



# An Audit Report on the Texas Windstorm Insurance Association

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## Audit Objectives:

The audit objectives were to determine whether the Texas Windstorm Insurance Association's (Association):

- Controls over selected financial processes produce accurate financial information and ensure accountability for Association funds.
- Claims processing procedures and related controls ensure that claims payments are authorized, supported, processed in a timely manner, and made in compliance with applicable requirements.
- Expenses are:
  - Reasonable and necessary.
  - Properly authorized and supported.
  - Paid in accordance with applicable statutory, regulatory, and contractual requirements and policies and procedures.



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## Background Information:

The scope of the audit was from January 1, 2011, through March 31, 2012. That time period was chosen because the Association had implemented new processes for claims. Since December 2008, the Association had undergone six external reviews, and some of those reviews identified issues in claims processing.

In addition, the Association:

- Had been under new executive management since April 2011.
- Hired a new vice president of claims and a new controller in January 2012.
- Was under the administrative oversight of the Department of Insurance.



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## Overall Conclusion:

### The Association:

- Has improved its processing of claims after previous external reviews had identified findings in that area.
- Has controls to produce accurate financial information and authorize non-claims-related expenditures.
- Has accounting practices for reporting financial transactions that comply with the National Association of Insurance Commissioners' standards.

### Auditors identified areas for improvement in the Association's:

- Processing of claims.
- Premium payments.
- Accounting adjusting journal entries.
- Contracting.
- Information technology.



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Processing of Claims: Auditors tested 156 claims payments in 7 categories. The table below summarizes the transactions tested.

Summary of Transactions Tested for Claims Processing at the Association		
Category	Number of Claims Tested	Storms Associated with Claims <sup>a b</sup>
Loss claims payments for policies with an effective date prior to 11/27/2011	30	Robstown: 28 Normal: 2
Loss claims payments for policies with an effective date on or after 11/27/2011 (The Association refers to those claims as "House Bill 3" claims.)	9	Normal: 9
Loss claims paid under commissioner of insurance order	30	Ike: 30
Payments exceeding Association examiners' dollar approval threshold of \$50,000	32	Robstown: 19 Ike: 13
Additional living expenses claims payments	8	Robstown: 1 Ike: 4 Normal: 3
Potential duplicate payments	17	Robstown: 12 Ike: 3 Humberto: 1 Normal: 1
Replacement cost coverage claims payments	30	Robstown: 27 Ike: 1 Normal: 2
Totals	156	Robstown: 87 Ike: 51 Humberto: 1 Normal: 17
<sup>a</sup> The commissioner of insurance determines whether a storm is catastrophic. Ike was catastrophic. Robstown and Humberto were non-catastrophic. <sup>b</sup> The Association classified some claims as "normal." According to the Association, normal claims cannot be associated with a specific storm template. The Association creates a storm template when a storm occurs that is expected to generate a large number of claims (typically 500 or more).		



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## Processing of Claims - Loss Claims Payments with Policies Effective Before 11/27/2011 and House Bill 3 Claims:

- All 39 claims payments tested in these two categories were made in accordance with statutory time lines, were authorized, and had supporting documentation.
- A claims examiner was formerly an employee of the firm that served as the claims adjuster for 3 (8 percent) of the 39 claims payments tested. For one of those three claims payments, the Association employee did not disclose that they had worked for the contracted adjuster firm within the last five years, as required by the Association's conflict of interest policy.



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## Processing of Claims – Loss Claims Payments Paid Under Commissioner of Insurance Order:

These claims payments did not follow the same processes as other loss claims payments tested. All 30 claims payments tested in this category were paid in accordance with an order issued by the commissioner of insurance. Auditors verified that those payments were made to policy holders.

## Processing of Claims – Payments Exceeding \$50,000:

At the time of our audit, the Association had a policy that required a supervisor to review and approve all claims payments exceeding \$50,000. The Association did not perform a supervisory review as required on 14 (44 percent) of the 32 claims payments exceeding \$50,000 that auditors tested.



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## Processing of Claims - Additional Living Expenses:

The Association did not pay additional living expenses in a timely manner for 4 (50 percent) of the 8 claims tested in this category. For those 4 claims, the number of calendar days that elapsed between the Association's receipt of the claim and the date the claim was paid ranged from 934 days to 1,250 days. Receiving payments for additional living expenses helps policyholders maintain a normal standard of living.

## Processing of Claims – Potential Duplicate Payments:

The Association processed two duplicate payments. Specifically:

- In one case, the claims examiner identified the error and corrected it by adjusting a subsequent payment to the policyholder. This error was approximately \$500.
- In another case, the Association did not identify the error and the policyholder received a duplicate payment of \$400.



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## Processing of Claims – Replacement Cost Coverage Claims:

These claims were for costs to replace damaged property. All 30 claims payments tested were accurate.

## Processing of Claims – Quality Assurance Reviews:

The Association implemented quality assurance reviews in July 2011 to monitor whether Association claims examiners and contracted claims adjusters complied with statutory requirements and Association policies and procedures for processing claims.





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## Processing of Claims – Quality Assurance Reviews (continued):

Auditors tested 30 quality assurance reviews completed between July 2011 and March 2012. The Association did not have formalized procedures for performing quality assurance reviews or for reporting the results of those reviews. The Association did not:

- Have evidence that supervisory reviews were performed. Supervisory reviews would help to ensure that staff complete the quality assurance reviews accurately and consistently.
- Have documentation that Association management was notified about errors identified during quality assurance reviews. Those errors included errors made by Association claims examiners and contracted claims adjusters.
- Produce accurate reports for management. For example, the January 2012 reports (1) did not include all reviews that were conducted, (2) erroneously included results that were not relevant for all claims, and (3) did not consider various scenarios that exist for claims. Association management relies on these monthly reports to determine any necessary corrective action that Association claims examiners and contracted claims adjusters must take.



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## Premium Payments:

Auditors tested 30 premium payments that the Association received and determined that the Association properly recorded and had supporting documentation for those payments. However, one Association employee was responsible for collecting and depositing checks, reviewing adjustments, and reconciling deposits with payments in the Association's information system. Those processes should be separated and assigned to more than one employee to minimize the risk of misappropriation of premium payments.

Auditors also tested 30 reconciliations of premium payments with deposit information on bank statements. The Association did not have documentation that a supervisory review was performed for 2 (7 percent) of the 30 reconciliations tested. Supervisory review is important because of the issue discussed above.



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## Accounting Adjusting Journal Entries:

Auditors tested 16 accounting adjusting journal entries and determined that the Association:

- Could not provide adequate support for two of the tested entries. Those two adjustments totaled approximately \$496 million.
- Did not have evidence that a supervisory review was performed on four of the adjusting journal entries tested. Those four adjustments totaled approximately \$235 million.



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## Contracting:

According to the Association, it had at least 332 active contracts.

Auditors tested 30 contracts for reasonableness and necessity as stated in Texas Insurance Code, Section 2210.056(b)(3). Seven (23 percent) of the 30 contracts tested were for contract workers, and the contracts did not contain detailed descriptions of services to be provided. Auditors were unable to determine whether the contracted services and related expenditures were reasonable and necessary based on language in the contract.

The Association's contract database was not reliable because it contained (1) duplicate contracts, (2) incorrect dates for contract inception and expiration, (3) contracts that had expired or had been replaced, and (4) documents for items that were not contracts.



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## Information Technology:

The Association had network password and account lockout settings that followed best practices, and its claims information system contained an audit trail for financial transactions.

However, the Association had not corrected all issues regarding information security identified in prior information technology reviews. Those issues were in the areas of security management and application management.



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## Selected Recommendations

The Association should:

- Monitor its assignments of claims to claims examiners with conflicts of interest.
- Ensure that claims examiners do not exceed their dollar threshold limit to approve claims.
- Establish and enforce time frames for paying additional living expenses.
- Develop and implement written procedures for quality assurance reviews that address documenting supervisory reviews, notifying management about errors, and producing accurate reports.
- Ensure that accounting functions are separated and assigned to more than one employee.
- Maintain supporting documentation of accounting adjusting journal entries, including evidence of supervisory reviews.
- Ensure that its contracts database has complete and accurate information.
- Prioritize all information technology issues identified in this audit and previous reviews and develop a plan for implementing the related recommendations.