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, 2016

Release Date: January 12, 2017

FINDINGS THIS AUDIT: 5	New	Repeat	Total
Category 1:	**0**	**0**	**0**
Category 2:	1	4	5
Category 3:	0	0	0
TOTAL	**1**	**4**	**5**
FINDINGS LAST AUDIT: 9			

AGING SCHEDULE OF REPEATED FINDINGS			
Repeated Since	**Category 1**	**Category 2**	**Category 3**
2014		**16-4**	
2012		**16-1, 16-2**	
2010		**16-3***	

*Prior to becoming a separate agency, issues associated with this finding had been previously reported in the Department of Financial and Professional Regulation's reports back to 2006.

SYNOPSIS

- **(16-1)** The Department did not fully comply with the requirements of the Workers' Compensation Act.
- **(16-2)** The Department did not fully comply with the requirements of the Illinois Pension Code.
- **(16-3)** The Department did not fully comply with the requirements of the Illinois Insurance Code.

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, 2016

EXPENDITURE STATISTICS	FY 2016	FY 2015	FY 2014
Total Expenditures	**$ 53,535,506**	**$ 74,720,181**	**$ 83,661,422**
OPERATIONS TOTAL	$ 51,170,610	$ 71,980,497	$ 81,337,479
% of Total Expenditures	95.6%	96.4%	97.2%
Personal Services	19,855,967	21,005,563	20,797,817
Other Payroll Costs (FICA, Retirement, Insurance)	15,740,892	15,272,565	15,108,955
Contractual Services	15,038,302	35,002,997	44,559,787
Telecommunications	312,079	372,753	490,639
Travel	65,526	178,886	221,645
Interest - Prompt Payment Act	63,532	9	-
All Other Operating Expenditures	94,312	147,724	158,636
AWARDS AND GRANTS	16,050	17,518	254,299
% of Total Expenditures	0.0%	0.0%	0.3%
REFUNDS	$ 2,348,846	$ 2,722,166	$ 2,069,644
% of Total Expenditures	4.4%	3.6%	2.5%
Total Receipts	**$ 526,872,732**	**$ 517,011,069**	**$ 471,708,458**
Average Number of Employees (not examined)	**253**	**251**	**255**

SELECTED ACTIVITY MEASURES (not examined)	2016	2015	2014
Consumer Market Activities			
New/Renewal Licenses Processed	107,266	99,947	89,563
Market Conduct Examinations completed	48	33	46
Closed Consumer Complaint Files	9,785	9,269	8,965
Financial-Corporate Regulatory Division			
Financial Statement Analysis Annual	349	353	357
Financial Examinations Started	59	65	119
Pension Fund Examinations completed	81	127	71

AGENCY DIRECTOR

During Examination Period: Andrew Boron (through 1-11-2015), James Stephens, Acting (1-12-2015 to 6-30-2015), Anne Melissa Dowling, Acting (beginning 7-1-2015)

Currently: Anne Melissa Dowling, Acting

FINDINGS, CONCLUSIONS, AND RECOMMENDATIONS

NONCOMPLIANCE WITH THE REQUIREMENTS OF THE WORKERS' COMPENSATION ACT

Failure to implement a system for the detection and prevention of fraud, waste, and abuse

The Department's Workers' Compensation Fraud Unit has not procured and implemented a system utilizing advanced analytics inclusive of predictive modeling, data mining, social network analysis, and scoring algorithms for the detection and prevention of fraud, waste, and abuse.

The Workers' Compensation Act (Act) requires the fraud and insurance non-compliance unit to procure and implement a system utilizing advanced analytics inclusive of predictive modeling, data mining, social network analysis, and scoring algorithms for the detection and prevention of fraud, waste, and abuse on or before January 1, 2012.

Failure to procure and implement the advanced analytics system is noncompliance with a statutory requirement and hinders the Department's ability in the detection and prevention of fraud, waste, and abuse. (Finding 1, pages 10-11). **This finding has been repeated since 2012.**

We recommended the Department either procure and implement a system utilizing advanced analytics or seek a legislative change.

Department accepted the recommendation

The Department accepts this finding, but notes compliance challenges caused by the General Assembly's failure to provide for the necessary appropriation. Despite the fact that this has always been an unfunded mandate, the Department issued a Request for Information (RFI) regarding a system utilizing advanced analytics, inclusive of predictive modeling, data mining, social network analysis, and scoring algorithms for the detection and prevention of fraud, waste, and abuse (advanced analytics system) in 2012. The responses to the RFI did not assist the Department in procuring the advanced analytics system. In 2015, the Department again analyzed the viability of such a system in light of the data available for analysis. The Department concluded that it does not have the data necessary to develop and utilize the data analytics system required by the Act. In the 2016 Annual Report, the Workers' Compensation Fraud Unit recommended that Section 25.5(e-5) of the Workers' Compensation Act, which contains the advanced analytics system requirement, be repealed. The Department continues to propose this course of action to the Governor's Office. ***(For the previous Department response, see Digest Footnote #1)***

NONCOMPLIANCE WITH THE REQUIREMENTS OF THE ILLINOIS PENSION CODE

Required examinations of police and firefighter pensions not performed as required

During testing, auditors noted the Public Pension Division did not perform required examinations of the 654 police and firefighters pension funds that are required to be examined once every three years. As a result of testing auditors noted:

- 3 (1%) have been examined on three occasions since 2004. The third examination occurred 8 years after the second examination.
- 217 (33%) have been examined on two occasions since 2004. The second examination occurred between 3 and 10 years after the first examination.
- 396 (61%) have been examined on one occasion since 2004.
- 18 (3%) pension funds were currently under examination as of the audit period. These were the 2nd examinations since 2004 for all 18 pension funds.
- 18 (3%) pension funds eligible for an examination have never been examined. The 18 pension funds were formed between January 2008 and July, 2012.

In addition, during testing of 11 pension fund examinations completed by the Public Pension Division during fiscal years 2015 and 2016, auditors noted 10 (91%) of the examination reports were not submitted to the Chief Executive Officer (CEO) of the municipality or the Fire Protection District as required by the Code. Upon bringing this to the Department's attention, the Department subsequently submitted a copy of the examination report to the CEO of the municipality or Fire Protection District.

Failure to perform the required examination of a pension fund every three years may result in the Department not being able to fully monitor that pension funds are in compliance with the Illinois Pension Code. Failure to submit a copy of the examination reports to the CEO of the municipality or the Fire Protection District is noncompliance with the Illinois Pension Code. (Finding 2, pages 12-14). **This finding has been repeated since 2012.**

We recommended the Department allocate sufficient resources to perform the pension fund examinations every three years as required by the Illinois Pension Code or continue to seek a legislative change. We also recommended the Department ensure examination reports are submitted to the CEO of the municipality or the Fire Protection District to comply with the Illinois Pension Code.

Department accepted the recommendation

The Department accepted the finding and noted, regarding the failure to meet the three (3) year audit cycle mandate, the Department has filed legislation to amend the Illinois Pension Code to shift to a risk-review audit process requiring an audit of each pension fund every five years. This legislation is pending in Committee, and the Department is continuing to work toward passage. Regarding the failure to submit a copy of the Report of Examination (the Report) to the CEO of the municipality, the Department would like to note that once the auditors notified the Department of this issue, the Department took corrective action to submit a copy of the Reports to the CEO of the municipalities. Further, the Pension Division has taken steps to properly train all Audit Group employees on the requirements of the applicable section of the Illinois Pension Code to ensure that this requirement is not missed in the future. Additionally, the Department has hired three employees and is working to fill another vacancy. The Department has also taken steps to implement electronic audit workpaper software that will increase productivity of the Audit Group and streamline the audit process. ***(For the previous Department response, see Digest Footnote #2)***

NONCOMPLIANCE WITH THE REQUIREMENTS OF THE ILLINOIS INSURANCE CODE

During testing the auditors noted several instances where the Department did not fully comply with certain requirements of the Illinois Insurance Code. Specifically the following was noted:

Life, accident and health policy forms filed with the Department were not always timely approved or disapproved

- Auditors identified that 23 (58%) of 40 life, accident and health policy forms filed with the Department were not approved or disapproved within 60 days after submission. The Department approved the policies between 7 to 140 days later than the required 60 day timeline.

  The Illinois Insurance Code (Code) requires the Director to approve or disapprove life, accident and health policy forms within 60 days after submission unless the Director extends by not more than an additional 30 days the period within which the Director shall approve or disapprove any such form by giving written notice to the insurer of such extension before expiration of the initial 60 day period.

Tax penalties were not always issued and in some instances not computed correctly

- During testing of 40 surplus line producer semi-annual tax statements, auditors noted the Department failed to: (1) Issue the penalty invoice for late filing for 3 (8%) surplus line producer semi-annual tax statements amounting to $1,396. (2) Correctly assess the penalty for 2 (5%) tax returns. The penalty for one return was understated by $1,293 and the other return was overstated by $19,242.

The Code requires the Department to add as a penalty $400 or 10% of the amount of such tax, whichever is greater, for each month or part of a month of failure to file, the entire penalty not to exceed $2,000 or 50% of the tax due, whichever is greater. The producer semi-annual tax statement form indicated the following penalties: (a) penalty for failure to file tax statement ($400/month or 10% of tax, whichever is greater), (b) penalty for failure to pay tax (10% of tax due) and (c) interest on tax paid after due date (Current IRS rate: Minimum rate 12% per annum).

HMO policy filings were not always approved or disapproved within 60 days after submission

- During testing of 40 Health Maintenance Organization (HMO) filings of group contract, evidence of coverage, endorsement, rider, bylaw or other policy forms, auditors noted 34 (85%) HMO policy filings were not approved or disapproved within 60 days after submission. The Department approved or denied the policies between 9 to 153 days later than the required 60 day timeline.

  The Code requires the Director to approve or disapprove an HMO group contract, evidence of coverage, endorsement, rider, bylaw, or other matter incorporated by reference or an application blank within 60 days after submission unless the Director extends by not more than additional 30 days the period.

Department failed to assess penalties for late financial regulation fee payments.

- During testing of 40 annual financial regulation fees, auditors noted 8 (20%) companies paid the fees 30 days after the date of the invoice. The Department failed to assess penalties for these late payments which were estimated at $23,200.

  During fiscal years 2015 and 2016, the auditors noted the Department sent the annual invoices to applicable companies on June 26, 2015 and June 27, 2016, respectively, which resulted in the payments not being received by the Department by June 30 as required by the Code. The invoices sent by the Department indicated the fee is due upon receipt and invoices unpaid after 30 days from the invoice date are subject to the penalty per 215 ILCS 5/412.

  The Code requires the invoice to be paid upon receipt and must be paid no later than June 30 of each calendar year. The Code also states when an insurance company or domesticated affiliated group failed to pay the full amount of any fee of $200 or more under Section 408 of the Code, there shall be added to the amount due as a penalty the greater of $100 or an amount equal to 10% of the deficiency for each month or part of a month that the deficiency remains unpaid.

By not approving or disapproving life, accident, or health insurance policy forms in a timely manner as required by the Illinois Insurance Code, insurance companies' distribution of their products to the market may be delayed. Failure to invoice and correctly assess penalties on late filing of tax returns and late payment of financial regulation fees results in a loss of State revenue as well as under utilizing a tool to enforce prompt filing. In addition, failure to timely send financial regulation fee invoices delays the timely payment by June 30 as required by the Code. (Finding 3, pages 15-18). **This finding has been repeated since 2012 at the Department of Insurance and since 2006 at the predecessor Department.**

We recommended the Department comply with the statutory requirements of the Insurance Code.

Department accepted the recommendation

The Department accepted the finding and noted while the statutory requirement to approve product filings within 60 days is important for efficient marketplace regulation, both the insurance industry and regulators agree that thorough reviews of product filings need to occur before they are presented to Illinois consumers. Currently, if a product filing is delayed beyond 60 days, Department staff keeps the filing active rather than reject the filing. This is for any multitude of reasons, but primary reasons are that the filings are being scrutinized by Actuarial or Legal Units. Another issue is that if a filing is rejected, the filing entity would need to resubmit a filing fee, unnecessarily driving up their costs, which would likely be passed on to consumers. Also, the timelines for Affordable Care Act compliant health policies are set by the Centers for Medicare and Medicaid Services (CMS) and are generally 150 days long – the Department cannot approve such policies prior to certification by CMS. A legislative proposal has been presented for consideration which would modify the statute to allow an entity making the filing to request a time extension for the Department's review rather than receive a rejected filing.

In response to the failure to assess the penalty in its entirety, the Department did not assess the penalty because the tax statement was never received. Historically, penalties have been manually assessed once a statement has been received. When a statement is not received, a penalty can be partially assessed through a manual process, but as additional time passes without the statement being filed, the penalty continues to accrue. The understatement of assessed penalty noted was due to the partial assessment without additional penalty amounts being manually applied. The overstatement of assessed penalty noted was due to a change in the statutory penalty amount between the two fiscal years under examination. The penalty invoice was correctly adjusted in the taxpayer's favor. An Excel spreadsheet was created by the Division to calculate the penalty amount. To further improve the process of penalty assessment, this process has been automated in the Department's cash receipts system to automatically assess the penalty as the tax statements are processed. Late filed statements will have the correct penalty calculated and automatically applied upon processing the receipt of the tax statement.

In addition, the Department noted that due to processing delays, the Department untimely mailed the Financial Regulation Fee invoices making the collection by June 30th nearly impossible. To correct the deficiency, the Department will create and mail the invoices more timely allowing the companies at least 30 days to pay. ***(For the previous Department response, see Digest Footnote #3)***

OTHER FINDINGS

The remaining findings are reportedly being given attention by the Department. Auditors will review the Department's progress towards the implementation of all the recommendations in the next engagement.

ACCOUNTANT'S REPORT

The auditors conducted a compliance attestation examination of the Department for the two years ended June 30, 2016 as required by the Illinois State Auditing Act. The accountant's stated the Department complied in all material respects, with the requirements described in the report.

SIGNED ORIGINAL ON FILE

FRANK J. MAUTINO
Auditor General

FJM:RPU

AUDITORS

E.C. Ortiz & Co., LLP were the Special Assistant Auditors for this examination.

DIGEST FOOTNOTES

#1 -2014 Noncompliance with the Requirements of the Worker's Compensation Act: The Department concurs with this finding. The Department issued a Request for Information (RFI) regarding a system utilizing advanced analytics inclusive of predictive modeling, data mining, social network analysis, and scoring algorithms for the detection and prevention of fraud, waste and abuse (advanced analytics system) in 2012. The response to the RFI did not assist the Department in procuring the advanced analytics system. The Department is again analyzing the viability of such a system given the near complete lack of information available to the Department for the analysis by such an advanced analytics system. Moreover, the Department has recommended in the Worker's Compensation Fraud Unit's 2013 and 2014 Annual Reports that were submitted to the Governor, General Assembly, Attorney General, and others, that the advanced analytics system requirement be removed from Section 25.5(e-5) of the Illinois Workers' Compensation Act.

The Department is currently working with the Secretary of State Archives Division to establish an approved records retention policy that complies with Section 25.5(e) of the Illinois Worker's Compensation Act.

#2-2014 Noncompliance with Requirements of the Illinois Pension Code: The Department concurs with the finding and will continue to seek legislation to either provide the resources needed to fully implement the three year compliance audit cycle or to modify the examination requirement as contained in 40 ILCS 5/1-104(b).

#3-2014 Noncompliance with Requirements of the Illinois Insurance Code: The Department concurs with the finding, but acknowledges it is unrealistic to accomplish with the current Cash Receipts (CR) cash management system. The CR system is not designed to insert additional charges of penalty and interest on existing outstanding invoices. The Department is developing a new Account Management System (AMS) that will be able to perform the function of inserting additional charges of penalty and interest. The timeframe in which the AMS program will be implemented is indeterminate. The Department further concurs that cash refunds should be processed in a timely manner. The finding has been mitigated by the replacement of retired staff.