

DEPARTMENT OF INSURANCE
STATE OF LOUISIANA



FINANCIAL STATEMENT AUDIT
FOR THE YEAR ENDED JUNE 30, 2007
ISSUED NOVEMBER 12, 2008

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LOUISIANA LEGISLATIVE AUDITOR
STEVE J. THERIOT, CPA

October 30, 2008

Independent Auditor's Report
on the Financial Statements

THE HONORABLE JAMES J. DONELON,
COMMISSIONER OF INSURANCE
DEPARTMENT OF INSURANCE
STATE OF LOUISIANA
Baton Rouge, Louisiana

We were authorized to audit the accompanying special purpose (legal basis) financial statements of the Department of Insurance, a department within Louisiana state government, as of and for the year ended June 30, 2007, as listed in the table of contents. These financial statements are the responsibility of management of the Department of Insurance.

As described in note 1-B to the financial statements, the accompanying special purpose financial statements present only the funds of the Department of Insurance. As such, they present the appropriated and non-appropriated activity of the department that are part of the accounts and fund structure of the State of Louisiana. The appropriated fund reflects appropriated activity of the department that is part of the General Fund of the State of Louisiana. The non-appropriated funds are individual funds of the State of Louisiana not subject to budgetary control. The financial statements do not purport to, and do not, present fairly the financial position of the State of Louisiana as of June 30, 2007, the changes in its financial position, or cash flows, where applicable, for the year then ended, in conformity with accounting principles generally accepted in the United States of America. Furthermore, as described in the notes to the financial statements, the special purpose financial statements have been prepared on a legal basis of accounting, the purpose of which is to reflect compliance with the annual appropriation act for the appropriated fund and the financial position of the non-appropriated funds. These practices differ from accounting principles generally accepted in the United States of America. The effects on the financial statements of the variances between legal basis accounting practices and accounting principles generally accepted in the United States of America, although not reasonably determinable, are presumed to be material.

As discussed in Exhibit A, there were findings reported in a Performance Audit Division report issued May 22, 2007, and two Compliance Audit Division reports issued May 23, 2007, and September 26, 2007, by the Legislative Auditor, regarding Citizens Property Insurance Corporation, the Property Insurance Association of Louisiana, and the Louisiana Automobile

Insurance Plan. These reports describe possible noncompliance with state laws and regulations, including possible violations of law by former members of management of the Department of Insurance. Exhibit A also includes, in part, findings regarding rate setting practices by the department and noncompliance with the state audit law. The Legislative Auditor has attempted to examine and review the books, records, instruments, documents, files, films, tapes, and other forms of recordation, including emails maintained by the Department of Insurance. Because the Legislative Auditor has not been afforded complete access to copy emails and attachments of the Department of Insurance, he has been limited in his ability to accumulate audit evidence. Given this lack of transparency by the Department of Insurance, this audit is limited in its scope. The auditor may have formed different conclusions and additional conclusions had he been allowed to audit in accordance with governmental auditing standards. The significance of the findings described in Exhibit A, and our inability to perform alternative procedures, constitute a limitation on the scope of our audit.

The agency funds in the special purpose financial statements include 28 insurance companies and 12 subsidiaries or affiliated entities in the Office of Receivership for which the Department of Insurance has fiduciary responsibility. Because of the nature of these insurance companies and their subsidiaries and affiliates and the reasons they are in liquidation or rehabilitation, some of the assets and their valuation may not be known to the department. The ultimate value of these assets cannot presently be determined. Consequently, the actual liquidation value of the assets may differ from the amounts reported by the department. Accordingly, the agency funds on Statement A and Schedules 1 and 2 contain only information that is known to the Department of Insurance as of June 30, 2007.

Because we were not able to obtain complete access to audit evidence and were unable to apply other auditing procedures to ensure completeness, the scope of our work was not sufficient to enable us to express, and we do not express, an opinion on these financial statements.

During August and September of 2005, the State of Louisiana suffered considerable damage from two major hurricanes, Katrina and Rita, resulting in the President of the United States declaring Louisiana a major disaster area. Because of the severity of these two separate events and the resulting damages sustained, it is unknown exactly what economic impact recovery efforts will have on state and local governmental operations in Louisiana. While the Department of Insurance did not directly suffer any major damage from these two hurricanes, the long-term effects of these events directly on the department cannot be determined at this time.

In accordance with *Government Auditing Standards*, we have also issued our report dated October 30, 2008, on our consideration of the Department of Insurance's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

Our audit was conducted for the purpose of attempting to form an opinion on the accompanying special purpose financial statements of the Department of Insurance taken as a whole. The accompanying supplemental information schedules, identified in the Table of Contents, are presented for the purpose of additional analysis and are not a required part of the special purpose financial statements. The supplemental information schedules have been subjected to the auditing procedures applied in the audit of the special purpose financial statements. For reasons previously stated in the third, fourth, and fifth paragraphs, we do not express an opinion on the special purpose financial statements. Similarly, we do not express an opinion on the supplemental information schedules.

Respectfully submitted,



Steve J. Theriot, CPA
Legislative Auditor

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**DEPARTMENT OF INSURANCE
STATE OF LOUISIANA
ALL APPROPRIATED AND NON-APPROPRIATED FUNDS**

Balance Sheet (Legal Basis), June 30, 2007

	APPROPRIATED FUND - GENERAL APPROPRIATION	NON-APPROPRIATED FUNDS		TOTAL (MEMORANDUM ONLY)
		MAJOR STATE REVENUES AND INCOME NOT AVAILABLE	AGENCY FUNDS	
ASSETS				
Cash and cash equivalents (note 2)	\$9,608,745		\$2,149,652	\$11,758,397
Investments (note 3)			67,858,546	67,858,546
Receivables (note 4)	637,619	\$53,289,037	16,365,600	70,292,256
Prepaid items	38,685		615,806	654,491
Other			17,826	17,826
TOTAL ASSETS	\$10,285,049	\$53,289,037	\$87,007,430	\$150,581,516
LIABILITIES AND FUND EQUITY				
Liabilities:				
Accounts payable	\$615,573		\$183,986	\$799,559
Payroll payable	699,420			699,420
Refunds payable	221,034			221,034
Advance from state treasury (note 10)	35,000			35,000
Major state revenues and income not available due to state treasury		\$53,289,037		53,289,037
Due to state treasury (note 13)	9,374,757			9,374,757
Amounts held in custody for others			86,823,444	86,823,444
Total Liabilities	10,945,784	53,289,037	87,007,430	151,242,251
Fund Equity:				
Fund balance - reserved (note 12)	38,685			38,685
Fund balance - unreserved - undesignated (deficit) (note 11)	(699,420)			(699,420)
Total Fund Balance	(660,735)	NONE	NONE	(660,735)
TOTAL LIABILITIES AND FUND EQUITY	\$10,285,049	\$53,289,037	\$87,007,430	\$150,581,516

The accompanying notes are an integral part of this statement.

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**DEPARTMENT OF INSURANCE
STATE OF LOUISIANA
GENERAL APPROPRIATION FUND**

**Statement of Revenues, Expenditures, and
Changes in Fund Balance (Legal Basis)
For the Year Ended June 30, 2007**

REVENUES

Appropriated by legislature - state General Fund	
by fees and self-generated revenues	\$35,459,097
Federal funds (note 1-I)	255,936
Total revenues	<u>35,715,033</u>

EXPENDITURES

Administration/fiscal	8,660,712
Market compliance	18,643,930
Total expenditures	<u>27,304,642</u>

EXCESS OF REVENUES OVER EXPENDITURES 8,410,391

OTHER APPROPRIATED FINANCING SOURCES (Uses)

Transfers in (note 13)	930,636
Transfers out (note 13)	(9,374,757)
Total other financing sources (uses)	<u>(8,444,121)</u>

**EXCESS OF EXPENDITURES AND OTHER USES
OVER REVENUES AND OTHER SOURCES** (33,730)

FUND BALANCE (Deficit) AT BEGINNING OF YEAR (627,005)

FUND BALANCE (Deficit) AT END OF YEAR (\$660,735)

The accompanying notes are an integral part of this statement.

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**DEPARTMENT OF INSURANCE
STATE OF LOUISIANA
GENERAL APPROPRIATION FUND**

**Statement of Revenues, Expenditures, and
Unexpended Appropriation - Budget
Comparison of Current-Year Appropriation -
Budget (Legal Basis) and Actual
For the Year Ended June 30, 2007**

	<u>BUDGET</u>	<u>ACTUAL</u>	VARIANCE FAVORABLE (UNFAVORABLE)
REVENUES			
Appropriated by legislature - state General Fund			
by fees and self-generated revenues	\$27,330,211	\$26,127,588	(\$1,202,623)
Federal funds	255,936	255,936	
Statutory dedication	1,008,616	887,388	(121,228)
Total appropriated revenues	<u>28,594,763</u>	<u>27,270,912</u>	<u>(1,323,851)</u>
EXPENDITURES			
Appropriated for:			
Early Retirement and Payroll Reduction Act	52,140		52,140
Administration/fiscal	9,012,494	8,664,334	348,160
Market compliance	19,530,129	18,606,578	923,551
Total appropriated expenditures	<u>28,594,763</u>	<u>27,270,912</u>	<u>1,323,851</u>
UNEXPENDED APPROPRIATION - CURRENT YEAR			
	<u>NONE</u>	<u>NONE</u>	<u>NONE</u>

The accompanying notes are an integral part of this statement.

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INTRODUCTION

The Louisiana Department of Insurance was created in accordance with Title 36, Chapter 17 of the Louisiana Revised Statutes of 1950, as part of the executive branch of government. The department is required to adequately supervise and regulate insurance companies transacting business in the state to ensure competitive and available insurance that responsibly serves the insurance needs of Louisiana citizens. The department is operated under the direction of the commissioner of insurance who represents the public interest in the administration of the department and is responsible to the legislature and the public. The commissioner of insurance administers all parts of Title 22 of the Louisiana Revised Statutes (Insurance Code). The department is comprised of two programs and has 360 full- and part-time employees as of June 30, 2007.

Although the Department of Insurance has fiduciary responsibility over the Office of Receivership, the department has had no jurisdiction over this office since October 5, 1995. The Office of Receivership has operated under the control and administration of the Nineteenth Judicial District pursuant to an order signed by Judge A. Foster Sanders.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A. BASIS OF PRESENTATION

The Governmental Accounting Standards Board (GASB) promulgates accounting principles generally accepted in the United States of America and reporting standards for state and local governments. These principles are found in the *Codification of Governmental Accounting and Financial Reporting Standards* published by the GASB. However, the accompanying financial statements have been prepared on a legal basis, which differs from the accounting principles generally accepted in the United States of America as explained in the following notes.

B. REPORTING ENTITY

GASB Codification Section 2100 has defined the governmental reporting entity to be the State of Louisiana. The accompanying special purpose financial statements represent activity of only the Department of Insurance, a department of state government and, therefore, are a part of the funds of the State of Louisiana and its basic financial statements. Annually, the State of Louisiana issues basic financial statements that are audited by the Louisiana Legislative Auditor.

C. FUND ACCOUNTING

The department uses fund accounting, along appropriation lines, to reflect its compliance with provisions of the annual appropriation act and to reflect the financial position of its non-appropriated funds. This differs from the fund accounting of accounting principles generally accepted in the United States of America where the intent is to measure the financial position and results of operation of the governmental reporting entity as a

whole. Therefore, the funds within the accompanying financial statements have been divided between appropriated and non-appropriated funds and not by the conventional fund types of accounting principles generally accepted in the United States of America.

The funds, except for the agency funds, do not include any noncurrent assets or liabilities. Noncurrent assets, capital assets, and long-term liabilities are reflected in the State of Louisiana's basic financial statements.

The funds presented in the special purpose financial statements are described as follows:

APPROPRIATED FUND

General Appropriation Fund

The General Appropriation Fund is the general operating fund of the Department of Insurance. It administers and accounts for the legislative appropriation provided to fund the general administrative expenditures of the department and those expenditures not funded through other specific legislative appropriations or revenues.

NON-APPROPRIATED FUNDS

Major State Revenues and Income Not Available

The department collects major state revenues that are remitted to the state treasury for deposit to statutorily dedicated funds. In addition, the department collects funds specifically identified by the Division of Administration, Office of Planning and Budget, as income not available that are remitted to the state treasury. These amounts are not available to the department for expenditure and, therefore, are not included on Statement B but are detailed on Schedule 3.

Agency Funds

The agency funds include the accounts for funds received from certain insurance companies and their subsidiaries and affiliates placed in rehabilitation or liquidation under the supervision of the court, as provided by Louisiana Revised Statutes (R.S.) 22:731-762. Disbursements from the funds are made by order of the court. These funds represent cash, cash equivalents, and investments, which primarily consist of investments in mutual funds, mortgage and promissory notes receivable, and real estate held for resale. Accounts receivable include current and noncurrent receivables.

The non-appropriated funds are custodial in nature (assets equal liabilities) and do not involve measurement of results of operations.

D. BASIS OF ACCOUNTING

The accounting and financial reporting treatment applied to a fund is determined by its measurement focus. The funds in the accompanying financial statements measure the resources provided by the legislature to fund current-year expenditures and the use of those resources by the department. This differs from accounting principles generally accepted in the United States of America in which the measurement focus would be to measure the flow of current resources.

Basis of accounting refers to when revenues and expenditures are recognized and reported in the financial statements, regardless of the measurement focus applied. The accompanying financial statements reflect revenues and expenditures in accordance with applicable statutory provisions and regulations of the Division of Administration, Office of Statewide Reporting and Accounting Policy.

Under the foregoing legal provisions, the department uses the following practices in recognizing revenues and expenditures:

Revenues

The state General Fund fees and self-generated revenues, federal funds, and non-appropriated revenues are recognized when earned, to the extent that they will be collected within 45 days of the close of the fiscal year.

Expenditures

Expenditures are generally recognized under the modified accrual basis of accounting when the related fund liability is incurred, except that obligations of employees' vested annual and sick leave are recognized as expenditures when paid. Furthermore, any expenditures of a long-term nature for which funds have not been appropriated during the current year are not recognized in the accompanying financial statements.

Other Appropriated Financing Sources and Uses

Transfers made to or received from the state treasury or any other agency are recognized in the year the transfers are authorized, in accordance with provisions of the Division of Administration, Office of Statewide Reporting and Accounting Policy.

E. BUDGET PRACTICES

The appropriations made for the general operations of the department are annual lapsing appropriations and are recorded in the General Appropriation Fund. Revenues and expenditures for budget purposes are recognized on the same basis of accounting as described in note 1-D, except that included in revenues on Statement C are transfers in relating to statutory dedications. In addition, salaries and related benefits are recognized

when paid on Statement C. The revenues and expenditures shown on Statement B are reconciled with the respective amounts shown on Statement C as follows:

Statement B revenues	\$35,715,033
Add - transfer in (statutory dedications)	930,636
Less - transfer out (return of appropriation)	<u>(9,374,757)</u>
Statement C revenues	<u>\$27,270,912</u>
Statement B expenditures	\$27,304,642
Add - prepaid expenditures (net)	2,373
Less - payroll payable (net)	<u>(36,103)</u>
Statement C expenditures	<u>\$27,270,912</u>

The department is prohibited by statute from over-expending the program levels established in the budget. Budget revisions are granted by the Joint Legislative Committee on the Budget. Interim emergency appropriations may be granted by the Interim Emergency Board. The budget information included in the financial statements includes the original appropriations plus subsequent amendments as follows:

Original approved budget	\$28,547,039
Amendments - fees and self-generated revenues	<u>47,724</u>
Statement C revenues	<u>\$28,594,763</u>

The non-appropriated funds are not subject to budgetary control.

F. CASH AND CASH EQUIVALENTS

Cash and cash equivalents include cash on hand, demand deposits, certificates of deposit, and cash in state treasury. Under state law, the department may deposit funds within a fiscal agent bank organized under the laws of the State of Louisiana, the laws of any other state in the Union, or the laws of the United States. Furthermore, the department may invest in time certificates of deposit of state banks organized under the laws of the State of Louisiana, national banks having their principal offices in Louisiana, in savings accounts or shares of savings and loan associations and savings banks, and in share accounts and share certificate accounts of federally or state-chartered credit unions.

G. INVESTMENTS

R.S. 22:739.1 authorizes the commissioner of insurance to invest monies held in any rehabilitation, liquidation, conservation, dissolution, and administrative supervision proceeding. Authorized investments include investments in or loans on United States or state general government obligations; bonds or notes secured by a mortgage or trust deed

issued, assumed, guaranteed, or insured by the United States or an agency of the United States; conventional first mortgage loans capable of being securitized into guaranteed Federal National Mortgage Association mortgage-backed securities; bonds issued by the Inter-American Development Bank or the African Development Bank; and first mortgage loans guaranteed by the administrator of veteran affairs.

H. PREPAID ITEMS

The department establishes prepaid expenditures for postage. Payments made for such items that will benefit periods beyond June 30, 2007, are recorded as prepaid items.

I. OPERATING AND CAPITAL GRANTS

Operating grants represent the total amount of the grant revenue for the year that are restricted by the grantor for operating purposes or that may be used for either capital or operating purposes at the discretion of the grantee. Capital grants represent the total amount of the revenues for the year from grants restricted by the grantor for the acquisition, construction, or renovation of capital assets.

For fiscal year ended June 30, 2007, the total operating grants and contributions were \$255,936. The department had no capital grants and contributions.

J. LONG-TERM OBLIGATIONS

The department is by statute not allowed to incur bonded indebtedness and, therefore, no recognition within the accompanying financial statements is necessary. Furthermore, any long-term obligations of the department arising from lease commitments, judgments, compensated absences, or from any other source are not recognized in the accompanying financial statements.

K. COMPENSATED ABSENCES

Employees earn and accumulate annual and sick leave at various rates, depending on their years of service, without limitation on the balance that can be accumulated. Upon termination, employees or their heirs are compensated for up to 300 hours of unused annual leave at the employee's hourly rate of pay at the time of termination but are not compensated for unused sick leave. Upon retirement, unused annual leave in excess of 300 hours plus unused sick leave are used to compute retirement benefits. The liability for unused annual and sick leave is not accrued (reflected) in the accompanying financial statements.

Certain employees of the department are eligible to earn compensatory time, as defined by the Department of State Civil Service and the Fair Labor Standards Act. These employees can earn and accumulate one hour or one and one-half hour for each hour of overtime worked, depending on their position and rate of pay. Generally, the employees are allowed to carry up to 360 hours of accrued compensatory leave from one fiscal year

to another. Accumulated compensatory leave is not accrued (reflected) in the accompanying financial statements.

L. TOTAL COLUMN ON BALANCE SHEET

The total column on the balance sheet is captioned "Total (Memorandum Only)" to indicate that it is presented only to facilitate financial analysis. Data in this column does not present financial position in conformity with accounting principles generally accepted in the United States of America. Neither is such data comparable to a consolidation.

2. CASH AND CASH EQUIVALENTS

Cash and cash equivalents (book balances) are composed of the following:

Petty cash on hand	\$300
Demand deposits	2,133,514
Certificates of deposit	50,838
Cash on deposit with state treasury	<u>9,573,745</u>
Total	<u><u>\$11,758,397</u></u>

These deposits are stated at cost, which approximates market value. Under state law, these deposits (or the resulting bank balances) must be secured by federal deposit insurance or the pledge of securities owned by the fiscal agent bank. The market value of the pledged securities plus the federal deposit insurance must at all times equal the amount on deposit with the fiscal agent. The department has deposit balances (collected bank balances) of \$2,622,942 at June 30, 2007, for which the department has control.

Cash balances held and controlled by the state treasurer are secured from risk by the state treasurer through separate custodial agreements, and the risk disclosures required by accounting principles generally accepted in the United States of America are included within the state's basic financial statements. The following is a summary of cash in the state treasury:

Means of finance	\$9,229,084
Operating account	<u>344,661</u>
Total	<u><u>\$9,573,745</u></u>

3. INVESTMENTS

At June 30, 2007, the Office of Receivership, for which the Department of Insurance has fiduciary responsibility, has investments totaling \$67,858,546. All of these investments are from companies in rehabilitation, liquidation, conservation, et cetera, as reported in Schedule 1, and are valued at current market value. A summary of the investments follows:

NOTES TO THE FINANCIAL STATEMENTS (UNAUDITED)

	Percentage of Investments	Credit Quality Rating*	Fair Value	Investment Maturities in Years				
				Less Than 1	1-5	6-10	11-20	Greater Than 20
Type of Investment:								
Repurchase agreements ¹	0.17%		\$117,167	\$117,167				
Corporate bonds ²	0.05%		33,000		\$33,000			
Money market mutual funds	94.09%	Aaa	63,849,019	63,849,019				
Fixed assets ³	0.03%		20,665					
Real estate ³	2.73%		1,850,201					
Notes/mortgages receivable ²	2.93%		1,988,494	1,159,869	10,345	\$16,760	\$364,451	\$437,069
Total investments	100.00%		\$67,858,546	\$65,126,055	\$43,345	\$16,760	\$364,451	\$437,069

* Credit quality ratings obtained from Moody's Investors Service.

¹ The investments and underlying securities are not rated by Moody's Investors Service; however, the underlying securities are implicitly guaranteed by the U.S. government.

² The investment is not rated by Moody's Investors Service.

³ Credit quality ratings are not required for these investments, which do not have specified maturities.

Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. State law limits the investments by type as described in note 1-G. The department does not have policies to further limit credit risk.

Custodial credit risk is the risk that, in the event of the failure of the counterparty, the department will not be able to recover the value of its investments or collateral securities that are in the possession of an outside party. Concentration of credit risk is the risk of loss attributed to the magnitude of an entity's investment in a single issuer. The investments are not exposed to custodial credit risk or concentration of credit risk.

Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. State law does not address interest rate risk, and the department does not have policies to limit this risk. Pursuant to a court order of the Nineteenth Judicial District, the Office of Receivership is not allowed to invest or reinvest the funds of companies in receivership for a length of time in excess of six months without prior court approval. This requirement reduces the department's exposure to interest rate risk. None of the investments are considered highly sensitive to changes in interest rates.

4. RECEIVABLES

The following table presents the adjustments necessary to convert the modified accrual basis accounts receivable, as shown in Statement A and the schedules, to full accrual basis accounts receivable as required by the Office of Statewide Reporting and Accounting Policy. All of the department's receivables, except for the agency fund receivables, are expected to be collectible. The \$16,365,600 in agency fund receivables presented in Statement A and Schedule 1 are reported on a full accrual basis. Because of the nature of the insurance companies in liquidation or rehabilitation, as disclosed in note 1-C, agency fund receivables are reported net of uncollectibles.

	Accounts Receivable - Modified Accrual Basis	Full Accrual Adjustment	Accounts Receivable - Full Accrual Basis
Appropriated Revenues:			
Fees and self-generated	\$268,549	\$272,991	\$541,540
Statutory-dedicated funds	306,152		306,152
Federal funds	62,918		62,918
Total appropriated revenues	<u>\$637,619</u>	<u>\$272,991</u>	<u>\$910,610</u>
Non-Appropriated Revenues:			
Major state revenues	\$53,286,543	\$18,524,997	\$71,811,540
Income not available	2,494		2,494
Total non-appropriated revenues	<u>\$53,289,037</u>	<u>\$18,524,997</u>	<u>\$71,814,034</u>

5. PENSION PLAN

Nearly all full-time employees of the department are members of the Louisiana State Employees Retirement System, a single-employer defined benefit pension plan. Required disclosures for the plan for fiscal year 2007 are included in the Louisiana Comprehensive Annual Financial Report prepared by the Louisiana Division of Administration, Post Office Box 94095, Baton Rouge, Louisiana 70804-9095.

6. POSTEMPLOYMENT HEALTH CARE AND LIFE INSURANCE BENEFITS

The department provides certain continuing health care and life insurance benefits for its retired employees. Substantially all of the department's employees become eligible for these benefits if they reach normal retirement age while working for the department. These benefits for retirees and similar benefits for active employees are provided through a state-operated group insurance program and various insurance companies whose monthly premiums are paid jointly by the employee and the department. The department's costs of providing retiree health care and life insurance benefits are recognized as expenditures when the monthly premiums are paid. For the year ended June 30, 2007, the costs of retiree benefits totaled \$655,097 for 120 retirees.

7. JUDGMENTS, CLAIMS, AND SIMILAR CONTINGENCIES

Obligations and losses arising from judgments, claims, and similar contingencies are paid through the state's self-insurance fund or by General Fund appropriation and are not reflected in the accompanying financial statements. The self-insurance fund is operated by the Office of Risk Management, the state agency responsible for the state's self-insurance program.

8. COMPENSATED ABSENCES

The liability for unused leave payable at June 30, 2007, computed in accordance with the *Codification of Governmental Accounting and Financial Reporting Standards* Section C60, is estimated to be \$1,268,244 for unused annual leave and \$2,577 for accrued compensatory leave. The leave payable is not accrued (reflected) in the accompanying financial statements.

9. LEASE AND RENTAL COMMITMENTS

The department has no capital leases but does have operating leases for office space. The annual rental payments for future fiscal years are as follows:

<u>Fiscal Year</u>	<u>Office Space</u>
2008	\$78,990
2009	25,546
2010	<u>5,172</u>
Total	<u><u>\$109,708</u></u>

All lease agreements have non-appropriation exculpatory clauses that allow for lease cancellation if the Louisiana Legislature does not make an appropriation for their continuation during any future fiscal period. Total operating lease expenditures for fiscal year 2006-2007 amounted to \$155,667 for office space and equipment.

10. ADVANCE FROM STATE TREASURY

The department received an advance from the state treasury for imprest fund operations totaling \$35,000, as authorized by the commissioner of administration in accordance with Title 39 of the Louisiana Revised Statutes. The advance, as reflected in Statement A, represents a liability.

11. FUND BALANCE - UNRESERVED - UNDESIGNATED (DEFICIT)

The General Appropriation Fund had an unreserved - undesignated fund deficit of \$699,420 for the year ended June 30, 2007. The deficit was the result of the recognition of accrued salaries and related benefits as required by the Office of the Governor, Division of Administration, and the fact that revenues to fund those accruals are appropriated in the subsequent year. The deficit will be resolved by paying for salaries and related benefits from fiscal year 2008 funds appropriated to pay those obligations of the 2006-2007 fiscal year.

12. FUND BALANCE - RESERVED

The amount of \$38,685, shown as reserved fund balance on Statement A, represents prepaid expenditures for the 2007-2008 fiscal year.

13. OTHER APPROPRIATED FINANCING SOURCES AND USES

As shown on Statement B, in accordance with provisions of the Division of Administration, Office of Statewide Reporting and Accounting Policy, other appropriated financing sources (transfers in) totaled \$930,636 while uses (transfers out) totaled \$9,374,757 for the year ended June 30, 2007. The transfers in consist totally of statutory-dedicated funds used for current year operations. The transfers out consist of \$9,331,509 in self-generated funds collected but not spent, which are due to the State Treasurer's Office at June 30, 2007, and \$43,248 in statutory-dedicated funds that were made available to the department by the State Treasurer's Office but were not warranted by the department by June 30, 2007.

14. DEFERRED COMPENSATION PLAN

Certain employees of the department participate in the Louisiana Public Employees Deferred Compensation Plan adopted under the provisions of Internal Revenue Code Section 457. Complete disclosures relating to the Plan are included in the separately issued audit report for the Plan, available from the Louisiana Legislative Auditor Web site at www.lila.la.gov.

15. RELATED PARTY TRANSACTIONS

Related party transactions, as defined by Financial Accounting Standards Board Statement Number 57, occur in the normal course of business between the 28 insurance companies and their 12 subsidiaries or affiliates for which the department has fiduciary responsibility. Also, transactions to pay the administrative costs, settlements, et cetera, of these insurance estates all flow through the Office of Receivership bank account. These transactions are included in the additions and deletions reported on Schedule 1.

16. SUBSEQUENT EVENTS

Effective January 1, 2008, Act 459 of the 2007 Regular Session of the Louisiana Legislature abolished the Louisiana Insurance Rating Commission and provided for a modified file and use rating system. The act transferred the commission's powers, duties, and functions to the department's Office of Property and Casualty.

Act 222 of the 2007 Regular Session of the Louisiana Legislature added to the officers of the Louisiana Department of Insurance the position of deputy commissioner for consumer advocacy. As a safeguard to the independence of the voice of this deputy commissioner, the legislation limits termination of the person appointed to the position to termination for cause shown.

**SCHEDULE OF CHANGES IN ASSETS AND LIABILITIES -
NON-APPROPRIATED FUNDS - AGENCY FUNDS**

Changes in assets and liabilities for the agency funds for the year ended June 30, 2007, presented on Schedule 1, include 28 insurance companies and 12 subsidiaries or affiliated entities that are custodial in nature and are administered in-house by the Office of Receivership.

**SCHEDULE OF ENDING BALANCES -
NON-APPROPRIATED FUNDS - AGENCY FUNDS**

The balances of assets for the agency funds including balances by individual insurance companies and their subsidiaries and affiliates are presented on Schedule 2.

**SCHEDULE OF NON-APPROPRIATED REVENUES -
MAJOR STATE REVENUES AND INCOME NOT AVAILABLE**

Schedule 3 reflects major state revenues and income not available collected by the department during the year that were not available to the department for expenditure.

**SCHEDULE OF PER DIEM PAID
INSURANCE RATING COMMISSION MEMBERS**

The per diem paid to the Louisiana Insurance Rating Commission members is presented on Schedule 4, as required by House Concurrent Resolution No. 54 of the 1979 Session of the Louisiana Legislature. In accordance with R.S. 22:1401, each member is paid \$50 for each day devoted to work of the commission.

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**DEPARTMENT OF INSURANCE
STATE OF LOUISIANA
NON-APPROPRIATED FUNDS - AGENCY FUNDS**

**Schedule of Changes in Assets and Liabilities
For the Year Ended June 30, 2007**

	BALANCE AT JULY 1, 2006, RESTATED	ADDITIONS	DELETIONS	BALANCE AT JUNE 30, 2007
ASSETS				
Cash and cash equivalents	\$2,517,853	\$26,688,816	\$27,057,017	\$2,149,652
Investments	72,077,461	14,560,208	18,779,123	67,858,546
Accounts receivable	22,968,802	5,346,297	11,949,499	16,365,600
Prepaid expenses	616,419	1,500	2,113	615,806
Other	23,299	501	5,974	17,826
TOTAL ASSETS	\$98,203,834	\$46,597,322	\$57,793,726	\$87,007,430
LIABILITIES				
Accounts payable	\$1,399,240	\$183,986	\$1,399,240	\$183,986
Amounts held in custody for others	96,804,594	46,413,336	56,394,486	86,823,444
TOTAL LIABILITIES	\$98,203,834	\$46,597,322	\$57,793,726	\$87,007,430

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**DEPARTMENT OF INSURANCE
STATE OF LOUISIANA
NON-APPROPRIATED FUNDS - AGENCY FUNDS**

**Schedule of Ending Balances
For the Year Ended June 30, 2007**

Insurance Trust Funds

Acadian Financial Group, Incorporated	\$6,976
Acadian Life Insurance Company	2,017,015
Alliance Casualty and Reinsurance Company	19,228
Amcare Health Plans of Louisiana	7,749,214
American Funding Services, Incorporated	1,036,105
Amwest Surety Insurance Company	13,464
ANA Insurance Group	3,555,397
Automotive Casualty Insurance Company	53,444
Automotive Financial Services	1,295,772
Benton Life Insurance Company, Incorporated	172,616
Blooming Insurance Company	965
Car Insurance Company	3,845,906
Cascade Insurance Company	110,186
Colonial Lloyd's	177,648
Far West Insurance Company	16,310
First Columbia Life Insurance Company	10,053
Gulf Coast Casualty	398,268
Gulf Coast Holding Company	423,081
Gulf National Insurance Services, Incorporated	96,434
Independence Life	74,105
Lloyd's Assurance	12,399,290
Louisiana Receivership Office Fiduciary Trust Account	965,964
Midwest Life Insurance Company	8,898,127
National Affiliated Investors Life	19,939
North American Indemnity Company	233,656
Patterson General Agency, Incorporated	10,709
Patterson Insurance Company	10,030,379
Physicians National Risk Retention Group	3,570,064
Premier General Agency	164,633
Public Investors Life Insurance Company	1,067,830

(Continued)

**DEPARTMENT OF INSURANCE
STATE OF LOUISIANA
NON-APPROPRIATED FUNDS - AGENCY FUNDS
Schedule of Ending Balances, 2007**

Insurance Trust Funds (Cont.)

Savant Insurance Company	\$931,176
Savings Life Insurance Company	70,526
Superior Life Insurance Company	21,978
The Oath for Louisiana, Incorporated	15,687,798
United Agents Holdings, Incorporated	570,425
United Agents Insurance Company of Louisiana	4,494,967
United Agents Underwriters, Incorporated	211,056
United States General Agency	6,586,726
Total Insurance Trust Funds	<u>\$87,007,430</u>

(Concluded)

**DEPARTMENT OF INSURANCE
STATE OF LOUISIANA
MAJOR STATE REVENUES AND INCOME NOT AVAILABLE**

**Schedule of Non-Appropriated Revenues
For the Year Ended June 30, 2007**

<u>NON-APPROPRIATED REVENUE FUND SOURCE</u>	<u>CASH RECEIPTS THROUGH JUNE 30, 2007</u>	<u>ACCOUNTS RECEIVABLE JUNE 30, 2007</u>	<u>TOTAL REVENUES</u>
Income not available	\$357,022	\$2,494	\$359,516
Major state revenues:			
Taxes	232,892,748	52,868,187	285,760,935
Statutory-dedicated - Health Insurance Portability Act	30	418,356	418,386
Statutory-dedicated - Insurance Fraud Assessment Act	3,274,182		3,274,182
Statutory-dedicated - Louisiana Automobile Theft and Insurance Fraud Prevention Authority	13,826		13,826
Assessments - municipal fire and police civil service	1,640,414		1,640,414
Retirement insurance proceeds	45,931,607		45,931,607
Subtotal - major state revenues	<u>283,752,807</u>	<u>53,286,543</u>	<u>337,039,350</u>
Total non-appropriated revenues	<u><u>\$284,109,829</u></u>	<u><u>\$53,289,037</u></u>	<u><u>\$337,398,866</u></u>

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**DEPARTMENT OF INSURANCE
STATE OF LOUISIANA**

**Schedule of Per Diem Paid Insurance
Rating Commission Members
For the Year Ended June 30, 2007**

	<u>AMOUNT</u>
G. Barry Busada	\$500
Joseph Godchaux, Jr.	2,350
Christine Hollman	700
Jabari Ragas	550
Steven Ruiz	<u>4,200</u>
Total	<u><u>\$8,300</u></u>

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OTHER REPORT REQUIRED BY
GOVERNMENT AUDITING STANDARDS

The following pages contain our report on internal control over financial reporting and on compliance with laws, regulations, and other matters as required by *Government Auditing Standards*, issued by the Comptroller General of the United States. This report is based on the audit of the financial statements and includes, where appropriate, any significant deficiencies and/or material weaknesses in internal control or compliance and other matters that would be material to the presented financial statements.

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LOUISIANA LEGISLATIVE AUDITOR
STEVE J. THERIOT, CPA

October 30, 2008

Report on Internal Control Over Financial Reporting
and on Compliance and Other Matters Based on an
Audit of the Financial Statements

**THE HONORABLE JAMES J. DONELON,
COMMISSIONER OF INSURANCE
DEPARTMENT OF INSURANCE
STATE OF LOUISIANA**
Baton Rouge, Louisiana

We were authorized to audit the special purpose (legal basis) financial statements of the Department of Insurance, as of and for the year ended June 30, 2007, and have issued our report thereon dated October 30, 2008. Our audit was to have been conducted in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. However, because the Legislative Auditor was not afforded complete access to the records of the department, we were limited in our ability to accumulate audit evidence, and we were not able to apply the foregoing standards and, therefore, were not able to express an opinion on the aforementioned financial statements.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Department of Insurance's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the department's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the department's internal control over financial reporting.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses. However, as discussed on the following page, we identified a deficiency in internal control over financial reporting that we consider to be a significant deficiency.

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the entity's financial statements that is more than inconsequential will not be prevented or detected by the entity's internal control. We consider the following deficiency to be a significant deficiency in internal control over financial reporting.

Ineffective Internal Audit Function

The Internal Audit Division of the Louisiana Department of Insurance (DOI) did not conduct a sufficient number of audits to be considered an effective internal audit function. The internal audit function should provide management with assurances that assets of the department are properly safeguarded, internal controls are established and operating in accordance with applicable laws and regulations, and procedures are sufficient to prevent or detect errors and/or fraud in a timely manner.

The number and scope of audits were not sufficient to constitute an effective internal audit function. Of the two audits issued, only one audit, which regarded producer license revocations, suspensions, and cancellations, related to fiscal year 2007. The Internal Audit Division consists of only one internal auditor. Considering the department's reported assets (approximately \$150.6 million) and the revenues it collects (approximately \$373.1 million), an effective internal audit function is needed to ensure that the department's assets are safeguarded and that management's policies and procedures are uniformly applied.

The department should take the necessary steps to ensure that the Internal Audit Division conducts a sufficient number of audits by either reallocating or increasing available internal audit resources or by pursuing other alternatives to accomplish this objective. Management concurred, in part, with the finding and provided a corrective action plan. Management responded, in part, that the department is not required by law to have an internal auditor, that no standards exist citing an exact number of audits needed for an internal audit function to be effective, and that the audit finding fails to acknowledge the risk analysis and other work that was performed by the internal auditor (see Appendix A, pages 1-3).

Additional Comments: The auditor did not cite noncompliance with the law. Management is responsible for the design and implementation of an effective control environment, which would include an effective internal audit function. Risk analysis is an important part of an internal audit function, but that analysis must be followed by adequate internal audit procedures to address those risks identified.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the entity's internal control.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in internal control that might be significant deficiencies and, accordingly, would not necessarily disclose all significant deficiencies that are also considered to be material weaknesses. However, we believe that the significant deficiency described previously is not a material weakness.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Department of Insurance's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and, accordingly, we do not express such an opinion. The results of our tests disclosed the following instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

Noncompliance With State Audit Law

DOI did not provide the legislative auditor with complete, unfettered access to DOI's electronic data. *Government Auditing Standards* describe that restrictions on the scope of an audit, whether imposed by the client or by circumstances, including the inability of the auditor to obtain sufficient, appropriate audit evidence, may require the auditor to qualify his opinion or to disclaim an opinion. Louisiana audit law, Revised Statute (R.S.) 24:513, states, in part, that “. . . the legislative auditor shall have authority to compile financial statements and to examine, audit, or review the books and accounts of the state treasurer, all public boards, commissions, agencies, departments, political subdivisions of the state, public officials and employees, public retirement systems enumerated in R.S. 11:173(A), municipalities, and all other public or quasi public agencies or bodies, hereinafter collectively referred to as the ‘auditee.’ The scope of the examinations may include financial accountability, legal compliance and evaluations of the economy, efficiency, and effectiveness of the auditee's programs or any combination of the foregoing. In addition to the authority granted above, the legislative auditor shall have access to and be permitted to examine all papers, books, accounts, records, files, instruments, documents, films, tapes, and any other forms of recordation of all auditees, including but not limited to computers and recording devices, and all software and hardware which hold data, is part of the technical processes leading up to the retention of data, or is part of the security system . . .”

The legislative auditor through his Compliance Audit Division repeatedly requested complete, unimpaired copies of e-mails and electronic attachments from DOI to provide evidence in the audit of DOI's records. DOI initially allowed a visual review but no copying of the e-mails or attachments. DOI instead required that the requested e-mails and attachments first be reviewed by its management and attorneys. After that internal review, certain copies of e-mails and attachments were not provided to the auditors. On January 29, 2008, Commissioner of Insurance James Donelon wrote the legislative

auditor stating, in part, “Please be advised that while we will assist you to the fullest extent possible in the completion of this audit, we are duty bound to inform you that the DOI must and will assert certain legally recognized privileges with regard to some information located at the DOI, should it be requested as part of this financial audit. While doubtful that your financial audit will encompass the types of privileged information over which such a claim would have to be made by the DOI, we wanted to alert you of this potential in advance. . . .”

The legislative auditor and the commissioner signed a confidentiality agreement on March 12, 2008, in an attempt to resolve the disagreement regarding auditor access so that the auditor could perform audits of DOI in accordance with the audit law and auditing standards. However, in a subsequent letter dated May 15, 2008, Commissioner Donelon stated, in part, that “As to the personal information contained in the other two (2) [auditor requested] e-mails, I am prohibited by decisions of the United States Supreme Court from revealing that information and again wish to emphasize to you that the only material removed from those e-mails was of a personal nature and had nothing whatsoever to do with Citizens or any other substantive material at all. . . .” Other copies of e-mails and attachments besides those mentioned in the commissioner’s letter were also removed from the auditor’s access.

Because the legislative auditor was not able to obtain complete, unfettered access to audit evidence and because we are unable to apply other auditing procedures to ensure completeness of the DOI records affecting the audit, the scope of our work is not sufficient to enable us to express an opinion on the fair presentation of the financial statements. In addition, the department is in noncompliance with state audit law.

DOI should provide the legislative auditor complete, unfettered access to its electronic data and records, including the ability to extract and/or copy e-mails. Management did not concur with the finding (see Appendix A, pages 4-8). The DOI should be contacted for the attachments referenced in management’s response.

Additional Comment: The auditor entered into the Confidentiality Agreement with the Department of Insurance to expedite the auditor’s unfettered access to documents and records of the department. Without such access, the auditor is unable to render an opinion on the department’s financial statements under generally accepted governmental auditing standards, and the department is in violation of state audit law, which requires the department to provide such access to the auditor. The auditor does not have the legal capacity to contract away his constitutional and statutory responsibilities with regard to complete review of the documents of an auditee.

Improper Adjustments to Residential Rate Filing

DOI made improper adjustments to the 2006 residential rate filing (excluding wind and hail-only coverages) which was submitted by the Louisiana Citizens Property Insurance Corporation (Citizens) to the Louisiana Insurance Rating Commission (LIRC) in November 2006. The adjustments resulted in lower rates for many of Citizens’ policyholders, but those rates are not in compliance with applicable laws. Those lower

rates caused Citizens, created by statute as the insurer of last resort, to be more competitive with private insurance companies. The lower rates paid by Citizens' policyholders increased the risk that higher future assessments may be levied against all privately insured citizens of the state. In addition, the lower rates increased the risk that Citizens will have insufficient funds to cover the capital losses of its insureds who live in high risk areas of the state.

For the 2006 rate filing period, R.S. 22:1430.12(A)(1) stated, in part, that Citizens' rates “. . . shall be actuarially justified . . .” and “. . . shall exceed by at least ten percent the rates charged among the ten insurers with the greatest total direct written premium in each parish for that line of business in the preceding year, except that with respect to mobile home coverage, the average rates of the plans shall exceed by at least ten percent the rates charged among the five insurers with the greatest total written premium for mobile homeowners' policies in each parish in the preceding year.” The statute further stated that “. . . the rates charged in a particular parish shall exceed by at least ten percent the rates of any insurer that has a minimum of three percent of the total premium for the parish.”

Citizens' rate-setting process for fiscal year 2007 included, in general, the following procedures:

1. Citizens' actuaries calculated rates based on Citizens' claims history, trends, expenses, and other relevant factors as recorded for calendar year 2004 in a manner similar to that employed by private insurance companies.
2. DOI collected unaudited market survey data from insurers using an "average" policyholder profile developed jointly by DOI and Citizens and provided the market survey results to Citizens for further analysis.
3. Citizens made adjustments to the unaudited market survey data for private insurer discounts, differences in deductibles, et cetera, and determined the highest rate in each parish by line of coverage.
4. Citizens compared the actuarially justified rate in each parish to 110% of the highest market survey rate and selected the higher of the actuarially justified or market survey rate.
5. Citizens submitted its completed rate filing to the LIRC in November 2006.
6. DOI reviewed that filing and made significant recommendations to Citizens and to the LIRC.
7. Citizens then submitted an amended filing proposal to the LIRC for approval, and LIRC approved Citizens' amended filing in January 2007.

During DOI's review and analysis of Citizens' residential rate filing, DOI noted possible errors in market survey rates submitted by private insurers. Rather than re-surveying insurers and correcting the possible errors, DOI elected to remove the highest survey rate in each parish for each line of coverage. DOI then compared 110% of the second-highest survey rate in each parish to the actuarially justified rate and selected the larger of the two rates for its rate calculation, resulting in Citizens' rates being more competitive with private insurers. As stated previously, Citizens (the insurer of last resort) is legislatively mandated to charge more for higher risk insureds rather than compete with private industry.

R.S. 22:1430.16 states, in part, "In the event that the governing board of the Louisiana Citizens Property Insurance Corporation determines that a deficit exists in either the Coastal Plan or the FAIR Plan, the corporation may levy regular and emergency assessments for each affected plan in order to remedy such deficit." Accordingly, DOI's decision to use the second-highest rate in each parish, effectively lowering Citizens' proposed rates, increases the likelihood that future assessments will be levied against privately insured citizens of the state.

The original rate filing submitted by Citizens to LIRC included a request for a statewide net rate level increase of 31.7%. However, that proposed increase was reduced to 6.8% primarily because of DOI's decision to use the second-highest rate in each parish (by line of coverage) as well as DOI's decision to make minimal changes to Citizens' actuarial calculations. On January 17, 2007, the LIRC approved a statewide net rate level increase for Citizens' residential policies of 6.8% (rounded to 7%) based on changes recommended by DOI.

In summary, Citizens requested a 31.7% rate increase. DOI recommended that the LIRC change this rate increase to 6.8%, a reduction of 24.9% from Citizens' original request. This DOI action is not in compliance with state law. The result of this action is that the entire citizenry of Louisiana and state government is more exposed in the event of ordinary losses and is potentially critically exposed in the event of a catastrophic occurrence, such as a Katrina-like storm.

DOI should comply with state statutes regarding Citizens' rates and should confine its rate or market corrections and adjustments to known errors to ensure compliance with applicable laws. Management did not concur with the finding and noted, in part, that Citizens' rate filing was amended to remove grossly excessive market data and correct faulty actuarial assumptions; Citizens was responsible for its own data and rate filing; DOI told Citizens early about problems with the market data; the filing package to LIRC, including amendments, was solely the decision of Citizens; the procedure to "toss" the highest of the market rates did not remove the highest rate but actually corrected it and made the filing more timely; state government is not exposed for Citizens losses because Citizens is not backed by the full faith and credit of the state; and the auditor's statement that the entire citizenry is exposed in the event of a catastrophic occurrence is opinion not fact (see Appendix A, pages 9-12).

Additional Comments: DOI indicated that its decision to remove the highest market survey rate in each parish for each line of coverage was based on a review of the highest rate for “most parish and line combinations” and included the removal of “suspect data,” rather than the removal of known errors only. Rather than re-surveying insurers and correcting the possible errors, DOI elected to remove the highest survey rate in each parish for each line of coverage. While DOI pursued this approach because it “significantly improved the timeline,” that is not a justification for noncompliance with R.S. 22:1430.12(A)(1) requiring the rates to be noncompetitive.

DOI responded that Citizens’ rates are actuarially justified or higher and, if based on market rates, more than actuarially sufficient to cover ordinary losses. However, a Legislative Auditor’s Performance Audit Division report dated May 22, 2007, on *Louisiana Citizens Property Insurance Corporation - Rate-Setting* indicated that the Citizens’ rate-setting process has not consistently produced actuarially justified, noncompetitive rates. In addition, improperly lowering Citizens’ rates increases Citizens’ exposure to risk, which may lead to ordinary losses. DOI’s response continues by noting that the Louisiana citizenry being critically exposed in the event of a catastrophic occurrence is opinion, not fact. However, after hurricanes Katrina and Rita, Citizens levied nearly \$193 million in regular assessments on private insurers to help cover deficits in the FAIR and Coastal Plans, which are ultimately recouped from policyholders. In addition, in 2006, Citizens borrowed over \$978 million by selling 20-year bonds to help cover the deficit in the FAIR Plan. Citizens pledged future emergency assessments to repay the bondholders. So, all applicable policyholders should expect to pay a percentage of their premiums for Citizens’ behalf until the debt is paid.

As noted in the finding, state law includes financing provisions for Citizens to use if either the Coastal Plan or the FAIR Plan incurs a deficit whether caused by ordinary losses or a catastrophic occurrence. If Citizens’ rates are allowed to be competitive, all privately insured citizens of the state are more likely to pay higher future regular assessments and emergency assessments. Detailed information about the assessment process can be found in the Legislative Auditor’s Performance Audit Division report issued December 6, 2006, titled *Louisiana Citizens Property Insurance Corporation - Assessments*.

Although Citizens’ bonds are not backed by the full faith and credit of the state, the risk to state government relates to Citizens’ ability to meet its debt requirements. As Citizens’ exposure to risk increases, which could be affected by improperly offering lower rates; uncertainty in its financial position; or a catastrophic occurrence, the likelihood of not meeting its debt requirements increases. Citizens has not provided an audit since the fiscal year ended December 31, 2004, and its current financial position is uncertain. Failure to meet its debt requirements could have a negative impact on the state’s bond market as future bondholders may be reluctant to purchase bonds of the state or its component units.

In its response, DOI repeatedly attempts to distance itself from its role with Citizens and Citizens' rate-setting process. However, R.S. 36:686(A) transferred Citizens to DOI while R.S. 22:1430.3A(1) places the commissioner of insurance or his designee on the governing board of Citizens. The commissioner's designee has served as chairman of Citizens' board since it was created. Also, Citizens' Plan of Operation provides that the commissioner not only appoints the chief executive officer and all senior management of Citizens, but can, at his discretion, remove those persons without any action on the part of the legislature or the Citizens board.

DOI took responsibility for requesting, collecting, and summarizing market data surveys and then submitting that information to Citizens. As part of its collection responsibilities, DOI corresponded extensively with private insurance companies regarding the accuracy of the data. As part of its review responsibilities, DOI reviewed the market survey data that it had previously collected and provided to Citizens. Finally, acting in an advisory capacity, DOI discussed alternatives with Citizens after known and potential errors were discovered in the data that DOI had reviewed. These facts demonstrate that DOI was actively involved with Citizens and its rate setting process, including the determination of the final rates that were approved by the LIRC.

DOI repeatedly states that Citizens was solely responsible for its rate filing to LIRC. That filing by Citizens was amended during the January 17, 2007, LIRC meeting based entirely on adjustments calculated by DOI. The motion to approve the amended filing was made by LIRC member Jabari Ragas, who is mentioned in a Legislative Auditor Compliance Audit Division Report dated May 23, 2007, in connection with a possible ethics violation related to a fishing trip he participated in that was paid for by Citizens.

DOI's responses to the findings identified previously are attached in Appendix A. We did not audit the department's responses, and, accordingly, we express no opinion on them.

OTHER REPORTS

On May 22, 2007, a performance audit report titled *Louisiana Citizens Property Insurance Corporation - Rate-Setting* was issued by the Louisiana Legislative Auditor. The report indicated that Citizens' rate-setting process has not consistently produced actuarially justified, noncompetitive rates. The report identified several cases where Citizens' rates for residential property were at or below the rates of private insurance companies. This report suggests ways Citizens can help ensure that it consistently produces actuarially justified, noncompetitive rates through a more streamlined rate-setting process. The report discloses that Citizens did not review and adjust all of its rates annually, as required by law.

On May 23, 2007, a compliance audit report titled *Louisiana Citizens Property Insurance Corporation - Professional Services Contracts* was issued by the Louisiana Legislative Auditor. The report presents the results of procedures performed on Citizens' records that involved the available contracts, invoices, and expense reports for three professional services vendors contracted with the Property Insurance Association of Louisiana (PIAL). The report discloses findings relating to unsigned contracts, fees for unsupported professional services, unnecessary and unreasonable expenses, and possible violations of the Code of Governmental Ethics by five

public officials and a consultant. Mr. Robert Wooley, former commissioner of insurance, and Mr. Chad Brown, former DOI deputy commissioner, were two of the public officials noted in the report. The consultant, Mr. Christian Faser, was also a former DOI deputy commissioner.

On September 26, 2007, a compliance audit report titled *Louisiana Citizens Property Insurance Corporation, Property Insurance Association of Louisiana, and Louisiana Automobile Insurance Plan* was issued by the Louisiana Legislative Auditor. The report presents the results of procedures performed on available accounting records and board minutes of Citizens, PIAL, and the Louisiana Automobile Insurance Plan. The report disclosed findings relating to unnecessary and unreasonable expenses and possible violations of state law and the Louisiana Constitution, again mentioning certain former DOI management personnel.

Those reports, including recommendations for improvement and management's responses, can be found at the Louisiana Legislative Auditor's Web site at www.la.gov.

This report is intended solely for the information and use of the department and its management and the Louisiana Legislature and is not intended to be, and should not be, used by anyone other than these specified parties. Under Louisiana Revised Statute 24:513, this report is distributed by the Legislative Auditor as a public document.

Respectfully submitted,



Steve J. Theriot, CPA
Legislative Auditor

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Management's Responses to the Findings and Recommendations



LOUISIANA DEPARTMENT OF INSURANCE

JAMES J. DONELON
COMMISSIONER

June 16, 2008

The Hon. Steve J. Theriot, CPA
Legislative Auditor
State of Louisiana
1600 North Third Street
P.O. Box 94397
Baton Rouge, LA 70804-9397

Re: June 2, 2008 finding of Ineffective Internal Audit Function

Dear Mr. Theriot:

The Louisiana Department of Insurance (DOI) concurs in part that an insufficient number of internal audits were conducted in FY 2006-07 to be considered "an effective audit function."

The hesitation to offer full concurrence stems from the following facts:

- HB 1 of the 2006 Regular Session states "The budget request of any agency with an appropriation level of thirty million dollars or more shall include within its existing table of organization the position of internal auditor." (Page 5, lines 8-9).
- By the end of FY 2006-07, the period reviewed under your audit, the appropriation level for the DOI was \$28,594,763, or more than \$1.3 million below the threshold required for an agency to have an internal auditor.
- There is no clear standard for a number and scope of audits that would constitute an "effective internal audit function." No standard measure is available from the internal audit practitioners, the Division of Administration, the legislature, or from the Office of the Legislative Auditor. No specific standard or goal was provided in this finding.

The DOI joins you in valuing the services of an internal audit function and it is our desire to use the internal auditor as one of our methods of safeguarding the department's assets and applying policies and procedures uniformly. Past audits have been useful and effective in improving our operational efficiencies, installing more adequate internal controls, as well as affirming where adequate

controls exist. In fact, of the two internal audits reviewed most recently by the Legislative Auditor, one gave invaluable guidance in avoiding and correcting errors in Property and Casualty Division's data entry procedures and the other affirmed that procedures for processing producer license revocation, suspensions and cancellations were free of weaknesses, either material or minor.

Both of these internal audits were scheduled as a result of our internal auditor performing in 2004 a thorough risk analysis of twenty-eight auditable processes performed at the DOI. Each process was evaluated for risk factors relative to (1) The financial/fiscal related transaction volume, (2) Adequacy of operations monitoring, (3) Impact of governmental regulations, (4) Complexity or volatility of transactions or activities, and (5) Pressure on management to meet objectives. The factors were weighted and each process was assigned a score. Processes were ranked and then chosen as subjects of an internal audit based on ranking and on the length of time since the process had undergone an internal audit. This management process for determining workload is a time-consuming and necessary step every three years to determine the priority of the processes to be audited. Such a risk assessment is consistent with the best practices recommended by the Institute of Internal Auditors and included in the International Standards for the Professional Practice of Internal Auditing. During FY 2006-07, the period audited by the Legislative Auditor, DOI's internal auditor performed a subsequent risk analysis of twenty-nine auditable functions which will guide her scheduling of internal audits for the coming three fiscal years.

Your finding fails to acknowledge the depth and importance of the risk analysis process as well as other detailed work performed by our internal auditor in revising DOI's Internal Audit Charter and Internal Audit Policies and Procedures, both of which were included in the schedule of internal audits and special projects which had been approved as her work schedule for FY 2006-07. Two of the six projects on the FY 2006-07 work schedule were postponed, which can be explained in part due to a combination of annual and sick leave taken by the internal auditor, but which fall within normal ranges.

Indeed, disciplines and resources for the internal auditor do need to be planned and provided by the DOI. Beginning in FY 2007-08, the DOI budget exceeded the \$30 million threshold and in FY 2007-08 began to be bound by the Appropriation Act's requirements to provide for the performance of internal auditing functions within our table of organization. At this time, the DOI for FY 2008-09 is committed to:

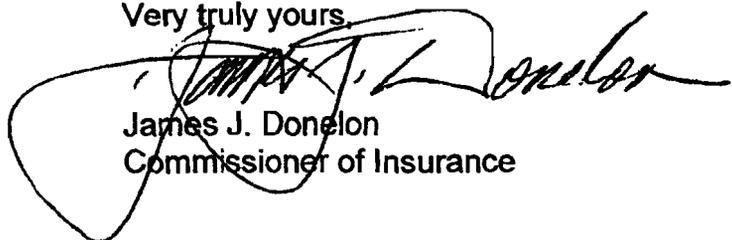
- Continuing its expectation that the internal auditor both manage and audit in a manner consistent with the best practices recommended by the Institute of Internal Auditors and included in the International Standards for the Professional Practice of Internal Auditing.
- Continuing to allow the internal auditor access to all personnel and any records, data and other information deemed necessary for the carrying out of her duties.
- Requiring the internal auditor to include in her annual schedule proposal, which is subject to approval by the Commissioner of Insurance, the risk ranking of the audits she proposes to undertake and a written explanation for why auditable functions with higher risk rankings are not included in the proposed audit schedule. The proposed schedule is due July 15, 2008.
- Supporting the internal auditor's participation in the growth and development of the Louisiana Council of State Audit Groups, a recently formed association of governmental internal auditors whose mission is to improve the functional efficiencies and quality of all state agency internal auditors and potentially provide a resource for peer review of audits performed for the DOI, as well as other state agencies.
- Adding another position or part of a position to assist in conducting internal audits of DOI.

You may contact our internal auditor Nancy Vogt or Chief Deputy Commissioner Denise Brignac to confirm that these actions have been taken.

If the Legislative Auditor wishes to provide the DOI further guidance as to what might be considered sufficient for the effectiveness of our internal audit process, we are open to his concrete suggestions. Even though the DOI's anticipated budget for FY 2008-09 exceeds the legislatively mandated threshold for providing internal auditing functions by only 6.04 percent, we believe it is prudent for the department to add to the staffing of the office of our internal auditor, not only to add to the scope and number of audits which can be performed annually, but also in anticipation of the perpetuation needs of the internal audit function.

With best wishes and kindest personal regards, I remain

Very truly yours,

A handwritten signature in black ink, appearing to read "James J. Donelon", is written over a large, loopy scribble.

James J. Donelon
Commissioner of Insurance

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JJJUN2008.2427



LOUISIANA DEPARTMENT OF INSURANCE

JAMES J. DONELON
COMMISSIONER

July 25, 2008

HAND DELIVERY

The Honorable Steve J. Theriot, CPA
Legislative Auditor
State of Louisiana
1600 North Third Street
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Baton Rouge, LA 70804-9397

RECEIVED
LEGISLATIVE AUDITOR
2008 JUL 28 PM 4:30

RE: Response to Legislative Auditor's reportable finding that the Department of Insurance is in Noncompliance with State Audit Law

Dear Mr. Theriot:

The Louisiana Department of Insurance (LDOI) appreciates the opportunity to respond to the Legislative Auditor's reportable audit finding (Reportable Finding) of LDOI dated June 20, 2008. LDOI disagrees with the Louisiana Legislative Auditor's (LLA) finding that LDOI is in noncompliance with state audit law and with the auditor's disclaimer of opinion. The LDOI and its personnel believe they are in full compliance with all applicable laws. LDOI and its personnel have made good faith efforts consistent with LSA-R.S. 24:513 *et seq.* to facilitate the LLA's full scope financial and compliance audit of LDOI and for certain agencies created under the Louisiana Insurance Code, namely Louisiana Citizens Property Insurance Corporation (Citizens), the Property Insurance Association of Louisiana (PIAL), the Louisiana Automobile Insurance Plan (LAIP), and all other entities enumerated under LSA-R.S. 36:686 as agencies transferred to the LDOI.

The Reportable Finding states that the Legislative Auditor "was not able to obtain complete, unfettered access to audit evidence and...we are unable to apply other auditing procedures to ensure completeness of the LDOI records affecting the audit..." This conclusion appears to be contrary to the evidentiary support required under Generally Accepted Governmental Auditing Standards and Generally Accepted Auditing Standards. Further, it fails to take into account the Confidentiality Agreement dated March 12, 2008, between LDOI and LLA that resolved the disputes over document access. Your office has all the evidentiary material necessary to render an unqualified audit opinion.

Moreover, it is unclear from the Reportable Finding whether the Legislative Auditor is only seeking "unfettered" access to certain Emails that are of a clearly personal nature and which your staff has already reviewed, or whether the Legislative Auditor is effectively ignoring the Confidentiality Agreement and is now insisting on the scope of production as originally sought in the subpoena duces tecum of the Legislative Audit Advisory Council dated November 7, 2007. In addition, the Reportable Finding is also directly contrary to the Motion of the Legislative Audit Advisory Council dated March 20, 2008, in which it is stated and found that "[i]t is the opinion of the Legislative Auditor that the Confidentiality

The Honorable Steve J. Theriot, CPA
Legislative Auditor
State of Louisiana

Agreement has resolved the problems regarding the Auditor's access to the records maintained by the LDOI for the completion of its audits."

The LDOI did, indeed, allow the Legislative Auditor's representatives "to examine, audit, or review (its) books and accounts." Additionally, the LDOI gave the Legislative Auditor's representatives access to all papers, books, accounts, records, files, instruments, documents, films, tapes, and other forms of recordation, including information stored on individual computers and the LDOI's backup disks. The LDOI provided these records in a manner agreed upon by the Legislative Auditor and, when disagreement arose relative to providing copies of privileged and confidential documents and information, including Emails, the parties jointly crafted a binding Confidentiality Agreement which was executed by both parties on March 12, 2008. It was clear that the Legislative Auditor understood and made a predetermination that six (6) types of privileged and confidential documents and information itemized in the Confidentiality Agreement, including certain categories of Emails, were not relevant to his stated audit objective and/or were otherwise not discoverable pursuant to applicable law. The limitations agreed to by the Legislative Auditor and LDOI were not disruptive of the Legislative Auditor's goal of auditing all relevant documentation. At no time during the negotiating and drafting of the Confidentiality Agreement did the Legislative Auditor indicate that the limited exclusions set forth therein were relevant to his stated audit objectives, would prevent his obtaining the evidentiary matter required for the stated objectives of the audit or would limit his scope in such a manner that it would impair his audit or restrict his ability to render an unconditional audit report.

In order to expedite the Legislative Auditor's process, the LDOI, in conjunction with the input of the Legislative Auditor, developed a system to conduct detailed searches of specified persons' Email archives and exchange accounts focused on specific terms that were intended to capture all relevant documents. Searches were conducted on the following terms: pial, pail, "property insurance association of," citizen, lcpic, "property insurance corporation," laip, "automobile insurance plan," as well as names of key personnel and a consultant for Citizens. These searches, conducted under the auditors' oversight, were intended to assist the auditors by reducing the volume of irrelevant records for their examination and were never intended to limit the auditors' access. Although invited to do so, the Legislative Auditor has not provided additional words or search terms which might generate additional relevant information.

At no time during the audit has LDOI withheld any document from examination by the Legislative Auditor. The only restriction was that some documents could not be copied and taken off the LDOI premises, and this restriction was not as all encompassing as the letter of June 20, 2008, and the Reportable Finding describe. All documents relative to Citizens, PIAL and LAIP were allowed to be copied and removed, and were provided without any redaction whatsoever. Copies of any other requested documents were provided

The Honorable Steve J. Theriot, CPA
Legislative Auditor
State of Louisiana

after redactions were made in conformity with the Confidentiality Agreement. Redactions were limited to Email communications or parts of Email communications protected by the attorney-client privilege; Email communications or parts of Email communications protected by the deliberative process privilege; Emails containing fraud related information maintained by LDOI's Fraud Division, except fraud information relating to Citizens, PIAL and LAIP; personal Email messages of LDOI employees; personnel information within LDOI, and personal health information of LDOI employees and health information submitted to LDOI by citizens of the state for assistance in consumer complaints. All of these six (6) exclusions were set forth in the Confidentiality Agreement agreed to by the Legislative Auditor. Further, the LDOI has continually offered to allow the Court to perform in-camera reviews of any disputed Email in order to determine the relevancy of redacted portions to the audit.

Without more specific information, I have no idea what the Legislative Auditor is referring to when he states: "Other copies of Emails and attachments besides those mentioned in the Commissioner's letter were also removed from the auditors' access." To the contrary, the Legislative Auditor has had unfettered access to inspect and review all LDOI documents and information, including all Email messages, with the copying restrictions set forth in the Confidentiality Agreement exclusions and redactions accompanied by logs detailing the specific privilege asserted. In fact, as previously set forth, I understand that your office has reviewed the Emails in question, that there is no dispute that the Emails are unrelated to the scope of your audit, and that the Emails are clearly within the items exempted under the Confidentiality Agreement. Your office has not shown that those particular Emails have any relevance to your audit or are not exempt under the Confidentiality Agreement.

The Legislative Auditor has my complete assurance that no concealment, removal from access or deletion of records of interest to the Legislative Auditor or his staff has ever taken place or is now taking place. Throughout this audit, the LDOI has followed its standard chain of custody procedure for all records sought and reviewed by the Legislative Auditor, a procedure that has been relied on numerous times by federal and state law enforcement agencies and federal and state courts. (See Exhibit A – Report of Security of Records and Other Records-Related Issues.)

In addition to the Legislative Auditor's misrepresentation of what was and what was not made available for examination, the LDOI takes exception to his position that he was deprived of material information such that he disclaims the ability to express an opinion on the fair presentation of the financial statements of the LDOI and its Title 22 agencies. Every document requested was available for the auditors' review; all Citizens, PIAL and LAIP documents were permitted to be copied and brought to the Legislative Auditor's office. The only information not permitted to be copied and transported to the Legislative Auditor's office was information the auditor had already deemed, under the terms and

The Honorable Steve J. Theriot, CPA
Legislative Auditor
State of Louisiana

conditions of the Confidentiality Agreement, not relevant to his stated audit objectives. (See Exhibit B - Confidentiality Agreement.) Further, you have already been furnished with the Privilege Logs that have been prepared to date (Exhibit C) indicating those items withheld from further review by the Legislative Auditor in accordance with the Confidentiality Agreement. LDOI has not received any response or challenge to the items listed on the Privilege Logs.

The LDOI's request that the parties enter into and abide by the Confidentiality Agreement is well founded based on two cases involving the Legislative Auditor's office. In *Kyle v. Perrilloux*, 868 So.2d 27, (La. App. 1 Cir. 2003), the court held that confidential records which the Legislative Auditor sent to a district attorney became public records once the district attorney completed his investigation. In *Kyle v. Louisiana Public Service Commission*, 878 So. 2d 650, (La. App. 1 Cir. 2004), the court found, under the separation of powers doctrine, no authority for the Legislative Auditor to conduct investigative audits or to evaluate, verify and analyze communications between employees of a particular agency, the entities they regulate and the citizens as a whole when the agency is an executive branch office.

The power of the Legislative Auditor is limited by statute, and the scope of its examination includes "financial accountability, legal compliance and evaluations of the economy, efficiency, and effectiveness of the auditee's programs or any combination of the foregoing." The access rights of the Legislative Auditor granted in LSA-R.S. 24:513 are not only subject to the scope limitation of the statute, but also by applicable United States and Louisiana Constitutional protections, particularly (but not exclusively) the Fourth Amendment of the United States Constitution and the Fifth Amendment of the Louisiana Constitution. Employees have constitutionally protected expectations of privacy, which in this instance appear reasonable. It is abundantly clear that governmental employees do not shed their constitutional rights at the office door. I believe that the breadth of documents seemingly now sought (as referred to in the Reportable Finding) by the Legislative Auditor would constitute unconstitutional searches and seizures and an invasion of privacy subjecting LDOI as well as the Legislative Auditor to possible damages. Without doubt you are aware of the substantial and extensive legal authorities governing this subject. I have always and will always comply with the laws governing the operation of my office, those being the laws of the state of Louisiana, the United States Constitution, and the Louisiana Constitution.

As Commissioner of Insurance, it is my duty to enforce the terms of the Confidentiality Agreement to which we both agreed and which was accorded judicial notice by the Nineteenth Judicial District Court. In addition, if necessary, I am prepared to set aside or seek modification to the Confidentiality Agreement and seek a determination by the Court regarding a department head's obligation to protect confidential and privileged information under his or her control as well as the scope of the rights of the Legislative

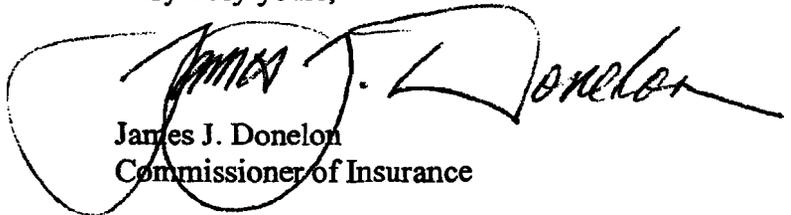
The Honorable Steve J. Theriot, CPA
Legislative Auditor
State of Louisiana

Auditor under Louisiana law and the United States and Louisiana Constitutions. It is an issue of paramount importance to the heads of all public entities subject to review by the Legislative Auditor.

LDOI has complied and will continue to fulfill its obligations to cooperate with the Legislative Auditor within the scope of the Legislative Auditor's statutory authority and the LDOI's own rights and responsibilities. The LDOI will continue to provide to the Legislative Auditor, as it has done at all times, unfettered access to its electronic data and records necessary for the auditor to perform his statutory duty. What the LDOI takes exception to is the Legislative Auditor's unfounded insistence that by being deprived of mere copies of communications and parts of communications which fall under the exclusions of the consensual Confidentiality Agreement he is unable to fulfill his statutory audit functions. None of the information redacted from documents which have been provided the Legislative Auditor bears any relevance to the financial statements of the LDOI or its affiliated agencies and none of the information has evidentiary value to the audit process.

With best wishes and kindest personal regards, I remain

Very truly yours,



James J. Donelon
Commissioner of Insurance

SDB/JJD:dtd

Attachments:

Exhibit A - Report of Security of Records and Other Records-Related Issues

Exhibit B - Confidentiality Agreement

Exhibit C - Privilege Logs



LOUISIANA DEPARTMENT OF INSURANCE

JAMES J. DONELON
COMMISSIONER

June 19, 2008

The Hon. Steve J. Theriot, CPA
Legislative Auditor
State of Louisiana
1600 North Third Street
P.O. Box 94397
Baton Rouge, LA 70804-9397

HAND DELIVERY

Re: June 4, 2008, Legislative Auditor's finding of Improper Adjustments to Citizens' November, 2006 Residential Rate Filing

Dear Mr. Theriot:

This is to advise you that I do not concur with the finding that our staff improperly adjusted the residential rate filing of Louisiana Citizens Property Insurance Corporation (LCPIC) made in November of 2006. In fact, not only did my staff act appropriately and in accordance with statute, we also acted in the public's best interest with respect to that rate filing.

Despite the nature of LCPIC as a close-to-government entity, my actuarial staff held LCPIC's rate filing to the same degree of scrutiny and statutory standards as it holds all other insurance companies. The standard is that no proposed rating plan shall be inadequate, excessive, or unfairly discriminatory.

We support the additional statutory requirement, as does LCPIC, that LCPIC's rates are to be non-competitive in the marketplace, but this does not mean LCPIC rates should be grossly excessive, based on erroneous actuarial assumptions, or based on erroneous market data. My staff identified problems with the proposed LCPIC rates and advised the Louisiana Insurance Rating Commission (LIRC) of those problems, and the LCPIC's filing was amended to remove grossly excessive market data and correct faulty actuarial assumptions.

Let me set forth a few facts that were either unknown to or misunderstood by your staff:

- Though my staff assisted LCPIC in gathering market data, LCPIC was and is responsible for verification of data and documentation of the rate filing procedures leading up to the submission of the rate filing. It is clear by statute and LCPIC's Plan of Operation that LCPIC has this responsibility.
- My staff notified LCPIC of potential problems with the market data months before the November 2006 rate filing was submitted to the LIRC. LCPIC acknowledged that it was its intent to investigate potential problems and verify the market data. It was discovered after LCPIC made the filing that LCPIC did not investigate or verify the market data.
- The filing package was put together solely by LCPIC staff and presented to LIRC by LCPIC.
- In accordance with La. R.S. 22:1401 (E) (*repealed effective Jan. 1, 2008*), my staff supported the LIRC by reviewing all submitted insurance company rate filings, including filings of LCPIC.
- With respect to the November 2006 LCPIC rate filing, my staff notified the LIRC (and LCPIC, again) of problems with the market data after the rate filing was submitted to the LIRC, problems which by now my staff had documented. Also relative to the November 2006, LCPIC rate filing, my staff notified the LIRC (and LCPIC and its actuary) of problems with the selected actuarial methodology and actuarial assumptions after the rate filing was submitted to the LIRC.
- The decision to amend the rate filing was solely LCPIC's decision.
- The decision to approve the rate filing, in an amended form or otherwise, was solely LIRC's decision.

I cannot emphasize enough that the rates originally submitted to the LIRC for approval were excessive for this insurer of last resort, due to the errors present in the market data and due to the flawed actuarial assumption in the actuarially indicated rates. LCPIC's decision to amend the rate filing was an appropriate decision.

The LIRC and my staff discussed with LCPIC's management various means by which the documented errors in market data could be addressed. Three possible corrective methods were considered: (1) Reissue the survey; (2) Audit all market data responses, and (3) Remove erroneous and suspect data. Because

the first two alternatives would have taken two to four months to complete, complicated by the fact that market data to be audited was almost two years old, my staff and LCPIC agreed to pursue the removal of erroneous and suspect data, as the third remedial approach significantly improved the timeline in that it could be documented and presented to the LIRC in a matter of a few days.

The procedure was to "toss" the highest of the market rates in each parish for each line of business, use the second-highest rate in LCPIC's rate methodology, and then proceed with the amended rate filing before the LIRC. This method did not actually remove the highest rate, but rather corrected it. LDOI staff audited the highest rate for most parish and line combinations and determined that all such audited rates were improperly calculated. The audit revealed that there were common errors in the market data for a few key companies that dominated the highest rate category. These audited rates, after correction, fell to the middle of the top ten companies, i.e., falling from the highest rank to below the second-highest market rate. That left the second-highest rate as the new highest market rate.

By following this method, LCPIC was able to amend its rate filing with the LIRC rather than to postpone the rate filing for months. The LCPIC was already a year behind in making this rate filing.

Your finding further states: "The result of this action is that the entire citizenry of Louisiana and state government is more exposed in the event of ordinary losses and is potentially critically exposed in the event of a catastrophic occurrence, such as a Katrina-like storm." First, let me correct this statement. State government is not exposed for LCPIC's losses, as state law (L.R.S. 22:1430.16(J)) states that LCPIC is not backed by the full faith and credit of the State of Louisiana. The conclusion regarding "ordinary losses" is also not true. LCPIC's rates are actuarially justified or higher, and if based on market rates, more than actuarially sufficient to cover ordinary losses. The statement that "...(T)he entire citizenry... critically exposed in the event of a catastrophic occurrence" is opinion, not fact. I have repeatedly stated that following the storms of 2005, the insurance marketplace and the citizens of Louisiana were better situated because LCPIC was in place, as the mechanism to fund FAIR and Coastal Plan losses prior to the creation of LCPIC would have severely handicapped Louisiana's voluntary property market and, therefore, the state's recovery. Also note that the "reduction of 24.9%" statement in your finding is a miscalculation and should be a reduction of 23.3%.

As the regulator of the insurance industry, I know that Louisiana consumers are better served if the market of last resort is priced above the private market, and I have said so repeatedly in many public settings. For the Department of Insurance to perform its legislatively mandated role in depopulating LCPIC, the corporation's coverages must be priced above the private market's. For that reason, I testified last year in the House Committee on Insurance in opposition to suspending the ten percent add on of LCPIC rates when that legislation passed in 2007, and I will

The Hon. Steve J. Theriot, CPA

June 19, 2008

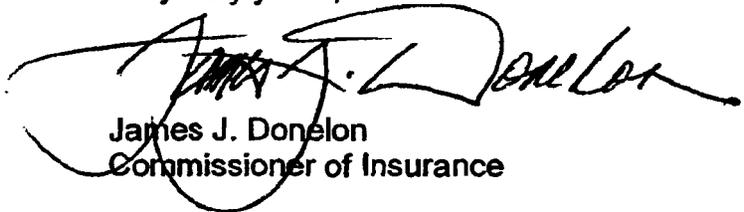
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continue to discourage lawmakers and my staff from actions that make LCPIC competitive with the private market.

In conclusion, I am amazed that your office finds fault with my staff and the LIRC's review of the originally submitted LCPIC rate filing. Staff reviewed the submitted filing in a manner consistent with how all rate filings are reviewed. Upon finding actuarial issues and market rate errors, staff appropriately brought these matters to the attention of LCPIC and LIRC in a timely manner. It was LCPIC's decision to amend the rate filing, and it was LIRC's action to approve the amended rate filing. In light of the issues raised by my actuarial staff, these actions were an appropriate and expedient resolution to LCPIC's statutory requirement to file rates that are actuarially sound, that are ten percent (10%) above the highest of the top ten writers (or 3% market share writers as changed by the Louisiana Legislature in 2005) in each parish, and that are filed on an annual basis. Lastly, given the rates are for the market of last resort, based on the highest market rate, and generally above the actuarially indicated rate in each parish, the rates approved by the LIRC are consistent with the LCPIC's statutory ratemaking requirements while not being inadequate, excessive, or unfairly discriminatory.

With best wishes and kindest personal regards, I remain

Very truly yours,

A handwritten signature in black ink, appearing to read "James J. Donelon", written over a circular stamp or seal.

James J. Donelon
Commissioner of Insurance

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JJDJUN2008.2426