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# California Insurance Guarantee Association

## *Operational Review* *Public Report*

March 2009



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TABLE OF CONTENTS

- Executive Summary ..... 4
  - Scope and Approach ..... 5
  - Authority and Purpose ..... 5
  - Significant Findings and Recommendations ..... 6
    - Corporate Governance ..... 6
    - Workers’ Compensation Bill Review Analysis ..... 11
    - Third Party Claims Administration Procurement and Contracts ..... 12
    - Internal Audit ..... 13
    - Workers’ Compensation Audit Analysis ..... 13
    - Information Technology General Controls Assessment ..... 14
    - Legal Contract Review ..... 14
    - Financial Statement and General Ledger Analysis ..... 15
    - Human Resources ..... 16
  - Plan of Operation ..... 18
    - Current Plan ..... 18
    - Proposed Plan ..... 18
- I. Corporate Governance ..... 20
  - A. Introduction ..... 20
  - B. Board Representation and Participation ..... 21
  - C. Board Policy Governance ..... 22
  - D. Documentation of Governance and Board Policies ..... 22
  - E. Committee Structure ..... 23
  - F. Legal Representation ..... 24
  - G. Management and Vendor Oversight ..... 25
  - F. Budget Process and Development ..... 26
- II. Workers’ Compensation Bill Review Analysis ..... 27
  - A. Bill Review Fees ..... 27

B. Bill Review Contracts .....	28
III. Third Party Claims Administration Procurement and Contracts.....	31
A. Request for Proposal (RFP) Process .....	31
B. TPA Contracts.....	32
IV. Internal Audit.....	34
A. Internal Audit Scope.....	34
B. Review of the 2008 Audit Plan and Risk Planning Model .....	34
C. Internal Audit Reports .....	35
D. Whistle-Blower Program .....	35
E. Internal Control Framework.....	35
V. Workers' Compensation Audit Analysis .....	37
A. Audit Review .....	37
B. Field Claims Bureau Referrals, Department of Insurance Complaints, and Fraud Referrals.....	38
C. Payment Evaluation .....	40
D. TPA Contract Review and Verification .....	40
VI. Information Technology General Controls Assessment.....	42
A. General Controls .....	42
B. Information Technology Strategic Plan.....	42
C. IT Steering Committee .....	42
D. Formal Annual IT Budget .....	43
E. CIGA Information Technology Department Risk Assessment.....	43
F. Information Security Officer .....	43
G. Information Technology Policies and Procedures .....	44
H. Formal Vendor Management Policy .....	44
I. Third-Party Vendor SAS-70 Reports.....	44
J. Annual Information Technology General Controls Evaluation .....	45
K. Reporting and Review of Network Resources .....	45
L. Disaster Recovery Plan .....	46
VII. Legal Contract Review .....	47
A. General Contract Review .....	47
B. Execution and Signing of Agreements.....	47
C. Termination of Agreement Provisions .....	48

D. Transfer of Risk.....	48
E. Monitoring of Insurance Requirement.....	49
F. Conflict of Interest Provisions .....	49
G. CIGA Purchasing Policy.....	50
VIII. Financial Statement and General Ledger Analysis .....	52
A. Financial Statement Disclosures and Reporting .....	52
B. Actuarial Estimate of Unpaid Claims Liability.....	53
C. Selection of Independent Financial Auditor .....	54
D. Accounting Policies and Procedures Manual .....	55
IX. Human Resources.....	56
A. Identification of Purpose.....	56
B. Personnel Policies.....	57
C. Human Resources Processes.....	57
D. Effective Communication .....	58
E. Documentation and Recordkeeping .....	58
F. Compensation Levels.....	58



Bickmore Risk Services & Consulting

March 31, 2009

Honorable Steve Poizner  
Insurance Commissioner  
California Department of Insurance  
Sacramento, California

Dear Commissioner:

Pursuant to your instructions, an Operational Review was made of the

### **California Insurance Guarantee Association**

at its home office located at 700 N. Brand Boulevard, Suite 1400, Glendale, California, 91203.

### **Executive Summary**

Bickmore Risk Services and Consulting (BRS) was appointed by the California Department of Insurance (CDI) to conduct an operational review of the California Insurance Guarantee Association (CIGA), established pursuant to California Insurance Code Section 1063.9. This review was initiated by the CDI in response to the findings of an independent consultant who was hired in May 2007 by CIGA management to conduct a review of internal controls within the organization. The consultant identified several areas of weakness with the existing internal controls, including the Request for Proposal and selection of third party claims administrators (TPA) process, internal audit procedures, possible conflicts of interest with TPA vendors, bill review costs and procedures, and a lack of segregation of duties in key positions.

The internal controls and documents subject to this operational review of CIGA conducted by BRS are reflective of the controls and documents in place during the time period of June 1, 2008, through November 30, 2008.

## Scope and Approach

This operational review of CIGA utilized several methods of data collection and analysis, including interviewing the executive management team, key personnel in the areas of internal audit, finance, human resources, procurement, and current and former CIGA Board members. BRS reviewed documents provided by CIGA and the CDI, and examined important functions and systems to gain an understanding of the organization and the day-to-day activities conducted by CIGA staff.

Our review focused on the following areas of CIGA:

- Corporate Governance
- Workers' Compensation Bill Review Analysis
- Third Party Claim Administration Procurement and Contracts
- Internal Audit
- Workers' Compensation Audit Analysis
- Information Technology General Controls Assessment
- Legal Contract Review
- Financial Statement and General Ledger Analysis
- Human Resources

## Authority and Purpose

CIGA was created by the California Legislature in 1969, and was organized pursuant to, and operates in accordance with, California Insurance Code, Division 1, Part 2, Article 14.2, Section 1063 et seq. As defined in California Insurance Code Section 1063, the purpose of the Association is to provide member insurers with insolvency insurance (defined in California Insurance Code Section 119.5 to include insurance against loss arising from the failure of an insolvent insurer to discharge its obligations under its insurance policies). CIGA is a statutory entity that depends on the California Insurance Code for its existence and authority. CIGA issues no policies, collects no premiums, makes no profits, and assumes no contractual obligations to the policyholders. CIGA functions pursuant to a Plan of Operation approved by the California Insurance Commissioner.

CIGA is managed by a thirteen member Board, eleven of which are appointed by the Insurance Commissioner, and one member each appointed by the President pro Tempore of the California State Senate and the Speaker of the California State Assembly.

CIGA administers and pays covered claims of insolvent property and casualty insurance carriers admitted to transact a class of insurance specified in California Insurance Code Section 1063(a). The classes of insurance that are covered by CIGA include: fire, plate glass, liability, workers' compensation, common carrier liability, boiler and machinery, burglary, sprinkler, team and vehicle, automobile, aircraft, and miscellaneous. The classes of insurance specifically excluded from CIGA coverage includes: life and annuity, title, fidelity or surety, including fidelity

and surety bonds and any other bonding obligation, disability or health, credit, mortgage, mortgage guarantee, insolvency or legal, financial guarantee, or other types of investment risk protection, the ocean marine portion of any marine insurance or ocean marine coverage policy, including the Federal Jones Act, Longshore and Harborworkers' Act or any other similar federal statutory enactment, any policy of reinsurance, or policies of fraternal fire organizations.

CIGA obtains funds to pay its covered claims through assessments (technically, "premium") charged to member companies, as well as releases of special statutory security deposits previously placed with the State by the insolvent carriers, distributions from insolvent carriers' estates and investment income. Assessed members are permitted to recoup their CIGA payments by adding a surcharge to the policies they issue. CIGA assessments are based on the amount of direct written premium. California Insurance Code Section 1063.5 requires that CIGA allocate its claim payments and costs, incurred or estimated to be incurred, to one or more of the following specific categories:

- (a) Workers' Compensation claims;
- (b) Homeowner and automobile claims; and
- (c) Claims other than workers' compensation, homeowner, and automobile claims.

## **Significant Findings and Recommendations**

### **Corporate Governance**

#### **A. Board Representation and Participation**

There is a lack of consistent participation on the Board. A disparity in experience, tenure, and participation on the Board has resulted in a diminishment of effective and balanced governance. This is compounded by a lack of adequate training and orientation for new Board members.

#### **Recommendations**

1. *Each Board member insurer should submit a written designation to CIGA and the Commissioner specifically naming the company's individual Board representative. Member insurers should commit to attending all Board meetings and meetings of Committees of which they are members.*
2. *Insurers should be required to make formal written appointments of alternates to represent the company in the absence or departure from employment of the primary Board designee. It is recommended that each member designate one alternate.*

3. *The CIGA Board should work with the Commissioner to facilitate recruitment of new members to fill existing or anticipated vacancies in order to provide new perspectives and expertise.*
4. *When Board vacancies arise, the Board should assist the Commissioner in the recruitment of new members so that there can continue to be broad professional expertise, including corporate governance and accountability, finance and accounting, legal, investment banking, workers' compensation claims management, and public or private non-profit sector experience.*
5. *CIGA management should provide all new Board and committee members with formal orientation training and a policy and procedures manual.*

## **B. Board Policy Governance**

The Board lacks a clear strategic vision and plan. The CIGA Board of Governors should focus on policy governance and not operational guidance.

### **Recommendations**

1. *CIGA should conduct a comparative analysis of the policy governance model of other similar non-profit entities, such as other guarantee associations, which focus on governance of "ends" and not "means" versus the policy governance model currently used by CIGA to determine potential enhancements to its current governance model.*
2. *The Board should hold an annual strategic planning session in which strategic objectives are set and evaluated. This could be conducted in conjunction with one of its quarterly meetings.*
3. *The Board should go beyond a traditional advisory role and engage in high level corporate governance and oversight, including:*
  - a. *Approval of a corporate philosophy, strategic plan, and mission;*
  - b. *Review and approval of an annual budget, business plan, risk assessment plan, financial objectives, and material transactions (i.e. major contracts);*
  - c. *Monitoring corporate performance, the budget, and the business and strategic plan; and*
  - d. *Granting authority to management for matters not reserved for the Board.*

### **C. Documentation of Governance and Board Policies**

Current minutes and agendas are brief and do not contain adequate information concerning the deliberations of the Board and its committees. Actions taken by motion of the Board are not stated and recorded with sufficient detail.

#### **Recommendations**

- 1. The Board should improve its governance documentation and record-keeping. Minutes of the Board and committee meetings should be more detailed with a greater description of the discussions of the agenda items, actions taken, and votes of each member. Motions should clearly identify the individual making the motions, seconds, and the results of the vote.*
- 2. Board and committee agendas should be more descriptive of items to be presented and actions to be taken. Agenda items should include staff or consultant recommendations with a written analysis supporting the recommendations.*
- 3. Resolutions should be used for all major Board actions and maintained in a formal resolution binder. Such resolutions should be used for actions which in the past would have been taken by regular Board actions and referenced in the Board minutes.*
- 4. CIGA should begin preparing for compliance with the new requirement for open meetings pursuant to Senate Bill SB1467, Chapter 407, Statutes of 2007-08, effective January 1, 2009. The Board should be trained by legal counsel on how to conduct meetings pursuant to Insurance Code 1063.07.*
- 5. Minutes of committee meetings should be maintained, with actions and recommendations clearly detailed. Attendees should be identified in the minutes.*

### **D. Committee Structure**

Currently, there are two standing committees of the Board: the Executive Committee and the Investment and Audit Committee. The Executive Committee is comprised of the officers of the Board and rarely holds formal meetings. The Investment and Audit Committee meets regularly, normally during the afternoon or evening before the quarterly Board meetings. No minutes of the committees are maintained.

The current committee structure is inadequate for an organization the size and complexity of CIGA.

## Recommendations

1. *A new committee structure should be established, with the following standing and ad hoc committees:*
  - **Executive Committee** - *this committee would be comprised of the Board Officers (Chair, Vice Chair, and Secretary), and would have specific authorities delegated to it by the Board.*
  - **Audit Committee** - *this committee would be responsible for the selection and oversight of independent financial auditors and CIGA's internal auditors. CIGA internal audit staff should report directly to this committee. Meeting frequency - quarterly.*
  - **Finance and Investment Committee** - *this committee would be responsible for overseeing the budget adoption, review of interim financial statements and budget results, developing investment policies, and monitoring investment results. Meeting frequency - quarterly.*
  - **Claims Committee** - *this committee would review the contracts and the performance of CIGA's third party claims administrators and CIGA's in-house claims department. Meeting frequency - quarterly.*
  - **Nominating Committee** - *this ad-hoc committee would make nominations to the appointers (the Commissioner, Speaker, or President Pro Tem) for replacements of Board members with expiring terms and when there are vacancies that need to be filled. This committee should be created and activated as soon as possible in order to provide the Insurance Commissioner (and other appointing authorities) with potential Board members to fill existing and future vacancies. Meeting frequency would be as needed.*
2. *The responsibilities and authorities of all committees should be specified in CIGA's Plan of Operation.*
3. *Membership of non-Board members should be allowed on certain committees. These committees should be filled by Board members and should include experts in certain disciplines.*

### E. Legal Representation

Current outside legal counsel provides counsel to both the CIGA Board and CIGA management. Providing counsel to both could create a potential conflict of interest. Expenses for outside legal counsel have averaged over \$1 million per year for the

last four fiscal years. Insurance Code 1063.07, a new statutory requirement that CIGA is subject to, requires a significantly different method of conducting meetings.

### **Recommendations**

1. *The Board should retain a general legal counsel. This counsel should be responsible to the Board, and not CIGA management, and report directly to the Board. Counsel should be experienced in:*
  - a. *Identifying and handling conflicts of interest (real or perceived);*
  - b. *Open meeting requirements;*
  - c. *Handling closed sessions and the “reporting-out” requirements;*
  - d. *Drafting and reviewing contracts;*
  - e. *Providing advice and counsel on personnel matters; and*
  - f. *Oversight of other legal counsel in litigation actions.*
2. *A cost-benefit analysis should be performed on whether the position of general legal counsel should be an employee or on a contract basis with an individual in a legal firm experienced with public or private non-profit clients.*

### **F. Management and Vendor Oversight**

There needs to be expanded accountability of upper management to the Board and improved oversight of major service providers by management.

### **Recommendations**

1. *The Board should develop management performance and accountability measures.*
2. *The Board should require an annual written report from management to the Board on all major activities that includes specific accountability measures.*
3. *Management should require that all major service providers prepare annual stewardship reports. These reports should be presented to the Board and appropriate committees. These reports should include the following:*
  - a. *A description of major activities and accomplishments;*
  - b. *Staffing levels and plans for the next fiscal year;*
  - c. *An annual conflicts of interest disclosure;*

- d. *Disclosure of ownership of the company and any ownership relationship with any other CIGA service providers;*
- e. *Disclosure of all compensation received for services provided to CIGA, directly or through other contractors;*
- f. *Verification of appropriate insurance coverages (errors and omissions liability, fidelity/crime coverage, general and automobile liability, and workers' compensation coverages); and*
- g. *Annual certification by the CEO of the company of the information in the report.*

#### **G. Budget Process and Development**

CIGA does not prepare a detailed annual operating budget of the projected annual revenues and expenditures for each fiscal year for adoption by the Board. There is a lack of detailed reporting to the Board on actual versus budgeted financial results and explanations for variances.

#### **Recommendations**

1. *The CIGA Board, through a Finance and Investment Committee, should review and approve an annual operating budget of projected revenues and expenses for the fiscal year. The budget should be in sufficient detail that the Board can evaluate detail, not just aggregate variances.*
2. *The Board should receive a comparison of budgeted revenues and expenditures to actual results in conjunction with the presentation of the quarterly internal financial statements.*

#### **Workers' Compensation Bill Review Analysis**

The analysis of bill review contracts included both "bundled" (contracts for TPA services that included both bill review and/or medical case management services) and "unbundled" (contracts for only TPA, bill review, or medical case management).

Although the analysis noted that CIGA has been historically inconsistent in its contracting process for Third Party Administrator (TPA) services and this has impacted the bill review fees, comparisons of the various bill review rates negotiated by CIGA from 2000 to 2007 are in line with those negotiated by other carriers, TPA's, and self-insured programs. This analysis indicates the rates negotiated by CIGA compared to industry rates were not excessive.

There are, however, improvements that can be made in how future bill review services are secured and in the basis for payment.

### **Recommendations**

1. *The CIGA Purchasing Policy should include a specific process for management and, when appropriate, Board review and approval of all significant vendor contracts.*
2. *Unless cost savings (or other operational efficiencies) are provided, CIGA should pursue future bill review contracts separate from the TPA contracts and with companies not associated with the TPA providing administration services. Documentation of projected savings on any future bundled contracts should be provided to the Board as part of its approval process.*
3. *All current CIGA TPA and bill review contracts should be reviewed to determine if the contracts encompass all services currently provided by each vendor as well as to verify the accuracy and acceptance of all billing rates.*

### **Third Party Claims Administration Procurement and Contracts**

CIGA was not able to provide documentation that it maintained accurate and complete records to show that its bidding and RFP process was based upon consideration for ongoing demands, resources, and pricing. Of the service agreements reviewed, some were found to be incomplete, lacking effective dates, and not signed by all parties. In addition, no documentation was provided to memorialize any dissolution of contractual agreements between CIGA and the various TPAs no longer handling CIGA claims.

### **Recommendations**

1. *CIGA should develop standardized fees and payment schedules along with measurable performance standards and expectations that should be coordinated with the audit process.*
2. *CIGA should develop a consistent contracting process to include a review of the initial contract with standardized review intervals. This process should also document a standardized method by which a contract would be terminated.*
3. *CIGA should review and evaluate the basis and process for the consolidation and related costs associated with the transition of cradle to grave contracts.*

## Internal Audit

The scope of authority of the Internal Audit Department and reporting relationships are not formally defined. The Board has not given specific guidance for the scope of the Internal Audit Department. The current scope of the internal audit activities does not include any of the operations of CIGA itself, except for internal in-house claims functions.

The internal control framework under development by CIGA is very basic. No formal internal audit reports have been prepared other than those reporting results of compliance audits related to third party administrator and bill review audits.

### Recommendations

1. *The Board should develop a comprehensive policy describing the scope of authority of the Internal Audit Department. This policy should require that the Department report directly to the Board or an audit committee.*
2. *The Board should authorize development of a comprehensive internal audit process that includes developing an Internal Audit Activity Charter, Audit Committee Charter, Internal Audit Manual, audit process, and reporting process.*

## Workers' Compensation Audit Analysis

The CIGA pre-July 2007 audit process did not adequately evaluate the technical abilities and contract compliance of those administering workers' compensation benefits. The claims auditing process has significantly improved over time, and was revised in late 2007 to include expectations as well as measurable results. While higher "unsatisfactory" results were initially seen in 37% of the audits conducted utilizing this new methodology, improvement has been noted in re-audits. The audit categories continue to require refinement and the continued use of the terms "satisfactory" or "unsatisfactory" do not adequately assess whether the claims are being handled according to industry best practices and CIGA guidelines.

### Recommendations

1. *CIGA should utilize existing resources such as the State Audit Unit annual reports, Field Claims Bureau Referrals and Department of Insurance complaints to determine appropriate areas of review, with a focus on the CIGA vision of assuring "that CIGA Claim Department staff and Third Party Administrators are administering benefits statutorily and in a timely manner."*

2. *The audit categories should be evaluated on a yearly basis with a focus on industry expectations and contract compliance. Continued review of the target scores and their impact to the overall CIGA program should be conducted at least annually.*

*Evaluation of the current targeted scores for a "Satisfactory" rating should continue to be considered as they relate to the audited area and its impact to the CIGA program. It is recommended that all areas directly relating to the timely provision of indemnity benefits be targeted at higher levels of expectation. A recommended reasonable target level should be established at a minimum of 85% based upon industry best practices.*

## **Information Technology General Controls Assessment**

The overall CIGA IT control environment needs to be improved. Control risk in certain areas of IT governance, logical security and computer operations is considered high.

CIGA has no written Information Technology (IT) Strategic Plan. Without a defined IT strategic plan, the risk of ineffective decision making leading to investments in IT that have insufficient return or a negative impact on the organization is significantly increased.

CIGA has no written annual IT budget developed or approved. No IT financial management framework has been established to manage the investments and costs of IT assets and services. Due to the lack of an IT budget, no cost management process is in place to compare actual IT costs to budgets.

### **Recommendations**

1. *CIGA should develop and implement an Information Technology Strategic Plan to ensure IT initiatives comply with governance requirements that potentially impact the organization's goals and responsibility to the public by management and the Board.*
2. *CIGA should develop and implement a formal annual IT budget.*

## **Legal Contract Review**

CIGA did not provide documentation that it had formal written guidelines prior to 2008 regarding the structure, negotiation, monitoring, and legal review of the language in agreements with outside vendors/contractors. The process in place before 2008 was informal, inefficient, and not enforced. The lack of formal guidelines and the failure to consistently monitor the various agreements did not fully protect CIGA from potential lack of performance or material breach of contract by others. CIGA did not provide documentation of any process to determine or monitor if the outside vendor/contractors were providing the required transfer of risk and insurance protection to shield CIGA from financial loss. CIGA did not have an established procedure to determine if any of the vendors/contractors had actual or perceived conflicts of interest situations.

It appears that CIGA has revised and improved the process of the legal review of contracts with formal guidelines developed in 2008, including a formal legal review. We were advised that this is now being monitored by the Claims Department, the Executive Director, and Legal Counsel. However, the documents provided by CIGA reveal that there is still no consistent follow-up and monitoring of the legal review process to assure that the contracts are legally enforceable, that the risks of liability are being properly transferred to others, that the insurance requirements are being properly tracked, and that conflicts of interest situations are being disclosed and addressed.

### **Recommendations**

1. *CIGA should assign a designated person(s) to focus on the current legal contract review process to continually monitor their agreements to ensure that they have been properly executed, that the required insurance/indemnity protection has been secured prior to the beginning of the work or service (and continuously maintained), and that any conflict of interest situations are disclosed and either approved or waived.*
2. *CIGA should develop a model services agreement with clear and unambiguous language regarding legal execution, termination, indemnification/hold harmless protection, transfer of risk techniques, insurance requirements, and conflict of interest situations. Since the failure to provide evidence of insurance coverage is, by contract, a material breach of the agreement, this will give CIGA leverage to negotiate, monitor, track and enforce agreements with outside vendor/contractors.*
3. *All agreements must clearly specify the "effective date" that services are to begin, the exact insurance limits and protection required for each loss exposure, and that any actual or perceived conflict of interest situations are addressed prior to the effective date of the agreement(s).*

### **Financial Statement and General Ledger Analysis**

CIGA's internal quarterly and annual audited financial statements contain only summary information on the administrative expenses incurred by CIGA, which does not provide the Board with sufficient information to understand the types of expenses incurred by CIGA for its operations or to review trends in expenses over time. CIGA does not maintain an accounting policies and procedures manual.

The Board does not formally accept the internal quarterly financial statements. CIGA management does not present financial statements to the Board that compare actual expense activity against an adopted budget or other benchmark.

CIGA has used the same independent financial auditor for at least the past eight years. CIGA does not obtain an independent actuarial evaluation of its total unpaid claim liabilities.

## Recommendations

1. *CIGA should disclose the following additional information in its quarterly internal financial statements and such statements should be formally accepted by the Board:*
  - a. *Material claims and administrative expenses that mirror those presented in the annual operating budget;*
  - b. *Actual revenue and expense results compared to the annual operating budget and percentage of the budget expended; and*
  - c. *Narrative explanation of material budget variances.*

*CIGA should also disclose material claims and administrative expenses in its annual audited financial statements.*

2. *CIGA should obtain an annual actuarial evaluation of its claim liabilities to develop estimates of its future payout of reserves and allocated (ALAE) and unallocated loss adjustment expenses (ULAE).*

*Obtaining an actuarial evaluation of these actual and future payouts by CIGA will provide CIGA management and the Board with more accurate information on its obligations for use when: 1) planning for the resources need to meet such obligations; 2) reporting to stakeholders such as policyholders, the Department of Insurance, and the Legislature; and 3) providing the independent financial auditors with more detailed and sophisticated analysis of its claims liability recorded on its annual financial statements and a better understanding of future estimated payouts.*

3. *The CIGA Board or the Audit Committee should initiate a request for proposal for independent financial audit services prior to the commencement of the audit of the fiscal year ending June 30, 2009.*
4. *The Board should formally receive and adopt the audited annual financial statements within a time frame established by the Board.*

## Human Resources

The Human Resources (HR) Department activities at CIGA are limited and do not sufficiently contribute to strategic management and planning.

Many of the traditional core functions of HR are not being performed by the HR department, and CIGA did not provide documentation that any other departments within the organization are performing these functions.

Human resources activities are not supported by documented operational procedures and policies and processes are inconsistently applied.

Communication as a key human resources activity is inadequate in the CIGA management process. Employees are insufficiently informed of organizational decisions.

There appears to be a lack of uniformity and consistency in applying policies and procedures. Management does not appear to have implemented best management practices in personnel decisions, and often make decisions that are not anchored in policy. CIGA has not implemented the best management practice of documenting important personnel activities.

### **Recommendations**

1. *The Human Resources Department should develop a formally stated purpose, clearly identifying chain of command for anticipated and potential complex situations.*
2. *New job descriptions should be developed for the Human Resources Department with clear and authoritative responsibility.*
3. *CIGA should conduct a market-based compensation analysis to ensure that pay at all levels is competitive and reasonable within the market to attract and retain qualified employees.*
4. *CIGA should develop new personnel and operational policies, comprehensive in scope, that contribute to CIGA's business operations and efficient management.*
5. *CIGA should conduct a review of current legally required practices for personnel recordkeeping and should modify any practices which are not in full compliance.*
6. *Human Resources should participate in documented consultative decision making with executive management.*
7. *CIGA should annually evaluate its business plan, with an HR review, to include areas such as recruitment strategy, benefits and compensation plan, anticipated turnover and succession planning, and workplace culture.*
8. *CIGA should conduct a market-based compensation analysis to ensure that pay at all levels is competitive and reasonable within the market to attract and retain qualified employees.*

## Plan of Operation

### A. Current Plan

California Insurance Code Section 1063(c) requires that CIGA adopt a plan of operation and that the plan, and any amendments to it, be approved by the California Insurance Commissioner. The plan primarily contains restatements of the Insurance Code Section 1063 and its subsections. The major sections of the plan are:

- Membership Requirements (Article III)
- Composition of the Board and Committees (Article IV)
- Powers of the Association (Article V)
- Servicing Facility (Article VI)
- Indemnification (Article VII)
- Recoupment of Assessments (Article VIII)
- Financial Reports (Article IX)

### B. Proposed Plan

CIGA has requested that the California Insurance Commissioner approve amendments to this plan. These amendments are to:

1. Add specific reference to two committees that have been operational within CIGA for many years: the Executive Committee and the Investment and Audit Committee.
2. Allow inter-account borrowing, a practice that had been permitted in the past, but was modified when CIGA began issuing revenue bonds to fund its operations.

### Recommendations

1. *The Plan of Operation should be modified substantially in order to incorporate certain key recommendations in this report. The Plan should be more specific in areas not addressed in California Insurance Code Section 1063.*
2. *A complete review of the purpose and scope of the Plan of Operation should be conducted. The Plan should be amended to provide more details of the governance, management, and accountability of CIGA to the California Insurance Commissioner, and the members of the Association.*

3. *The Plan should be amended to include:*
  - a. *The new committee structure recommended in this report;*
  - b. *Specific duties and responsibilities of each committee (committee charters);*
  - c. *Requirements for clear designations of Board members and alternates;*
  - d. *Duties of officers, including consideration of the position of treasurer;*
  - e. *A mission statement reflecting the Board's governance philosophy and management accountability;*
  - f. *Specific authority reserved to the Board;*
  - g. *Responsibilities and authority of the Executive Director;*
  - h. *Meeting procedures for compliance with the Open Meetings Act;*
  - i. *Appointment of a general counsel by the Board, with duties and responsibilities detailed;*
  - j. *Annual adoption of a budget and submission to the California Insurance Commissioner;*
  - k. *Annual reporting to the California Insurance Commissioner, members, and the California employer community;*
  - l. *A requirement for the adoption of a strategic plan;*
  - m. *A requirement for the adoption of organizational, management and service provider performance measures and evaluations; and*
  - n. *A requirement for the annual review and approval by the Board of CIGA's investment policy.*

## I. Corporate Governance

### A. Introduction

CIGA is governed by a Board of Governors (Board) comprised primarily of insurance company representatives (nine of 13 members appointed by the Insurance Commissioner). In addition, there are two public members, one labor representative and one business representative, both appointed by the Insurance Commissioner. At least five of the companies must be domestic insurers. At least three members must be stock insurers and three non-stock insurers (California Insurance Code Section 1063(b)). The members of the CIGA Board of Governors serve voluntarily and are not compensated for their services. They are reimbursed solely for expenses incurred.

The current member insurers, their designated Board representatives, and regular term expiration dates are shown below. Members without term expiration dates serve at the discretion of the appointing authority. A member can continue to serve beyond the expiration date of his or her term until a replacement is appointed by the Insurance Commissioner.

### CIGA Board of Governors

(As of December 2008)

Composition (13 Total)	Appointee
Three (3) Stock Companies	Linda Smith, Preferred Employers Insurance Company (Chairperson) – (2008) James Sevey, California Casualty Insurance Company (Vice Chairperson) (2008) Kathleen Dubia, Chubb Insurance Company (2011)
Three (3) Non-Stock Companies	John Boyle, Automobile Club of Southern California (2011) Robert Chick, Lawyers Mutual Insurance Company (2008) Thomas Rudder, Liberty Mutual Insurance Company (2007)
Three (3) Stock or Non-Stock Companies	Ron Coble, Mid Century Insurance Company (2011) Janet Frank, State Compensation Insurance Fund (2007) Felix Mantilla, Allstate Insurance Company (Secretary) (2007)
One (1) Public Member (President Pro Tem, Senate)	Scott Hauge, CAL Insurance Associates
One (1) Public Member (Speaker of Assembly)	Vacant
One (1) Business Representative (Commissioner)	Dan Jacobson, Jacobson and Associates
One (1) Labor Representative (Commissioner)	Bob Balgenorth, State Building and Trades Council of California

## **B. Board Representation and Participation**

### **Findings**

Member insurers are appointed by the Commissioner to the CIGA Board, and they are currently allowed to designate the employees within the companies to attend and participate in Board meetings. There is a lack of consistent participation on the Board. Frequently, different representatives of insurer Board members attend the meetings.

A disparity in experience, tenure, and participation on the Board has resulted in a diminishment of effective and balanced governance. This is compounded by a lack of effective training and orientation for new Board members.

A major portion of the nine insurance company Board positions are companies that have significant workers' compensation written premium in California. Over 90% of CIGA's operation is related to the handling of workers' compensation carrier insolvencies. Most of its assessment income is derived from workers' compensation assessments.

### **Recommendations**

- 1. Each Board member insurer should submit a written designation to CIGA and the Insurance Commissioner specifically naming the company's individual Board representative. Member insurers should commit to attending all Board meetings and meetings of Committees of which they are members.*
- 2. Insurers should be required to make formal written appointments of alternates to represent the company in the absence or departure from employment of the primary Board designee. It is recommended that each member designate one alternate.*
- 3. The CIGA Board should work with the Commissioner to facilitate recruitment of new members to fill existing or anticipated vacancies in order to provide new perspectives and expertise.*
- 4. When Board vacancies arise, the Board should assist the Commissioner in the recruitment of new members so that there can continue to be broad professional expertise in such areas as corporate governance and accountability, finance and accounting, legal, investment banking, workers' compensation claims management, and public or private non-profit sector experience.*
- 5. CIGA and the CDI should explore ways to encourage participation on the CIGA Board and Committees.*

6. *In assisting the Commissioner in the recruitment of new members to fill vacancies, CIGA should attempt, to the extent possible, to provide the Commissioner with prospective members with expertise in the lines of business most under management by CIGA.*
7. *CIGA management should provide all new Board and committee members with formal orientation trainings and a policy and procedures manual.*

### **C. Board Policy Governance**

#### **Findings**

The Board lacks a clear strategic vision and plan. The CIGA Board of Governors should focus on policy governance and not operational guidance.

#### **Recommendations**

8. *CIGA should conduct a comparative analysis of the policy governance model of other similar non-profit entities, such as other guarantee associations, which focus on governance of “ends” and not “means” versus the policy governance model currently used by CIGA to determine potential enhancements to its current governance model.*
9. *The Board should hold an annual strategic planning session, in which strategic objectives are set and evaluated. This could be conducted in conjunction with one of its quarterly meetings.*
10. *The Board should go beyond a traditional advisory role and engage in high level corporate governance and oversight, including:*
  - a. *Approval of a corporate philosophy, strategic plan, and mission;*
  - b. *Review and approval of an annual budget, business plan, risk assessment plan, financial objectives, and material transactions (e.g. major contracts);*
  - c. *Monitor corporate performance against the budget, business and strategic plan; and*
  - d. *Granting authority to management for matters not reserved for the Board.*

### **D. Documentation of Governance and Board Policies**

#### **Findings**

Current minutes and agendas are brief and do not contain adequate information concerning the deliberations of the Board and its committees. Actions taken by motion of the Board are not stated and recorded with sufficient detail.

## **Recommendations**

11. *The Board should improve its governance documentation and record-keeping. Minutes of the Board and committee meetings should be transcribed in more detail with greater description of the discussions of the agenda items, actions taken, and votes of each member. Motions should clearly identify the individual making the motions, seconds, and the results of the vote.*
12. *Board and committee agendas should be more descriptive of items to be presented and actions to be taken. Agenda items should include staff or consultant recommendations with a written analysis supporting the recommendations.*
13. *Resolutions should be used for all major Board actions and should be maintained in a formal resolution binder. Such resolutions should be used for actions which in the past would have been taken by regular Board actions and referenced in the Board minutes.*
14. *CIGA should begin preparing for compliance with the new requirement for open Board meetings pursuant to Senate Bill SB1467, Chapter 407, Statutes of 2007-08, effective January 1, 2009. The Board should be trained by legal counsel on how to conduct meetings pursuant to Insurance Code 1063.07.*
15. *Minutes of committee meetings should be kept, with actions and recommendations clearly detailed. Attendees should be identified in the minutes.*

## **E. Committee Structure**

### **Findings**

Currently, there are two standing committees of the Board: the Executive Committee and the Investment and Audit Committee. The Executive Committee is comprised of the officers of the Board, and rarely holds formal meetings. No minutes of the committees are maintained. The Investment and Audit Committee meets regularly, normally the afternoon or evening before the quarterly Board meetings. No minutes of the committees are maintained.

The current committee structure is inadequate for an organization the size and complexity of CIGA.

### **Recommendations**

16. *A new committee structure should be established, with the following standing and ad hoc committees:*

- **Executive Committee** - this committee would be comprised of the Board Officers (Chair, Vice Chair, and Secretary), and would have specific authorities delegated to it by the Board.
- **Audit Committee** - this committee would be responsible for the selection and oversight of independent financial auditors and CIGA's internal auditors. CIGA internal audit staff should report directly to this committee. Meeting frequency - quarterly.
- **Finance and Investment Committee** - this committee would be responsible for overseeing the budget adoption, review of interim financial statements and budget results, developing investment policies, and monitoring investment results. Meeting frequency - quarterly.
- **Claims Committee** - this committee would review the contracts and the performance of CIGA's third party claims administrators and CIGA's in-house claims department. Meeting frequency - quarterly.
- **Nominating Committee** - this ad hoc committee would make nominations to the appointers (the Commissioner, Speaker, or President Pro Tem) for replacements of Board members with expiring terms and when there are vacancies that need to be filled. It is recommended that this committee be formed and activated as soon as possible in order to provide the Insurance Commissioner (or other appointing authority) with a listing of qualified candidates to fill current or future vacancies. Meeting frequency - as needed.

17. *The responsibilities and authorities of all committees should be specified in the CIGA's Plan of Operation.*

18. *Membership and/or participation of non-Board members should be allowed on certain committees. These committees should be filled with at least one or two Board members and should include experts in certain disciplines.*

## **F. Legal Representation**

### **Findings**

Current outside legal counsel to the Board provides counsel to both the CIGA Board and to CIGA management. Providing counsel to both could create a potential conflict of interest. Expenses for outside legal counsel have averaged over \$1 million for the last four fiscal years. Insurance Code 1063.07, a new statutory requirement that CIGA is subject to, requires a significantly different method of conducting meetings.

CIGA also engages a legislative advocate to represent it on legislative matters.

## **Recommendations**

19. *The Board should retain a general legal counsel. This counsel should report directly to the Board and be experienced in:*
  - a. *Identifying and handling conflicts of interest (real or perceived);*
  - b. *Open meeting requirements;*
  - c. *Handling closed sessions and the “reporting-out” requirements;*
  - d. *Drafting and reviewing contracts;*
  - e. *Providing advice and counsel on personnel matters; and*
  - f. *Oversight of other legal counsel in litigation actions.*
20. *A cost-benefit analysis should be performed on whether the position of general legal counsel should be an employee or on a contract basis with an individual in a legal firm experienced with public or private non-profit clients.*
21. *The Board should receive enhanced reporting in closed session of matters assigned to outside general counsel, including costs associated with each matter cumulatively and for each fiscal year or portion thereof.*

## **G. Management and Vendor Oversight**

### **Findings**

There needs to be expanded accountability of upper management to the Board and improved oversight of major service providers by management.

### **Recommendations**

22. *The Board should develop management performance and accountability measures.*
23. *The Board should require an annual written report from management to the Board on all major activities that includes specific accountability measures.*
24. *Management should require that all major service providers prepare annual stewardship reports. These reports should be presented to the Board and appropriate committees. These reports should include the following:*
  - a. *A description of major activities and accomplishments;*
  - b. *Staffing levels and plans for the next fiscal year;*

- c. *An annual conflicts of interest disclosure;*
- d. *Disclosure of ownership of the company and any ownership relationship with any other CIGA service providers;*
- e. *Disclosure of all compensation received for services provided to CIGA, directly or through other contractors;*
- f. *Verification of appropriate insurance coverages (errors and omissions liability, fidelity/crime coverage, general and automobile liability, and workers' compensation coverages); and*
- g. *Annual certification by the CEO of the company of the information in the report.*

## **H. Budget Process and Development**

CIGA's revenues are primarily generated through assessments of members, investment income, and liquidator advances. CIGA assessments, the largest revenue item, are paid entirely by member insurers who are allowed to recoup the assessments through a surcharge on their insurance policies. Historically, this assessment has been between 1% and 2% of the total direct premiums written by admitted insurers whose claims would be subject to coverage by CIGA in the event of insurer insolvency.

Expenses are more typical of an insurance enterprise, and include benefit payments to injured workers, claims adjusting costs, changes in outstanding claim liability, and administrative expenses. Bonds issued in 2004 have resulted in interest and other bond issuance related expenses.

### **Findings**

CIGA does not prepare a detailed annual operating budget of the projected annual revenues and expenditures for each fiscal year for adoption by the Board. There is a lack of detailed reporting to the Board on actual versus budgeted financial results and explanations for variances. A formal budget process will allow the Board and management to evaluate and monitor the activities of CIGA throughout the year, and better hold management responsible for their results.

### **Recommendations**

- 25. *The CIGA Board, through a Finance and Investment Committee, should review, approve, and adopt an annual operating budget of projected revenues and expenses for the fiscal year. The budget should be in sufficient detail that the Board can evaluate detail, not just aggregate variances.*
- 26. *The Board should receive a comparison of budgeted revenues and expenditures to actual results in conjunction with the presentation of the quarterly internal financial statements.*

## II. Workers' Compensation Bill Review Analysis

### A. Bill Review Fees

CIGA has been inconsistent in its contracting process for Third Party Administrator (TPA) services. This has resulted in the potential for overpayment of bill review fees.

The number of insolvent insurance carriers beginning in 2000 significantly increased the inventory of workers' compensation claims for which CIGA was responsible. Claims increased from 4,100 to 140,000. This tremendous increase required the use of multiple TPAs to adjust claims and provide bill review and medical case management services.

Our analysis of bill review services and fees included both "bundled" contracts (TPA services that included bill review and/or medical case management services) and "unbundled" contracts (only TPA, bill review, or medical case management services). Bill review services and fees are generally contracted for in a combination of ways, from a flat rate per bill to a per line fee, to a percentage of savings, or a combination of any of these methods.

- Flat Rate charges are a fixed amount per bill.
- Per Line rates are frequently combined with flat rates. Per line rates establish a minimum number of lines (header lines, set up lines – generally a four line minimum) and a maximum number of lines per bill (example of a 16 line maximum).
- Percentage of savings charges are based on a percentage applied to the amount of fee deduction

Figure 1 provides a comparison of CIGA bill review contracting rates to a sample of other industry contract rates.

Figure 1

Comparison of Bill Review Rates

	Percentage of Savings	Per Line Fee	Flat Rate (Per Bill Fee)
<b>CIGA Contracts</b>	11% to 18%	*\$1.15 - 1.38 per line	\$7.00 per Bill - \$50.00 per Hospital Bill
<b>**Non-CIGA Contracts</b>	10% - 25%	*\$1.00 - 1.15 per line	\$4.50 – 12.50 per bill (non-hospital)

\*Contracts may contain a minimum and/or maximum number of lines billed per invoice.

\*\*Sample of actual industry contracts compiled by BRS.

## Findings

Comparisons of the various bill review rates negotiated by CIGA from 2000 to 2007, although inconsistent, are in line with those negotiated by other carriers, TPA's, and self-insured programs. This analysis indicates that the rates negotiated by CIGA compared to industry rates were not excessive.

CIGA has initiated steps to improve upon their contracting processes. CIGA adopted a Purchasing Policy dated March 5, 2008, which states it is "designed to be efficient, cost effective and flexible with reasonable provisions for competitiveness, fairness, and opportunity to vendors."

## Recommendations

27. *The CIGA Purchasing Policy should include a specific process for management and, when appropriate, Board review and approval of all significant vendor contracts.*
28. *Unless cost savings (or other operational efficiencies) are provided, CIGA should pursue future bill review contracts separate from the TPA contracts and with companies not associated with the company providing claims administration services. Documentation of projected savings on any future bundled contracts should be provided to the Board as part of its approval process.*
29. *All current CIGA TPA and bill review contracts should be reviewed to determine if the contracts explicitly define all services currently provided by each vendor and to verify the accuracy and acceptance of all billing rates.*

## B. Bill Review Contracts

From the period of January 2001 to this report date, CIGA has negotiated claims servicing agreements to provide workers' compensation administration services that included bill review and medical case management services. Over time, services that have been assumed to be part of these contracts included provisions for ancillary services such as durable medical equipment (DME), pharmacy, and transportation services.

## Findings

A majority of the TPA contracts specified a medical case management vendor affiliated or owned by the TPA (refer to *Figure 2*).

Figure 2

Bill Review Contracts - Specified Vendors

Insolvency	TPA	Med Mgt/Bill Review Company Specified
Global Contract	Broadspire	*Kemper Nat. Svs.
Western Employers	Intercare	*Intermed
Superior(s)	Intercare	*Intermed
Credits	Intercare	*Intermed
HHH & Great States	Intercare	*Intermed
Reliance/ICA	Intercare	*Intermed
PHICO	Intercare	*Intermed
Paula	Intercare	*Intermed
Legion Villanova	Ward N. America	Spectrum Managed Care
Legion Villanova	United Risk Management	Foothill Medical
Legion Villanova	Tristar Risk Management	*Tristar Managed Care
Legion Villanova	REM	Corvel Corporation
Legion Villanova	Affinity	Strata Care
Legion Villanova	Intercare	*Intermed
Legion Villanova	Broadspire	Spectrum Managed Care
Western Growers	Intercare	*Intermed
Home	PACS	Lien on Me
Fremont	Keenan	PRIME

\*Owned or affiliated with the TPA

In reviewing the TPA contracts, we were unable to identify any significant savings in claims administration services when bundled with bill review services.

**Recommendations**

30. CIGA should perform a cost benefit analysis to determine if overall savings could be derived from separating bill review services from claims administration (TPA) on any of its existing TPA contracts.

**Findings**

Many basic areas of contracting were incomplete or inaccurate. Contracts were noted that lacked service start dates, contract termination dates, and clear rates of payment. When the TPA contract involved bill review, managed care services, or ancillary services, the deficient areas extended to those services as well.

Many of the service agreements provided for increases in fee schedules based upon inflation factors. CIGA did not provide documentation that it had a process for review and accuracy of fee schedule changes.

The workers' compensation industry continues to change and many of these changes impact bill review, managed care and ancillary services. Prime examples are the fee schedules

established for Durable Medical Equipment (DME) and pharmacy which were established in 2003 and are regularly revised and updated (Labor Code Section 5307.1). TPA contracts were not formally amended to include ancillary services such as DME, pharmacy and transportation services.

### **Recommendations**

31. *It is recommended that all TPA, bill review and ancillary service agreements be reviewed and renegotiated as necessary to assure that the current fees billed and paid are appropriate and that all services provided are included in the agreements. The impact of fee schedule changes should be considered in the contract language, allowing for review and amendment of the contracts as appropriate.*

### III. Third Party Claims Administration Procurement and Contracts

#### A. Request for Proposal (RFP) Process

As part of the operational overview analysis, BRS reviewed and analyzed the CIGA procurement process and contracts for third party claims administration (TPA).

Limited documentation was provided by CIGA relating to any past bidding process or generation of Request for Proposals (RFP) prior to March 2008. In November 2007, CIGA disseminated an RFP to consolidate vendors for the provision of Durable Medical Equipment (DME), pharmacy, and transportation. This RFP process appeared well documented, and was presented to the CIGA Board.

A Purchasing Policy was developed in March 2008 that allows three methods of procurement based upon the annual expenditure and transaction size. Methods outlined are:

- Telephonic solicitation and procurement;
- Written solicitation and procurement; and
- Formal RFP process.

As part of the policy, authority levels are established within CIGA by management position and any transaction that exceeds \$1 million requires the consent of the CIGA Board.

An RFP for TPA and Medical Bill Review (MBR) services for three non-cradle to grave units with monthly or annual claims administration fees was disseminated on June 13, 2008. The recipients included third party claims administrators and medical bill review entities as well as companies providing both services. Bids were to be "unbundled" for the individual services with entities allowed to include "bundled" pricing as well.

CIGA was assisted in the selection process by an independent contractor. The results of the selection process were presented at the November 12, 2008, CIGA Board meeting.

#### Findings

It was noted that from November 2003 to June 2008 the number of TPAs administering CIGA claims was reduced to four. Many of these contracts with the TPAs no longer handling CIGA claims had "cradle to grave" service agreements in place, but there was no documentation provided that indicated the basis for the termination.

#### Recommendations

32. *CIGA should review and evaluate the basis and process for the consolidation and related costs associated with the transition of "cradle to grave" contracts to monthly fee basis. A standardized process should be put in place to review the "cradle to grave" contracts.*

## Findings

During the period of 2000 through 2003, CIGA was under pressure to take over many small to large insolvent workers' compensation claim programs within a limited time period. The recently disseminated Request for Proposal (RFP) stated that "CIGA contracts on a liquidation by liquidation basis to allow for clear allocation of the costs to the appropriate estates." The contractual agreements received and reviewed to date do not provide clear documentation of the allocation of these costs.

CIGA was not able to provide documentation that it maintained accurate and complete records to show that its bidding and RFP process was based on consideration for ongoing demands, resources, and pricing. Further refinement of this process is needed.

## Recommendations

33. *CIGA should establish a consistent and formal process for the selection of TPAs, as with all vendors, to provide for the ongoing evaluation of the contractual agreements at given intervals for maximum cost effectiveness.*
34. *Vendors should be reviewed annually to identify changes in ownership and relationships with other vendors as the result of acquisitions or mergers.*

## B. TPA Contracts

Some of the TPA service agreements reviewed were found to be incomplete. Many of the earlier agreements did not contain an explicit definition of the effective date of the agreement and many of the agreements provided to BRS were either not signed by one of the parties or had no date of the signatures at the end of the document. Some of the agreements have apparently renewed automatically each year with no actual monitoring or oversight of this process. Lastly, some of the addendums to the original agreements were not properly signed or dated, making them potentially legally unenforceable. There also appear to be contract amendments that have not been documented. In addition, some of the contracts were amended and the pricing structure revised from "cradle to grave" to a monthly fees basis.

It was also noted that from November 2003 to June 2008, the number of TPAs handling CIGA claim files was reduced from seventeen to four. No documentation was received regarding the termination of the contracts with the various providers or the basis for transferring claims administration from existing "cradle to grave" contracts.

## Findings

Of the services agreements provided and reviewed, it was noted there were inconsistent contracts for the individual insolvencies and service agreements were found to be incomplete. In addition, no documentation was provided to memorialize any dissolution of contractual agreements between CIGA and the various TPAs no longer handling CIGA claims.

## **Recommendations**

35. *CIGA should develop standardized fees and payment schedules, along with measurable performance standards and expectations, that should be reviewed during the audit process.*
36. *CIGA should develop a consistent contracting process to include a review of the initial contract with standardized review intervals. This process should also document a standardized method by which a contract would be terminated.*

## IV. Internal Audit

### A. Internal Audit Scope

The internal audit process has primarily focused on certain claims compliance areas and completeness and documentation of the files. The process does not cover an overall assessment of risk and controls or a review of the operations of CIGA by the Internal Audit Department. This approach has not included the review of financial controls at the TPA's and has not included a controls review of any of the operations of CIGA itself.

#### Findings

The Internal Audit Department is not independent and operates under the direct control of the Executive Director.

The scope of authority of Internal Audit Department is not formally defined and the Board has not given specific guidelines for the internal audit scope. The Executive Director and Claim Services Manager have provided "guidelines" for what is reviewed, but the scope of activities is almost exclusively TPA audit and legal bill review.

#### Recommendations

37. *CIGA should develop a Board approved policy describing the scope of authority of the Internal Audit Department. This policy should require that the Department report directly to the Board or an audit committee.*

### B. Review of the 2008 Audit Plan and Risk Planning Model

#### Findings

CIGA has indicated that it is evaluating specific risks as a part of its 2009 internal audit approach. This grading is by functional area and identified in Financial, Operational, and Compliance areas under each function. Although functional areas were all listed and graded, the depth of risk analysis did not approach and address efficiency and effectiveness. Draft Internal Audit Department audit programs developed in September 2008 were very basic.

#### Recommendations

38. *The Internal Audit Manager should consider a structured approach based on the following basic audit objectives:*
  - *Existence/Occurrence;*
  - *Completeness;*
  - *Valuation or Allocation (accuracy);*
  - *Rights and Obligations; and*
  - *Presentation and disclosure (financial reporting)*

*The audit approach should include an evaluation of what could go wrong, risk areas, opportunities for errors and irregularities, efficiency, and effectiveness. Additionally, each area should address compliance.*

## **C. Internal Audit Reports**

### **Findings**

CIGA did not provide documentation that any formal internal audit reports have been prepared. Reports issued to date appear to have been on the results of compliance audits related to TPA and bill review. CIGA has not adopted an audit activity charter or developed an internal audit manual.

### **Recommendations**

39. *The Board should authorize development of a comprehensive internal audit process that includes developing an Internal Audit Activity Charter, Audit Committee Charter, Internal Audit Manual, audit process, and reporting process. Assessing how CIGA monitors critical data should be part of the internal audit function. Reports should be prepared that:*

- a. *List who prepared or is signing the report.*
- b. *Compare percentage ratings to prior period and benchmarks.*
- c. *Recommend auditing claim files that have certain characteristics. For example: multiple reserve changes in a short time or home healthcare expenditure.*
- d. *Charting data and develop statistics that bring together claim and financial statistics onto a claims system (reporting). That can be used to identify risk areas to study.*
- e. *Generate reports that can:*
  - i) *Identify duplicates and overpayments.*
  - ii) *Identify changes in reserves to help evaluate reserve adequacy.*

## **D. Whistle-Blower Program**

### **Findings**

The third party whistle-blower program implemented for CIGA operations does not include vendors. Since claim administrators and other vendors are involved in making significant decisions in expending monies, they should be included in the third party whistle-blower program.

### **Recommendations**

40. *This program should be expanded to include access and training for CIGA vendors.*

## **E. Internal Control Framework**

### **Findings**

The internal control framework under development is very basic.

Control Environment - there are no formal programs or processes by Internal Audit to specifically address this area.

Risk assessment - Internal Audit has taken a preliminary approach in identifying risks to the organization through the Audit Plan and Risk Assessment for 2009. It consists of a table that rates the risk of each functional area and arrives at a total rating. Internal Audit has prepared audit programs for the functional areas but they are basic and are limited on the risk assessment approach.

Control Activities - the audit approach is defined in the internal audit programs review for compliance with organizational policies and procedures. Some programs direct the auditor to review the adequacy of controls but others do not. If the audit programs were built based on basic audit assertions and risk based objectives, then it is more likely that they would be more complete.

Information and communication - there is no formal process for providing internal audit reports internally and externally, except for TPA compliance audits.

Monitoring - there is no formal process for internal audit to monitor activities.

#### **Recommendations**

41. *CIGA should develop an audit framework that includes Control Environment, Control Activities, Information and Communication, and Monitoring.*

## V. Workers' Compensation Audit Analysis

### A. Audit Review

Pursuant to California Insurance Code Section 1063(i)(2), CIGA must annually audit one-third of the TPAs retained to adjust the claims of insolvent programs and coordinate an independent audit of the three largest TPAs at least once every three years.

To determine the effectiveness of the CIGA workers' compensation audit process, BRS conducted an analysis of the existing process and developed recommendations for improvement.

During 2007, CIGA changed their methodologies for their audits. As part of the new methodology, the percentage required for satisfactory compliance has been increased. During the review period, some of the audits were done under the older methodology and some under the new methodology. This resulted in some of the audit reports showing satisfactory compliance under the older methodology that would have been out of compliance using the new methodology. Audit results, utilizing the initial audit methodology lacked measurements of performance areas and appeared to be based upon determinations of either unqualified statements of "SATISFACTORY" or "UNSATISFACTORY" performance.

### Findings

CIGA has improved and expanded their audit methodology and increased targeted scores for satisfactory results. In developing their revised methodology and increasing the target from 70% to 75%, CIGA is moving toward greater expectations in claims administration both internally and externally.

CIGA developed a Workers' Compensation Claims Audit & Compliance Manual in July 2007. This manual outlines the CIGA audit process and establishes a "point system" for the 19 categories reviewed. Although not stated in the manual, but evidenced by the actual audit reports reviewed, there is an expectation of compliance in each category at 75%.

Categories reviewed in each audit have been revised to target those areas that are better focused on appropriate case resolution.

The CIGA Workers' Compensation Claims Audit & Compliance Manual indicates the "vision" of the "CIGA audit and compliance examinations help to assure that CIGA Claim Department staff and Third Party Administrators are administering benefits statutorily and in a timely manner". Further, the "audits shall assure that all covered claims are being investigated, adjusted, and paid in accordance with customary industry standards and practices and all applicable statutes, rules and regulations. . ."

The audits reviewed utilizing the revised audit methodology provide clearer expectations and measurement with enhanced performance areas. As a result of the revised audit criteria, unsatisfactory ratings have increased (refer to Figure 3 below). This, however, is a better indicator of TPA performance.

Figure 3

**CIGA Audit Results  
2007 Compared to 2008**

	<b>2007</b>	<b>2008</b>
<b>Claims Adjusting Satisfactory</b>	89%	63%
<b>Claims Adjusting Unsatisfactory</b>	11%	37%

**Recommendations**

42. *The audit categories should be evaluated on a yearly basis with a focus on industry expectations and contract compliance. Continued review of the target scores and their impact to the overall CIGA program should be conducted at least annually.*

*Evaluation of the current targeted scores for a "Satisfactory" rating should continue to be considered as they relate to the audited area and its impact to the CIGA program. It is recommended that all areas directly relating to the timely provision of indemnity benefits be targeted at higher levels of expectation. A recommended reasonable target level should be established at a minimum of 85% based upon industry best practices.*

**B. Field Claims Bureau Referrals, Department of Insurance Complaints, and Fraud Referrals**

The California Department of Insurance (CDI) conducts Field Claims Bureau Examinations of CIGA operations regarding their review and oversight of the TPAs' work product. The CDI has identified very appropriate areas of concern that are currently addressed with CIGA on a case by case basis. The primary areas of concern identified by CDI involve:

- CIGA policies for follow-up with TPAs
- CIGA's responsibility for assuring compliance

The CIGA audit reporting process includes a brief mention of the CIGA Fraud/Special Investigation Unit processes, however, no information is provided regarding the number of claims submitted through this process, nor is there information regarding the success rate of the submissions.

**Findings**

The CIGA audit process does not adequately utilize their resources to address areas of concern identified by other sources, nor do they apply these concerns to improve the CIGA audit process.

The California Department of Industrial Relations, Division of Workers' Compensation, conducts annual audits to determine general industry expectations and achievements and areas of concern as well as specific audit results as they relate to CIGA's TPAs. State Audits have outlined specific expectations for twenty-one major categories (refer to Figure 4) which directly impact the accurate administration of workers' compensation benefits. Many of these categories duplicate or encompass those identified by CIGA.

## Recommendations

43. CIGA should utilize some of the information and concerns outlined in the Field Claim Referrals as a resource and tool for enhancing the CIGA Audit Process and the State audit results.

Identification of potentially fraudulent activity is another important aspect of the claims adjuster's and TPA's responsibility. Payments made to individuals or companies that may be involved in fraudulent activity must be actively monitored and reported by CIGA.

Figure 4

### Key Areas Identified in the State Audit Process

Item #	Nature of Violation by Category
1	Late first payment of temporary disability indemnity benefits.
2	Late first payment of permanent disability indemnity benefits.
3	Late first payment of vocational rehabilitation indemnity benefits.
4	Late subsequent payment of indemnity benefits.
5	Late first payment of death benefits indemnity benefits.
6	Failure to issue benefit notices other than specific notices for vocational rehabilitation and for denial of injury.
7	Late provision of benefit notices other than specific notices for vocational rehabilitation and notices for denial of injury.
8	Failure to pay or object to medical expenses within specific timeframe including payment of interest and increase.
9	Failure to pay or object to medical-legal expenses within specific time frame including payment of interest and increase.
10	Failure to pay or object to vocational rehabilitation expenses within specific time frame.
11	Failure to timely assign a qualified rehabilitation representative to an employee after 90 aggregate days of total temporary disability for injuries prior to 1/1/94.
12	Failure to notify an injured employee in a timely manner of vocational rehabilitation information as required after 90 aggregate days of total temporary disability for injuries 1/1/94 through 12/31/03.
13	Failure to notify an injured employee in a timely manner of potential eligibility for vocational rehabilitation as required for injuries through 12/31/03.
14	Failure to notify an injured employee in a timely manner of non-eligibility for vocational rehabilitation as required.
15	Failure to notify an injured employee in a timely manner of the procedure to evaluate permanent disability as required.
16	Failure to provide notices denying all liability or death benefits as required.
17	Failure to timely respond to a request to provide or authorize medical treatment.
18a	Failure to pay any temporary disability indemnity benefit or salary continuation in lieu of temporary disability indemnity.
18b	Failure to pay any permanent disability indemnity benefit.
18c	Failure to pay any vocational rehabilitation indemnity benefit.
18d	Failure to pay any 10% self-imposed increase for any late paid indemnity benefits.
18e	Failure to pay any indemnity as ordered by the Workers' Compensation Appeals Board (WCAB) or as ordered by the Rehabilitation Unit.
18f	Failure to pay any other indemnity, including but not limited to failure to pay any interest on a WCAB Order or Award; failure to pay any death benefits.
19	Failure to include specific items or properly designate entries on a claim log.
20a	Materially incomplete or inaccurate benefit notices including denial for all liability, other than specific vocational rehabilitation notices.
20b	Late payment of WCAB Orders or Awards or Rehabilitation Unit Orders for late payment of attorney fees and issues other than late payment of indemnity.
20c	Other penalties for failure to comply with any regulation of the Administrative Director not otherwise assessed.
21	Unsupported denial of all liability for a claim.

### **C. Payment Evaluation**

The current CIGA audit methodology applies to a very short period of payments, approximately three months. This short period of review does not provide a sufficient audit period for an accurate evaluation of payment processes, duplicate payments, overpayments, and payment accuracy. By limiting the review period to only three months, identification of trends and areas that have financial impact are limited.

#### **Findings**

Although all audits reviewed identified overpayments, duplicate payments, and penalties incurred by the TPA due to its errors, there is no clear indication these amounts have been reimbursed to CIGA. As indicated above, the limited period of payment review has likely minimized the financial impact these errors have on the CIGA claims.

#### **Recommendations**

44. *It is recommended the period of payments reviewed be extended to one year from the start of the audit to allow for an accurate evaluation of the payment processes, duplicate payments, overpayments, payment accuracy, and identification of penalties incurred by the TPAs. A follow-up report from the TPAs to each audit report indicating payment status of the appropriate reimbursements to CIGA as well as corrective actions implemented should be included.*

### **D. TPA Contract Review and Verification**

Each TPA has an original contract to provide workers' compensation services for CIGA insolvencies. Over time, these contracts may be amended to reflect fee agreements different from those originally negotiated.

#### **Findings**

The audit reports comment or discuss various areas that are directly related to the TPA contracts, such as bill review rates, TPA contract rates, ancillary vendor agreements, and staffing levels. Verification of fees charged against actual contracts was not noted in the audits reviewed.

#### **Recommendations**

45. *It is recommended that a review of the specific and current TPA contracts be conducted prior to an audit. All contracted rates should be noted and compared against those charged by the TPAs. TPA invoices for administration services, bill review, and other ancillary services should be included in the audit process to verify invoicing and payment at contracted rates.*

#### **Findings**

All audit reports reviewed indicated the average caseload for each adjuster handling "active" indemnity files and indicate the caseload for adjusters handling "inactive future medical" files (IFM). However, the staffing levels noted did not match those referenced in the TPA contracts provided by CIGA for review.

## **Recommendations**

46. *A review of the current TPA contracts should be undertaken to verify the staffing level or determine if a lower rate of payment should be considered for the handling of the IFM files which may require less experienced adjusters.*

## VI. Information Technology General Controls Assessment

### A. General Controls

The overall IT Controls environment is inadequate and needs improvement.

### B. Information Technology Strategic Plan

#### Findings

CIGA has no written information technology (IT) strategic plan. Without a defined IT strategic plan, the risk of ineffective decision making leading to investments in IT that have insufficient return or a negative impact on the organization is significantly increased. Costs, benefits and risks of IT-enabled business initiatives can become unclear or misunderstood. The risk that the organization's mission is not being supported by IT is also increased. IT initiatives must ensure compliance with governance requirements that potentially impact management and the Board's public responsibility. Undefined or confusing accountability and responsibility may arise without a properly developed strategy. Lack of common understanding of business and IT priorities can lead to conflicts about allocation of resources and priorities. The lack of an adequately designed strategic plan increases the risk that IT management decisions do not follow the organization's direction.

#### Recommendations

47. *CIGA should develop and implement an Information Technology Strategic Plan to ensure IT initiatives comply with governance requirements that potentially impact the organization's goals and responsibility to the public by management and the Board.*

### C. IT Steering Committee

#### Findings

CIGA has no IT Steering Committee. This increases the risk that IT is not focused on priorities and that business requirements are not understood or addressed by IT management. An IT steering committee reduces the risk that IT plans are not aligned with business needs, unnecessary IT initiatives and investments occur and IT plans inconsistent with the organization's expectations or requirements.

#### Recommendations

48. *CIGA should establish an IT Steering Committee to provide consistent, effective and secure technological solutions that ensure the IT function is aligned with strategic planning and organization goals. Establishment of a committee should provide technology guidelines, advice on infrastructure products and guidance on the selection of technology, and measure compliance with these standards and guidelines. This committee should*

*direct technology standards and practices based on their business relevance, risks and compliance with external requirements.*

#### **D. Formal Annual IT Budget**

##### **Findings**

CIGA had no written annual IT budget developed or approved. No IT financial management framework has been established to manage the investments and costs of IT assets and services. This may result in IT expenditures not reflecting business needs, and may result in inappropriate allocation of financial resources of IT operations. Due to the lack of an IT budget, no cost management process is in place to compare actual IT costs to budgets.

##### **Recommendations**

*49. CIGA should develop and implement a formal annual IT budget.*

#### **E. CIGA Information Technology Department Risk Assessment**

##### **Findings**

The CIGA Information Technology Department Risk Assessment is not based on acknowledged industry standards or leading practices, such as COBIT standards. The lack of standardization inhibits the ability to clearly establish the scope and purpose of the internal control framework, roles and responsibilities, and methodologies to be used.

##### **Recommendations**

*50. The CIGA Information Technology Department Risk Assessment should be revised so it is based on acknowledged industry standards or leading practices, such as COBIT standards.*

#### **F. Information Security Officer**

##### **Findings**

CIGA has no Information Security Officer (ISO) role defined. The Director of IT and Audit of CIGA has assumed the responsibility of information security.

##### **Recommendations**

*51. CIGA should formally define the ISO position to effectively manage IT security at the highest appropriate organizational level, and to ensure that management of security actions is in line with business requirements.*

## **G. Information Technology Policies and Procedures**

### **Findings**

Not all Information Technology Policies and Procedures are updated and approved by the Board on at least an annual basis. In addition, not all IT policies document the date of management approval and date of last update.

### **Recommendations**

52. *CIGA should develop and maintain a set of policies to support IT strategy. These policies should include policy intent, roles and responsibilities, exception process, compliance approach, and references to procedures, standards and guidelines. Their relevance should be confirmed and approved annually.*

## **H. Formal Vendor Management Policy**

### **Findings**

It was determined that a formal vendor management policy does not exist. A vendor management policy ensures that vendor relationships are administered and monitored appropriately.

### **Recommendations**

53. *CIGA should develop a vendor management policy that includes a formalized process for monitoring and re-aligning business needs and priorities. The framework should include processes for establishing and modifying service requirements, service definitions, service level agreements and funding resources.*

## **I. Third-party Vendor SAS-70 Reports**

### **Findings**

CIGA did not provide any documentation to indicate that third-party vendor SAS-70 reports are being evaluated and client control considerations are being addressed. CIGA does not document their response to vendor control exceptions.

### **Recommendations**

54. *CIGA should perform and document reviews of vendor SAS-70 reports to ensure that the supplier is meeting current business requirements and continuing to adhere to the contract agreements and service level agreements.*

## **J. Annual Information Technology General Controls Evaluation**

### **Findings**

CIGA does not appear to perform an annual information technology general controls (ITGC) evaluation. The lack of an ITGC evaluation performed by an IT specialist on at least an annual basis increases the risk that controls over IT are not operating effectively and are not being remediated in a timely manner.

### **Recommendations**

55. *CIGA should obtain independent control reviews by an internal or external auditor that specializes in IT controls.*

### **Findings**

CIGA does not have a process in place to review network access rights. Performing regular management review of all accounts and related privileges protects IT systems and confidential data from unauthorized access.

### **Recommendations**

56. *CIGA should perform a review of access rights to ensure that users have authorization from the system owner for the use of the information system or service, and the level of access granted is appropriate to the business purpose, consistent with the organizational security policy and are reflective of employee responsibilities.*

### **Findings**

CIGA does not have a network vulnerability assessment performed at least annually. Security management includes performing security monitoring and periodic testing and implementing corrective actions for identified security weaknesses or incidents. Effective security management protects all IT assets to minimize the business impact of security vulnerabilities and incidents.

### **Recommendations**

57. *CIGA should have a network vulnerability assessment and penetration test conducted on an annual basis to proactively discover and remediate security vulnerabilities.*

## **K. Reporting and Review of Network Resources**

### **Findings**

CIGA lacks adequate reporting and review of network resources related to capacity and utilization. Effective IT performance management requires a monitoring process. This process includes defining relevant performance indicators, systematic and timely reporting of performance, and prompt action upon deviations.

## Recommendations

58. *CIGA should implement a process to regularly perform a comprehensive review of network capacity, utilization and security. CIGA should review performance against agreed-upon targets and initiate necessary remedial action. CIGA should establish a process for regular reporting of IT's goals, achievements, mitigation of risks, and the usage of resources.*

## L. Disaster Recovery Plan

### Findings

CIGA does not have a formally documented disaster recovery (DR) plan. Development of IT continuity plans reduces the impact of a major disruption on key business functions and processes.

### Recommendations

59. *CIGA should develop and formalize a documented disaster recovery plan to define procedures to utilize CIGA's recovery systems. The DR plan should at a minimum address the following attributes:*

- *The conditions and responsibilities for activating and/or escalating the plan*
- *Prioritized recovery strategy, including the necessary sequence of activities*
- *Minimum recovery requirements to maintain adequate business operations and service levels with diminished resources*
- *Emergency procedures*
- *Fallback procedures*
- *Temporary operational procedures*
- *IT processing resumption procedures*
- *Maintenance and test schedule*
- *Awareness, education and training activities*
- *Responsibilities of individuals*
- *Regulatory requirements*
- *Critical assets and resources and up-to-date personnel contact information needed to perform emergency, fallback and resumption procedures*
- *Alternative processing facilities as determined within the plan*
- *Alternative suppliers for critical resources*

*A periodic (at least annually) test and certification of the DR plan should be performed to ensure the operating effectiveness of the plan.*

## VII. Legal Contract Review

Prior to 2008 CIGA did not have a formal contract review process in place to monitor compliance, conflicts of interest, insurance requirements, and legal enforceability. In 2008 a set of written guidelines has been developed. Main areas of concern for CIGA is to confirm that all contracts (1) contain the necessary elements to make them legally enforceable, (2) require evidence of necessary insurance coverage and (3) require disclosure of conflicts of interest.

### A. General Contract Review

#### Findings

Historically, the drafting, negotiation, and monitoring of the provisions of the various TPA contracts has been a collaborative effort by the Executive Director, the Director of Claims, the TPA, and the Director of Finance.

Some agreements had automatic renewal provisions with no apparent periodic review process within CIGA. There was evidence of multiple overlapping agreements with the same effective dates.

Prior to 2008 CIGA did not have formal written policy guidelines regarding the structure, negotiation, monitoring, and legal review of the outside vendor/contractor agreements, including those with the workers' compensation TPAs. Not all agreements were reviewed by legal counsel.

There was no formal process in place to monitor any actual or perceived conflict of interest situations involving the workers' compensation TPAs. Although CIGA now has written guidelines in place for these reviews, the guidelines were not consistently followed for some of the current agreements provided to us by CIGA.

#### Recommendations

60. *CIGA should develop a model services agreement with clear and unambiguous language regarding legal execution, termination, indemnification/hold harmless protection, transfer of risk techniques, insurance requirements, and conflict of interest situations. Since the failure to provide evidence of insurance coverage is, by contract, a material breach of the agreement, this will give CIGA leverage to negotiate, monitor, track and enforce agreements with outside vendor/contractors.*

### B. Execution and Signing of Agreements

Beginning in 2008, CIGA implemented the use of a Contract Review Cover Sheet and a confirmation of Legal Review.

#### Findings

The standard language in most of the agreements specifies an effective date within the text of the agreement. However, not all agreements contain the specific effective date.

Some of the 2008 non-TPA agreements reviewed did not include the Contract Cover Sheet or a Legal Review. Some of these agreements signed in 2008 were not properly signed by one of the parties.

### **Recommendations**

61. *All agreements must clearly specify the "effective date" that services are to begin, the exact insurance limits and protection required for each loss exposure, and that any actual or perceived conflict of interest situations are addressed prior to the effective date of the agreement(s).*
62. *All contracts should be signed and executed by both parties.*

### **C. Termination of Agreement Provisions**

#### **Findings**

Although we saw some improvement in this area in recent agreements, inconsistencies remain in contract termination clauses. Some agreements had two ways that one party could terminate the agreement, while later ones had as many as four ways.

#### **Recommendations**

63. *It is recommended that all standard agreements with TPAs and outside vendors contain consistent language for termination that has been reviewed by outside legal counsel.*

### **D. Transfer of Risk**

#### **Findings**

The standard language found in most agreements provides that each party will be responsible for its own wrongdoing that may contribute to a claim for damages. As worded, this standard language is sufficient to protect each party while providing that the contractor will defend, indemnify and hold CIGA harmless for a mishandling of the file by the TPA or other vendor/contractor. This language is adequate.

Some of the agreements had no requirement for independent contractors to procure, maintain or provide evidence of the necessary liability coverages to support the indemnification language. Many agreements had different limits of liability for each coverage form.

#### **Recommendations**

64. *It is recommended that specific types of insurance be required in the agreements with all service providers. These requirements may vary depending on the type of service being provided, but in general should include:*

*Fidelity/Crime Insurance - This coverage would protect CIGA against criminal taking of monies belonging to the liquidated insurer, CIGA, or monies of the TPA. A stated purpose of most fidelity bonds (or crime insurance) is not to protect the TPA for loss of its funds,*

*but the loss of money being monitored or controlled by CIGA. If this coverage form is in the name of the contractor to cover the acts and omissions of its employees, it must be clear that the monies to be protected belong to CIGA, and not any funds of the contractor. If the coverage is in the name of CIGA, it must be clear that it covers the acts or omissions of the employees of the contractor. It may be possible for CIGA to have the contractor's policies specifically endorsed for this added protection.*

General Liability and Automobile Insurance - *This coverage should be required on an "occurrence" basis with applicable limits depending on the nature of the services being performed.*

Workers' Compensation Coverage - *Statutory workers' compensation coverage should be required.*

Professional/Errors and Omissions Liability Insurance - *All TPA and professional service firms should be required to provide evidence of the appropriate professional liability coverage for the type of service rendered on behalf of CIGA. All contracts should require:*

- *Additional Insured Endorsements*
- *Certificates of Insurance*
- *Notice of Cancellation*

## **E. Monitoring of Insurance Requirements**

### **Findings**

CIGA was not able to document that it consistently monitors evidence of recommended coverages.

### **Recommendations**

65. *CIGA should assign a designated person(s) to focus on the current legal contract review process to continually monitor their agreements to ensure that they have been properly executed, that the required insurance/indemnity protection has been secured prior to the beginning of the work or service (and continuously maintained), and that any conflict of interest situations are disclosed and either approved or waived.*

## **F. Conflict of Interest Provisions**

A conflict of interest can develop when a workers' compensation claims administrator "bundles" services with an ancillary or subsidiary company to perform such cost containment services such as bill review, PPO savings, managed care, field case management services, transportation, pharmacy benefit plans (PDM), IMEs, durable medical equipment (DME), utilization reviews, vocational rehabilitation, and others. Since the TPA may have a financial

interest in the ancillary or subsidiary company, they may not always seek the best or lowest price or the best alternative service.

## **Findings**

As indicated in Section III of this report, many contracts with TPAs were for bundled services. Although some of these arrangements were clearly disclosed in the agreement, there did not seem to be any process in place for the prior approval of this arrangement, or the continued monitoring of performance, pricing, payment or the quality of service being provided.

Current agreements do not require adequate disclosure and treatment of conflicts of interest. Some cost containment fees and conflict of interest situations were identified in CIGA's March 2008 and September 2008 audit compliance reports, however, no assurances were given by CIGA staff that these potential conflict situations were addressed.

Some agreements reviewed included a provision stating that "In the event a conflict of interest or a perceived conflict of interest arises on a particular file, \_\_\_\_\_ shall immediately advise CIGA and obtain a conflict waiver within ten (10) business days. If a conflict waiver cannot be obtained, \_\_\_\_\_ shall assure that the file is returned to CIGA immediately, assuring that the claim is handled properly in accordance with the California workers' compensation statutes, regulations and case law authorities through the time of the transfer." Many of the agreements reviewed did not have any conflict of interest section.

## **Recommendations**

66. *It is recommended that language requiring full disclosure of conflicts of interest be developed and included in every request for proposal, bid document, or contract between CIGA and any outside agency, vendor or contractor. The provision should also include language to the effect that contracting with a subsidiary or ancillary company in which the TPA has ownership or interest is a conflict of interest. This requirement of disclosure and approval should also apply to situations where the TPA buys another ancillary company or merges with such a company during the term of the agreement.*

## **G. CIGA Purchasing Policy**

### **Findings**

CIGA adopted a procurement policy, dated March 5, 2008, designed to be "efficient, cost effective and flexible with reasonable provisions for competitiveness, fairness and opportunity to vendors." The express purpose of the policy is to "procure appropriate and necessary goods and services on behalf of staff and employees of the Association in a timely manner and at a reasonable cost to the Association." Three specific goals and objectives are to 1) "obtain the best possible value for the goods or services received"; 2) "guard against misappropriation of assets procured through the purchasing system"; and 3) "insure that the best value is obtained for the Association's money." The Originating Department is tasked with "assuring that draft contracts are provided to the Director of Finance and the General Counsel for their review when required under this policy." General Counsel will review all contracts with annual expenditures in

excess of \$50,000 for "legal review prior to execution." The Workers' Compensation Claims Manager has annual expenditure authority of up to \$20,000. The Executive Director has authority of up to \$1 million annually without seeking Board approval.

The policy recognizes that there are special circumstances "for which the normal procurement process may need to be suspended or quickly expedited." This is certainly reasonable and necessary as long as the process is reviewed or audited periodically to make sure that the CIGA contractors are complying with CIGA policy and are handling the claims in a cost-effective manner.

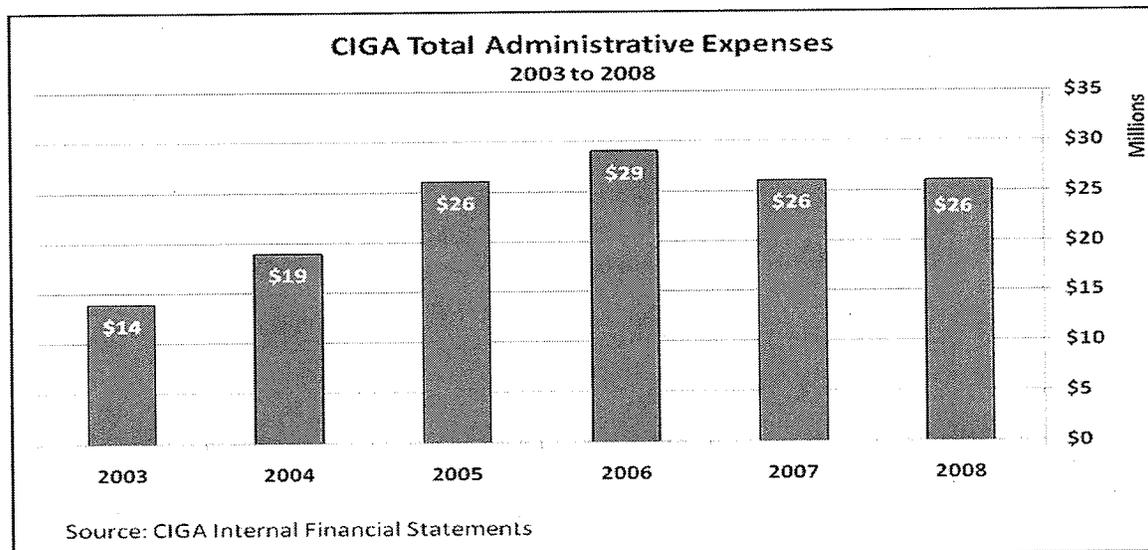
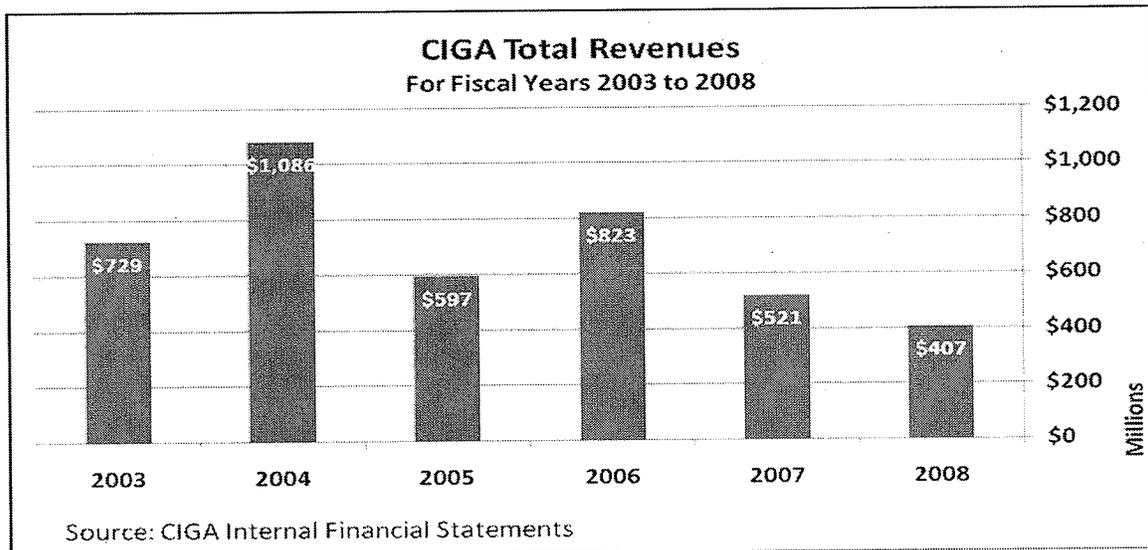
### **Recommendations**

67. *CIGA general counsel should be involved in the negotiation, drafting, and review of all contracts prior to execution.*

## VIII. Financial Statements and General Ledger Analysis

### A. Financial Statement Disclosures and Reporting

CIGA's revenues are primarily generated through assessments of members, investment income, and liquidator advances. Expenses are typical of an insurance enterprise and include benefit payments to injured workers, claims adjusting costs, changes in outstanding claim liability, and administrative expenses. Bonds issued in 2004 resulted in special policyholder assessment revenue as well as interest and other bond issuance related expenses. The following charts display CIGA's historical revenue and major expenses over the past six years.



CIGA maintains a detailed general ledger of revenues and expenses including separate accounts for each insolvent carrier assumed by CIGA. CIGA prepares quarterly internal

financial statements and obtains an independent audit of its annual financial statements. These reports are presented to the Board of Governors.

## **Findings**

CIGA's internal quarterly and annual audited financial statements contain only summary information on the administrative expenses incurred by CIGA. These reports do not provide the Board of Governors or other readers with sufficient information to understand the types of expenses incurred by CIGA for its operations or to review trends in expenses over time.

In addition, CIGA does not present financial statements to the Board that compare actual expense activity against an adopted budget or other benchmarks. The Board of Governors does not formally accept the internal quarterly financial statements.

## **Recommendations**

68. *CIGA should disclose the following additional information in its quarterly internal financial statements and such statements should be formally accepted by the Board:*
- d. Material claims and administrative expenses that mirror those presented in the annual operating budget;*
  - e. Actual revenue and expense results compared to the annual operating budget and percentage of the budget expended; and*
  - f. Explanations of material budget variances.*

*CIGA should also disclose material claims and administrative expenses in its annual audited financial statements.*

## **B. Actuarial Estimate of Unpaid Claims Liability**

As of June 30, 2008, CIGA recorded a liability for unpaid claims and claims adjusting expenses of approximately \$2.7 billion. CIGA obtained an actuarial evaluation of its unpaid loss and loss adjustment expenses as of June 30, 2006, but historically has not obtained such an evaluation of its ultimate unpaid claim liability, except to assist with claims payment projections. CIGA has not pursued annual actuarial evaluations of unpaid loss and loss adjustment expense. The claims data received by CIGA upon assumption of the claims is often incomplete and has presented difficulties in obtaining an actuarial opinion on the unpaid claim liability as of the fiscal year-end. It was noted that actuarial analyses on specific insolvencies have been prepared in the past.

We acknowledge that data limitations exist and that the quality of data is not necessarily consistent with that provided by a solvent insurer. However, the limitations should not necessarily prohibit an actuary from using alternative methods that provide reasonable estimates of unpaid loss and loss adjustment expenses for financial statement purposes, as

was done by CIGA's consulting actuary in a 2006 evaluation. Generally Accepted Accounting Principles require that unpaid claim liabilities be based on the "best estimate" of ultimate loss, which is typically accomplished through an actuarial estimate of the ultimate claims costs reflecting recent settlements, claims frequency, and other economic, social, and inflationary factors.

## **Findings**

CIGA does not obtain an independent actuarial evaluation of its total unpaid claim liabilities for reporting on its financial statements. CIGA's independent financial auditors have issued qualified opinions on CIGA's financial statements in part because they are unable to determine the reliability and completeness of the ultimate unpaid claim liability.

## **Recommendations**

69. *CIGA should obtain an annual actuarial evaluation of its claim liabilities to develop estimates of its future payout of reserves and allocated (ALAE) and unallocated loss adjustment expenses (ULAE).*

*Obtaining an actuarial evaluation of these actual and future payouts by CIGA will provide CIGA management and the Board with more accurate information on its obligations for use when: 1) planning for the resources need to meet such obligations; 2) reporting to stakeholders such as policyholders, the Department of Insurance, and the Legislature; and 3) providing the independent financial auditors with more detailed and sophisticated analysis of its claims liability recorded on its annual financial statements and a better understanding of future estimated payouts.*

## **C. Selection of Independent Financial Auditor**

### **Findings**

CIGA's has used the same independent financial auditor for at least the past eight years.

### **Recommendations**

70. *The CIGA Board or the Audit Committee should initiate a request for proposal for independent financial audit services prior to the commencement of the audit of the fiscal year ending June 30, 2009.*

## **D. Accounting Policies and Procedures Manual**

### **Findings**

CIGA does not maintain an accounting policies and procedures manual.

### **Recommendations**

71. *CIGA should develop an accounting policies and procedures manual to: 1) document CIGA's internal accounting procedures over its major accounting cycles; 2) identify the safeguards in place to protect CIGA's assets; 3) promote accurate, efficient, and consistent application of accounting policies, and 4) identify the roles and responsibilities of those that play a part in the accounting and financial reporting for CIGA.*

*In addition, the Internal Audit Department should participate in the development of the manual and assist in the identification and documentation of appropriate internal control activities for each area identified in the manual.*

*CIGA should strive to complete such a manual within a three year period.*

## IX. Human Resources

### A. Identification of Purpose

The Human Resources (HR) Department activities at CIGA are limited and do not sufficiently contribute to strategic management and planning.

Many of the traditional core functions of HR are not being performed by the HR Department, and CIGA did not provide documentation that any other departments within the organization are performing these functions.

Human resources activities are not supported by documented operational procedures and policies and processes are inconsistently applied.

Communication as a key human resources activity is inadequate in the CIGA management process. Employees are insufficiently informed of organizational decisions.

### Findings

CIGA's human resources department currently fulfills the role of benefits administrator and personnel record-keeper. Activities of the department are not strategic and do not contribute to organizational goals. Management decisions and key personnel activities often occur outside of, and in absence of, the Human Resources Department.

### Recommendations

72. *Human resources should play a more significant and strategic role. All activities of the department should be evaluated and retained or eliminated based on their support of the organizational objectives. Job descriptions of the Human Resources Department should be established that reflect a greater responsibility and accountability.*
73. *CIGA should annually evaluate its business plan, with an HR review, to include areas such as recruitment strategy, benefits and compensation plan, anticipated turnover and succession planning, and workplace culture.*
74. *CIGA stated that Human Resources meets regularly with senior management to discuss current and future staffing needs and recruiting strategies. These discussions should be documented by written notes or minutes of the meetings.*
75. *The Human Resources Department should develop a formally stated purpose, clearly identifying chain of command for anticipated and potential complex situations.*
76. *New job descriptions should be developed for the Human Resources Department with clear and authoritative responsibility.*

## **B. Personnel Policies**

### **Findings**

CIGA policies are outdated and inconsistently applied. There is a general lack of understanding about the purpose and application of many personnel policies, and knowledge about issues such as the pay period, payment of wages, payment of expenses, paycheck documentation, and payment of overtime wages is insufficient to protect CIGA from financial and reputational harm.

The purpose of some policies seems out of alignment with the nature of work performed.

### **Recommendations**

77. *CIGA should develop new personnel and operational policies, comprehensive in scope, that contributes to CIGA's business operations and efficient management.*
78. *It is recommended that the employee handbook be updated in its entirety to ensure compliance with current laws and standard "best" practices. Thereafter, amendments to the handbook should take place annually or as needed, with a full review and revision conducted on a biennial basis. New state and federal law changes must be implemented immediately and amendments to the policies distributed timely to employees. Further, every employee and supervisor should receive training on the application and purpose of policies.*

## **C. Human Resources Processes**

The development and documentation of formal processes for essential human resources activities helps to insulate an organization from claims of disparity, reduces cultural noise and judgment error, and ensures the consistent application of an organization's stated policies.

### **Findings**

CIGA lacks any formal or documented human resources processes. Many of the traditional core functions do not appear that they are being performed by the HR Department, and CIGA was not able to document that they are being performed by any other department within the organization.

### **Recommendations**

79. *CIGA should develop an operational handbook describing all routine and essential duties of the Human Resources Department and the processes to be followed for the execution of the human resources activities.*

## **D. Effective Communication**

Meaningful communication is the cornerstone of trust and integrity within an organization. Employees need to understand the reasons behind orders and instructions, to be allowed to offer insight and contribute ideas, and to be apprised of what is going on within the organization.

### **Findings**

Communication as a key human resources activity is inadequate in the CIGA management process. Employees are insufficiently informed of organizational decisions and there is insufficient two-way communication in personnel activities.

### **Recommendations**

80. *Information should be communicated to employees in a timely manner. A formal communication strategy, including the information chain of command, should be developed that addresses both internal and external changes that affect either employees or the organization.*

## **E. Documentation and Recordkeeping**

CIGA operates in a complex legal environment with many constraints on business and personnel practices. Consistency with the documentation and recordkeeping process is one of the best lines of defense against claims of discrimination brought by employees.

### **Findings**

CIGA was not able to document that it had a consistent process to document important personnel activities and decisions.

### **Recommendations**

81. *CIGA should conduct a review of current legally required practices for personnel recordkeeping and should modify any practices which are not in full compliance. Managers and supervisors should be trained to document personnel activities and events, and to refer to this documentation as a means of ensuring that management response is consistent among employees.*

## **F. Compensation Levels**

### **Findings**

There was no evidence provided by CIGA that salaries and benefits ranges paid to management and operational level employees is comparable to those paid by other organizations similar to CIGA (insurers, security funds, non-profit associations, or claims administrative firms).

82. *CIGA should conduct a market-based compensation analysis to ensure that pay at all levels is competitive and reasonable within the market to attract and retain qualified employees.*

*CIGA should additionally evaluate its benefits programs to ensure that benefits are meaningful and equitable to employees of all levels and that total compensation appropriately incentivizes high-level staff.*