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August 4, 2020

The Honorable Anthony Kern, Chair
Joint Legislative Audit Committee

The Honorable Rick Gray, Vice Chair
Joint Legislative Audit Committee

Dear Representative Kern and Senator Gray:

We have recently completed an initial followup of the performance audit and sunset review of the Arizona Department of Insurance (Department) regarding the implementation status of the 23 audit recommendations (including subparts of the recommendations) presented in the performance audit report released in September 2019 (Auditor General Report 19-110). Effective July 1, 2020, the Department was renamed the Arizona Department of Insurance and Financial Institutions, pursuant to Laws 2019, Ch. 252. As the attached grid indicates:

- 5 have been implemented.
- 14 are in the process of being implemented.
- 3 are not yet applicable.
- 1 has not been implemented.

We will conduct an 18-month followup with the Arizona Department of Insurance and Financial Institutions on the status of those recommendations that have not yet been fully implemented.

Sincerely,
Dale Chapman, Director
Performance Audit Division

cc: Evan Daniels, Director
Arizona Department of Insurance and Financial Institutions

Arizona Department of Insurance

Auditor General Report 19-110

Initial Follow-Up Report

Recommendation

Status/Additional Explanation

Finding 1: Department's new fraud-referral prioritization process lacks components to ensure it investigates high-priority referrals

1. The Department should strengthen its fraud-referral prioritization process by:

a. Developing and implementing a referral template, reporting requirements, and/or instructions that define the specific information and level of detail that insurance companies should provide when reporting suspected instances of insurance fraud.

Implementation in process

In March 2020, the Department developed and provided a guidance document to insurance companies to explain the information that should be provided when reporting suspected instances of insurance fraud. Additionally, the Department is participating in the National Association of Insurance Commissioners (NAIC) Antifraud Task Force to help establish national fraud reporting requirements for insurance companies. According to the Department, once the national fraud report requirements are finalized, it plans to revise this guidance document to reflect requirements adopted by the NAIC Antifraud Task Force.

b. Developing and implementing a process to use available referral data to help identify fraud trends and prioritize fraud referrals.

Implementation in process

The Department reported that it has weekly meetings with the National Insurance Crime Bureau (NICB) to discuss fraud referral data and fraud trends in the State, including fraud cases by location and policy type, and that it incorporates this information into its fraud-referral prioritization process. Additionally, as reported for Recommendation 1a, the Department created a guidance document and is participating in the NAIC Antifraud Task Force's effort to establish national fraud reporting requirements that, once implemented, should result in the Department obtaining more consistent, complete fraud referral data that it can then analyze.

c. Developing and implementing instructions to guide investigators' efforts to input referral and investigation information into the database completely and consistently.

Implementation in process

The Department updated its fraud unit case management policies and procedures manual to explain that fraud investigators should add notes and investigative plans to the database for each case they are assigned. However, the procedures do not specify the information that should be reported or standardized in some fields, such as fraud type. As reported for Recommendation 1a, the Department is participating in the NAIC Antifraud Task Force's effort to establish national fraud reporting requirements. According to the Department, it plans to update its procedures for inputting referral and investigation information into its database once the NAIC's reporting requirements are

Recommendation

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- d. Developing and implementing policies and procedures to incorporate the information discussed during the outreach events it conducts into its fraud-referral prioritization process and evaluating the effectiveness of these events.

finalized. The Department reported this will help ensure that required data is available in the system to effectively manage cases, produce meaningful reports, and support the Department's fraud-referral prioritization efforts.

Implementation in process

As reported for Recommendation 1b, the Department reported that it incorporates fraud trend information obtained during its weekly meetings with the NICB into its fraud referral prioritization process. However, it has not yet developed policies and procedures to incorporate information discussed during the outreach events it conducts with insurance companies' Special Investigative Units, antifraud organizations, and law enforcement into its prioritization process. According to the Department, it plans to update its policies and procedures to include its fraud outreach efforts and how information discussed during the outreach events will be incorporated into its fraud-referral prioritization process in the future.

- e. Developing and implementing a risk-based supervisory review process for referrals that are not investigated to help ensure that Department staff do not inappropriately close referrals that should be prioritized for investigation.

Implemented at 6 months

- f. Developing and implementing policies and procedures for its fraud-referral prioritization system and training additional staff on these policies and procedures.

Implementation in process

The Department updated its fraud unit case management policies and procedures to incorporate its process for prioritizing and investigating prioritized fraud referrals. Additionally, the Department is in the process of developing a training manual for new fraud investigators. However, the training manual does not include information about the fraud-referral prioritization process.

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- 2. The Department should evaluate whether its prioritization process has facilitated the Department's ability to focus on high-priority referrals and determine and implement any changes needed to continue to improve the prioritization process.

Implementation in process

The Department reported that its fraud investigative unit supervisor evaluates fraud investigators' workloads based on the priority levels of cases assigned to better distribute high-priority cases to investigators who have capacity to investigate these cases and help ensure that fraud investigators focus their time on high-priority cases. Additionally, the Department reported that it was in the process of evaluating the effectiveness of the new prioritization process.

Recommendation

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3. Once the Department has taken steps to evaluate and strengthen its prioritization process, it should assess its fraud investigative staffing needs to help ensure it investigates all the high-priority fraud referrals it receives. This assessment should include a documented workload analysis that compares the Department's workload, including an estimate of future workload, with its staff resources and then identifies the level of resources needed based on workload and responsibilities. If the Department determines additional resources are needed, it should work with the Legislature to obtain these resources.

Not yet applicable

As explained in Recommendations 1a through 2, the Department is taking steps to strengthen its fraud prioritization process and has reported that it is in the process of evaluating the effectiveness of the new prioritization process. Until the Department has implemented these recommendations, it will not be able to assess its workload based on the process changes it has implemented and identify its resource needs.

Finding 2: Department's practices for managing conflicts of interest increase risk of non-disclosure

4. The Department should develop and implement a conflict-of-interest policy that (1) requires all employees to complete an annual disclosure form; (2) defines a process for managing any disclosed potential conflicts of interest to ensure the conflict will not interfere with the performance of the employee's duties; and (3) defines a process for ensuring that completed forms are maintained in the Department's separate special disclosure file for public inspection.

Implementation in process

As of March 2020, the Department had developed conflict-of-interest policies and procedures and revised its disclosure form. The Department's policies, procedures, and form require all employees to complete an annual disclosure form, define its processes for managing any disclosed potential conflicts, and define its process for maintaining completed forms for public inspection. According to the Department, as of March 2020, 113 employees' forms were submitted, reviewed by the Department, and saved to its designated special disclosure file. The Department reported it was in the process of reviewing 20 forms submitted by employees and determining if any further action should be taken.

5. The Department should update and implement the policies and procedures for the Arizona Life and Disability Insurance Guaranty Fund Board, the Arizona Property and Casualty Insurance Guaranty Fund Board, and the Arizona Workers' Compensation Appeals Board to (1) require board members to complete an annual disclosure form; (2) define a process to allow board members to fully disclose substantial interests during public meetings, document these disclosures in the board's meeting minutes—including the name of the person with an interest (i.e., board member or board member's relative), the interest's description, and the reason the board member is refraining from discussing or otherwise participating; and (3) define a process for ensuring that completed forms are maintained in the Department's separate special disclosure file for public inspection.

Implementation in process

The Department has developed a conflict-of-interest disclosure form for board members. Additionally, the Department has developed policies and procedures requiring board members to complete the form annually and defining the process for maintaining board member disclosure forms in a special disclosure file for public inspection. However, the Department's policies and procedures do not define a process for documenting a board member's disclosures of a potential or real conflict of interest in the board's meeting minutes or for ensuring board members refrain from participating in any matter related to a disclosed potential or real conflict of interest during a board meeting. As of May 2020, the Department was in the process of obtaining disclosure forms from its board members.

6. The Department should update its disclosure form to require employees and public officers to comply with conflict-of-interest statutes by requiring the disclosure of both substantial financial and decision-making interests.

Implementation in process

The Department has taken steps to update its conflict-of-interest disclosure forms for employees and board members. However, the form for its employees does not explicitly require disclosure of substantial decision-making interests.

Recommendation**Status/Additional Explanation****Sunset Factor #2: The extent to which the Department has met its statutory objective and purpose and the efficiency with which it has operated**

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| 7. The Department should improve its administration of long-term care insurance rate reviews by:

a. Researching an appropriate time frame and then providing information to the Legislature regarding the need to revise the statutory time frame in order to allow more time to review long-term care insurance rates.

b. Establishing and implementing a formal process for notifying insurance companies to waive the time frame requirement for long-term care insurance rates.

c. Implementing the NAIC long-term care insurance task force's recommendations for improving long-term care insurance rate review when available and if appropriate and helpful. | Implemented at 6 months
Laws 2020, Ch. 37, §102, effective June 30, 2020, amended A.R.S. §20-1691.08 to increase the Department's review period from 30 days to 60 days and retained the Department's ability to extend the review period for up to 15 additional days.

Implemented at 6 months

Not yet applicable
The Department is participating in the NAIC Long-Term Care Task Force, which is working to develop a consistent national approach for reviewing long-term care insurance rates. The Task Force met in December 2019 and plans to present its proposed long-term care insurance rate review recommendations to the NAIC Executive Committee by fall 2020. |
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| 8. The Department should determine whether the Insurance Consumer Advisory Board is necessary and provides value to the Department and, based on its determination, take appropriate steps to either form this body to perform its statutory function or provide information to the Legislature regarding the need for a statutory change to sunset this body. | Implemented at 6 months
Laws 2020, Ch. 37, §44, effective June 30, 2020, repealed the Insurance Consumer Advisory Board. |
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| 9. The Department should determine whether it is necessary to reconvene the Continuing Education Review Committee. If the Department determines it is not necessary to reconvene this body, it should provide information to the Legislature regarding the need for a statutory change to sunset this body. | Implemented at 6 months
Laws 2020, Ch. 37, §121, effective June 30, 2020, repealed the Continuing Education Review Committee. |
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| 10. The Department should update and finalize its policies and procedures manual for the Arizona Property and Casualty Insurance Guaranty Fund and the Arizona Life and Disability Insurance Guaranty Fund. | Implementation in process
The Department has taken steps to update its policies and procedures manual for the 2 insurance guaranty funds. The Department reported that it has circulated the updated manual to the guaranty funds' staff and the Deputy Director for comments, and that once it has incorporated these comments, it will present the updated manual to the Property and Casualty Insurance Guaranty Fund Board and the Life and Disability Insurance Guaranty Fund Board to review and finalize. |
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Recommendation

Status/Additional Explanation

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| 11. The Department should ensure that all required reconciliations are completed and that a monthly financial review is being performed and subsequently verified by Department leadership, consistent with SAAM requirements. | Implementation in process
The Department updated its monthly reconciliation and reporting procedures in April 2020 to require the Administrative Services Division supervisor to create monthly reports showing all required reconciliations are being completed, consistent with SAAM requirements. Additionally, as of June 2020, the Department reported that it was in the process of implementing an updated procedure and using an Arizona Department of Administration, General Accounting Office form for performing required monthly financial reviews. |
| 12. The Department should conduct a risk assessment to evaluate, document, and prioritize the areas in the Department's IT systems with the highest security risks, and use the results of its risk assessment to guide its efforts to develop and implement all required IT security program policies and procedures in line with ASET requirements and credible IT standards, focusing on high-risk areas first. | Not implemented
Laws 2019, Ch. 252, §1, consolidated the Department, the Arizona Department of Financial Institutions, and the Automobile Theft Authority into the new Arizona Department of Insurance and Financial Institutions, effective July 1, 2020. The Department reported that it plans to hire a third-party consultant during fiscal year 2021 to conduct a risk assessment of its IT systems as part of its consolidation efforts. |
| 13. The Department should, once it has developed and implemented all required IT policies and procedures, provide training to its employees on these policies and procedures. | Not yet applicable
The Department reported that it has updated and drafted some ASET-required IT policies and procedures and plans to train its employees on these policies and procedures once they are implemented. However, it has not yet developed and implemented all ASET-required policies and procedures and, therefore, has yet to train its employees on these policies and procedures. |
| 14. The Department should work with ASET to define and document the scope of IT security services ASET provides to the Department and ensure that ASET provides these services. | Implementation in process
The Department reported that it has requested information from ASET to document the scope of IT services ASET provides to the Department and the IT services and security controls that are available to all State agencies. |

Sunset Factor #4: The extent to which rules adopted by the Department are consistent with the legislative mandate.

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| 15. The Department should conduct rulemakings to adopt or revise rules it has identified that need to be established, amended, or repealed. | Implementation in process
The Department revised some of its rules in fiscal year 2020 to address necessary changes identified in the Department's 2018 5-year rule review. Additionally, in December 2019, the Department identified rules that needed to be established or amended, and as of May 2020, was in the process of undertaking rulemakings to establish or amend these identified rules. |
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Recommendation**Status/Additional Explanation**

Sunset Factor #5: The extent to which the Department has encouraged input from the public before adopting its rules and the extent to which it has informed the public as to its actions and their expected impact on the public.

16. The Department should ensure that it makes board meeting minutes or a recording of board public meetings for the boards it supports available for public inspection 3 working days following a meeting as required by statute.

Implementation in process

The Department supports 3 boards that are subject to open meeting law requirements: the Arizona Life and Disability Insurance Guaranty Fund Board, the Arizona Property and Casualty Insurance Guaranty Fund Board, and the Arizona Workers' Compensation Appeals Board. According to the Department, these boards' meeting minutes are now printed and stored in binders at the Department and are available for public inspection. However, the Department reported that the minutes for the Arizona Life and Disability Insurance Guaranty Fund Board's November 2019 meeting were not prepared and made available for public inspection until December 2019, beyond the 3-day requirement. The other 2 boards did not meet during our follow-up review period and, therefore, we were unable to review these boards' and the Department's compliance with the 3-day requirement. The Department reported that it is in the process of updating its policies and procedures to include guidance for preparing board meeting minutes and will train staff on these policies and procedures once they are updated.