Claire McCaskill
Missouri State Auditor

October 2005

INSURANCE

Department of Insurance

Two Years Ended June 30, 2004

Report No. 2005-75

auditor.mo.gov

Office Of The
State Auditor Of Missouri
Claire McCaskill

October 2005

YELLOW SHEET

The following problems were discovered as a result of an audit conducted by our office of the Department of Insurance (MDI).

The department's examination billing policies may not comply with state law, and amounts billed may not accurately reflect actual costs incurred. State law requires the MDI to bill the expenses of any examination and to bill an additional 15 percent of the total expenses of the examination to pay for supervision and support of the examiners. Examination billings include indirect labor and operating expenses which appear to include some costs for the supervision and support of the examiners. Therefore, the billing of certain indirect labor costs, in addition to the 15 percent fee, could be considered double-billing of certain expenses.

In addition, current billing policies do not allow the department to track the true costs of examinations. Salaries for directors, managers, and closers are approximately $550,000 annually. Salaries for managers are billed monthly as indirect labor costs on a pro-rata basis. Based upon estimates made by department personnel, it appears approximately $350,000 of directors', managers', and closers' annual salaries could be billed as direct costs.

The State of Missouri is one of only five states to allow insurance companies to receive tax credits for examination costs. For the tax years 2004 and 2003, examination tax credits claimed were approximately $2.7 and $3.2 million, respectively. For the tax year 2004, available credits were $7.3 million with a carryover of approximately $4.3 million. In essence, the state's General Revenue Fund is paying a significant portion of examination costs instead of charging the costs to insurance companies as part of doing business in Missouri.

MDI policies do not require examiners to evaluate alternative work schedules to ensure the most cost-effective schedule is selected. Failure to evaluate alternative work schedules for each examination could result in increased travel costs. A similar finding was noted in our prior report. Additionally, MDI policies do not require examiners to obtain airfare quotes prior to incurring the costs. Also, airfare can be billed directly to the MDI or reimbursed through the examiner's expense accounts. Airfare costs billed directly to MDI for the two years ended June 30, 2004 and 2003, were approximately $139,000 and $165,000, respectively. However, MDI does not adequately track airfare costs to protect against double-billings.

(over)

The MDI does not require insurance companies in receivership to obtain independent audits, and the MDI does not perform examinations of these companies. At June 30, 2004, there were two Missouri chartered insurance companies in rehabilitation and sixteen in liquidation. Many of these receiverships have continued for several years with eleven companies in receivership since the 1990s.

Surplus lines revenues have almost tripled over the last five years. Revenues for the year ended June 30, 2000, were approximately $7.8 million, while revenues for the year ended June 30, 2004, were approximately $23.3 million. The number of surplus lines brokers also increased from 250 to 547 during this same time period. Examinations of surplus lines brokers are not conducted at least once every three years, as specified in MDI policy, and surplus lines procedures may be inadequate to handle current growth in surplus lines insurance. Additionally, the MDI does not bill examination costs to out-of-state surplus lines brokers as required by state law. This statute has been in effect since 1989 and the MDI has not billed any applicable costs.

Premiums on title insurance make up less than one percent of the total insurance premiums paid in Missouri; however, approximately 10 percent of the MDI's market conduct staff are used exclusively to conduct examinations of title insurance companies. State law requires examinations of all title insurance companies once every four years. The MDI should review current title insurance examination requirements and consider seeking legislation to revise the current requirements to better utilize MDI resources.

Receipts handled by the MDI totaled approximately $41.5 million and $39.5 million for the years ended June 30, 2004 and 2003, respectively. Some receipts are not transmitted to the Department of Revenue (DOR) for deposit on a timely basis. Additionally, for the period reviewed, approximately 75 percent of all monies were sent to a post office box specifically used for certain types of receipts. It appears that the receipts in this post office box could be sent directly to the support services section to be processed and not handled in the mailroom process, reducing the risk of loss or misuse of funds.

The MDI contracts with a not-for-profit foundation to provide insurance counseling services for senior citizens. As similarly noted in prior audits, the MDI does not always require the foundation to provide detailed documentation supporting amounts claimed for reimbursement under the grant agreement. Amounts paid to the foundation totaled approximately $272,000 and $312,000 for the years ended June 30, 2004 and 2003, respectively.

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FINANCIAL SECTION

State Auditor's Reports

CLAIRE C. McCASKILL
Missouri State Auditor

INDEPENDENT AUDITOR'S REPORT ON
THE FINANCIAL STATEMENTS

Honorable Matt Blunt, Governor
and
W. Dale Finke, Director
Department of Insurance
Jefferson City, MO 65102

We have audited the accompanying Combined Statement of Receipts, Disbursements, and Changes in Cash and Investments of the Missouri Department of Insurance (MDI) - Federal Fund, Insurance Examiners Fund, Department of Insurance Dedicated Fund, and Receivership Accounts; Comparative Statement of Receipts of the General Revenue Fund, Worker's Compensation Fund, and State School Moneys Fund; and Comparative Statement of Appropriations and Expenditures of the various funds of the Department of Insurance as of and for the years ended June 30, 2004 and 2003. These financial statements are the responsibility of the department's management. Our responsibility is to express opinions on these financial statements based on our audit.

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 financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and the significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

As discussed more fully in Note 1, these financial statements were prepared using accounting practices prescribed or permitted by Missouri law, which differ from accounting principles generally accepted in the United States of America. The effects on the financial statements of the variances between these regulatory accounting practices and accounting principles generally accepted in the United States of America, although not reasonably determinable, are presumed to be material.

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In our opinion, because of the effects of the matter discussed in the preceding paragraph, the financial statements referred to in the first paragraph do not present fairly, in conformity with accounting principles generally accepted in the United States of America, the financial position of the Department of Insurance as of June 30, 2004 and 2003, or the changes in its financial position for the years then ended.

In our opinion, the financial statements referred to in the first paragraph present fairly, in all material respects, the receipts, disbursements, and changes in cash and investments of the MDI - Federal Fund, Insurance Examiners Fund, Department of Insurance Dedicated Fund, and Receivership Accounts; the receipts of the General Revenue Fund, Worker's Compensation Fund, and State School Moneys Fund; and the appropriations and expenditures of the various funds of the Department of Insurance as of and for the years ended June 30, 2004 and 2003, on the bases of accounting discussed in Note 1.

In accordance with *Government Auditing Standards*, we also have issued our report dated April 14, 2005, on our consideration of the department's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

Our audit was conducted for the purpose of forming an opinion on the financial statements, taken as a whole, that are referred to in the first paragraph. The accompanying financial information listed as supplementary data in the table of contents is presented for purposes of additional analysis and is not a required part of the financial statements. Such information has been subjected to the auditing procedures applied in the audit of the financial statements and, in our opinion, is fairly stated, in all material respects, in relation to the financial statements taken as a whole, that were prepared on the bases of accounting discussed in Note 1.

The accompanying History, Organization, and Statistical Information is presented for informational purposes. This information was obtained from the department's management and was not subjected to the auditing procedures applied in the audit of the financial statements referred to above. Accordingly, we express no opinion on the information.

An integral part of the department's funding comes from federal awards. Those federal awards are reported on in the State of Missouri Single Audit Report issued by the State Auditor's office. The single audit is conducted in accordance with the provisions of U.S. Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*.

Claire McCaskill
State Auditor

April 14, 2005 (fieldwork completion date)

The following auditors participated in the preparation of this report:

Director of Audits:	Kenneth W. Kuster, CPA
Audit Manager:	Mark Ruether, CPA
In-Charge Auditor:	Lonnie Breeding III
Audit Staff:	Terese Summers, CPA
	Keri Wright
	Ali Arabian

CLAIRE C. McCASKILL
Missouri State Auditor

INDEPENDENT AUDITOR'S REPORT
ON INTERNAL CONTROL OVER FINANCIAL REPORTING
AND ON COMPLIANCE AND OTHER MATTERS

Honorable Matt Blunt, Governor
and
W. Dale Finke, Director
Department of Insurance
Jefferson City, MO 65102

We have audited the financial statements of the Department of Insurance as of and for the years ended June 30, 2004 and 2003, and have issued our report thereon dated April 14, 2005. 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.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements of the Department of Insurance, we considered the department's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide an opinion on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be material weaknesses. A material weakness is a reportable 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 misstatements caused by error or fraud in amounts that would be material in relation to the financial statements 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 the internal control over financial reporting and its operation that we consider to be material weaknesses.

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Compliance and Other Matters

As part of obtaining reasonable assurance about whether the financial statements of the Department of Insurance are free of material misstatement, we performed tests of the department's compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. 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. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

However, we noted certain matters which are described in the accompanying Management Advisory Report.

This report is intended for the information and use of the management of the Department of Insurance and other applicable government officials. However, pursuant to Section 29.270, RSMo, this report is a matter of public record and its distribution is not limited.

Claire McCaskill
State Auditor

April 14, 2005 (fieldwork completion date)

Financial Statements

Exhibit A-1

DEPARTMENT OF INSURANCE
COMBINED STATEMENT OF RECEIPTS, DISBURSEMENTS, AND CHANGES IN CASH AND INVESTMENTS
YEAR ENDED JUNE 30, 2004

		MDI - Federal Fund	Insurance Examiners Fund	Department of Insurance Dedicated Fund	Receivership Accounts	Total (Memorandum Only)
RECEIPTS						
Federal grant	$	272,210	0	0	0	272,210
Examination fees		0	7,791,248	0	0	7,791,248
Producer licenses and permits		0	0	5,173,890	0	5,173,890
Merchant licenses		0	0	991,499	0	991,499
Regulatory fees and renewals		0	0	1,787,206	0	1,787,206
Miscellaneous fees		0	0	669,215	0	669,215
Filing fees		0	0	675,063	0	675,063
Interest		0	0	148,073	0	148,073
Premium/investment income		0	0	0	53,832	53,832
New receiverships		0	0	0	707,862	707,862
Other		0	0	31,777	0	31,777
Total Receipts		272,210	7,791,248	9,476,723	761,694	18,301,875
DISBURSEMENTS						
Personal service		0	4,693,047	4,610,135	0	9,303,182
Employee fringe benefits		0	1,204,912	1,537,890	0	2,742,802
Expense and equipment		0	1,528,207	1,162,516	0	2,690,723
State office building rent, maintenance and repair		0	47,828	386,922	0	434,750
Workers' compensation claims		0	0	24,951	0	24,951
Insurance counseling contract costs		272,210	0	0	0	272,210
Lease parking		0	0	8,280	0	8,280
Other refunds		0	14,267	47,642	0	61,909
Cost allocation plan		0	168,680	167,332	0	336,012
Transfer to General Revenue Fund-State		0	0	7,471,680	0	7,471,680
Claims/distributions		0	0	0	76,569	76,569
Administration/legal fees		0	0	0	11,617	11,617
Other		0	0	0	137,179	137,179
Total Disbursements		272,210	7,656,941	15,417,348	225,365	23,571,864
RECEIPTS OVER (UNDER) DISBURSEMENTS		0	134,307	(5,940,625)	536,329	(5,269,989)
CASH AND INVESTMENTS, JULY 1		0	876,913	12,147,178	2,367,257	15,391,348
CASH AND INVESTMENTS, JUNE 30	$	0	1,011,220	6,206,553	2,903,586	10,121,359

The accompanying Notes to the Financial Statements are an integral part of this statement.

Exhibit A-2

DEPARTMENT OF INSURANCE
COMBINED STATEMENT OF RECEIPTS, DISBURSEMENTS, AND CHANGES IN CASH AND INVESTMENTS
YEAR ENDED JUNE 30, 2003

		MDI - Federal Fund	Insurance Examiners Fund	Department of Insurance Dedicated Fund	Receivership Accounts	Total (Memorandum Only)
RECEIPTS						
Federal grant	$	312,958	0	0	0	312,958
Examination fees		0	8,021,550	0	0	8,021,550
Producer licenses and permits		0	0	5,788,066	0	5,788,066
Merchant licenses		0	0	941,642	0	941,642
Regulatory fees and renewals		0	0	1,829,238	0	1,829,238
Miscellaneous fees		0	0	647,075	0	647,075
Filing fees		0	0	824,940	0	824,940
Interest		0	0	282,629	0	282,629
Premium/investment income		0	0	0	59,354	59,354
Other		0	2,286	60,827	0	63,113
Total Receipts		312,958	8,023,836	10,374,417	59,354	18,770,565
DISBURSEMENTS						
Personal service		0	4,826,628	4,768,761	0	9,595,389
Employee fringe benefits		0	1,202,830	1,499,946	0	2,702,776
Expense and equipment		0	1,589,794	1,384,400	0	2,974,194
State office building rent, maintenance, and repair		0	50,005	404,602	0	454,607
Workers' compensation claims		0	14,136	18,850	0	32,986
Insurance counseling contract costs		312,958	0	0	0	312,958
Lease parking		0	0	8,099	0	8,099
Article X refunds		0	5,545	6,233	0	11,778
Other refunds		0	0	63,455	0	63,455
Cost allocation plan		0	107,846	148,679	0	256,525
Claims/distributions		0	0	0	37,807	37,807
Administration/legal fees		0	0	0	9,305	9,305
Other		0	0	740	10,046	10,786
Total Disbursements		312,958	7,796,784	8,303,765	57,158	16,470,665
RECEIPTS OVER (UNDER) DISBURSEMENTS		0	227,052	2,070,652	2,196	2,299,900
CASH AND INVESTMENTS, JULY 1		0	649,861	10,076,526	2,365,061	13,091,448
CASH AND INVESTMENTS, JUNE 30	$	0	876,913	12,147,178	2,367,257	15,391,348

The accompanying Notes to the Financial Statements are an integral part of this statement.

Exhibit B

DEPARTMENT OF INSURANCE
COMPARATIVE STATEMENT OF RECEIPTS

		Year Ended June 30,	
		2004	2003
GENERAL REVENUE FUND			
Premium taxes	$	168,746,261	164,246,024
Surplus lines taxes		23,300,481	19,545,211
Total General Revenue Fund	$	192,046,742	183,791,235
WORKERS' COMPENSATION FUND			
Workers' compensation taxes	$	45,774,987	18,558,537
STATE SCHOOL MONEYS FUND			
Fines and forfeitures	$	752,780	1,330,377

The accompanying Notes to the Financial Statements are an integral part of this statement.

Exhibit C

DEPARTMENT OF INSURANCE
COMPARATIVE STATEMENT OF APPROPRIATIONS AND EXPENDITURES

	Year Ended June 30,					
	2004			2003		
	Appropriations	Expenditures	Lapsed Balances	Appropriations	Expenditures	Lapsed Balances
MDI - FEDERAL FUND						
Purpose of funding programs providing counseling on health insurance coverage and benefits to Medicare beneficiaries	$ 450,000	272,210	177,790	450,000	312,958	137,0
Total MDI - Federal Fund	450,000	272,210	177,790	450,000	312,958	137,0
INSURANCE EXAMINERS FUND						
Market conduct and financial examinations of insurance companies -						
Personal Service	5,369,071	4,693,047	676,024	5,333,899	4,826,628	507,2
Expense and Equipment	2,095,607	1,518,980	576,627	2,095,607	1,589,794	505,8
Refunds	14,267	14,267	0	1	0	
Total Insurance Examiners Fund	7,478,945	6,226,294	1,252,651	7,429,507	6,416,422	1,013,0
DEPARTMENT OF INSURANCE DEDICATED FUND						
Real Property Leases	26,622	8,280	18,342 *	8,099	8,099	
Personal Service	5,000,976	4,610,135	390,841	4,973,628	4,769,257	204,3
Expense and Equipment	1,803,056	1,162,516	640,540	1,967,156	1,384,400	582,7
Refunds	50,000	47,642	2,358	75,000	63,455	11,5
Total Department of Insurance Dedicated Fund	6,880,654	5,828,573	1,052,081	7,023,883	6,225,211	798,6
Total All Funds	$ 14,809,599	12,327,077	2,482,522	14,903,390	12,954,591	1,948,7

* Biennial Appropriations

The accompanying Notes to the Financial Statements are an integral part of this statement.

Notes to the Financial Statements

DEPARTMENT OF INSURANCE
NOTES TO THE FINANCIAL STATEMENTS

1. Summary of Significant Accounting Policies

A. Reporting Entity and Basis of Presentation

The accompanying financial statements present only selected data for each fund of the Department of Insurance.

Receipts, disbursements, and changes in cash and investments are presented in Exhibit A for the MDI – Federal Fund, Insurance Examiners Fund, Department of Insurance Dedicated Fund, and Receivership Accounts. Appropriations from these funds, excluding the Receivership Accounts, are expended by or for the department for restricted purposes. The Receivership Accounts are controlled entirely by the department and are not subject to appropriations.

The Department of Insurance takes control of the assets and operations of insurance companies ordered into rehabilitation or liquidation by the courts, commonly referred to as receiverships. At June 30, 2004, eighteen insurance companies were in rehabilitation or liquidation. Department officials or employees control the operations and assets of three of these companies, which are included in the Receivership Accounts on Exhibit A. The department has appointed special deputy receivers to control the operation and assets of ten companies and has contracted with one vendor in the Kansas City area to oversee the operations and assets of five companies. The special deputy receivers and the vendor are not officials or employees of the department, therefore, the financial activities of these companies are not presented in the financial statements.

The "Total (Memorandum Only)" column is presented as additional analytical data. Because this column does not identify the restrictions that exist by fund, it should be read only with reference to the details of each fund.

Receipts are presented in Exhibit B for the state's General Revenue Fund, Workers' Compensation Fund, and State School Moneys Fund. Receipts include monies the department collects during its normal activities and remits to the funds. These amounts are not necessarily related to appropriations.

Appropriations, presented in Exhibit C, are not separate accounting entities. They do not record the assets, liabilities, and equity or other balances of the related funds but are used only to account for and control the department's expenditures from amounts appropriated by the General Assembly.

Expenditures presented for each appropriation may not reflect the total cost of the related activity. Other direct and indirect costs provided by the department and other state agencies are not allocated to the applicable fund or program.

B. Basis of Accounting

The Statements of Receipts, Disbursements, and Changes in Cash and Investments, Exhibit A, prepared on the cash basis of accounting, present amounts when they are received or disbursed.

The Statement of Receipts, Exhibit B, also prepared on the cash basis of accounting, presents amounts when received.

The Statement of Appropriations and Expenditures, Exhibit C, is presented on the state's legal budgetary basis of accounting. Expenditures generally consist of amounts paid by June 30, with no provision for lapse period expenditures unless the Office of Administration approves an exception. Amounts encumbered at June 30 must be either canceled or paid from the next year's appropriations.

However, the General Assembly may authorize continuous (biennial) appropriations, for which the unexpended balances at June 30 of the first year of the 2-year period are re-appropriated for expenditure during the second year. Therefore, such appropriations have no lapsed balances at the end of the first year.

The cash basis of accounting and the budgetary basis of accounting differ from accounting principles generally accepted in the United States of America. Those principles require revenues to be recognized when they become available and measurable or when they are earned and expenditures or expenses to be recognized when the related liabilities are incurred.

C. Fiscal Authority and Responsibility

The department administers transactions in the funds listed below. The state treasurer as fund custodian and the Office of Administration provide administrative control over fund resources within the authority prescribed by the General Assembly, except for the Receivership Accounts which are controlled entirely by the department.

<u>MDI – Federal Fund</u>: The department administers a program financed wholly or partially by federal monies maintained in the state treasury in the Missouri Department of Insurance's - Federal Fund. These federal monies may be received in advance, when related expenditures are made, or after they are made. Appropriations from this fund authorize disbursement of the department's federal monies.

<u>Insurance Examiners Fund</u>: This fund is authorized by Sections 374.160 and 374.162, RSMo, to receive all monies paid to the state by insurance companies for the costs incurred by the department in conducting examinations, valuations, or proceedings against such companies. Expenditures, authorized by appropriations, are to be used for the purpose of paying the compensation of insurance examiners and

expenses incurred for supervision and support of the examiners. Any unexpended balances in this fund are perpetually maintained for the purposes of the fund.

Department of Insurance Dedicated Fund: This fund is authorized by Section 374.150, RSMo, to receive all fees due to the state under the provision of the insurance laws. Appropriation from this fund are to be used solely for the payment of expenditures incurred by the department in performing the duties required by law which are not paid for by another source of funds. Any unexpended balance in this fund is perpetually maintained for the purposes of this fund unless the unencumbered balance at the close of the biennium year exceeds two times the total amount appropriated, paid, or transferred to the fund during such fiscal year.

Receivership Accounts: The department established various joint bank accounts and investments outside of the state treasury for the payment of claims and administrative expenses for insurance companies that were placed under rehabilitation or liquidation by the department. These funds are not state funds.

General Revenue Fund: The department does not receive appropriations from this fund and does not maintain a proprietary interest in the fund. Receipts collected by the department and deposited into the state's General Revenue Fund include the following:

1) Premium taxes: In accordance with various provisions of Chapter 148, RSMo, insurance companies licensed in the state are required to pay a two percent tax on direct premiums received during the calendar year. The department certifies to the Department of Revenue the amount of premium taxes due together with the amount of quarterly installments to be paid by the insurance companies. The Department of Revenue collects the premium taxes and deposits them into the General Revenue Fund. Some premium taxes deposited into the General Revenue Fund are not available for general revenue purposes. The provisions of Chapter 148, RSMo, restrict about 50 percent of such premium taxes for distribution to the various school districts in the state.

2) Surplus lines taxes: In accordance with various provisions of Chapter 384, RSMo, the department collects and deposits into the General Revenue Fund a five percent tax on net premiums for high risk insurance that is underwritten by a surplus lines insurer. The department certifies to the Department of Revenue all penalties and interest due as a result of late payments. The Department of Revenue collects the penalties and interest and deposits them into the General Revenue Fund.

Workers' Compensation Fund: In accordance with Section 287.690, RSMo, on October 31 each year, the director of the Division of Workers' Compensation estimates the amount of revenue required to administer this chapter and determines the rate of tax for the following calendar year based on that estimate as well as the estimated December 31 balance of the fund. The tax, which is imposed upon all insurance companies providing workers' compensation insurance coverage and authorized self-insurers, shall not exceed two percent in lieu of all other taxes on the workers' compensation net deposits, net premiums, or net assessments. The Department of Revenue collects these taxes and deposits them into the Workers' Compensation Fund.

State School Moneys Fund: Fines and forfeitures imposed and collected by the department under the Missouri Insurance Code are deposited into the State School Moneys Fund.

D. Employee Fringe Benefits

In addition to the social security system, employees are covered by the Missouri State Employees' Retirement System (MOSERS) (a noncontributory plan) and may participate in the state's health care, optional life insurance, cafeteria, and deferred compensation and deferred compensation incentive plans. The optional life insurance and cafeteria plans involve only employee contributions or payroll reductions. The deferred compensation plan involves employee payroll deferrals and the deferred compensation incentive plan a state contribution for each employee who participates in the deferred compensation plan and has been employed by the state for at least one year.

The state's required contributions for employee fringe benefits are paid from the same funds as the related payrolls. Those contributions are for MOSERS (retirement, basic life insurance, and long-term disability benefits); social security and medicare taxes; health care premiums; and the deferred compensation incentive amount.

Employee fringe benefits in the financial statements at Exhibit A are the transfers from the Insurance Examiners Fund and Department of Insurance Dedicated Fund for costs related to salaries paid from those funds. Transfers related to salaries are not appropriated by agency and thus are not presented in the financial statement at Exhibit C.

2. Cash and Investments

The balances of the MDI – Federal Fund, Insurance Examiners Fund, and Department of Insurance Dedicated Fund are pooled with other state funds and invested by the state treasurer.

The balances of the Receivership Accounts are held outside the state treasury and are not considered state funds.

3. State Office Building Rent, Maintenance, and Repair

The Office of Administration calculated the proportional share of operating costs and maintenance, repair, and renovation costs for the department's occupancy in state-owned buildings. Monthly transfers were made from the Insurance Examiners Fund and Department of Insurance Dedicated Fund to the state's General Revenue Fund to cover each fund's share of the costs.

4. Insurance Counseling Contract Costs

The department contracted with the Missouri Patient Care Review Foundation to provide insurance counseling services for senior citizens. This expenditure category represents the costs associated with the contract paid from the MDI – Federal Fund.

5. Lease Parking

The Missouri General Assembly made appropriations from the Department of Insurance Dedicated Fund for the department's proportionate share of lease parking at the state office buildings in St. Louis and Kansas City. These appropriations are administered by the Office of Administration, Division of Facilities Management.

6. Article X Refunds

Article X, Sections 16 through 24 of the Missouri Constitution establishes a revenue limit for Missouri State Government. Total state revenues exceeded this limit in fiscal year 2000, which triggered income tax refund liabilities in fiscal year 2003 under provisions of the Constitution. The Office of Administration calculated the proportional share of the liabilities to be allocated to each fund and transfers were made from the Department of Insurance Dedicated Fund to the state's General Revenue Fund to cover the fund's share of the liabilities.

7. Cost Allocation Plan

The Office of Administration calculated the state's costs of services provided by the Office of Administration, Department of Revenue, State Auditor, State Treasurer, and retiree health care to be allocated to the various state funds based on how the various funds create work for agencies in the pools. Transfers were made from the Insurance Examiners Fund and Department of Insurance Dedicated Fund to the state's General Revenue Fund to cover each fund's share of the costs.

8. Transfer to General Revenue Fund

With the passage of Senate Bill 675, effective August 28, 2003, the General Assembly authorized an immediate one-time transfer of the greater of $6,015,855 or 55 percent of the balance of the Department of Insurance Dedicated Fund to the state's General Revenue Fund. As a result, $7,471,680, which represented 55 percent of the fund balance, was transferred.

9. Securities on Deposit

Insurance companies doing business in Missouri are required to deposit securities with the department for the protection of policy holders and creditors in accordance with various provisions of Chapters 354, 376, 379, 381, and 384, RSMo. Only capital securities are required and the requirements are dependent on the type of insurance company.

Securities having a total accepted value of approximately $283 million and $338 million at June 30, 2004 and 2003, respectively, were on deposit with the contracted bank. The accepted value is the market value of each security at year-end. These amounts are not included in the financial statements because the department has no ownership interest in them. Missouri domiciled insurance companies sometimes maintain securities on deposit in excess of Missouri requirements to meet the depository requirements of other states in which they do business. Foreign domiciled insurance companies are frequently not required to deposit securities with the department if securities meeting Missouri requirements are on deposit with the applicable state of domicile.

10. Reconciliation of Total Disbursements to Appropriated Expenditures

Disbursements on Exhibit A reconcile to appropriated expenditures on Exhibit C as follows:

Insurance Examiners Fund

	Year Ended June 30, 2004	2003
DISBURSEMENTS PER EXHIBIT A	$ 7,656,941	7,796,784
Employee fringe benefits	(1,204,912)	(1,202,830)
State office building rent, maintenance, and repair	(47,828)	(50,005)
Workers' compensation claims	0	(14,136)
Article X refunds	0	(5,545)
Cost allocation plan	(168,680)	(107,846)
Other	(9,227)	0
EXPENDITURES PER EXHIBIT C	$ 6,226,294	6,416,422

Department of Insurance Dedicated Fund

		Year Ended June 30,	
		2004	2003
DISBURSEMENTS PER EXHIBIT A	$	15,417,348	8,303,765
Employee fringe benefits		(1,537,890)	(1,499,946)
State office building rent, maintenance, and repair		(386,922)	(404,602)
Workers' compensation claims		(24,951)	(18,850)
Article X refunds		0	(6,233)
Cost allocation plan		(167,332)	(148,679)
Transfer to General Revenue Fund-State		(7,471,680)	0
Other		0	(244)
EXPENDITURES PER EXHIBIT C	$	5,828,573	6,225,211

11. Prior Period Adjustment

The July 1, 2002 cash and investment balance of the Receivership Accounts was increased by $2,240,029 for amounts not previously reported.

Supplementary Data

Schedule

DEPARTMENT OF INSURANCE
COMPARATIVE STATEMENT OF EXPENDITURES (FROM APPROPRIATIONS)

		Year Ended June 30,				
		2004	2003	2002	2001	2000
Salaries and wages	$	9,303,182	9,595,885	9,578,426	9,176,471	8,709,450
Travel, in-state		266,763	403,959	360,821	296,436	348,109
Travel, out-of-state		1,087,842	1,001,410	1,230,230	1,110,729	1,065,140
Fuel and utilities		0	0	0	0	66
Supplies		222,291	243,260	268,817	0	0
Administrative supplies		0	0	0	272,575	236,909
Merchandising supplies		0	0	0	325	1,909
Repair, maintenance, and usage supplies		0	0	0	3,432	2,432
Residential supplies		0	0	0	917	879
Specific use supplies		0	0	0	5,079	3,441
Professional development		71,886	143,369	121,462	112,843	152,951
Communication service and supplies		215,799	227,574	208,347	213,969	16,985
Services:						
Business		0	0	0	199,587	171,708
Professional		458,625	460,601	496,368	191,039	213,047
Housekeeping and janitorial		53	442	0	61	57
Maintenance and repair		103,228	85,172	60,198	0	0
Equipment maintenance and repair		0	0	0	71,386	92,090
Transportation maintenance and repair		0	0	0	1,116	0
Computer equipment		140,346	281,749	178,110	134,623	414,586
Electronic and photo equipment		0	0	0	9,528	2,500
Motorized equipment		10,185	34,737	0	32,196	0
Office equipment		11,026	1,235	33,375	103,271	32,755
Specific use equipment		0	0	0	161	0
Stationary equipment		0	0	0	3,929	0
Property and improvements		0	0	4,087	0	17,202
Debt service		7,882	14,746	9,741	0	0
Real property rentals and leases		8,608	10,030	10,898	8,705	7,948
Equipment rental and leases		76,279	69,277	43,623	0	0
Building lease payments		0	0	0	82,923	82,077
Building and equipment rentals		0	0	0	3,792	35,122
Miscellaneous expenses		8,965	4,731	2,462	3,717	4,108
Rebillable expenses		0	0	0	0	324,723
Refunds		61,909	63,455	79,739	39,734	37,446
Program distributions		272,210	312,958	400,000	357,316	166,306
Total Expenditures	$	12,327,077	12,954,591	13,086,704	12,435,860	12,139,946

Note: Certain classifications of expenditures changed during the five-year period,
which may affect the comparability of the amounts.

MANAGEMENT ADVISORY REPORT SECTION

Management Advisory Report -
State Auditor's Findings

DEPARTMENT OF INSURANCE
MANAGEMENT ADVISORY REPORT -
STATE AUDITOR'S FINDINGS

We have audited the financial statements of the Department of Insurance as of and for the years ended June 30, 2004 and 2003, and have issued our report thereon dated April 14, 2005.

The following Management Advisory Report presents our findings arising from our audit of the department's financial statements. During our audit, we also identified certain management practices which we believe could be improved. Our audit was not designed to be a detailed study of every system, procedure, and transaction. Accordingly, the findings presented in the following report should not be considered all-inclusive of areas needing improvement.

1. Examination Billings

The department's examination billing policies may not comply with state law, and amounts billed may not accurately reflect actual costs incurred. Conducting financial and market conduct examinations is an important responsibility of the Missouri Department of Insurance (MDI). Financial examinations assess the insurance companies financial stability, whereas market conduct examinations review insurance companies compliance with Missouri's insurance laws. During the years ended June 30, 2004 and 2003, the department received $7.8 and $8.0 million, respectively, from fees billed to insurance companies for conducting financial and market conduct examinations.

Current billing policies were established in 1993 when the legislature authorized the establishment of the Insurance Examiners Fund. Section 374.160.3, RSMo, states:

> "The director shall assess the expenses of any examination against the company examined and shall order that the examination expenses to be paid into the insurance examiners fund created by section 374.162. The director shall also assess an additional amount equal to fifteen percent of the total expenses of examination, to be paid for supervision and support of the examiners. . . ."

MDI's policy allows for examination billings to include the following four components:

- Actual examiners' salaries, benefits, and travel expenses.
- Actual contractual services.
- Indirect labor and operating expenses. Indirect labor consists of annual leave and sick leave taken by all examiners during the billing period, salaries and benefits of audit managers, special in-house projects prepared by examiners, and meetings and training for managers and examiners. Operating expenses include office supplies, computers, and other equipment used by examination staff.

- Fifteen percent administration fee for supervision and support of the examiners. Supervisory staff includes the Deputy Chief Financial Examiner, directors, and closers.

It appears that some of the amounts billed as indirect labor and operating costs could be considered as supervision and support of the examiners, and as such, should be included in the 15 percent administration fee as defined by state law. In particular, a portion of audit managers salaries and all meeting and training expenses appear to fall within the supervision and support definition. Therefore, the billing of certain indirect labor and operating expenses in addition to the 15 percent administration fee could be considered double-billing of certain expenses.

In addition, current billing policies do not allow the department to track the true costs of examinations. Salaries for directors, managers, and closers are approximately $550,000 annually. Salaries for managers are billed monthly as indirect labor costs based upon a percent of all examiners' direct hours worked on a particular examination as compared to total examiners' direct hours during the month (i.e. pro-rata basis). Salaries for directors and closers are considered part of the 15-percent administration fee. Directors and managers generally review and approve the examination plans and reports and closers work with insurance companies on finalizing penalties resulting from market conduct examinations. Therefore, it would appear reasonable for the department to track time spent directly by directors, managers, and closers on specific examinations and include these amounts as direct time billed to the insurance companies, and the remainder of their time could be considered part of the 15-percent administration fee. Based upon estimates made by department personnel, it appears approximately $350,000 of directors', managers', and closers' annual salaries could be billed as direct costs.

A review of one market conduct examination noted that it was conducted entirely by a manager. Because manager time is pro-rated based on direct time spent by the examiners, nothing was billed to this insurance company for this market conduct examination. In addition, manager travel costs are pro-rated in the same manner as salary costs, which appears unreasonable because these costs could be easily tracked and billed as direct costs. The department's four managers usually make one or two trips to the work site during each examination.

The MDI should review its current examination billing policies to ensure they comply with state law and ensure billings reflect the true costs of each examination. The MDI should consider seeking legislation or legal opinions regarding any issues needing clarification.

WE RECOMMEND the MDI review its current examination billing policies and ensure the true cost of each examination is tracked and billed. Any legal matters needing clarification should be resolved by seeking applicable legislation or legal opinions.

AUDITEE'S RESPONSE

The Department has used its current methodology of allocating expenses of financial and market conduct examinations since 1992. The Department believes this method is reasonable and in accordance with the law. The Department will review its current examination billing policies to determine if there is a more accurate, equitable, and efficient way to bill expenses to the individual companies and if changes are necessary.

2. Examination Tax Credit

The State of Missouri is one of only five states to allow insurance companies to receive tax credits for examination costs. Section 148.400, RSMo, allows all insurance companies to deduct the entire cost of examinations from premium taxes paid to the state and deposited into the state's General Revenue Fund. Additionally, a state law passed in 2001 allows insurance companies to carry forward these credits for five years beginning with the 2004 tax year. For the tax years 2004 and 2003, examination tax credits claimed were approximately $2.7 and $3.2 million, respectively. For the tax year 2004, available credits were $7.3 million with a carryover of approximately $4.3 million. In essence, the state's General Revenue Fund is paying a significant portion of the examination costs instead of charging all the costs to insurance companies as a part of doing business in Missouri.

WE RECOMMEND the MDI review this issue and consider seeking legislation to reduce or eliminate the examination tax credit.

AUDITEE'S RESPONSE

The Department will continue to provide information on the examination tax credit as well as the other tax credits taken by insurance companies to the general assembly as required under the Tax Credit Accountability Act - SB 1099. The Department will review this tax credit along with other examination billing issues identified in this audit to determine if legislative changes should be sought.

3. Travel Costs and Policies

Insurance examiners travel to the insurance companies' domicile to conduct required examinations. Annual travel costs for the two years ended June 30, 2004 and 2003, averaged approximately $1.3 million. Our review of travel costs and policies noted the following concerns:

A. MDI policies do not require examiners to evaluate alternative work schedules to ensure the most cost-effective schedule is selected. Current travel policies require examiners to return home every weekend unless it is less expensive to stay at the job site one weekend and return home every second weekend. However, examiners are not required to document and compare estimated travel costs for the two alternative work schedules if they just choose to return home every weekend. Therefore, the least expensive alternative may not be chosen for each examination. Failure to evaluate alternative work schedules for each examination could result in increased travel costs.

A similar finding was noted in our prior report.

B. MDI policies do not require examiners to obtain airfare quotes prior to incurring the costs. In addition, MDI does not adequately monitor and track airfare costs.

1) Examiners book their own flights but are not required to obtain airfare quotes. The MDI should adopt a policy which requires examiners to obtain and document more than one airfare quote prior to the start of each examination and select the lowest and best airfare. Supervisory review and approval of this process should be documented. Because airfares tend to change frequently, the MDI should also consider requiring periodic updates of the airfare quotes throughout the examination.

2) Airfare can be billed directly to the MDI or reimbursed through the examiner's expense accounts. Airfare costs billed directly to MDI for the two years ended June 30, 2004 and 2003, were approximately $139,000 and $165,000, respectively. However, MDI does not separately track airfare cost reimbursed through the examiners expense accounts. The MDI should adopt policies and procedures to separately track and monitor all airfare costs. By not monitoring all airfare costs and allowing employees to have airfare billed direct or billed through the expense accounts, the opportunity for double-billings is increased.

<u>WE RECOMMEND</u> the MDI:

A. Adopt policies which require examiners to document planned travel costs for each examination and require the least expensive travel methods to be used. Any extenuating circumstances which require use of a more expensive travel method should be fully documented and approved by management.

B.1. Require examiners to obtain more than one airfare quote and use the lowest and best rates, and require supervisory approval of airfare costs prior to incurring the related expenditure.

B.2. Adopt procedures to monitor all airfare costs, whether direct-billed or incurred through employee expense accounts.

AUDITEE'S RESPONSE

A. The Department is committed to conducting examinations in as cost-effective manner as possible. In response to a previous audit finding, the Department implemented a system where examiners come home every weekend unless it is more reasonable to stay. Currently only deviations from the travel policy or examiner work schedule are documented and approved. The Department will review current practices and put in place a procedure to document planned travel costs during the examination planning stage to ensure the most reasonable travel methods are used. The Department will monitor the documented planned travel arrangements and exam work schedules to ensure they are consistent with effective and efficient management of examinations.

B.1. Examiners currently compare various airfares for cost and flight times when planning for an examination. The Department will incorporate documentation of the airfare quotes to be included in the procedure referenced in the response above.

B.2. The Department has implemented the use of sub object codes when processing expense accounts so airfares can be monitored regardless of whether they are direct-billed or incurred through an expense account.

4. Receiverships

The MDI does not require insurance companies in receivership to obtain independent audits, and the MDI does not perform examinations of these companies. Sections 375.1150 to 375.1246, RSMo, provide the director of the MDI with the authority to administer Missouri chartered insurance companies requiring rehabilitation or liquidation, commonly referred to as receiverships. Such companies placed into receivership are under circuit court supervision with the judge appointing the MDI director as receiver. The director may appoint a special deputy receiver or agent. At June 30, 2004, there were two Missouri chartered insurance companies in rehabilitation and sixteen in liquidation. Many of these receiverships have continued for several years with eleven companies in receivership since the 1990s.

For those companies involved in the liquidation process, significant administrative expenses are incurred which decrease the overall assets available at final liquidation. These expenses can include items such as special deputy receiver fees, legal fees, investment fees, payroll, travel, professional services, office expenses, and income taxes. Based upon the reports submitted to the MDI, total administrative expenses for receiverships exceeded $31 million in 2004, with over $20 million being incurred by one receivership.

The MDI has established regulations regarding reporting requirements for insurance companies in receivership, but these regulations do not require independent audits and/or examinations by MDI staff. Without performing examinations of the accounting records maintained by the special deputy receivers or requiring audits of these records, the MDI has less assurance that the reports submitted to the MDI are accurate and can be relied upon. In addition, examinations or audits would provide additional assurance that receivership expenses are reasonable and prudent and that claims are properly handled.

WE RECOMMEND the MDI require independent audits for all receiverships or perform examinations or other monitoring procedures to ensure the information and reports submitted by the special deputy receivers or agent are accurate.

AUDITEE'S RESPONSE

The Department has monitoring procedures in place to assure that reports submitted are accurate. The Department requires an annual financial report from each company in receivership. The Department receives copies of all bank statements from each bank account of each company. The Department approves the salaries of all employees and approves all fee invoices of professional persons rendering services to the company, as does the supervising court. Many of the smaller receiverships are under the direct control of the Department, because they have no special deputy receiver. For some of them, the checkbook is at the Department. Two of the larger receiverships retain independent auditors. Missouri statutes require that periodic financial reports be filed with the supervising court. The receivership section actively monitors the activities of the receiverships and the Department believes that the interest of the creditors, to the extent that the expense involved would further reduce claims payments would not be served by requiring independent audits or MDI examinations of all receiverships. In addition, supervising courts have the discretion, by statute, to order an audit of any receivership at any time.

5. Surplus Lines

The department's examination policies for surplus lines brokers are not being met and the department does not bill examination costs to out-of-state brokers. The policy on assessing fines for late filings is vague and is not always followed. Receipts recorded on the surplus lines tax system is not reconciled to receipts recorded on the Statewide Advantage for Missouri System (SAM II).

The MDI regulates the placement of coverage and collection of taxes on premiums for insurance policies written in the non-admitted market known as surplus lines. The non-admitted market consists of insurers that are not otherwise licensed to do business in Missouri, but are eligible to write insurance policies for coverage not served in the general commercial market. Surplus lines brokers are required to report annually the premiums for policies issued and remit a tax of five percent of total premiums to the MDI. The MDI also collects delinquent premium taxes and certifies the delinquent collection amounts to the Department of Revenue (DOR), and the DOR collects applicable interest and penalties.

Surplus lines revenues have almost tripled over the last five years. Revenues for the year ended June 30, 2000, were approximately $7.8 million, while revenues for the year ended June 30, 2004, were approximately $23.3 million. The number of surplus lines brokers also increased from 250 to 547 during this same time period. In general, the increase in the number of brokers can be attributed to a 2001 state law allowing out-of-state brokers to sell surplus lines insurance in Missouri.

A. The department's examination policies for surplus lines brokers are not being met, and the overall policies and procedures of the surplus lines section appear to impact the timeliness and adequacy of examinations.

1) Examinations of surplus lines brokers are not conducted at least once every three years, as specified in MDI policy. This policy appears to be based upon Section 384.048, RSMo, requiring each surplus lines broker to keep all insurance contracts subject to examination by the MDI for a period not less than three years following termination of the contract.

MDI's listing of surplus lines examinations conducted through calendar year 2004 noted the following:

- 22 Missouri brokers have not been examined since prior to 2002.
- 35 Missouri brokers have never been examined and 16 of these brokers had a license effective date prior to 2002.
- 71 out-of-state brokers have not been examined and 8 had a license effective date prior to 2002.

2) Surplus lines procedures may be inadequate to handle current growth in surplus lines insurance. Currently, the MDI surplus lines section employs three examiners and one supervisor. Surplus lines personnel indicated they spend significant time entering premium tax form data into the MDI surplus lines tax information system, and it appears that some of the data entry is a duplication of tax payment information received from and already recorded by the Support Services Section. In addition to duplicating tax payment information, MDI must input filings for each policy written and then date stamp and return a copy of the filing to the insurance companies. During 2004, MDI received approximately 55,000 filings on policies written.

Staffing levels, duties, and policies and procedures should be reviewed to ensure adequate monitoring of surplus lines broker and to determine if duplication of procedures performed by other sections can be minimized or eliminated. Failure to conduct periodic examinations of surplus lines brokers could result in lost revenues.

B. The MDI does not bill examination costs to out-of-state surplus lines brokers. Section 384.048, RSMo, states such examination costs shall be paid by nonresident surplus lines licensees. This statute has been in effect since 1989 and the MDI has not billed any applicable costs. MDI records indicate that 7 examinations of out-of-state surplus lines brokers were conducted during the two years ended June 30, 2004. Failure to bill the costs of these examinations results in lost revenues.

C. The MDI does not have a formal policy for assessing fines on late filings for policies issued. These reports on policies issued are compared to annual reports filed by brokers to help ensure all premium taxes have been paid. Section 384.071, RSMo, allows MDI to assess up to $1,000 for the first offense and up to $2,000 for additional offenses. MDI's unwritten rule is to assess a penalty if ten percent of a broker's reports are filed untimely; however, no fines have been charged to date. Failure to assess fines could result in an increased number of surplus lines tax forms not being filed in a timely manner.

D. Receipts recorded on the MDI surplus line tax system are not reconciled to receipts recorded on the SAM II system. Receipts are initially recorded by the Support Services Section and reconciled to SAM II. However, the surplus line tax system is not reconciled to SAM II even though this system is used to generate delinquent tax collection letters. Without a reconciliation, MDI has less assurance that the surplus lines tax system contains accurate receipt information.

WE RECOMMEND the MDI:

A. Review the staffing levels and duties of current surplus lines staff and ensure surplus lines examinations are conducted at least once every three years in accordance with department policy.

B. Bill for surplus lines examinations of out-of-state brokers, as required by state law.

C. Establish policies for assessing fines for untimely filings of surplus lines tax forms.

D. Reconcile receipts recorded on the surplus lines tax system to SAM II.

AUDITEE'S RESPONSE

A. The Department will review staffing levels and duties within the section as well as the policy to conduct examinations once every three years for possible changes. The Department is currently conducting a review of the surplus lines area to determine if efficiencies can be gained and if staffing levels are adequate and duties are appropriately assigned.

B. Historically, the examinations of non-resident producers have occurred just over the borders of Missouri and have been done in conjunction with resident producers in the same area. Doing multiple examinations of resident and non-resident producers during the same trip makes allocation of the expenses difficult. The Department will pursue establishment of a procedure to bill non-resident producers where costs for examination can be identified.

C. The Department will establish a formal guideline for assessing fines for untimely filings of surplus lines tax forms.

D. *The Department will review its IT capabilities to determine if reconciling surplus lines receipts to SAM II is possible and not cost prohibitive.*

6. Title Insurance Examinations

Premiums on title insurance make up less than one percent of the total insurance premiums paid in Missouri; however, approximately 10 percent of the MDI's market conduct staff are used exclusively to conduct examinations of title insurance companies. MDI personnel indicated that the number of staff devoted to this area is necessary due to the specialized expertise required for conducting these examinations.

Section 381.241, RSMo, required the MDI to review each title insurance company at least once every four years. This statute was repealed by the 2000 General Assembly as part of Senate Bill 894, which contained other significant changes to title insurance laws. As a result, the MDI reduced the number of applicable examinations since the title insurance business represented a small portion of all premiums paid in Missouri, and the staff that specialize in this area were utilized on other types of examinations. In 2002, the Missouri Supreme Court upheld a lower court decision which ruled that Senate Bill 894 was unconstitutional. Therefore, the MDI again started performing the title insurance examinations in accordance with Section 381.241, RSMo.

The MDI should review its current policies regarding examinations of title insurance companies and determine if changes are needed, such as legislative changes, to better utilize its resources.

WE RECOMMEND the MDI review the current title insurance examination requirements and consider seeking legislation to revise the applicable statute to better utilize MDI resources.

AUDITEE'S RESPONSE

The statutes require examination of title companies once every four years. The Department strives to use our resources effectively to better protect Missouri consumers by examining carriers that have trends of potential noncompliance identified based on market analysis. The Department agrees that the ability to select a title company for examination based on market analysis rather than a statutory requirement would be more efficient use of staff and resources.

7. Receipts

The MDI collects receipts for various taxes, fees, licenses, fines, and other miscellaneous items. Receipts handled by the MDI totaled approximately $41.5 million and $39.5 million for the years ended June 30, 2004 and 2003, respectively. Our review of controls over receipts noted the following concerns:

A. Some receipts are not transmitted to the DOR for deposit on a timely basis. While it appears some improvement has been made subsequent to the audit period, frequently checks are held by the Support Services Section until the receipt can be identified or notification is received from another section of the MDI that the check is for the correct amount. If the check is not for the correct amount, it will be returned to the party submitting it. The Support Services Section records the checks being held on a "pending check log," and also records the date the check is transmitted or returned on this log.

A review of the June 2004 log noted 329 checks totaling approximately $223,000 were held an average of four days for checks that were returned to the party submitting them and six days for checks that were transmitted to the DOR. To adequately safeguard monies and reduce the risk of loss or misuse of funds, checks should be returned or transmitted to the DOR on a timely basis.

B. Controls over receipt processing should be improved by eliminating receipt handling by mailroom employees and by processing receipts in a more secure location. A mailroom employee picks up the mail which is sorted by three mailroom employees. A support services employee will also help sort mail on days with larger mail volume. Once sorted, mailed receipts are sent to support services. Two support services employees record and prepare receipts for deposit. Access to the mailroom and the support services section is not limited to individuals only involved in the handling or processing of receipts.

For the period reviewed, approximately 75 percent of all monies were sent to a post office box specifically used for certain types of receipts. It appears that the receipts in this post office box could be sent directly to support services to be processed, thus eliminating the need for mailroom employees to be involved in this process.

To adequately safeguard monies and reduce the risk of loss or misuse of funds, the number of employees receiving, processing, and monitoring cash processing should be reduced and access to these areas should be limited to necessary employees.

<u>WE RECOMMEND</u> the MDI:

A. Reduce the number of days receipts are held prior to being transmitted to DOR for deposit.

B. Improve controls over receipt processing by eliminating, to the greatest extent possible, handling by mailroom employees, and ensure receipts are processed in a secure location.

AUDITEE'S RESPONSE

A. *MDI has reduced the number of days a check can be held from 15 to 10 working days. Checks are held and recorded in a check log when MDI is unable to determine what the check is for and where it should be deposited. MDI will promptly notify sections that a check is being held and follow up with section supervisors to ensure checks are not held beyond the established timeframe.*

B. *MDI has installed a split door with locks to ensure mail is processed in a secure location. MDI will review if additional modifications can be made to accounts receivable area to limit access while deposits are being processed. MDI will review procedures and duties for accounts receivable and mailroom staff to determine if reassignment of duties or staff is necessary.*

8. Federal Grant Expenditures

The MDI receives a federal grant from the U.S. Department of Health and Human Services (DHHS), Centers for Medicare and Medicaid Services. This grant is used to contract with a not-for-profit foundation to provide insurance counseling services for senior citizens. As similarly noted in prior audits, the MDI does not always require the foundation to provide detailed documentation supporting amounts claimed for reimbursement under the grant agreement. Amounts paid to the foundation totaled approximately $272,000 and $312,000 for the years ended June 30, 2004 and 2003, respectively.

To obtain payment from the MDI, the foundation submits monthly invoices listing the hours spent by various personnel and the hourly reimbursement rate for the applicable personnel. Also included on the invoice are other operating expenses, such as temporary employees, telephone, promotional items, postage, and travel. The MDI tracks these expenses to ensure they are within the grant budget amount and also compares these expenses to monthly performance reports for reasonableness; however, detailed documentation is not always received from the foundation. For example, expenses of approximately $36,000 related to a conference were mainly supported by figures provided on a calculator tape, but did not include copies of invoices or other detailed documentation. In general, our review noted improvements in supporting documentation submitted by the foundation, but additional improvement is needed to ensure there is support for significant expenditures.

Also included on the invoices are amounts for fringe benefits and indirect costs, which represent the largest expense categories for the grant. The foundation bills for fringe benefits and indirect costs based upon provisional rates approved by the DHHS. However, the MDI does not require an adjustment once the final fringe benefit and indirect cost rates have been approved by the DHHS.

To ensure amounts paid are reasonable and in compliance with the grant requirements, the MDI should establish expenditure thresholds and require supporting documentation for expenditures above these thresholds. In addition, fringe benefits and indirect costs should be billed at the final rates approved by the DHHS.

WE RECOMMEND the MDI should establish expenditure thresholds and require supporting documentation for expenditures above these thresholds. In addition, the contract between MDI and the foundation should be amended to include an adjustment clause once the actual fringe benefits and indirect costs have been approved.

AUDITEE'S RESPONSE

MDI amended the contract with foundation beginning with the FY05 contract year. MDI will review historical expenditures by category and set baseline thresholds for each category that require additional supporting documentation when exceeded.

This report is intended for the information and use of the management of the Department of Insurance and other applicable government officials. However, pursuant to Section 29.270, RSMo, this report is a matter of public record and its distribution is not limited.

Follow-Up on Prior Audit Findings

DEPARTMENT OF INSURANCE
FOLLOW-UP ON PRIOR AUDIT FINDINGS

In accordance with *Government Auditing Standards*, this section reports the auditor's follow-up on action taken by the Department of Insurance on findings in the Management Advisory Report (MAR) of our prior audit reports issued for the three years ended June 30, 2002, and our audit of the department's Division of Consumer Affairs, Complaint Processing issued in June 2002. The prior recommendations which have not been implemented, but are considered significant, are repeated in the current MAR. Although the remaining unimplemented recommendations are not repeated, the department should consider implementing those recommendations.

DEPARTMENT OF INSURANCE
THREE YEARS ENDED JUNE 30, 2002

1. Examiners' Expense Accounts

   A. The Missouri Department of Insurance (MDI) travel policies allow examiners domiciled in the same location and working on the same examination to use different travel methods, which appears to result in higher travel costs.

   B. The MDI does not require examiners to ride together when driving to the examination site or to the airport.

   Recommendation:

   The MDI:

   A. Adopt policies which require examiners to document planned travel costs for each examination and require the least expensive travel methods to be adopted and approved. Any extenuating circumstances which require adoption of more expensive travel methods should be fully documented.

   B. Require examiners to ride together to examination sites when feasible.

   Status:

   A. Not implemented. See MAR finding number 3.

   B. Not implemented. The department reviewed its policy and decided not to change the policy based upon liability concerns. Although not repeated in the current MAR, our recommendation remains as stated above.

2. Surplus Lines Delinquent Premium Taxes

The MDI did not always certify surplus lines delinquent premium taxes to the Department of Revenue (DOR) within the time frame outlined in a cooperative agreement between the two parties.

Recommendation:

The MDI certify delinquent surplus line premium tax collections to DOR within time frames required by the cooperative agreement.

Status:

Implemented.

3. Federal Grant Expenditures

The MDI received a federal grant to contract with a not-for-profit foundation to provide insurance counseling services to senior citizens. The MDI did not require the foundation to provide detailed documentation supporting the amounts claimed for reimbursement, including its fringe benefit and indirect cost rate calculations.

Recommendation:

The MDI require the foundation to submit adequate supporting documentation to support expenses claimed for reimbursement. In addition, the MDI should require the foundation to document its fringe and indirect cost rate calculations.

Status:

Partially implemented. The MDI modified the contract to establish maximum quarterly payments and made other changes to the contract terms. However, the MDI has not required the foundation provide detailed documentation to support some expenses claimed for reimbursement. See MAR finding number 8.

DEPARTMENT OF INSURANCE
DIVISION OF CONSUMER AFFAIRS
COMPLAINT PROCESSING

1.1 The Consumer Services section handled the processing of insurance complaints received from consumers. Formal policies and procedures for the Consumer Services section had not been established. In addition, adequate responses were not always obtained from insurance companies prior to closing complaint cases.

1.2 Supervisors did not review consumer complaint files before they were closed to ensure reasonably specific information was received from insurance companies.

1.3 Supervisors indicated they performed monthly reviews of open complaint files but did not document those reviews.

Recommendation:

The Director, Department of Insurance:

1.1 Establish written policies and procedures for the Consumer Services section, including the use of enforcement tools to obtain specific responses.

1.2 Establish procedures for a supervisory review of complaint files before they are closed.

1.3 Evaluate the effectiveness of the monthly management reports.

Status:

1.1 The department is in the process of developing written policies and procedures for this section. Although not repeated in the current MAR, our recommendation remains as stated above.

1.2&
1.3 Implemented.

STATISTICAL SECTION

History, Organization, and
Statistical Information

DEPARTMENT OF INSURANCE
HISTORY, ORGANIZATION, AND
STATISTICAL INFORMATION

The Missouri Division of Insurance was created by an act of the Missouri legislature in 1869. With the enactment of the state Omnibus Reorganization Act of 1974, the agency was transferred to the Department of Consumer Affairs, Regulation and Licensing. Constitutional Amendment No. 6, passed in August 1984, changed the name of the Department of Consumer Affairs, Regulation and Licensing, to the Department of Economic Development, effective September 7, 1984. Constitutional Amendment No. 4, passed in August 1990, created a new Department of Insurance (MDI), effective July 1, 1991.

The department operates under the authority of Chapter 374, RSMo. The management and control of the department is vested in a director who is nominated by the governor with the advice and consent of the Senate. Scott Lakin served as Director from March 15, 2001 to January 7, 2005. Douglas M. Ommen, currently the Deputy Director, served as acting Director from January 8, 2005 to February 23, 2005. W. Dale Finke was appointed Director on February 24, 2005, and continues to serve in that capacity.

When the agency was organized in 1869, 51 domestic and 120 foreign insurance companies were licensed in Missouri. As of May 2004, there were 244 domestic and 1,562 foreign insurance companies licensed in Missouri.

The MDI regulates the insurance industry in the state through enforcement of Chapters 325, 354, and 374 through 385, RSMo. The department regulates and licenses the insurance industry in the state; ensures that the insurance industry is financially sound, trustworthy, competent, and responsive to the insurance-buying public; and ensures that the insurance industry complies with the laws of the state. To fulfill these responsibilities, the department maintains a central office in Jefferson City and branch offices in St. Louis and Kansas City. As illustrated in the following organization chart, the MDI is organized into these functional units: Market Regulation, Consumer Affairs, Resource Administration, and Financial Regulation. The MDI had 207 employees at June 30, 2004.

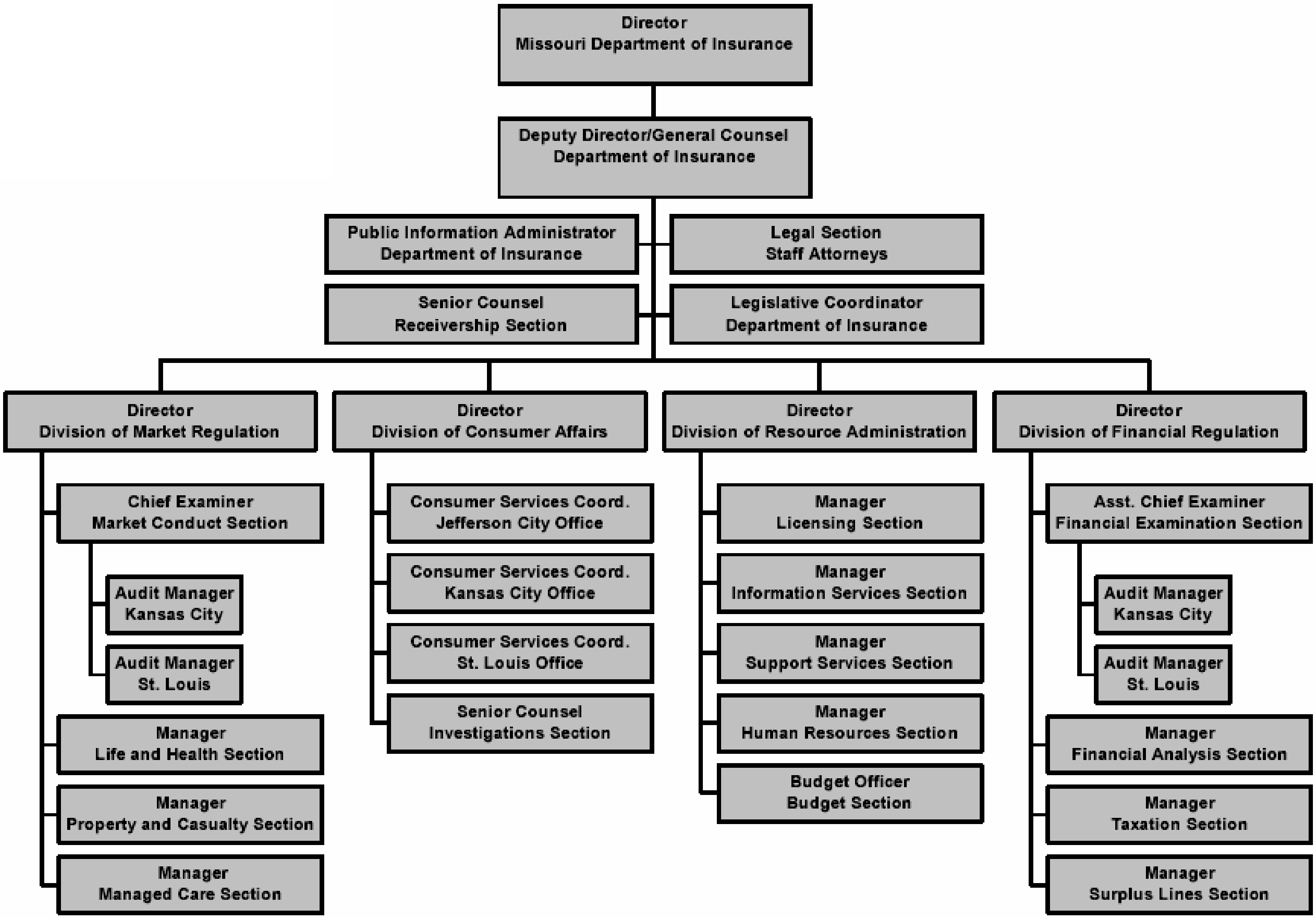
The MDI is authorized to administer Missouri chartered insurance companies requiring rehabilitation or liquidation, commonly referred to as receiverships. Such companies placed into receivership are under circuit court supervision with the judge appointing the MDI director as receiver. The director may appoint a special deputy receiver or agent. For five companies in receivership during the two years ended June 30, 2004, the department has contracted with a vendor in the Kansas City area to act as agent for these companies. While the vendor is not considered a department employee or official, the department retains certain supervisory functions over these companies that would normally be assigned to a special deputy receiver. This section contains schedules showing the financial activity of these five companies assigned to the vendor for the two years ended June 30, 2004.

The following provides a breakdown of the type of companies licensed in the state.

Type of Company	As of May 25, 2004 Missouri Domicile	Foreign
Assessment	2	0
FAIR Plan	1	0
Foreign Fire	0	6
Fraternal Benefit	2	33
Health Maintenance Organization	18	4
Health Services	1	0
Life	37	539
Malpractice	4	0
Missouri (Farm) Mutuals	23	0
Missouri Mutuals	92	0
Mutual Casualty	6	42
Mutual Fire	0	26
Prepaid Dental Plan	6	8
Reciprocal Inter-Insurance Exchange	4	13
Reinsurer	0	61
Risk Retention Group	0	64
Self-Insured Liability	7	0
Stock Casualty	37	648
Stock Fire	1	101
Title	3	17
Totals	244	1,562

According to the National Association of Insurance Commissioners (NAIC), for 2003, Missouri ranks thirteenth nationally in the number of companies incorporated in the state and nineteenth in the amount of premium volume written. The department's budget for fiscal year 2003 ranks nineteenth nationally.

DEPARTMENT OF INSURANCE
ORGANIZATION CHART
JUNE 30, 2004



DEPARTMENT OF INSURANCE
STATEMENT OF RECEIPTS, DISBURSEMENTS, AND CHANGES IN CASH AND INVESTMENTS
FOR RECEIVERSHIPS ADMINISTERED BY KANSAS CITY-AREA VENDOR
YEAR ENDED JUNE 30, 2004

		International Financial Security Life Insurance Company	Lutheran Benevolent Insurance Exchange	Professional Medical Insurance Company	Professional Mutual Insurance Company Risk Retention Group	U.S. Physicians Mutual Insurance Company Risk Retention Group
RECEIPTS						
Premiums/investment income	$	4,310,480	72,198	199	22,138	29,883
Total Receipts		4,310,480	72,198	199	22,138	29,883
DISBURSEMENTS						
Claims/distributions		0	112,461	0	0	1,286,503
Special deputy receiver and legal fees		1,521,552	69,426	71,078	0	41,685
Other		205,886	27,561	662	0	0
Total Disbursements		1,727,438	209,448	71,740	0	1,328,188
RECEIPTS OVER (UNDER) DISBURSEMENTS		2,583,042	(137,250)	(71,541)	22,138	(1,298,305)
ACCRUAL ADJUSTMENTS		(1,069,210)	(291,196)	0	0	4,380
CASH AND INVESTMENTS, JULY 1		10,245,052	5,541,969	182,151	0	1,473,761
CASH AND INVESTMENTS, JUNE 30	$	11,758,884	5,113,523	110,610	22,138	179,836

DEPARTMENT OF INSURANCE
STATEMENT OF RECEIPTS, DISBURSEMENTS, AND CHANGES IN CASH AND INVESTMENTS
FOR RECEIVERSHIPS ADMINISTERED BY KANSAS CITY-AREA VENDOR
YEAR ENDED JUNE 30, 2003

		International Financial Security Life Insurance Company	Lutheran Benevolent Insurance Exchange	Professional Medical Insurance Company	Professional Mutual Insurance Company Risk Retention Group	U.S. Physicians Mutual Insurance Company Risk Retention Group
RECEIPTS						
Premiums/investment income	$	200,847	46,349	152,261	9,094	41,186
Total Receipts		200,847	46,349	152,261	9,094	41,186
DISBURSEMENTS						
Claims/distributions		0	450,092	2,511,782	719,633	73,311
Special deputy receiver and legal fees		1,166,464	3,854	50,097	16,533	232,379
Other		132,495	85,220	144,580	79,469	0
Total Disbursements		1,298,959	539,166	2,706,459	815,635	305,690
RECEIPTS OVER (UNDER) DISBURSEMENTS		(1,098,112)	(492,817)	(2,554,198)	(806,541)	(264,504)
ACCRUAL ADJUSTMENTS		3,613,624	117,458	(81,408)	(516)	8,451
CASH AND INVESTMENTS, JULY 1		7,729,540	5,917,328	2,817,757	807,057	1,729,814
CASH AND INVESTMENTS, JUNE 30	$	10,245,052	5,541,969	182,151	0	1,473,761