



New York State Office of the State Comptroller
Thomas P. DiNapoli

Division of State Government Accountability

Costs to Administer the Insurance Division Operations for the Three Fiscal Years Ended March 31, 2012

Department of Financial Services



Executive Summary

Purpose

To determine whether the Department of Financial Services (Department) is reporting its assessable expenses accurately, pursuant to Section 332, Article 3 of the Insurance Law. Our audit covered the period April 1, 2009 through March 31, 2012.

Background

The Department was established with the merger of the former Departments of Insurance and Banking on October 3, 2011. The Department's Insurance Division carries on the core functions of regulating all insurance activities in New York, including life, property/casualty and health insurance. Insurance regulation includes ensuring that the interests of insurance policyholders, providers and producers are balanced. The Department's specific insurance regulatory responsibilities include monitoring the financial solvency of insurers; approving the formation, consolidation or mergers of insurance organizations; and licensing/monitoring agents, brokers and adjusters.

In accordance with Section 332 of the Insurance Law, the costs to administer the Department's Insurance Division are to be borne by the insurance industry via assessments on all domestic insurers and all licensed United States branches of foreign insurers domiciled in New York State. Section 332 requires the State Comptroller to audit the expenses of the Department's Insurance Division. The Insurance Division's recoverable costs are assessed against the insurance industry by prorating costs among insurers based on the dollar value of premiums written in New York State.

Key Findings

- We found that the Department is reporting its assessable expenses accurately. The funds spent by the Department for the Healthy New York program, postage, and equipment rental were related to Department activities and were adequately documented. The funds spent by the two sub-allocation agencies (Department of Health's Immunization Program and Department of Law's Automobile Insurance Fraud Unit) were related to the purpose of each program as stated in their appropriation documents and were adequately documented.
- With the merger in 2011-2012, the Department determined that certain operational functions benefit both its Insurance and Banking Divisions, and developed a methodology to allocate these costs. However, the Insurance Division incorrectly applied the percentages for these costs, resulting in \$229,662 assessed to the Banking Division that should have been allocated to the Insurance Division. Management intends to correct this understatement of the Insurance Division's costs by adjusting to the current year (2012-2013) assessment.

Key Recommendation

- Take appropriate steps to correct the \$229,662 cost allocation error identified as a result of this audit.

Other Related Audits/Reports of Interest

[State Insurance Department: Costs to Administer Department Operations for the Three Fiscal years ended March 31, 2009 \(2009-S-85\)](#)

**State of New York
Office of the State Comptroller**

Division of State Government Accountability

October 9, 2013

Benjamin M. Lawsky
Superintendent
Department of Financial Services
One State Street
New York, NY 10004

Dear Superintendent Lawsky:

The Office of the State Comptroller is committed to helping State agencies, public authorities and local government agencies manage government resources efficiently and effectively and, by so doing, providing accountability for tax dollars spent to support government operations. The Comptroller oversees the fiscal affairs of State agencies, public authorities and local government agencies, as well as their compliance with relevant statutes and their observance of good business practices. This fiscal oversight is accomplished, in part, through our audits, which identify opportunities for improving operations. Audits can also identify strategies for reducing costs and strengthening controls that are intended to safeguard assets.

Following is a report of our audit entitled *Costs to Administer the Insurance Division Operations for the Three Fiscal Years Ended March 31, 2012*. This audit was performed pursuant to the State Comptroller's authority under Article X, Section 5 of the State Constitution and Article II, Section 8 of the State Finance Law.

This audit's results and recommendations are resources for you to use in effectively managing your operations and in meeting the expectations of taxpayers. If you have any questions about this report, please feel free to contact us.

Respectfully submitted,

*Office of the State Comptroller
Division of State Government Accountability*

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This report is also available on our website at: www.osc.state.ny.us

Background

The Department of Financial Services (Department) was established with the merger of the former Departments of Insurance and Banking on October 3, 2011. The merger consolidated two of the nation's oldest regulatory agencies to create a more modern, effective regulatory agency with a broad overview of the entire range of financial services.

The Department regulates and supervises financial services entities with assets totaling approximately \$6.1 trillion. These regulated entities include: nearly 500 life insurance and 1,100 property/casualty insurance companies; approximately 100 health insurers and managed care organizations; 240,000 insurance licensees; about 300 state chartered banks; approximately 1,600 licensed financial entities and 6,000 mortgage loan originators.

The Department's Insurance Division carries on the core functions of regulating all insurance activities in New York State, including life, property/casualty and health insurance. Insurance regulation includes ensuring that the interests of insurance policyholders, providers, and producers are balanced. The Department's specific insurance regulatory responsibilities include monitoring the financial solvency of insurers, approving the formation, consolidation or mergers of insurance organizations, and licensing/monitoring agents, brokers and adjusters. The Department also acts as the financial conduit between regulated insurers and six State entities for the financing of several insurance industry-related programs. The funding for these programs is appropriated as part of the Department's overall budget but the actual program expenditures are made by the individual entities receiving the sub-allocations.

In January 2010, the New York Insurance Association, Inc., a trade association of property/casualty insurers doing business in New York State, joined several domestic property/casualty companies in filing a lawsuit against New York State, the Governor, the Superintendent of Insurance and the Director of the Budget alleging the improper implementation of Section 332 of the Insurance Law. The claim is that the assessments contain expenses not connected with the operation of the Insurance Department. The plaintiffs seek a judgment to prohibit the inclusion of expenditures that do not represent actual direct and indirect operating expenses of the Insurance Department and a refund of all improper assessments from 2008 to the present, with interest. The New York Health Plan Association, Inc., a trade association of health insurers and health maintenance organizations, along with several health insurers, has filed a motion to join the lawsuit as plaintiffs. At the time of our audit the lawsuit was ongoing.

Audit Findings and Recommendation

Assessable Expenses

In accordance with Section 332 of the Insurance Law, the costs to administer the Department's Insurance Division are to be borne by the insurance industry via assessments on all domestic insurers and all licensed United States branches of foreign insurers domiciled in New York State. The Insurance Division's recoverable costs are assessed against the insurance industry by prorating costs among insurers based on the dollar value of premiums written in New York State. Section 332 also requires the State Comptroller to audit the expenses of the Department's Insurance Division.

Prior to the 2008-2009 State fiscal year, the Department of Insurance assessed insurance companies for its operating expenses using the cash basis of accounting. Chapter 503 of the Laws of 2009 and Chapter 56 of the Laws of 2010 authorized the Department of Insurance to begin billing based on the amount of its appropriations, regardless of when these funds were actually expended. Appropriations totaled more than \$455 million for the 2009-2010 fiscal year and about \$450 million in 2010-2011. For 2011-2012, the assessment was again based on the Insurance Division's expenditures. However for this year, the Department adopted the accrual method of accounting and a new chart of accounts based on functional areas or cost centers. Expenses for this year totaled more than \$408 million.

The change to the accrual method was made to coincide with the method used by the former Banking Department when performing its comparable assessment applied to the banking industry. As a result of the merger and these other changes, the financial information that the Department developed, and which are presented in the Exhibits included in this report, has also changed across the years. Exhibit A shows assessable expenses reported by specific account (internal cost category) for years up to and including 2010-2011. Exhibit B shows expenses reported by functional area (cost centers) for 2011-2012.

We concluded that the Department accurately compiled these statements of assessable expenses for the Insurance Division in all material respects. The amounts reported by the Department as expended for Insurance Division activities were adequately supported and documented, with the exception of one item that is discussed in the following paragraph. In addition, our tests show the funds reported as spent by the six agencies receiving sub-allocations of funds were related to the purpose of each program as described in relevant appropriation documents and were adequately documented.

With the merger in 2011-2012, the Department determined that some cost centers captured expenses that benefited both the Insurance and Banking Divisions. These expenses were allocated 60 percent to the Insurance Division and 40 percent to the Banking Division, based on a methodology developed and approved by the Department management. However, our tests showed the Insurance Division incorrectly applied these percentages for the certain cost centers,

resulting in \$229,662 inappropriately assessed to the Banking Division, thereby understating the Insurance Division's costs. Officials believe this minor error occurred largely because 2011-2012 was a complex year when staff had to deal with the merger, three different reporting entities, two financial systems, and accounting periods which used different accounting principles and methods. Officials indicated they would correct the error via a special adjustment to the 2012-2013 assessment.

Recommendation

1. Take appropriate steps to correct the \$229,662 cost allocation error identified in this audit.

Audit Scope and Methodology

We audited whether the Department is reporting its assessable expenses accurately, pursuant to Section 332, Article 3 of the Insurance Law. Our audit covered the period April 1, 2009 through March 31, 2012.

To achieve our audit objective, we reviewed relevant laws and regulations, interviewed Department officials and officials from selected State agencies that receive sub-allocations of funding included in the annual assessment. We also applied audit procedures to the annual assessment statements prepared by the Department. These audit procedures included analytical reviews to identify areas of risk and unique transactions that warrant additional consideration, as well as tests of selected transactions and such other procedures as we considered necessary in the circumstances. We also substantiated the assessable costs presented in these statements by tracing them to financial records maintained by the Department and by the State Comptroller. We conducted our performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

In addition to being the State Auditor, the Comptroller performs certain other constitutionally and statutorily mandated duties as the chief fiscal officer of New York State. These include operating the State's accounting system; preparing the State's financial statements; and approving State contracts, refunds, and other payments. In addition, the Comptroller appoints members to certain boards, commissions and public authorities, some of whom have minority voting rights. These duties may be considered management functions for purposes of evaluating organizational independence under generally accepted government auditing standards. In our opinion, these functions do not affect our ability to conduct independent audits of program performance.

Authority

The audit was performed pursuant to the State Comptroller's authority as set forth in Article V, Section 1 of the State Constitution and Article II, Section 8 of the State Finance Law.

Reporting Requirements

We provided a draft copy of this report to Department officials for their review and comment. Their comments have been considered in preparing this final report. Officials reported that they have already corrected the cost allocation error that we identified. A complete copy of their response is included at the end of this report.

Within 90 days after final release of this report, as required by Section 170 of the Executive Law, the Superintendent of the Department of Financial Services shall report to the Governor, the State Comptroller, and the leaders of the Legislature and fiscal committees, advising what steps were taken to implement the recommendation contained herein, and if the recommendation is not implemented, the reasons why.

Contributors to This Report

John Buyce, Audit Director
Walter Irving, Audit Manager
Robert Mainello, Audit Supervisor
Michael Cantwell, Examiner-in-Charge
Thierry Demoly, Staff Examiner
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Vision

A team of accountability experts respected for providing information that decision makers value.

Mission

To improve government operations by conducting independent audits, reviews and evaluations of New York State and New York City taxpayer financed programs.

Exhibit A

**New York State Department of Financial Services
Consolidated Statement of Costs to Administer the Division of Insurance
For the Fiscal Years Ended March 31, 2010 and March 31, 2011**

<u>Account (Cost Category)</u>	<u>Fiscal Year 2010</u>	<u>Fiscal Year 2011</u>
Health Related Programs	\$ 357,681,767	\$ 200,767,380
Personal Services	74,508,797	72,571,799
Fringe Benefits	34,591,948	36,583,495
Real Estate Rental	8,946,811	9,566,247
Miscellaneous Contract Services	5,118,222	4,725,701
Travel	2,159,985	1,956,884
OGS Telecommunications	620,596	625,759
Equipment	517,303	1,046,110
General Office Supplies	475,051	493,843
Telephone	342,005	180,958
Postage	283,005	367,152
Repair of Equipment	221,599	234,075
Rental of Equipment	155,602	202,686
OGS/OFT Computer	147,558	223,477
OGS Interagency Courier	32,373	21,729
Printing	17,800	12,981
Total Direct Costs	<u>\$ 485,820,422</u>	<u>\$ 329,580,276</u>
Sub-Allocations to Other Agencies	<u>91,392,883</u>	<u>80,091,592</u>
Total Operating Costs	\$ 577,213,305	\$ 409,671,868
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Exhibit B

**New York State Department of Financial Services
Consolidated Statement of Costs to Administer the Division of Insurance
For the Fiscal Year Ended March 31, 2012**

<u>Functional Area (Cost Center)</u>	
Healthy New York	\$160,795,565
Insurance Regulation	42,918,996
HMO Direct	39,200,000
Fringe/Indirect Regulation	19,692,663
Undistributed Regulation	9,661,361
Systems	7,207,091
Consumer Services	6,977,404
DFS Wide - Insurance Expenses	6,498,705
General Counsel/Legal	3,788,980
Fringe/Indirect Administration	3,694,602
Frauds	3,529,001
Fringe/Indirect Consumers	2,800,726
DFS Wide - Banking Expenses	2,600,152
Executive	2,201,266
Examiner Training Pool	1,966,869
Licensing	1,816,869
Capital Markets	1,235,975
Research & Technical Applications	1,025,624
Human Resources Management	1,013,157
Administration	915,559
Entertainment Workers	711,861
Administrative Operations	689,371
Criminal Investigations Bureau	617,641
Taxes and Accounts	539,008
Office Services	376,327
Budget and Finance	188,802
Public Information Office	162,757
Policy	145,911
Holocaust Claims Processing Office	132,494
Undistributed Consumers	111,978
Fair Lending/Consumer Help Unit	107,678
Communication & Media Relations	<u>64,579</u>
 Total Direct Costs	 \$ 323,388,972
Sub-Allocations to Other Agencies	<u>85,276,171</u>
 Total Operating Costs	 <u>\$ 408,665,143</u>

Exhibit C

**New York State Department of Financial Services
Cost to Administer the Division of Insurance
Comparative Statement of Sub-Allocations to Other Agencies
For the Three Fiscal Years Ending March 31, 2012**

<u>Sub-Allocated Agency</u>	<u>Fiscal Year 2010</u>	<u>Fiscal Year 2011</u>	<u>Fiscal Year 2012</u>
Department of Health	\$ 59,414,831	\$ 51,283,585	\$ 52,972,703
Department of State	22,949,575	11,185,519	6,380,622
Department of Law	6,615,870	5,907,275	5,553,381
Division of Criminal Justice Services	1,755,515	1,989,629	1,984,658
Department of Banking	427,859	404,765	200,520
Inspector General	229,233	270,767	250,000
Department of Homeland Security	<u>0</u>	<u>9,050,052</u>	<u>17,934,287</u>
Total	<u>\$ 91,392,883</u>	<u>\$ 80,091,592</u>	<u>\$ 85,276,171</u>

Agency Comments



NEW YORK STATE
DEPARTMENT *of*
FINANCIAL SERVICES

Andrew M. Cuomo
Governor

Benjamin M. Lawskey
Superintendent

September 10, 2013

John Buyce, CPA, CIA, CGFM
Audit Director
Office of the State Comptroller
Division of State Government Accountability
110 State Street – 11th Floor
Albany, NY 12236

Re: Audit Report 2013-S-6 - Costs to Administer the Insurance Division Operations for the
Three Fiscal Years Ended March 31, 2012

Dear Mr. Buyce,

I write on behalf of the Department of Financial Services ("DFS") in response to the Draft Audit Report from the Office of the State Comptroller ("OSC") regarding the above-referenced audit report dated August 14, 2013.

DFS has resolved the open issue, as stated in the attached letter dated July 26, 2013. Accordingly, DFS considers this matter closed.

Very truly yours,

A handwritten signature in black ink, appearing to read 'Lawrence Montle'.

Lawrence Montle
Director of Internal Audit

cc: Daniel S. Alter



NEW YORK STATE
DEPARTMENT of
FINANCIAL SERVICES

Andrew M. Cuomo
Governor

Benjamin M. Lawskey
Superintendent

July 26, 2013

Robert Mainello
Division of State Government Accountability
Office of the State Comptroller
110 State Street – 11th Floor
Albany, NY 12236

Re: Audit Report 2013-S-6 - Costs to Administer the Insurance Division Operations for the
Three Fiscal Years Ended March 31, 2012

Dear Mr. Mainello,

I write on behalf of the Department of Financial Services ("DFS") in response to the Preliminary Report from the Office of the State Comptroller ("OSC") regarding the above-referenced audit report dated July 18, 2013. The OSC's Preliminary Report addresses an allocation error in the assessment of the insurance industry for the 2011-2012 fiscal year. Out of the thousands of assessment transactions processed by DFS, the OSC discovered one error, which was not financially significant. The error amounted to less than a tenth of one percent of the overall assessment.

Upon discovery of the billing error, DFS took steps to correct the error by increasing the assessment to the insurance industry by \$229,662 and applying a commensurate decrease to the banking industry in bills for the 2012-2013 fiscal year. Accordingly, DFS considers this matter closed.

Very truly yours,

Lawrence Montle
Director of Internal Audit

cc: Daniel S. Alter