter pensions not performed as required

The Department of Insurance's (Department) Public Pension Division did not perform required examinations of the 656 police and firefighters pension funds once every three years as required by the Illinois Pension Code (Code). Specifically, we noted the following:

- Two (0.3%) pension funds have been examined three times since 2004. As a result, in the 14 years since 2004, the Department did not complete one examination for each of the two funds.
- 230 (35%) pension funds have been examined on two occasions since 2004. As a result, in the 14 years since 2004, the Department did not complete two examinations for each of the 230 funds.
- 383 (58%) pension funds have been examined on one occasion since 2004. As a result, in the 14 years since 2004, the Department did not complete three examinations for each of the 383 funds.
- 36 (5%) pension funds were currently under examination as of the end of the audit period. Seventeen of the 36 pension fund examinations currently under examination at the end of the audit period were the funds' initial examination. Formed between 2008 and 2012, these 17 pension funds did not have 1 or 2 examinations conducted by the Department in the 6-10 years since the date of their formation. The remaining 18 pension funds were in the process of their second examination and one pension fund on its third examination since 2004. As a result, in the 14 years since 2004, the Department did not complete three examinations for each of the 19 funds.
- One (0.2%) pension fund has not been examined. The pension fund was formed in 2011. As a result, in the 7 years since 2011, the Department did not complete two examinations for the fund.

The Code (40 ILCS 5/1A-104(a)) requires the Public Pension Division to make periodic examinations and investigations of all pension funds. Section 1A-104(b) of the Code further requires the Public Pension Division to examine or investigate each pension fund established under Article 3 (Police) or Article 4 (Firefighters) of the Code once every 3 years. (Finding 1, pages 13-14) **This finding has been repeated since 2012.**

We recommended the Department perform the pension fund examinations every three years as required by the Code or continue to seek a legislative change.

Department accepted the recommendation

The Department accepted the recommendation and noted it was pursuing legislation to amend the Illinois Pension Code to shift to a risk-based audit approach requiring an audit of each pension fund every five years. *(For the previous Department response, see Digest Footnote #1.)*

INADEQUATE CONTROLS OVER THE TIMELINESS OF APPROVING AND DENYING INSURANCE AND HMO COMPANY POLICY FORMS

The Department did not maintain adequate controls over the timeliness of approving and denying insurance and Health Maintenance Organization (HMO) company policy forms. Specifically, we noted the following:

43% of life, accident, and health policy forms tested were approved between 8 to 432 days late.

- 17 of 40 (43%) life, accident, and health policy forms filed by insurer companies were not approved or disapproved by the Department within the required 60-day time period after the form's submission. The Department approved the policy forms between 8 to 432 days late.
- 10 of 18 (56%) HMO group contracts, evidence of coverage, endorsement, rider, bylaw or other policy forms were not approved or disapproved by the Department within the required 60-day time period after the form's submission. The Department approved the policy forms between 1 to 113 days late.

56% of HMO policy forms tested were approved between 1 to 113 days late.

By not approving or disapproving life, accident, health insurance, or HMO policy forms in a timely manner as required by the Illinois Insurance Code or the Health Maintenance Organization Act, insurance and HMO companies' distribution of their products to the market may be delayed and represents noncompliance with the State law. (Finding 2, pages 15-16).

We recommended the Department comply with the statutory requirements of the Illinois Insurance Code and the Health Maintenance Organization Act.

Department accepted the recommendation

The Department accepted the recommendation and noted it acknowledges the filings were not approved within the 60-day statutory timeline due to various circumstances that may warrant the Department to request additional documentation from the insurers or may require actuarial review.

INADEQUATE INTERNAL AUDIT FUNCTION

The Department failed to adhere to provisions in the Fiscal Control and Internal Auditing Act (Act).

The Department is a designated State agency and is required to have its own CIA and maintain a full-time program of internal auditing.

The Act requires the Department as a designated State agency to have a Chief Internal Auditor appointed by the agency head and to maintain a full-time program of internal auditing. In addition, the Act also states “[a]gencies which do not have full-time internal audit programs may have internal audits performed by the Department of Central Management Services” (30 ILCS 10/2001 (b)).

The Act was originally a Legislative Audit Commission initiative designed to address deficiencies noted in a May 1988 management audit of Illinois’ State Programs of Internal Auditing. The audit report’s conclusions and recommendations and the legislation that became the Act demonstrated an understanding that agencies which are not required to have their own full-time program of internal auditing could obtain internal auditing assistance from an agency such as the Department of Central Management Services (CMS). In other words, each designated State agency must have a full-time program of internal auditing and each State agency that is not so designated is not required to have a full-time program of internal auditing but may receive internal audit services from CMS.

In 2009, the General Assembly unanimously rejected the consolidation of internal audit authority in CMS

In 2003, by Executive Order (2003-10) the Governor transferred the internal auditors from the various State agencies and consolidated them into a bureau at CMS. In 2009, the General Assembly unanimously rejected this consolidation of internal audit authority in CMS and directed that the internal auditors and their functions be returned to their respective designated State agencies (P.A. 96-795, effective July 1, 2010).

On January 15, 2018, the Department entered into an IGA with CMS to provide internal auditing services

On January 15, 2018, the Department entered into an agreement with CMS’ Bureau of Internal Audit to provide the Department with internal auditing services. As of the end of our fieldwork (February 11, 2019), CMS’ Chief Internal Auditor was acting as Chief Internal Auditor for eight State agencies (CMS, Agriculture, Corrections, Financial and Professional Regulation, Human Rights, Insurance, Labor, and Illinois Finance Authority).

During testing, we noted the following:

The Department does not have own CIA

- The Department’s Director has not appointed an individual to fill the Department’s chief internal auditor position. This position was vacated on May 31, 2017, 395 days prior to the end of the examination period on June 30, 2018. The Act (30 ILCS 10/2002(a)) requires the Director to appoint a chief internal auditor.

The Department did not obtain the Governor’s approval for CMS to provide internal auditing services

- The Department and CMS did not obtain the Governor’s approval for CMS to provide professional internal auditing services to the Department. The Code (20 ILCS 405/405-293(a)) states that CMS “is responsible for providing professional services for or on behalf of State agencies for all functions transferred to the Department by Executive Order No. 2003-10. . .” Since the part of Executive Order 2003-10 related to internal audit was reversed by P.A. 96-795 this portion of the Section is not applicable in the circumstances. The Section goes on to state that CMS may “with the approval of the Governor, provide additional services to or on behalf of State agencies.” “Additional services” is not defined and no approval for CMS to provide internal auditing services specifically to the Department, a designated State agency under the Act, was obtained from the Governor.

- While testing the Expenses and Support Cost section of the intergovernmental agreement between the Department and CMS, we requested the Department provide us with sufficient and appropriate audit evidence related to costs of the Department's internal audit function from January 15, 2018, through the end of the examination period on June 30, 2018. We requested the documentation to substantiate (1) the authorization of CMS to use the Department's appropriation for processing payroll as allowed for under the intergovernmental agreement, and (2) that CMS only charged the Department for payroll services of CMS internal auditors who provided internal audit functions to the Department. The Department was unable to provide us with the documentation requested. Specifically, we noted the following internal control deficiencies:

- It does not appear the Department is monitoring the current costs of its internal audit function. As a result, we were unable to audit the cost of the Department’s internal audit function to ensure the Department is accurately reimbursing CMS payroll costs as stipulated by the intergovernmental agreement.
- The Department granted CMS authorization through its intergovernmental agreement to charge the Department’s appropriations for payroll costs associated with CMS’ rendering of professional internal audit services to the Department; however, it is not the Department’s nor CMS’ intent to process any vouchers against the Department’s appropriations. As a result, we believe there is a significant internal control risk with potentially delegating a State’s appropriation authority unnecessarily.

The Department is not tracking current internal auditing costs

The Department gave unnecessary appropriation authority to CMS to process payroll expenditures

Failure to establish a full-time internal audit program in accordance with the requirements of the Act – where the chief internal auditor develops a deep understanding of the Department’s functions and processes, oversees, and performs audits of the Department’s major systems of internal accounting and administrative controls on a periodic basis, and oversees and reviews major new and modifications to information systems prior to implementation – weakens the Department’s ability to assess its overall internal control environment and represents noncompliance with State law. Further, the establishment of the Department’s internal audit function by interagency agreement hinders the operational autonomy intended by the General Assembly for internal auditors. Department management cannot terminate an appointed chief internal auditor prior to the conclusion of their term without cause and a hearing before the Executive Ethics Commission, but management can terminate the interagency agreement with CMS at any time for any reason. Failure to obtain the approval of the Governor for expanding the professional services provided to the Department by CMS limits governmental oversight and represents noncompliance with the Code. Failure to adequately track internal audit costs and be able to provide the auditors with adequate cost support related to the Department’s internal audit function results in the auditors being unable to determine the Department’s compliance with the Act. Finally, granting CMS authorization to expend the Department’s payroll appropriations weakens the Department’s overall internal control environment and represents noncompliance with State law. (Finding 4, pages 19-23).

We recommended the following: 1) the Department’s Director appoint a chief internal auditor and ensure a full-time program of internal auditing is in place and functioning at the Department; 2) if another agency is to be relied upon to supplement internal audit functions at the Department, the Department should obtain written approval of the Governor for these services and ensure such services are provided in accordance with the Act’s requirements; 3) the Department implement policies and procedures to track internal audit costs, maintain documentation which adequately documents the costs of the Department’s internal audit function, and ensure other agencies providing services to the Department are only reimbursed for allowable costs; and 4) the Department should not grant another agency the authority to process payroll against the Department’s appropriations unnecessarily or without implementing and documenting proper controls.

The Department accepted the recommendation and noted it will work with CMS to develop a responsive, effective, and sustainable long-term solution for the CIA appointment, obtain written approval from the Governor’s Office to supplement internal audit functions, track the costs associated with the audit services and develop a plan to review the costs for reimbursement of federal monies, and revise the

Department accepted the recommendation

Auditor Comment

intergovernmental agreement to remove the portion on processing payroll.

The auditors commented that although the Department indicates it will work with CMS to revise the intergovernmental agreement under which CMS' Chief Internal Auditor acts as the Chief Internal Auditor for the Department, as well as for numerous other agencies through other intergovernmental agreements, the auditors do not believe this arrangement meets the requirements of the Fiscal Control and Internal Auditing Act and, as a result, we are requesting a formal, written opinion from the Attorney General's Office on the matter.

OTHER FINDINGS

The remaining findings pertain to the overstocking of postage inventory, failure to assess penalties and interest to insurance companies, failure to procure and implement a fraud prevention and detection information system, noncompliance with federal grant agreements, and inadequate controls over reporting, employee performance evaluations, surplus equipment items, and voucher processing. We will review the Department's progress towards the implementation of our recommendations in our next compliance examination.

ACCOUNTANT'S OPINION

The accountants conducted a compliance examination of the Department for the two years ended June 30, 2018, as required by the Illinois State Auditing Act. The accountants qualified their report on State compliance for Findings 2018-001 through 2018-004. Except for the noncompliance described in these findings, the accountants stated the Department complied, in all material respects, with the requirements described in the report.

This compliance examination was conducted by Adelfia LLC.

SIGNED ORIGINAL ON FILE

JANE CLARK
Division Director

This report is transmitted in accordance with Section 3-14 of the Illinois State Auditing Act.

SIGNED ORIGINAL ON FILE

FRANK J. MAUTINO
Auditor General

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DIGEST FOOTNOTES

#1-2016 Noncompliance with Requirements of the Illinois Pension Code: The Department accepts the finding. Regarding the failure to meet the three (3) year audit cycle mandate, the Department has filed legislation to amend Section 1A-104 of the Illinois Pension Code to shift to a risk-review audit process requiring an audit of each pension fund every five years. This legislation, HB4660, is pending in Committee, and the Department is continuing to work toward passage.