

EXECUTIVE DIGEST

FINANCIAL ANALYSIS DIVISION

INTRODUCTION

This report contains the results of our performance audit of the Financial Analysis Division, Insurance Bureau, Department of Commerce, for the period January 1, 1992 through November 30, 1994.

AUDIT PURPOSE

This performance audit was conducted as part of the constitutional responsibility of the Office of the Auditor General. Performance audits are conducted on a priority basis related to the potential for improving effectiveness and efficiency.

BACKGROUND

The Insurance Bureau, under the direction of the Insurance Commissioner, is responsible for enforcing laws related to the insurance and surety business. The Bureau derives its authority from Sections 500.100 - 500.8302 and Sections 550.1 - 550.1704 of the *Michigan Compiled Laws*. The Commissioner is empowered by statute to examine the financial condition and affairs of insurance companies authorized to operate in Michigan to ensure that the companies operate in a manner that will provide for a financially stable, reliable industry in the State.

These responsibilities are carried out in the Office of Financial Standards. The Financial Analysis Division is 1 of 4 divisions within the Office of Financial Standards. This Division monitors the financial stability of active insurance companies and their compliance with statutory requirements regarding reserves and other financial criteria. The Division is responsible for conducting analytical and financial reviews of annual and quarterly financial statements filed by approximately 1,700 insurance companies. Division analysts perform cursory reviews of all companies' financial statements and in-depth financial reviews of companies with potential financial problems.

As of November 30, 1994, the Division had 8 employees: a Division director, 6 analysts, and a secretary. The Division expended approximately \$537,000 for operations for the fiscal year ended September 30, 1994.

**AUDIT OBJECTIVES,
CONCLUSIONS, AND
NOTEWORTHY
ACCOMPLISHMENTS**

Audit Objective: To assess the effectiveness and efficiency of the Division in carrying out its statutory responsibilities and its policies and procedures related to the financial monitoring of insurance companies.

Conclusion: Generally, the Division was not effective or efficient in carrying out its statutory responsibilities. Our assessment noted a material reportable condition related to

the Division's effectiveness and efficiency in monitoring insurance companies' financial stability:

- Management actions reduced the Division's effectiveness and efficiency in monitoring the financial stability of insurance companies (Finding 1).

The Bureau disagreed with the conclusion that the Division was not effective or efficient in carrying out its statutory responsibilities. However, the Bureau has made changes and agreed with the audit recommendations. During the period covered by the audit, various actions, outside of the control of the Bureau, affected funding for the Bureau. For example, during fiscal year 1992-93, funding was eliminated by action of the State Legislature. As a result, the Bureau needed to replace the funding or lay off significant numbers of employees. Actions were implemented to prevent layoffs affecting various units of the Bureau. The actions included the reassignment of staff to the Receivership Division and the implementation of a special examination and investigation task force to provide additional regulatory oversight for Michigan's policyholders. These actions did not result in any increased exposure to Michigan's policyholders.

We also noted that the Division could improve its effectiveness and efficiency by evaluating the effectiveness of Division operations, enforcing documentation filing requirements, compiling significant financial ratios, acting within its statutory authority, and assigning the administrative

oversight of voluntary liquidations to the Receivership Division (Findings 2 through 6).

Audit Objective: To assess the effectiveness of the Division's methodology for performing insurance company financial statement reviews.

Conclusion: The Division's methodology for performing insurance company financial statement reviews could result in an effective system. However, because of problems noted in Finding 1, we could not fully measure the effectiveness of the Division's prescribed methodology.

Audit Objective: To assess the Division's timeliness in addressing problems and developing corrective action plans for insurance companies with financial problems identified during the financial monitoring process.

Conclusion: The Division was generally timely in addressing problems once they were identified during the financial monitoring process. We also noted that the Division could improve documentation of its monitoring efforts and follow-up actions (Finding 7).

Audit Objective: To assess the adequacy of the Division's efforts to obtain National Association of Insurance Commissioners (NAIC) accreditation.

Conclusion: We concluded that the Division's efforts were instrumental in securing legislation and implementing policies and procedures necessary to become accredited.

Noteworthy Accomplishments: On December 5, 1994, the Michigan Insurance Bureau received its NAIC Certificate of Accreditation.

**AUDIT SCOPE
AND
METHODOLOGY**

Our audit scope was to examine the program and other records of the Financial Analysis Division for the period January 1, 1992 through November 30, 1994. Our audit was conducted in accordance with *Government Auditing Standards* issued by the Comptroller General of the United States and, accordingly, included such tests of the records and such other auditing procedures as we considered necessary in the circumstances.

Our methodology included interviewing Division staff and management and reviewing the Michigan Insurance Code and Division policies and procedures to gain an understanding of the Division's purpose and responsibilities. We reviewed related research, independent studies, and audit reports of other states related to monitoring the financial stability of insurance companies.

We reviewed and tested the internal control structure over the financial statement review process. We also reviewed selected insurance companies' financial statements and Division work sheets and files to assess the effectiveness and efficiency of the Division's financial monitoring, notification of deficiencies, and follow-up.

In addition, we reviewed the Division's methodology for prioritizing its reviews of insurance companies' annual and quarterly statements and assessed its effectiveness in ensuring that troubled companies were reviewed in a timely manner.

We also reviewed the NAIC accreditation requirements and evaluated the Division's implementation plan for accreditation.

**AGENCY
RESPONSES
AND PRIOR AUDIT
FOLLOW-UP**

Our audit report includes 7 findings and 11 recommendations. The Bureau agreed with the recommendations.

The Division complied with 3 of 4 of the prior audit recommendations included in the scope of our current audit. The remaining prior audit recommendation was no longer applicable.