Georgia Department of Audits and Accounts
Performance Audit Division
Greg S. Griffin, State Auditor
Leslie McGuire, Director

Why we did this review

This special examination of the Office of the Commissioner of Insurance was conducted at the request of the House Appropriations Committee.

The Committee asked that we examine the transparency of revenue collection and budgeting functions. The committee also asked that we evaluate whether there are compelling reasons to transfer responsibility for the Industrial Loan program to the Department of Banking and Finance.

About the Office of the Commissioner of Insurance

The Office of the Commissioner of Insurance (OCI) is responsible for enforcing Georgia's insurance laws and other state laws governing fire safety and small loans. OCI licenses insurance companies and agents, investigates insurance fraud, handles consumer complaints, and collects revenue from licenses, permits, and taxes. OCI enforces state minimum fire safety standards for buildings and structures, regulates amusement rides and other attractions, and investigates suspicious fires. OCI also provides consumer protection by regulating small loans made in the amount of $3,000 or less. Approximately $21.6 million was appropriated to OCI for fiscal year 2018.

Office of the Commissioner of Insurance

Series of salary and personnel decisions led to risk of budget shortfall

What we found

The Office of the Commissioner of Insurance (OCI) took a number of actions in recent years that directly led to the impending budget shortfall in fiscal year 2017. OCI avoided a budget shortfall by implementing layoffs and furloughs.

OCI's monthly spending exceeded the levels necessary to meet its annual budget for six of the first seven months of fiscal year 2017 (July 1, 2016 to June 30, 2017). Not until April 2017 did the agency decrease spending to a level below its monthly allotment, and significant spending reductions were necessary in the final two months in order to avoid a budget shortfall. The spending cuts were primarily achieved by laying off 12 employees and furloughing 212 employees for four days.

The overspending resulted from a number of factors, including OCI's decision to internally fund pay increases and to hire additional staff. A smaller factor was the pay increase required as part of a statewide initiative to retain law enforcement officials.

- **OCI-initiated pay increases** – Between fiscal years 2014 and 2017, the agency provided more than 300 pay increases without requesting additional funding from the General Assembly. Some of the pay increases were based on salary studies that did not follow best practices. The pay increases contributed about $2.2 million to fiscal year 2017 expenditures.

- **Hiring additional employees** – In the second half of fiscal year 2016 and in early fiscal year 2017, OCI began to address long-term vacancies in its Fire Safety and Insurance Regulation programs. Both programs had unfilled positions, but the hiring increased fiscal year 2017 expenditures by $1.8 million. In addition to hires in those programs, in January 2017, OCI filled a deputy commissioner position that had been vacant for more than a year, increasing agency expenditures by $90,000 over the final six months of fiscal year 2017.

- **Law enforcement pay increases** – Like all agencies employing law enforcement officials, OCI increased the salaries of ten of its employees in January 2017. The salary changes increased agency expenditures by approximately $45,000, though $11,600 in additional funds were provided in the amended appropriations act.

In an attempt to meet its agency and program spending limits, OCI failed to comply with state law and budget instructions. The appropriations act sets the budget for each of the agency's five programs, but we found that OCI bypassed budgetary controls to spend above the limit in two programs. OCI charged the salaries and benefits of personnel assigned to two programs to the budget of a different program. In fiscal year 2017, the budget for personal services (employee salaries and benefits) in the agency's Administration program was $1.8 million but we identified expenditures of more than $3.4 million. Likewise, the Insurance Regulation program had a personal services budget of $5.0 million and expenditures of $6.3 million.

Most of the additional funds used by the two programs were redirected from the Special Fraud Fund. The funds' use is inconsistent not only with Program-Based Budgeting but with state law establishing a special fraud assessment on insurance company premiums. O.C.G.A. § 33-1-17 restricts the use of the Special Fraud assessment to the investigation and prosecution of insurance fraud in the state. While $4.0 million was budgeted for personal services in the Special Fraud program in fiscal year 2017, $1.0 million was spent on program activities. Although Administration and Insurance Regulation may provide some assistance to fraud activities, it is questionable that three-quarters of fraud funding would be spent in other programs.

In addition to our review of the financial administration of OCI, we found that the Industrial Loan program's mission and purpose is better aligned with the Department of Banking and Finance (DBF). The regulation of small loan lenders is similar to DBF's purpose of regulating financial institutions, which provide a variety of financial instruments including loans. DBF and Industrial Loan program staff perform similar functions, which includes licensing, conducting examinations, and collecting fees and taxes. Moving the program may also result in efficiencies in small loan regulation for both the state and some businesses that are currently regulated by two different state agencies. Our review of 12 other states found that all use a banking or similar financial agency to regulate small loan lenders.

The state should also consider increasing the loan limit for small loans regulated by the state. The $3,000 maximum was set in 1975. Some businesses that are regulated for their loans under $3,000 also offer unregulated loans for several times that amount. Our review of 12 other states found that only Alabama had a lower limit (less than $1,500). Others ranged from $5,000 to no limit.

What we recommend

OCI leadership should develop a strong control environment and system of control. To come into compliance with Program–Based Budgeting requirements and state law establishing a fraud assessment on insurance company premiums, OCI should develop a sound methodology for allocating Special Fraud funds to cover a portion of costs associated with insurance regulation activities and administration. Once a methodology has been developed, the General Assembly may need to appropriate additional funds in the fiscal year 2018 supplemental budget, and/or OCI may need to cut its expenditures.

The General Assembly should consider transferring the Industrial Loan program from OCI to the Department of Banking and Finance and increasing the maximum amount of the loans regulated under the Industrial Loan Act to provide greater consumer protection.

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Purpose of the Special Examination

This review was conducted at the request of the House Appropriations Committee. The Committee requested that we examine the transparency of revenue collection and budgeting in the Office of the Commissioner of Insurance (OCI). In addition, the Committee requested that we determine whether there are compelling reasons to transfer the Industrial Loan program to the Department of Banking and Finance. Based on this request, we addressed the following questions:

1. What factors put OCI at risk of a budgetary shortfall during fiscal year 2017 and how did OCI remain within spending limits?
2. Did OCI comply with Program-Based Budgeting?
3. Did OCI comply with statutes and regulations governing the Special Fraud Fund?
4. Did OCI follow best practices and state regulations for pay increases?
5. Are there compelling reasons to transfer responsibility for the Industrial Loan program to the Department of Banking and Finance?
6. Should the maximum amount of the loans regulated by the Industrial Loan program be increased?

A description of the objectives, scope, and methodology used in this review is included in Appendix A. A draft of the report was provided to the Office of the Commissioner of Insurance for its review and pertinent responses were incorporated into the report.

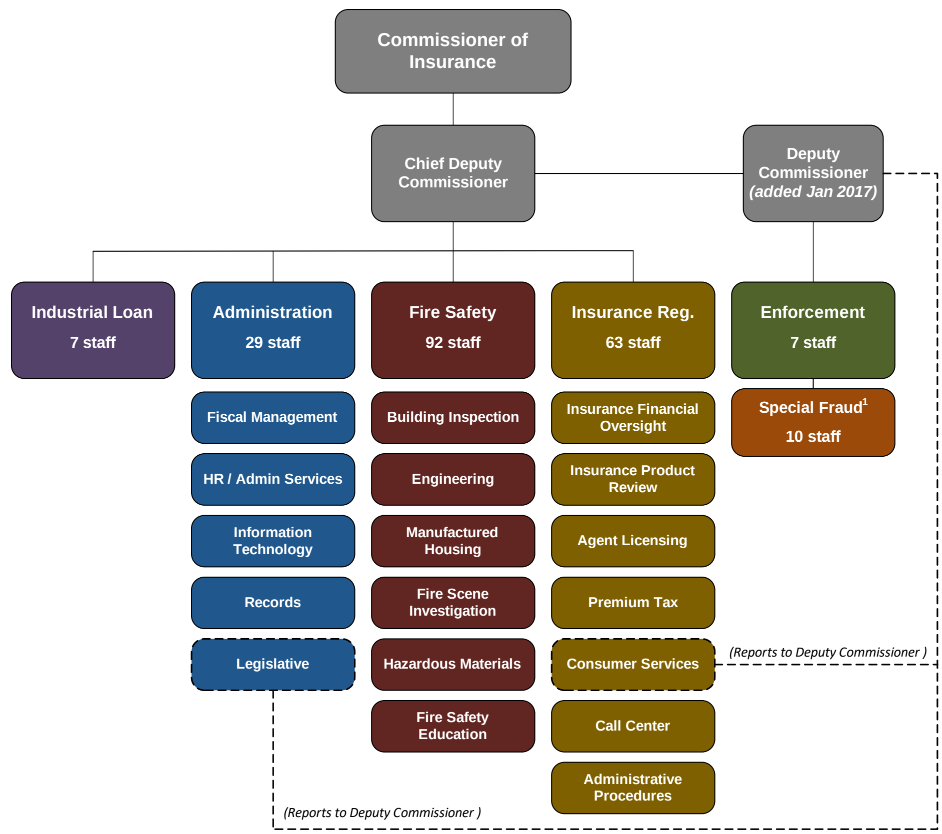
Background

The Office of the Commissioner of Insurance (OCI) is responsible for enforcing Georgia's insurance laws and other state laws governing fire safety and small loans. O.C.G.A. § 33-2-1 establishes the Office of the Commissioner of Insurance and designates the Commissioner of Insurance as the chief officer of OCI. The Commissioner of Insurance has the authority to regulate insurance companies and individuals, including agents, brokers, and adjusters. Also, the commissioner may assess and collect license fees and taxes. O.C.G.A. § 25-2-2 creates the Office of the Safety Fire Commissioner and designates the Commissioner of Insurance as the Safety Fire Commissioner. The Safety Fire Commissioner has responsibility for enforcing state fire safety standards, investigating the cause of fires, and making arrests for criminal violations. O.C.G.A. § 7-3-7 establishes the Office of the Industrial Loan Commissioner and designates this role to the Commissioner of Insurance. State law authorizes the Industrial Loan Commissioner to regulate loans made in the amount of $3,000 or less.

Organizational Structure

Exhibit 1 shows the organizational structure of OCI. OCI's regulatory duties are performed by approximately 200 staff assigned to five programs and one subprogram. The primary functions of each program are discussed below.

Exhibit 1
OCI Has Five Programs and Over 200 Employees, October 2017



[1]*Special Fraud is a subprogram of Insurance Regulation.*
Source: OCI

- **Program Administration** provides management and administrative support. Administration includes executive leadership, financial operations, human resources, procurement, information technology, and records management
- The **Insurance Regulation** program regulates insurance companies, agents and other individuals conducting insurance related business. Also, the program investigates policyholder complaints, collects all applicable fees, and handles complaints insurers file against agents. In addition, it processes state insurance premium tax returns, assesses and collects the annual special fraud assessment, and assesses, collects, and distributes the local premium tax.
- **Enforcement** provides administrative and legal research services and advises OCI on all legal issues relating to insurance, fire safety, and small loan regulations. The program also administers insurance holding company laws and receiverships.
- **Fire Safety** regulates the fire protection industry, manufactured housing industry and those who use and store hazardous materials by setting and enforcing minimum safety standards. Also, it reviews and approves plans for buildings in the planning and construction stages and examines new and

existing structures for compliance with state and national safety standards. In addition, Fire Safety assists local fire officials with determining the cause of suspicious fires.

- **Industrial Loan** administers the Georgia Industrial Loan Act of 1955, which provides consumer protection against lenders of consumer loans of $3,000 or less.

- **Special Fraud** identifies and investigates allegations of illegal insurance activities committed by companies, agents, or individuals. Cases deemed appropriate for prosecution are submitted to a local district attorney for criminal prosecution, while other cases may be referred for administrative action.

Revenue Collection

OCI collects revenues from taxes, licenses, permits, fraud assessments, penalties, and interest for deposit into the state's general fund, as described below. As shown in **Exhibit 2**, these collections have averaged over $1 billion in fiscal years 2016 and 2017. OCI does not retain any of this revenue for internal operations.

Exhibit 2
OCI Collects Approximately $1 Billion in Revenue Annually, Fiscal Years 2012-2017

State Revenue Source	2012	2013	2014	2015	2016	2017
Premium Tax - Local [1]	$425,074,987	$456,626,275	$466,427,365	$494,647,572	$529,460,016	$568,075,401
Premium Tax - State	$309,192,366	$325,600,752	$375,750,794	$419,622,258	$428,738,211	$480,154,152
Business Licenses & Permits	$25,744,927	$45,104,449	$28,173,694	$41,551,227	$31,753,306	$42,320,869
Safety Engineering [2]		$4,615,263	$3,741,183	$5,224,708	$4,903,101	$5,049,199
Non-Business Licenses & Permits	$4,323,578	$4,249,009	$4,740,008	$4,861,057	$4,642,495	$4,386,529
Special Fraud Fund	$3,935,763	$3,934,404	$4,114,866	$4,213,389	$4,214,365	$4,358,117
Penalties and Interest	$3,146,558	$10,683,471	$3,499,553	$2,943,842	$1,479,739	$3,553,081
Total	**$771,418,179**	**$850,813,623**	**$886,447,463**	**$973,064,052**	**$1,005,191,232**	**$1,107,897,349**

[1] Local Premium tax revenues are sent to local governments.

[2] The Safety Engineering function was transferred to OCI from the Department of Labor.

Source: *TeamWorks*

- **Taxes** - OCI levies state and local insurance premium taxes on each insurance company in the state. These taxes are a percentage of the aggregate amount of insurance policy premiums held by customers each year. The State Insurance Premium Tax is due quarterly and remitted to the state treasury. The Local Premium Tax is due by August 1 of each year and is subsequently remitted to local governments by October 15 of each year. OCI also collects a 3% tax on the net interest charged for each month for loans made by licensed industrial loan lenders.
- **Licenses and Permits** - OCI collects annual license fees from insurance companies, agents, brokers, adjusters, and other individuals of the insurance industry. OCI also collects permit fees from businesses within the small loan industry and fire protection industry. This includes fees collected from safety engineering related businesses for the licensing and inspection of amusement rides, elevators, and escalators.
- **Special Fraud Assessment** - OCI collects an annual special fraud assessment from all insurance companies writing premiums in the state. The

Commissioner of Insurance sets the total amount of the annual assessment, which is intended to fund OCI's insurance fraud activities for one fiscal year.

- **Penalties and Interest** - OCI collects penalties and interest from individuals that participate in substantiated cases of insurance fraud, as well as businesses and individuals that fail to pay required taxes and fees on schedule.

Retained Funds

OCI also collects revenue from federal and other sources that it retains for internal operations. As shown in **Exhibit 3**, these collections totaled over $1.6 million in fiscal year 2017. Most of the federal funds collected in fiscal year 2017 were derived from fees collected for inspections conducted by the Fire Safety Program through contractual agreements with the U.S. Department of Housing and Urban Development. OCI also receives reimbursement from the Department of Labor for activities performed by the Bureau of Labor and Statistics section of Fire Safety. OCI collects other revenue from a contract with the Department of Community Health (DCH), which provides reimbursement for healthcare facility inspections, and from photocopies made in response to open records requests.

Exhibit 3
OCI's Revenues and Expenditures Totaled $1.6 Million from Federal and Other Funds in Fiscal Year 2017

Type	2013	2014	2015	2016	2017
Federal					
US Housing and Urban Development (HUD)[1]	$712,352	$855,062	$757,213	$434,891	$498,079
US Housing and Urban Development (HUD)[2]	$452,710	$385,940	$417,205	$263,949	$328,024
US Department of Labor, Bureau of Labor and Statistics	$130,175	$190,203	$152,787	$191,392	$204,228
Federal Seized Funds	$14,553	$8,606	$6,476	$6,208	$2,764
Consumer Assistance Program	$215,659	$75,555	$0	$0	$0
Occupational Safety and Health Administration	$7,495	$0	$0	$0	$0
Total Federal	$1,532,945	$1,515,367	$1,333,681	$896,440	$1,033,096
Other					
Department of Community Health	$327,026	$327,026	$327,046	$465,721	$607,742
Copies	$122	$1,036	$157	$434	$151
Miscellaneous	$5,924	$0	$0	$0	$0
Total Other	$333,071	$328,062	$327,203	$466,155	$607,892
Total	**$1,866,016**	**$1,843,429**	**$1,660,884**	**$1,362,595**	**$1,640,988**

[1]OCI receives funds from HUD for serving as the State Administrative Agency for the Manufactured Housing Program.

[2]OCI receives funds from HUD for serving as the State Inspection Agency for the Manufactured Housing Program.

Source: Office of the Commissioner of Insurance

Revenue Collection Process

The revenue collection process is decentralized within OCI. Ten units within OCI collect revenue pertaining to their activity. For example, Premium Tax staff within the Insurance Regulation program is responsible for collecting state premium taxes, local premium taxes, and Special Fraud assessments from insurance companies. Similarly, Agent Licensing staff (also a unit of Insurance Regulation) collects regulatory fees charged to individuals of the insurance industry such as insurance agents, brokers, and adjusters. Each unit performing revenue collection functions has employees responsible for processing, reviewing, reconciling, and reporting revenue collected.

Appendix B provides a description of the source, authorization, and amount of revenue collected by each unit.

OCI accepts payments by check, money order, electronic funds transfer, and through an automated clearinghouse. Payments by check or money order are sent to OCI's lockbox system operated by a bank for processing, while OCI uses a payment vendor to process electronic payments. Most units receive a daily report of the revenue collected and use this information to reconcile the daily balance and report revenue to OCI's fiscal staff. Most units utilize an electronic tracking system to trace revenues and reconcile collections monthly against an internally generated report.

Financial Information

As shown in **Exhibit 4**, OCI has expended, on average, $21.2 million per year during fiscal years 2014 through 2017. State appropriations are OCI's primary source of funding (93% of total expenditures in fiscal year 2017). In addition, OCI receives federal grant funds for the Fire Safety program (safety inspections) and the Special Fraud program (fraud recoveries). OCI receives other funds from a contract with DCH and fees. OCI has lapsed between $46,000 and $153,000 in state appropriations in fiscal years 2014 through 2017. Federal funds carried over from year-to-year have varied, but OCI had no federal funds remaining at the end of fiscal year 2017. Federal funds earned during the year and in prior years were used to fund 2017 program expenditures.

The majority of OCI's funds were expended in the Fire Safety and Insurance Regulation programs, and primarily for personnel costs. In fiscal year 2017, 90% of all expenditures were for personnel (salaries and benefits).

Exhibit 4
OCI Budgets and Expenditures, Fiscal Years 2014-2018

Budget	Fund Source	2014	2015	2016	2017	2018[1]
Administration	State	$1,746,908	$1,812,192	$1,870,136	$1,926,999	$1,969,256
Enforcement	State	$756,822	$774,303	$789,431	$807,981	$823,783
Fire Safety	State	$6,906,358	$7,132,951	$6,894,544	$7,058,464	$7,198,381
	Federal	$809,039	$1,327,206	$890,233	$1,030,333	$425,368
	Other	$328,062	$327,204	$466,157	$607,893	$339,026
Industrial Loan	State	$656,703	$670,948	$668,212	$683,914	$697,288
Insurance Regulation	State	$5,144,676	$5,277,604	$9,677,670	$9,914,797	$10,118,232
	Federal	$75,556	$0	$3,444	$4,355	$0
Special Fraud[2]	State	$4,114,094	$4,214,365			
	Federal	$2,131	$6,476			
Total Budget		$20,540,349	$21,543,249	$21,259,827	$22,034,736	$21,571,334
Expenditures[3]	**Fund Source**	**2014**	**2015**	**2016**	**2017**	**2018[1]**
Administration	State	$1,744,287	$1,806,932	$1,866,727	$1,922,571	*$1,703,045*
Enforcement	State	$754,775	$743,917	$785,671	$807,885	*$379,117*
Fire Safety	State	$6,900,831	$7,119,127	$6,831,584	$7,028,928	*$3,286,906*
	Federal	$809,036	$1,238,714	$727,212	$1,030,331	*$323,275*
	Other	$328,062	$327,203	$466,155	$607,892	*$178,933*
Industrial Loan	State	$653,841	$669,481	$656,717	$682,616	*$301,200*
Insurance Regulation	State	$5,143,913	$5,270,725	$9,618,546	$9,904,512	*$3,552,098*
	Federal	$75,555	$0	$3,444	$4,354	*$0*
Special Fraud[2]	State	$3,975,880	$4,207,439			
	Federal	$2,131	$267			
State Lapse	State	$152,845	$74,858	$141,055	$45,590	
Federal Carryover	Federal	$628,695	$94,700	$165,784	$0	
Total Expenditures		$20,388,312	$21,383,805	$20,956,056	$21,989,090	*$9,724,574*

[1]Fiscal year 2018 expenditures as of December 19, 2017.
[2]Special Fraud was made a subprogram of Insurance Regulation in fiscal year 2016.
[3]Expenditures **do not reflect** OCI's reallocation of salaries between programs (see page 15).
Source: *TeamWorks*

State Budgeting

Programs are discrete sets of activities designed to carry out the agency's primary mission and objectives.

The appropriations act serves as the official annual authorization for state programs to expend state funds for 12 months (July 1 to June 30). State agencies are appropriated funds by budgetary program. Authorizing funds by program is intended to provide greater budgetary control and performance management by establishing a link between program activities and the appropriation of funds.

At the start of the fiscal year, agencies can begin to request a portion of their appropriation to cover expenses by requesting authorization from the Office of Planning and Budget (OPB). Agencies have the option of requesting an even amount of state funds each month (1/12 of the total annual appropriation) per program or, in certain circumstances, may request an additional amount in one or more months to pay for necessary expenses subsequent to approval by OPB. Once the allotment is authorized, agencies may then expend the requested funds from the state's general fund through the Office of the State Treasurer. Personnel costs, including the costs for salaries and benefits, may make up a large portion of state agency expenditures. Agencies make regular monthly payments, generally at the beginning of each month, for benefits such as employee retirement and health.

Budget Controls

Once funds are appropriated, there are multiple budget and spending-related requirements to ensure that appropriated funds are used for their intended purpose. State regulations, statutes, and policies and procedures require agencies to control expenditures in conformance with the appropriations act, as amended. The appropriations act restricts agencies from overspending their authorized budgeted amounts at the legal level of budgetary control.

Key State Budgetary Controls

Article VII, Section IV, Paragraph VIII of the Constitution of the State of Georgia requires that, "…the credit of the State shall not be pledged or loaned to any individual, company, corporation or association". This prohibits agencies from spending in excess of the funds available.

O.C.G.A. §§ 45-12-80 through 45-12-89 requires that state agency expenditures conform to the amounts in the Appropriations Act and no funds can be obligated over the approved amounts. Further, no payment will be made for any appropriation unless authorized as part of the agency's approved operating budget (AOB). Any state funds remaining at the end of the fiscal year lapse back to the Treasury.

OPB's ***Annual Operating Budget, Amendment, and Allotment Policies and Procedures, Fiscal Year 2018***, states that agency AOB's must comply with appropriations by program and fund source and that agencies may only transfer funds between object classes within a program by the use of budgetary amendments. All amendments must be explained with documentation.

OPB's ***General Budget Preparation Procedures for Prioritized Program Budget, Amended Fiscal Year 2018 and Fiscal Year 2019***, states that agencies are expected to manage their expenditures through the flexibility provided in program budgeting.

The ***State Accounting Policy Manual***, maintained by the State Accounting Office (SAO), requires that agency management be responsible for the accuracy of its financial reports and compliance with all laws and regulations. Agencies are required by statute to comply with state accounting policies and procedures.

The ***Statewide Internal Control Guidance*** requires agencies have sufficient internal controls to provide reasonable assurance of accurate budgetary reporting and compliance with laws and regulations. Agency management is responsible for the agency's internal controls and should identify risks to the agency's objectives and design activities to respond to those risks. Management should rely on accurate information and communicate that information internally and externally.

Budgets are tracked by program, fund source (e.g., state, federal, and other), and object class (e.g., personnel, regular operating expenses). Agencies are required to routinely monitor program expenditures against approved annual operating budgets (AOB) and project estimated year-end expenditures to ensure that they do not exceed budgets. The following *TeamWorks*[1] financial reports may be used:

- **Program Budget Comparison Report (PBCR)** - Used to track budgetary compliance throughout the year; shows the original and amended budgets compared to expenditures by program on a monthly basis.
- **Budget Comparison Report (BCR)** - Shows the adjusted budget, monthly expenditures, encumbrances, and the remaining AOB by program. The BCR reflects the agency's budget activity and whether expenditures exceed available funds.

[1] *TeamWorks* is the state accounting system.

Agencies facing a potential budget shortfall in one or more programs by the end of the fiscal year have three options other than internal measures to reduce expenses, to address projected deficits. These options, although not guaranteed to provide a respite, include:

- **Amended Budget Request** - Agencies have the opportunity to submit an amended budget request to OPB in September of the current fiscal year. The amended budget allows agencies to adjust projected spending needs based on the first quarter of actual activity. Requests for additional funding that OPB considers necessary or a priority may be included in the Governor's Amended Budget Report for recommendation to the General Assembly to consider during the legislative session.

- **Fiscal Affairs Subcommittees** - Once the legislative session has ended, agencies seeking to offset a potential shortfall by transferring funds *between* programs must request approval from the Fiscal Affairs Subcommittees of the House and Senate. Agencies first file the request with OPB, which may forward the request to the joint subcommittees for consideration. The subcommittees meet annually in June (at the end of the fiscal year) and consider all agency transfer requests.

- **Governor's Emergency Fund** - The Governor's Emergency Fund is exclusively controlled by the Governor. Agencies can, in dire circumstances, request that OPB consider recommending that the Governor release these funds for a specific need.

Requested Information

What factors put OCI at risk of a budgetary shortfall in fiscal year 2017 and how did OCI remain within spending limits?

In April 2017, it was publicized that OCI was projected to overspend its fiscal year 2017 appropriation. At the time, OCI estimated that the projected budgetary shortfall was at least $170,000. To balance its budget, OCI reduced personnel expenditures by laying off 12 employees between January and April 2017 and furloughing employees for four days beginning in May 2017. OCI personnel stated they were aware of the projected budget shortfall as early as September or October 2016 based on a monthly review of the Budget Comparison Report[2]. **Exhibit 5** shows OCI was spending at a rate above its budget from the beginning of fiscal year 2017, and projected expenditures in multiple programs exceeded the program's budget.

Control environment is the foundation of internal controls. Established by management, it establishes integrity, ethical values, oversight, expectations of competence and accountability.

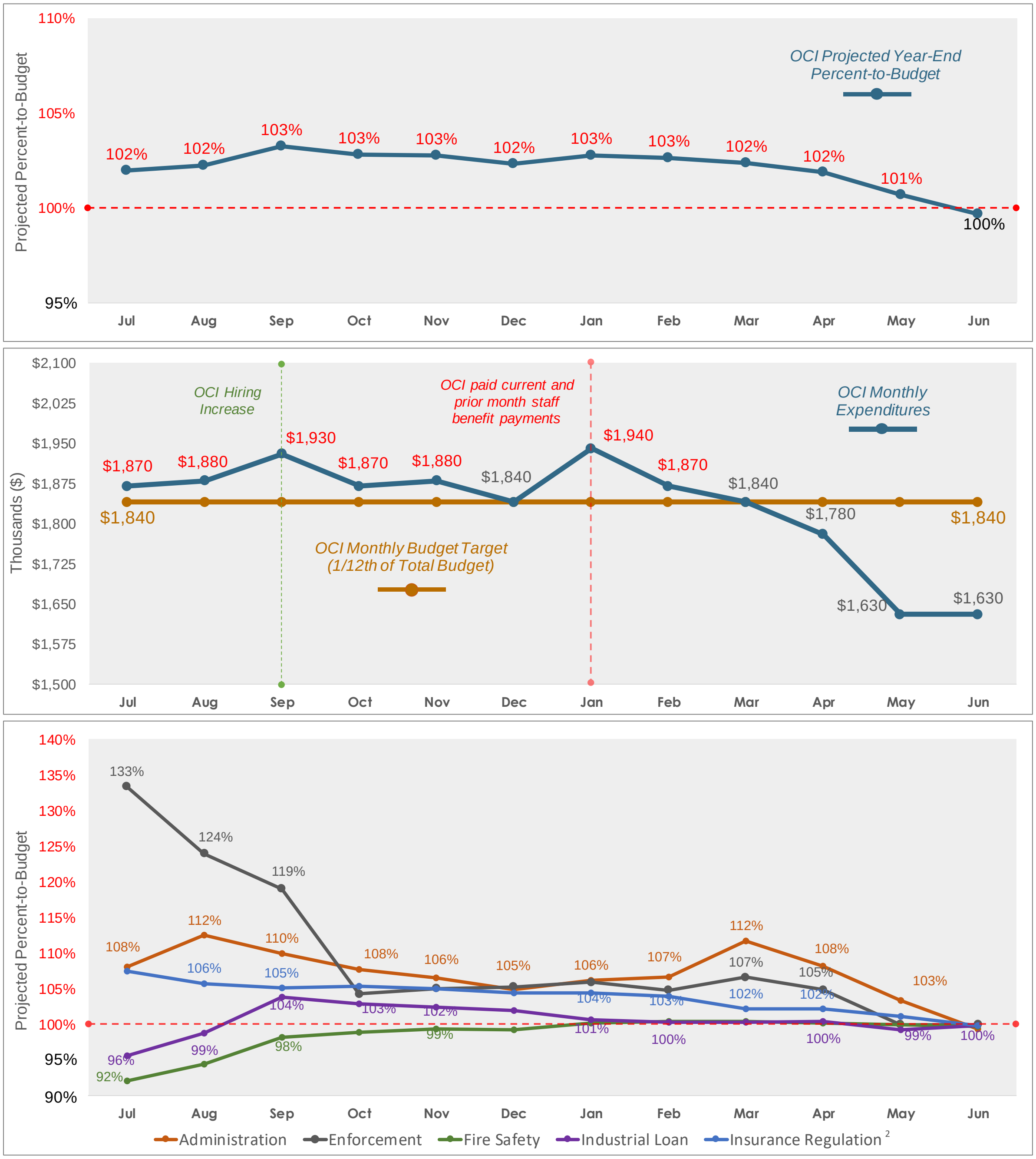
Factors Leading to Risk of Shortfall

While there were specific decisions made over several years that caused OCI's projected budget shortfall, the underlying cause was a poor control environment. We found that OCI's management did not comply with state law regarding program-based budgeting, budget directives from OPB, accounting directives from the State Accounting Office (SAO), and human resources requirements of the State Personnel Board.

As shown in **Exhibit 6**, OCI made a series of management decisions between fiscal years 2014 and 2017 that had a cumulative negative impact on its budget, which resulted in the projected budget shortfall. These management decisions include: OCI-initiated pay increases, OCI's decision to fill vacant positions, and OCI's decision to fill a deputy commissioner position. In addition, state-mandated pay increases for law enforcement personnel impacted OCI'S budget. These factors are described in the actions beginning on page 12.

[2] The Budget Comparison Report is a standard monthly financial report extracted from the state accounting system, *TeamWorks*, and used by state agencies to monitor the budget.

Exhibit 5
Monthly Expenditures Compared to Budget Show OCI Was Projected to Overspend Its Budget During Fiscal Year 2017[1]



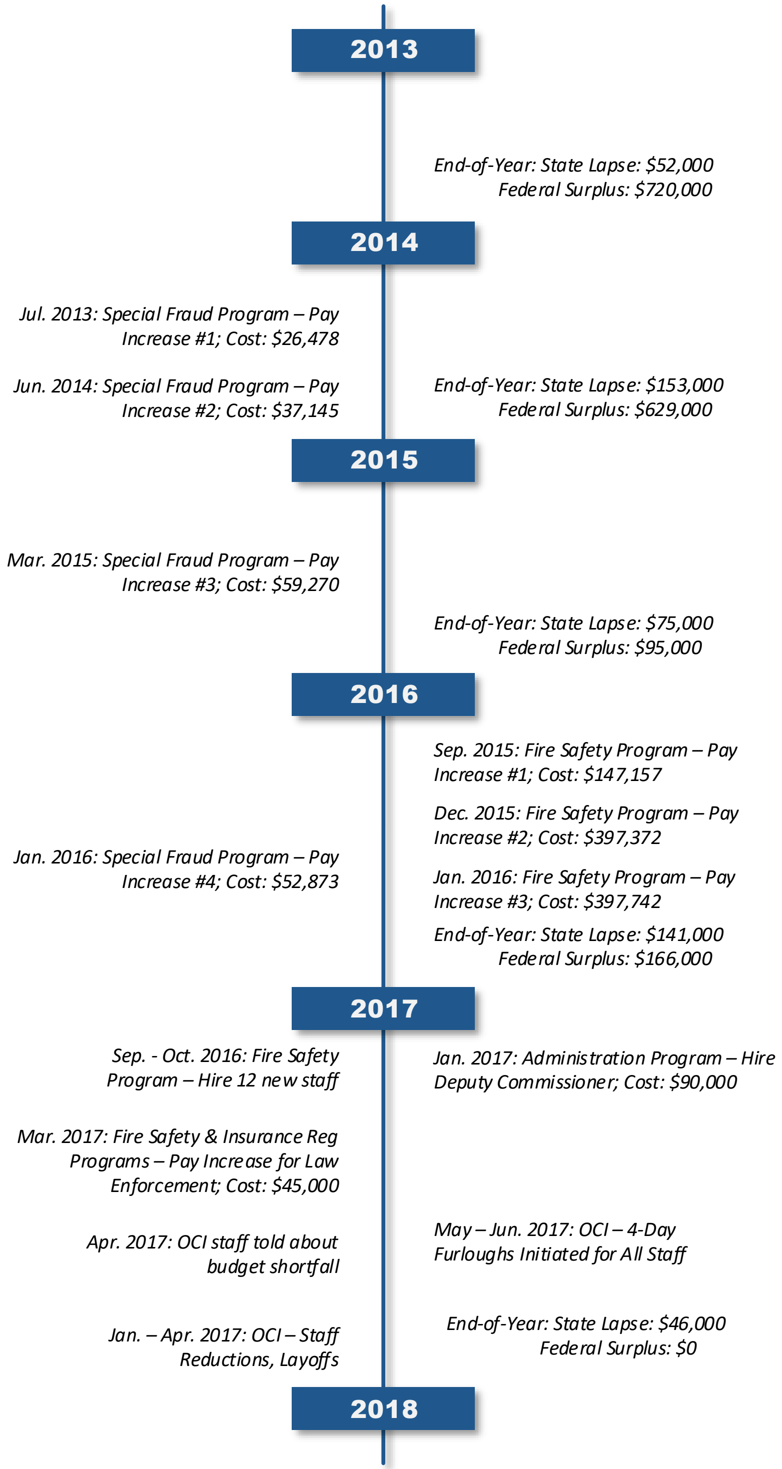
The above graphics show, for fiscal year 2017, the projected OCI year-end percent-to-budget per month based on current and preceding months' expenditures (*top*), total OCI expenditures per month compared to the budget target (*middle*), and the projected year-end percent-to-budget per program per month based on current and preceding months' expenditures (*bottom*). Projected figures are based on the period's expenditures plus the combined average of all prior periods. Values over 100% indicate that, at the end of that month, the program was projected to overspend by the end of the year. Figures are from the *TeamWorks* Program Budget Comparison Report, a standard monthly financial report used by state agencies to monitor the budget.

[1]Figures shown have not been adjusted for labor distribution allocations made by OCI.

[2]Special Fraud is a subprogram of Insurance Regulation. All Special Fraud expenditures are included here.

Source: *TeamWorks*

Exhibit 6
Examples of Management Decisions That had a Negative Impact on OCI's Budget, Fiscal Years 2013-2017[1, 2]



[1]Annualized cost shown for all pay increases.

[2]Pay increase amounts are not intended to match the Annual Costs reported in Exhibit 7 (see page 12). These exhibits are reporting different information.

Source: TeamWorks, OCI

Specific Factors

OCI-Initiated Pay Increases

As shown in **Exhibit 7,** OCI-initiated pay increases (occurring between fiscal years 2014 and 2017) contributed approximately $2.2 million to fiscal year 2017 expenditures. Of the $2.2 million, $1.1 million was due to pay increases based on two salary studies, and $1 million was due to ad hoc pay increases. OCI staff stated that ad hoc pay increases are initiated under various circumstances, such as to retain employees, compensate employees who have been assigned more responsibility, or reward performance. These pay increases were funded by OCI with its existing budget and were in addition to annual pay increases funded through the appropriations act.

Exhibit 7
OCI-Initiated Pay Increases Contributed $2.2 Million to Fiscal Year 2017 Expenditures, Fiscal Years 2014 - 2017[1]

Fiscal Year	Number of Employees[2]	Average Pay Increase	Percent	Cost During Year Implemented[3]	Annual Cost[3,4]
2014	111	$2,857	7%	$292,676	$552,312
2015	31	$4,262	9%	$77,755	$212,445
2016	181	$4,580	11%	$686,333	$1,340,267
2017	18	$3,204	4%	$92,014	$93,536
Total					$2,161,390

[1]Expenditures do not include pay increases funded through the appropriations act.

[2]In some instances, employees received multiple pay increases within the same fiscal year.

[3]Includes the cost of employee benefits.

[4]Annual expenditures may include costs associated with employees who left employment since receiving a pay increase.

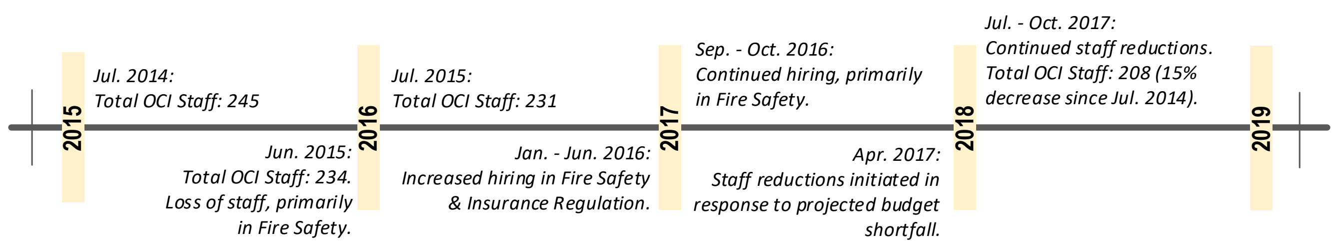
Source: *TeamWorks*

Lower Vacancy Rates

In fiscal year 2016, OCI decided to address long-term vacancies in the Fire Safety and Insurance Regulation programs. As shown in **Exhibit 8**, in the second half of fiscal year 2016 (between January and June 2016), OCI began filling vacancies by hiring 14 employees in these programs. These new employees increased OCI's expenditures by $375,000 in fiscal year 2016 and $1.1 million in fiscal year 2017. In the first half of fiscal year 2017 (between July and December 2016), OCI continued to fill vacancies by hiring 14 additional employees. The employees hired in fiscal year 2017 increased OCI's fiscal year 2017 expenditures by $717,000. The combined fiscal year 2017 expenditure for employees hired in fiscal years 2016 and 2017 was $1.8 million. OCI management stated that they believed the agency had adequate funds to afford the additional staff but could not provide any documentation or internal analyses of the projected fiscal impact.

As discussed above, OCI funded pay increases in fiscal years 2015 and 2016 through vacancies. However, in late fiscal year 2016 and early fiscal year 2017, when OCI increased hiring, it increased its personnel costs. Together, these two actions significantly contributed to OCI's projected shortfall.

Exhibit 8: OCI Began Filling Vacancies During Fiscal Year 2016, Fiscal Years 2015-2018



Source: *TeamWorks*

Deputy Commissioner

OCI rehired a former employee in January 2017 to serve as deputy commissioner, a position that had been vacant for over a year. The resulting hire increased the Administration program's expenditures by approximately $90,000 for the remainder of fiscal year 2017. The deputy commissioner was hired to oversee OCI's Enforcement and Special Fraud programs, as well as the Consumer Services and Legislative divisions. OCI also expected the deputy commissioner to lead the department's response to federal health care reform as well as oversee the review of the proposed mergers of several of Georgia's largest health insurers.

Law Enforcement Pay Increases

OCI was required to implement pay increases in fiscal year 2017 as part of the statewide initiative to provide pay increases for law enforcement and related personnel. Additional appropriations to fund the initiative were included in the fiscal year 2017 amended budget. OCI initiated the pay increase in March 2017 and was required to pay the increase retroactively to January 2017. The cost of the pay increase was $44,662 for 10 eligible employees in fiscal year 2017.[3] The fiscal year 2017 amended budget included 26% ($11,629) of the cost of the pay increases. OCI was expected to fund the remainder ($33,033) of the pay increases from its initial fiscal year 2017 appropriation.

Flat Budget Requests

OCI did not request additional state funds[4] in its annual or amended budget requests to fund the initiatives that increased expenditures. OPB instructions required the agency to submit flat[5] budget requests for fiscal years 2014 to 2018. The only funds OCI requested during that time was $300,000 to fund OCI's new Captives Division, but, according to OCI management, OPB denied this request.

[3] Employee eligibility was determined based on job title and current salary. Employees whose salary exceeded the established pay range were not eligible for the pay increase.

[4] This does not reflect any increases to the Special Fraud program.

[5] A flat budget indicates including the same level of funds per program as the prior year.

Actions Taken to Balance Budget

During fiscal year 2017, OCI had to resolve two financial issues that resulted from spending at a rate above its budget. The first was to ensure adequate funds were available to pay its monthly obligations. The second was to correct the projected budget shortfall by the end of the fiscal year. To ensure adequate funds were available, OCI delayed benefits payments. To correct the budget shortfall, OCI laid off employees and implemented a furlough. The combined cost reduction of the layoff and furlough was $533,000 in fiscal year 2017.

- **Delay benefits payments** - During fiscal year 2017, OCI received an equal monthly allotment of its state appropriation (1/12 per month). Because OCI was spending at a rate above its budget from the beginning of fiscal year 2017, OCI did not always have adequate funds to pay its monthly obligations. Therefore, OCI delayed making some benefits payments to ERS and the State Health Benefit Plan to the month following the due date. OCI would make the benefits payment after the next month's allotment was received. OCI's monthly expenditures spiked in January and May because it made two benefits payments in those months.
- **Layoffs** - OCI released 12 employees between January 2017 and April 2017. The estimated cost avoidance was $248,359 for fiscal year 2017.
- **Furlough employees** - OCI decided at the end of April 2017 that it was necessary to furlough employees to further reduce expenditures. Employee pay was reduced by four workdays (32 hours) beginning in May 2017, resulting in a decrease of approximately $284,450 in personnel expenditures.[6] The pay reductions affected 212 of OCI's 215 employees.[7]
- **Federal funds** - OCI expended both its carryover and current year federal funds in fiscal year 2017, resulting in no federal funds being carried over to fiscal year 2018.

OCI's Response: *The Commissioner of Insurance cited problems with the former Chief Financial Officer (CFO) and noted that "inaccurate budget projections led to my decisions to spend what I believed to be surplus dollars on pay raises to retain staff." OCI also noted that "[w]ell after those decisions were made, and as late as February of 2017, that same individual was providing budget numbers that did not come close to representing the true scope of our budget challenges."*

***Auditor's Response**: Interviews with current members of OCI management and staff as well as the former CFO revealed that the former CFO met with members of the senior leadership team (not including the Commissioner) on a monthly (or near monthly) basis to discuss the budget and shortfall projections. While OCI cites repeated examples of inaccurate budget projections in its response to this report, members of current management confirmed that the former CFO provided reports at these monthly meetings but did not retain them. The audit team viewed a number of the reports retained by the former CFO, which did show monthly budget shortfalls. In addition, the audit team was able to reproduce the actual budget projection reports from TeamWorks that*

[6] Pay reductions for classified employees were made over two pay periods (16 hours each) while pay reductions for unclassified employees were made over four pay periods (8 hours each).

[7] OCI did not reduce the pay of two employees that submitted notification of their intent to retire and one employee who was on leave without pay.

reportedly served as the basis for the reports shared at these budget meetings. These reports show that as early as September 2016 OCI was facing a potential budget shortfall. While we cannot confirm the nature of the discussions or any advice given at the budget meetings, the former CFO, certain members of the current senior leadership team and the Commissioner all share responsibility for the decisions that led to the projected budget shortfall.

Did OCI comply with Program-Based Budgeting?

OCI did not comply with Program-Based Budgeting requirements and legal budgetary controls that restrict the use of an agency's state appropriation. The appropriations act requires state agencies to spend their state appropriations within the programs to which the funds are appropriated. For example, if $1 million is appropriated to OCI for its Insurance Regulation program, OCI is legally required to spend the funds within that program. OCI cannot legally spend the funds appropriated to one program in another program. These legal budgetary requirements ensure that state funds are utilized for their intended purpose.

Special Fraud subsidized OCI's Administration and Insurance Regulation programs.

OCI bypassed legal budgetary controls by using funds from one program to subsidize another program. OCI accomplished this subsidization by charging the salary and benefits of staff in one program to another program to manage its budget (also known as reallocation of labor costs). OCI predominantly charged labor costs from the Departmental Administration ("Administration") and Insurance Regulation programs to Special Fraud.

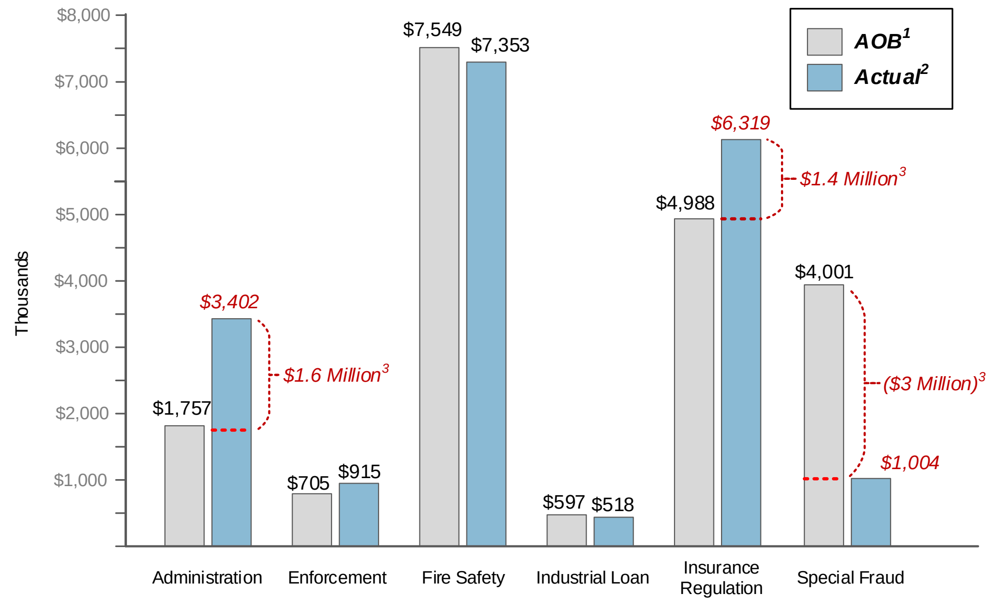
As shown in **Exhibit 9**, OCI was budgeted $1.8 million[8] for salaries and benefits[9] for Administration, but actual expenditures were approximately $3.4 million. OCI allocated $1.6 million in Administration salaries and benefits to Special Fraud. Approximately $1.4 million in Insurance Regulation expenses for salaries and benefits was allocated to Special Fraud.[10] While Special Fraud was budgeted $4 million for salaries and benefits, actual program expenditures were $1 million.

[8] Various figures are cited for Administration in the report; $1.6 million for the amount of the Administration program's salaries and benefits expenditures allocated to the Special Fraud program, $1.8 million for the Administration program's personal services budget, and $1.7 million for the amount of Special Fraud funds being requested for transfer to Administration in the fiscal year 2018 amended budget.

[9] Personal Services (object class 300) amended AOB, fiscal year 2017.

[10] Special Fraud was made a subprogram of Insurance Regulation in fiscal year 2016 after a recommendation by OPB in its annual Zero-Based Budget (ZBB) report.

Exhibit 9
Actual Program Expenditures for Salaries and Benefits Vary Significantly from State Budget, Fiscal Year 2017



[1]Annual Operating Budget (AOB) for Personal Services - Object Class 300 per program, fiscal year 2017.

[2]Actual figures adjusted to account for improper labor distribution allocations by OCI.

[3]Reallocations from Special Fraud only. The graphic only shows reallocations from Special Fraud to Administration (**$1.6 million**) and Insurance Regulation (**$1.4 million**). There were additional smaller reallocations between programs not shown here.

Source: *TeamWorks*

Exhibit 10 shows an analysis of three fiscal years (2015-2017) of OCI's salaries and benefit expenditures for fiscal years 2015-2017, which shows similar labor reallocations. Approximately $8.4 million in salaries and benefits for staff in Administration and Insurance Regulation was charged to Special Fraud ($4 million from Administration and $4.4 million from Insurance Regulation). The Special Fraud program, while reporting $3.4 to $4 million in expenditures each fiscal year only expended between $700,000 to $1 million of its available funds for intended purposes. Based on audit work conducted by DOAA, the SAO initiated audit adjustments to OCI's accounting records. These adjustments moved expenditures from Special Fraud to Administration. These audit adjustments are reflected in the fiscal year 2017 *State of Georgia Budgetary Compliance Report*. The report reflects OCI's non-compliance with Program-Based Budgeting.

Exhibit 10
Special Fraud's Expenditures for Salaries and Benefits Were Significantly Less Than the Budgeted Amount, While Expenditures in Other Programs Exceeded Budgeted Amounts, Fiscal Years 2015 - 2017

[1]The above graphic shows a comparison of OCI budgets and actual expenditures for employee **salaries and benefits** only for three programs, Special Fraud, Insurance Regulation, and Administration.
[2]Amended Annual Operating Budget (AOB), Personal Services (Object Class 300).
[3]Expenditures – Adjusted for labor distribution reallocations by OCI.

Source: *TeamWorks*

OCI staff stated the Administration program has been underfunded for multiple years and the labor reallocations were necessary to meet payroll obligations. OCI staff stated it did not disclose its reallocations to state budgetary officials or request additional state appropriations to correct the situation.

OCI's Response: *The Commissioner of Insurance noted that "[n]either I nor my senior leadership at the Department was aware that the former CFO engaged in improper allocation of expenses across budget programs." OCI also noted that "[w]hile the former CFO did not allocate funds across programs through a pre-defined and written allocation plan, some utilization of funds from other programs to Program Administration were appropriate."*

OCI noted that it has hired a new CFO effective January 1, 2018 and that "[o]ne of his first tasks will be to determine a reasonable, consistent and written allocation model." OCI noted that once proper allocations are established, Program Administration will have funds for 2018, but that it does "expect that we will need budgetary re-allocations during the next legislative session to remain budget compliant within Program Administration."

Auditor's Response: *Since 2008, and as late as fiscal year 2016, the Department of Audits and Accounts and the Office of Planning and Budget have separately informed OCI[11] that it needed to develop an allocation methodology to justify the amount of Special Fraud funds utilized for Insurance Regulation. In the 10 years since the issue was first raised, OCI has not developed an allocation method to justify the amount of Special Fraud funds used for Insurance Regulation. In addition, both DOAA and OPB questioned the use of Special Fraud funds for any program outside of Insurance Regulation. OCI used approximately $380,000 in Special Fraud funds to pay administrative costs in fiscal year 2010 and $510,000 in fiscal year 2011. In fiscal year 2012 (July 2011 to June 2012), OCI continued these allocations. While the former CFO (in place at the time of the 2017 budget shortfall) continued the practice, this practice pre-dates the former CFO's employment at OCI, which began in January 2012.*

Also, there is not a reasonable methodology that justifies the use of Special Fraud funds to fund 47% of OCI's administrative costs given that the Special Fraud program consists of 5% of the agency's personnel and 5% of the agency's expenditures. If one assumes, for example, that 5% of Program Administration's $3.4 million budget is used to support administrative activities related to Special Fraud, the use of approximately $170,000 as opposed to the $1.6 million in Special Fraud funds might be justified.

Did OCI comply with statutes and regulations for the use of the Special Fraud Fund?

OCI did not comply with O.C.G.A. § 33-1-17, which restricts the use of the Special Fraud assessment to the investigation and prosecution of insurance fraud in the state. In fiscal year 2017, OCI collected approximately $4 million from the Special Fraud assessment on insurance company premiums and expended approximately $1 million

[11] The Department of Audits and Accounts conducted a performance audit of the Special Fraud Program in 2008 and a follow up review in 2010. OPB conducted Zero-Based Budget reviews of Insurance Regulation and Administration in fiscal years 2016 and 2018, respectively.

directly on the Special Fraud program. OCI expended the remaining funds on Insurance Regulation ($1.4 million) and Administration ($1.6 million).

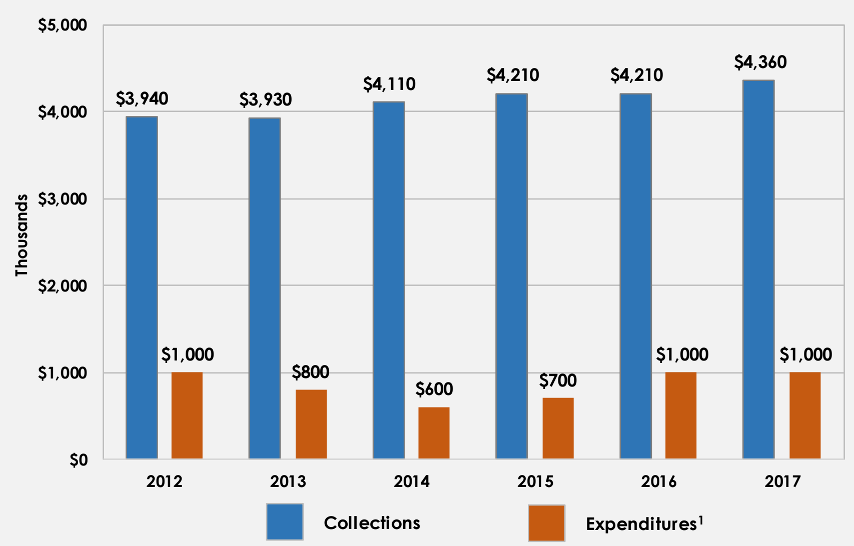
Special Fraud Fee Assessment

All insurance companies writing premiums in the State of Georgia are required to pay into the Special Fraud Fund annually. The fee is assessed on a sliding scale based on the total amount of premiums written. In 2017, 1,505 insurance companies were assessed and paid fees ranging from $18 to $33,000.

Source: Office of the Commissioner of Insurance

Each fiscal year, OCI develops a budget intended to fund its fraud activities, which OCI has increased over time by an arbitrary amount. The budget request is submitted to OPB and then submitted to the General Assembly for appropriation. Once the amount is appropriated by the General Assembly, OCI assesses insurance companies the required fee. Because this amount has gone through the budgetary process relatively unchanged, OCI effectively controls the amount it receives from the Special Fraud assessment. **Exhibit 11** shows the amount of the Special Fraud fee collections compared to the actual expenditures of the Special Fraud program for fiscal years 2012-2017.

Exhibit 11
Special Fraud Assessment Fee Collections Significantly Exceeded Expenditures, Fiscal Years 2012 - 2017



1Expenditures reflect Special Fraud program staff salaries and benefits only. A lesser amount of Special Fraud funds was expended on other areas (including motor vehicles, rent, travel, IT, etc.) not shown here. The majority of Special Fraud program expenditures was for staff salaries and benefits.

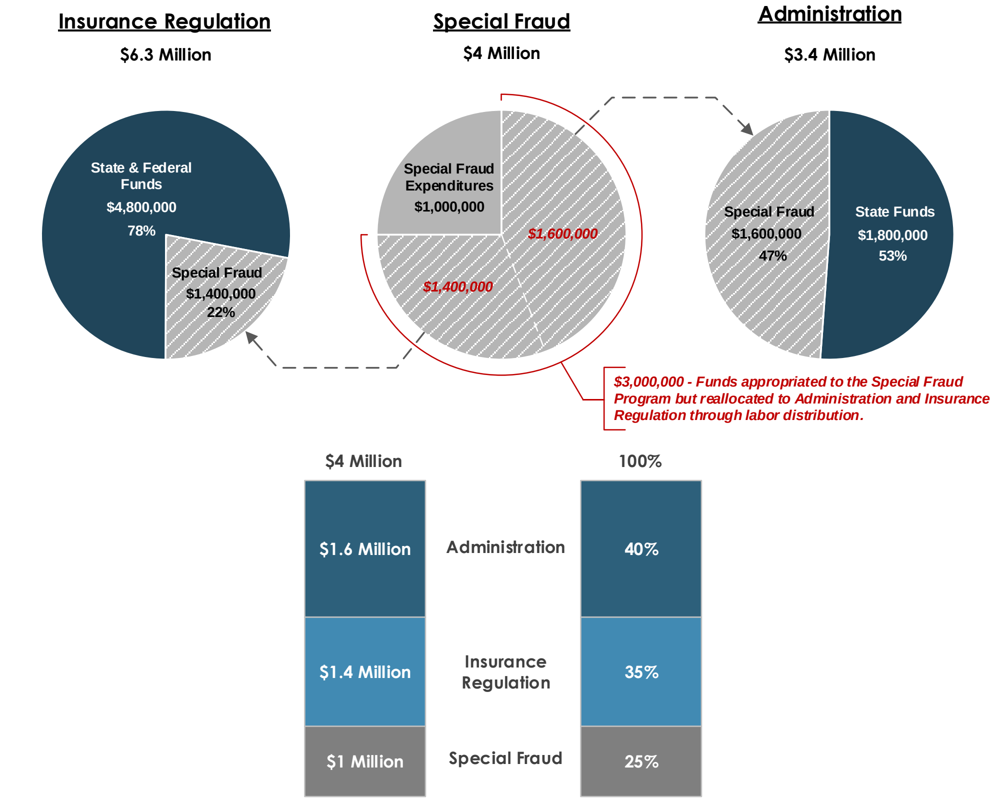
Source: *TeamWorks*

OCI has collected approximately $24.8 million for the Special Fraud program from fiscal years 2012 to 2017.[12] However, only $5.1 million has been expended on salaries

[12] Approximately 98% of all funds for the program; a small amount comes from a federal grant.

and benefits in the Special Fraud program during the period, while $16.5 million was used to support other programs, primarily Administration and Insurance Regulation.[13] **Exhibit 12** shows the amount of Special Fraud Fund revenue expended on other programs during fiscal year 2017. While the Special Fraud program accounts for 5% of OCI's total expenditures and staff (approximately 10 staff), the Special Fraud assessment is supporting 47% of OCI's actual administrative costs.

Exhibit 12
OCI Used Special Fraud Funds to Support Insurance Regulation and Departmental Administration Programs, Fiscal Year 2017



OCI's Special Fraud program is funded through assessments on all insurance companies writing premiums in the state. The total amount of the annual assessment is based on the Special Fraud program's budget, as submitted by OCI. In Fiscal Year 2017, OCI reallocated approximately **$3,000,000** (75%) of Special Fraud funds to Administration (**$1,600,000**, 40%) and Insurance Regulation (**$1,400,000**, 35%). A small amount of funds from other OCI programs was also reallocated but is not shown here.

Source: *TeamWorks*

OCI stated that revenues from the Special Fraud Fund *should* be used for a portion of the expenditures in the Insurance Regulation program to support that program's activities. OCI could not provide any documentation to demonstrate how the Insurance Regulation program's activities reduce insurance fraud. OCI also stated that the use of Special Fraud funds in the Administration program was justified in that Administration activities support all other OCI programs. Although Administration and Insurance Regulation may provide some assistance to fraud activities, it is questionable that three-quarters of fraud funding would be spent in other programs. The Administration program, which includes OCI leadership, human resources,

[13] The remainder was spent in Special Fraud on expenditures other than salaries and benefits.

finance, procurement, information technology and records management, has been funded by appropriations according to the budgets submitted by OCI.

By the beginning of fiscal year 2018, OCI ceased reallocating salaries to the Special Fraud program through labor distribution. For fiscal year 2018, staff salaries and benefits have been allocated within the proper programs based on each staff member's position and responsibilities. However, the agency will have expended its fiscal year 2018 budget in some programs as early as December 2017 (six months into the fiscal year).

OCI staff submitted an amended 2018 budget to OPB requesting that $3 million in state funds be permanently moved from Special Fraud to Insurance Regulation (a subprogram to program transfer of $1.3 million) and Administration (a program to program transfer of $1.7 million).[14] However, the use of Special Fraud funds is restricted by O.C.G.A. § 33-1-17. Funds collected through the Special Fraud assessment cannot be used for any purpose except the investigation and prosecution of insurance fraud. Therefore, it is unclear as to how OCI will continue to fund its Administration program and parts of its Insurance Regulation program without action by OPB and the General Assembly.

OCI's Response: *Regarding the practice of using of Special Fraud funds for Insurance Regulation, OCI noted that "[t]he current wording of this finding ignores that the practice cited has been in place for 14 years, that it originated at the General Assembly's instruction, that several past audits have reviewed the practice and not declared it to be in violation of budget rules or the statute which established the fund in question, and that the Office of Planning and Budget reviewed the practice for FY 2016." OCI further stated that "[t]he practice has not changed-just the auditor's interpretation of it."*

OCI also noted that "[t]he simplest remedy for this long-standing practice would be to reduce the money designated for Special Fraud and provide a corresponding increase in other programs. However, because the money designated for Special Fraud comes from insurance company assessments, a reduction in Special Fraud and an increase in other programs would increase taxpayers' financial obligation to pay for the regulation of insurance companies and, in effect, be a tax cut for insurance companies."

Auditor's Response: *DOAA's 2008 performance audit expressed concern about the practice of using Special Fraud funds for insurance regulation activities because the agency did not adequately demonstrate that the activities were in support of insurance fraud investigations. In a 2016 Zero-Based Budget review, the Office of Planning and Budget recommended OCI develop a consistent and defensible method for determining the amount of regulatory expense that will be billed to the Special Fraud Insurance Fund. Further, both DOAA and OPB cited concerns but neither offered an explicit opinion on whether using Special Fraud funds for expenditures other than insurance regulation violates the statute.*

[14] Special Fraud is a subprogram of Insurance Regulation and the transfer of funds from subprogram to program are less restricted under state regulations than transfers between programs (such as to Administration). However, it is still necessary that funds be used to investigate and prosecute insurance fraud.

In the 10 years since the issue was first raised, OCI has not developed a method to justify the amount of Special Fraud funds used to cover Insurance Regulation or Administration expenditures. OCI cites legislative intent when defending its use of Special Fraud funds for the Insurance Regulation program, but OCI has not cited legislative intent to use the Special Fraud funds to support OCI's administrative costs. In addition, since our 2008 report, the magnitude of OCI's use of Special Fraud funds to support non-fraud activities has increased. The Special Fraud Fund is specifically designed to fund the investigation and prosecution of insurance fraud. The assessment is not a tax on insurance companies to pay for the regulation of insurance companies.

Did OCI follow best practices and state regulations for pay increases?

OCI did not follow best practices when conducting salary comparisons for entry-level positions in Special Fraud and Fire Safety to recruit and retain employees. Staff believed the entry-level salaries for these positions were low and needed to be raised. The salary comparisons for Special Fraud and Fire Safety were conducted separately but shared similar weaknesses, including the comparison of dissimilar positions. In addition, the salary comparison conducted for Fire Safety positions also lacked complete information regarding education and certification requirements. OCI also did not comply with state regulations prohibiting salary adjustments from exceeding the maximum pay range applicable to an employee's position. Fire Safety had the largest number of employees whose salaries exceeded the maximum pay range at the beginning of fiscal year 2017.

Special Fraud

In fiscal year 2013, OCI staff conducted a salary comparison for employees responsible for criminal investigations. The salary comparison was not comprehensive and was limited to a search of job titles in Open Georgia's salaries and travel reimbursement report[15] to identify employees at other state agencies responsible for conducting investigations. Once the similar job titles were identified, staff calculated the average salary of the employees at each agency and used the results to institute a new salary range for OCI's entry-level criminal investigators in Special Fraud.

According to best practices, choosing benchmark jobs are key to conducting effective salary evaluations, but precautions should be taken during selection because jobs with identical titles may differ in factors that impact the level of compensation. To adjust for these differences, a thorough review of actual job duties and qualifications is necessary and a rating scale may be used. We found OCI utilized salary data for employees in positions that were dissimilar. For example, we found comparison employees in more advanced positions that require them to perform duties such as supervising the work of other employees, developing and administering policy, assisting in employee selection, and preparing budgets. Also, the salary and reimbursement report does not provide information about each employee's years of experience. Best practices also recommend using the median for analyzing salary survey data, as opposed to the average, because the average may be skewed when the

[15] Open Georgia, which contains information for various state agencies, is an online resource for obtaining information about how the state spends tax dollars and other revenue. The salaries and travel reimbursement report provides the amount paid to state employees for salaries and travel reimbursement for the year.

sample is small or there are significant outliers. Staff stated that it did not evaluate job descriptions or other information to identify possible differences in job duties or remove outliers.

Based on the results of the salary comparison, the entry-level salary for Special Fraud criminal investigators was increased from $38,000 to $42,000 in fiscal year 2014 and increased to $51,000 by fiscal year 2017. Also, a 10% salary adjustment for current employees was instituted in fiscal year 2014 to prevent salary compression.[16] Additional incremental pay increases were given to Special Fraud investigators until fiscal year 2016. **Exhibit 13** shows that pay increases given to Special Fraud employees based on OCI's salary comparison contributed more than $175,000 to OCI's expenditures during fiscal year 2017.

Exhibit 13
Pay Increases to Special Fraud Employees Contributed About $176,000 to Fiscal Year 2017 Expenditures, Fiscal Years 2014-2017

Date of Pay Increase	Fiscal Year	Number of Employees	Average Pay Increase	Percent	Cost During Year Implemented Cost[1]	Annual Cost[1]
July 1, 2013	2014	4	$4,092	10%	$26,478	$26,478
June 16, 2014	2014	7	$3,295	8%	$1,548	$37,145
March 16, 2015	2015	8	$4,601	10%	$17,287	$59,270
January 16, 2016	2016	10	$3,285	7%	$24,233	$52,873
Total						**$175,766**

[1]Includes the cost of employee benefits.

Source: *TeamWorks*

Fire Safety

In fiscal year 2016, OCI staff conducted a salary comparison for Fire Safety arson investigators, building inspectors, engineers, and elevator inspectors. The salary comparison examined salary data and qualifications from job descriptions and vacancy announcements for similar positions at local government agencies and fire and safety related agencies in other states. Staff compiled information regarding the qualifications and salary for the positions into a spreadsheet for management. Based on conclusions drawn from the salary comparison, OCI increased the entry-level salary for Fire Safety positions (increases ranged from $6,000 to $10,000) and increased the salaries of existing employees.

As noted earlier, choosing benchmark jobs is key to conducting effective salary comparisons. We found that OCI's salary comparison for Fire Safety positions utilized salary data for positions that were dissimilar. For example, we found comparison positions OCI used for arson investigators that were more advanced and required employees to perform duties such as managing a group of fire stations, conducting law enforcement and safety training, evaluating employee performance, and investigating other crimes including homicide and gambling. We also found that the salary comparison documentation contained incomplete data regarding the required qualifications for comparison positions and did not include a summary of the results of the analysis. As a result, we could not identify a clear link between the salary

[16] Salary compression occurs when an organization compensates employees with varying levels of experience and responsibility at or near the same amount.

comparison and the actual pay increases. As shown in **Exhibit 14**, pay increases to Fire Safety employees contributed over $942,000 to OCI's fiscal year 2017 expenditures.

Exhibit 14
Pay Increases to Fire Safety Employees Contributed Over $942,000 to Fiscal Year 2017 Expenditures, Fiscal Years 2016-2017

Date of Pay Increase	Fiscal Year	Number of Employees	Average Amount	Percent	Cost During Year Implemented[1]	Annual Cost[1]
September 1, 2015	2016	34	$2,674	7%	$122,631	$147,157
December 16, 2015	2016	39	$6,313	17%	$215,483	$397,372
January 16, 2016	2016	33	$7,468	19%	$182,298	$397,742
Total					**$520,412**	**$942,271**

[1]Includes the cost of employee benefits.

Source: *TeamWorks*

Salaries Exceed Maximum of the Pay Range

Personnel Board Rule 478-1-.12, which governs employee salaries, prohibits agencies from making salary adjustments that exceed the maximum of the pay range applicable to the employee's assigned position. Between fiscal years 2015 and 2016, the number of Fire Safety employees whose salary exceeded the maximum of the pay range increased from 1 to 24. As shown in **Exhibit 14**, OCI implemented three pay increases for Fire Safety employees during fiscal year 2016. Fire Safety employees accounted for 59% (24) of all OCI employees whose salaries exceeded the maximum pay range at the beginning of fiscal year 2017.

OCI's Response: *OCI noted that while the salary studies might have been technically deficient, "we believe that the salaries that resulted from those studies are justified." OCI also noted that "even after we had implemented our revised pay scale, we were required at the end of Fiscal Year 2017 to provide additional pay increases because our officer salaries did not meet the state-created law enforcement minimum pay requirements." OCI noted that DOAA should have cited the amount of excess raises that resulted from the salary study deficiencies.*

Auditor's Response: *Calculating the excess pay increases that resulted from the salary studies' deficiencies is not possible without conducting a proper salary study, which OCI should have completed prior to awarding pay increases. The pay increases did result in the salaries of 25 of 83 Special Fraud and Fire Safety employees exceeding the maximum of the pay range applicable to their assigned job at the beginning of fiscal year 2017, which may be an indicator of excess pay. Of the 83 Special Fraud and Fire Safety employees that received pay increases, 10 received state mandated pay increases in fiscal year 2017. As a result of the pay increases OCI had already given to Special Fraud and Fire Safety employees, 9 of 19 employees assigned to positions included in the state-wide initiative to increase law enforcement salaries were not eligible for a pay increase. At the time of the initiative, the salary for these employees already exceeded the maximum of the pay range used to calculate the amount of the pay increase.*

Are there compelling reasons to transfer responsibility for the Industrial Loan program to the Department of Banking and Finance?

Industrial loans are consumer loans of $3,000 or less.

There are multiple reasons to transfer responsibility for the Industrial Loan program to the Department of Banking and Finance (DBF), including better alignment with DBF's purpose, better alignment of regulatory functions, increased efficiencies by using DBF's technologies, and increased efficiencies in business examinations. Also, in 12 other states[17] reviewed, the responsibility for regulating small loan lenders was placed in the banking or financial department responsible for regulating financial institutions.

The reasons to transfer responsibility and the potential benefits are discussed further below.

- **The Industrial Loan program fits within DBF's mission and purpose.** The Industrial Loan program was created within OCI in 1955 to provide consumer protection by regulating small loan lenders. However, OCI's primary purpose is to regulate the state's insurance industry. DBF's primary purpose is to regulate both depository and non-depository financial institutions, including a wide variety of financial instruments such as loans. DBF's Non-Depository Financial Institution (NDFI) division regulates mortgage lenders, brokers, processors, originators, and money service businesses, which include check cashers, money transmitters, and sellers of payment instruments.

- **Staff in the Industrial Loan program and DBF's Non-Depository Financial Institution division perform similar regulatory functions.** Industrial Loan program staff is responsible for licensing, investigating applicants, conducting site visits and examinations, providing restitution to borrowers, and collecting monthly and quarterly tax reports and payments. Industrial Loan has five examiners and one supervisory examiner to regulate licensees throughout the state, and a business support specialist responsible for overseeing the licensing process.

  NDFI staff is responsible for licensing, investigating applicants, conducting on- and off-site examinations, and collecting fees. NDFI has 10 examiners, two supervisory examiners, one licensing technician, and one supervisory licensing technician who also performs functions for mortgage programs. We found similarities in the nature of the reviews conducted.

- **DBF technologies could improve the efficiency of small loan regulation.** Currently, OCI's Industrial Loan staff manually reviews applications and records tax payments, as well as performs administrative steps. For example, applicants provide OCI-required documents for licensure in paper form, which are reviewed, scanned into the document management system, and then shredded. By contrast, DBF uses the Nationwide Multistate Licensing System and Registry (NMLS), which is an online system used in the regulation of mortgage and non-depository industries. NMLS is used by multiple states and allows regulators to collect application or renewals fees, review licensee information electronically prior to examinations, and assess

[17] We examined small loan regulation in five southern states and seven states identified during our research of the Nationwide Multistate Licensing System.

fines. Seven of the twelve states we examined also utilize this system to regulate small loans.

By utilizing the NMLS or a similar system, the Industrial Loan program could perform its regulatory duties more efficiently. Specifically, Industrial Loan staff could review documents online, reducing the number of steps and amount of paper processed. Additionally, using the NMLS could generate efficiencies for businesses by eliminating the need to utilize paper forms when applying for or renewing licenses and making payments.

- **By combining examinations, DBF could potentially increase the efficiency of small loan examinations.** Industrial Loan and NDFI currently regulate some of the same businesses. Our limited review identified four businesses with 148 offices (16% of industrial loan licenses) providing industrial loans and mortgage or check cashing services. Therefore, both the Industrial Loan program and the NDFI division currently regulate all four businesses. There is potential to combine examinations conducted by both groups to decrease the number of state examinations conducted at businesses with overlapping licenses.

Our review of information available for 12 states found that the responsibility for regulating small loan lenders was placed primarily within either a banking or financial department (see **Exhibit 15**). These departments regulated small loan lenders and other financial related businesses, such as mortgage lenders, money transmitters, and check cashers.

Exhibit 15
Small Loan Industry is Typically Regulated by a State's Banking or Financial Regulator, Fiscal Year 2018

State	Banking or Financial Department	Insurance Department
Alabama	X	
Connecticut	X	
Florida	X	
Iowa	X	
Georgia		**X**
Massachusetts	X	
Minnesota	X	
Montana	X	
New Hampshire	X	
North Carolina	X	
Rhode Island	X	
South Carolina	X	
Tennessee	X	

Source: Agency personnel and documents

RECOMMENDATION

The General Assembly should consider transferring the Industrial Loan program from OCI to DBF. Industrial Loan is a self-contained program within OCI and could be transferred without disrupting OCI's other functions. DBF staff stated that it could administer the function but would need Industrial Loan's resources to do so.

OCI's Response: *The Commissioner of Insurance noted, "I am unaware of any substantive complaints related to my regulation of the entities licensed under the Georgia Industrial Loan Act." OCI also noted that "any potential efficiencies or savings from such a transfer are unlikely given the Department of Banking and Finance's assertion that it would need the same appropriation that I currently receive to administer the program."*

Should the maximum amount of the loans regulated by the Industrial Loan program be increased?

The state should consider raising the maximum amount of the loans regulated under the Industrial Loan Act to provide better protection for the state's borrowers. Increasing the maximum regulated amount would allow the state to monitor loans that are currently unregulated. The maximum amount of loans regulated under the Industrial Loan Act has increased once since the act was enacted in 1955. In 1975, the maximum loan amount was increased from $2,500 to $3,000. Our 1994 performance audit of the Industrial Loan program recommended removing the loan limit entirely or increasing it based on inflation. The original loan maximum of $2,500 would be equivalent to approximately $23,000 today.

Businesses offering industrial loans of $3,000 or less may also offer loans greater than the current regulated loan limit. Therefore, loans provided by these businesses that are greater than $3,000 are unregulated. Two of the three businesses we visited during our review offered loans greater than $3,000. Both of the businesses offered loans up to $10,000. Borrowers of unregulated loans are at greater risk of being charged higher fees and interest rates. Our 1994 performance audit cited additional concerns.

- Program staff indicated that lenders denied industrial loan licenses were able to legally open loan offices offering unregulated loans of more than $3,000 with no review of rates and fees being charged.

- Since loans greater than $3,000 are not subject to industrial loan taxes (3% of the loan), the tax base for industrial loan taxes has eroded as loans started exceeding the established ceiling.

As shown in **Exhibit 16**, small loans regulated in 11 of the 12 states[18] reviewed have limits greater than Georgia. The maximum amount of the loans regulated by the 12 states we examined with small loan programs ranged from no limit to less than $1,500. Alabama was the only state that currently has a loan limit lower than Georgia. After Georgia, the lowest limit on regulated loans is $5,000 (Rhode Island).

In some states, consideration is given to interest rates charged on loans in addition to the loan amount, resulting in some smaller loans with high interest rates being regulated, while larger loans with lower interest rates may not. All neighboring states we examined, except Alabama, have a higher loan limit than Georgia. Among these states, North Carolina had the lowest loan limit at $15,000, while South Carolina did not have a limit. Since our 1994 performance audit, North Carolina and South Carolina have increased the limit on regulated loans from $10,000 and $25,000, respectively.

[18] We examined small loan regulation in five southern states and seven states identified during our research of the Nationwide Multistate Licensing System.

Exhibit 16
Georgia Has One of the Lowest Dollar Amounts of Regulated Small Loans, Fiscal Year 2018

States	Small Loan Maximum
Iowa	No Limit
Montana	No Limit
South Carolina	No Limit[1]
Minnesota	$100,000
Tennessee	$50,000[2]
Florida	$25,000
North Carolina	$15,000
Connecticut	$15,000[3]
New Hampshire	$10,000
Massachusetts	$6,000
Rhode Island	$5,000
Georgia	**$3,000**
Alabama	Less than $1,500

[1] Loans with interest rates greater than 12% must be provided by a licensed lender; however, there is no maximum loan amount.

[2] Maximum for non-mortgage lending; however, the mortgage lending maximum is $200,000.

[3] Loans with interest rates of 36% or higher for loans up to $5,000 and 25% or higher for loans between $5,000 and $15,000 must be licensed; however, if interest rates are below either limit, then the loan is not considered a small loan.

Source: Agency websites and personnel.

Increasing the maximum amount for industrial loans regulated by the Industrial Loan program may potentially increase the workload for program staff. This additional workload could not be determined because the number of loans greater than $3,000 is unknown. However, the additional fees would help fund the additional resources needed to regulate the additional loans.

RECOMMENDATION

The General Assembly should consider increasing the maximum amount of the loans regulated under the Industrial Loan Act to provide greater consumer protection.

Appendix A: Objectives, Scope, and Methodology

Objectives

This report examines the Office of the Insurance Commissioner's (OCI). Specifically, our examination set out to determine the following:

1. Are there adequate controls related to OCI's revenue cycle, including collection, distribution, and reporting of revenues?
2. Is OCI appropriately managing its state appropriations?
3. Did OCI follow best practices and State Personnel Board rules regarding pay increases and personnel actions?
4. Are there compelling reasons to transfer responsibility for Industrial Loan Regulation to the Department of Banking and Finance?

Scope

This special examination generally covered activity related to the Office of the Commissioner of Insurance that occurred from fiscal years 2016 - 2017, with consideration of earlier or later periods when relevant. Information used in this report was obtained by reviewing relevant state laws, rules, and regulations, reviewing agency policies and procedures, and interviewing agency officials and program staff from the Office of the Commissioner of Insurance, and the Department of Administrative Services, We also reviewed information from DOAA's 2008 report examining the Special Fraud Program and the 1994 report examining the Industrial Loan program. Revenue and expenditure data from the state's accounting system was used to inform multiple objectives.

Methodology

To determine whether there are adequate controls related to OCI's revenue cycle, we analyzed data and interviewed OCI staff about the types and sources of revenue and the process for collecting and managing the funds. We also reviewed agency documentation pertaining to the types, sources, and authorization for revenue collection. Further, we extracted and analyzed records of OCI's transfer of revenues to the state general fund and receipt by the Office of the State Treasurer using *TeamWorks*.

To obtain information on whether OCI appropriately manages its state appropriations, we interviewed staff at the State Accounting Office, Office of the State Treasurer, and the Office of Planning and Budget about state budgeting practices. We extracted financial information from *TeamWorks*, including OCI's budgets, expenditures, state appropriations, state fund allotments, employee benefits payments, and revenue transfers to treasury. We also reviewed state accounting and audit reports, including the *Georgia Revenues and Reserves Report*, *Comprehensive Annual Financial Report*, *Budgetary Compliance Report*, *Single Audit Report*, and *Georgia Tax Handbook* to document revenue collection, distribution, and reporting. Further, we reviewed all statutes, regulations, and directives pertaining to agency budgeting and expenditures and the use of funds from the Special Fraud Fund. Finally, we analyzed OCI's month-to-month expenditure levels and projected year-end percent-to-budget figures for fiscal year 2017 to determine what budgetary information was available to OCI staff throughout the fiscal year.

To determine whether OCI followed best practices and State Personnel Board rules regarding pay increases and personnel actions, we interviewed OCI staff about internal policies and personnel practices. We also reviewed personnel files, job descriptions, and other personnel documents. We reviewed State Personnel Board rules pertaining to hiring, pay increases, reduction in force and other personnel actions. We also interviewed Department of Administrative Services' Human Resource Administration staff about Board rules, recommended best practices, and resources provided to agencies. We obtained and analyzed historical compensation data and personnel actions reports for OCI employees. We also reviewed compensation-related resources obtained from staff in the Human Resources Management division of the University of Georgia's Carl Vinson Institute of Government.

To determine whether there were compelling reasons to transfer responsibility for Industrial Loan regulation to the Department of Banking and Finance, we interviewed Industrial Loan program administrators and field staff examiners on field visits to licensees. The audit team conducted site visits to three small loan offices. During these site visits, the team observed field examiners as they conducted audits of Industrial Loan program licensees. The audit team also conducted interviews of licensees during these site visits. We also interviewed Department of Banking and Finance staff about their regulatory duties and obtained agency documents, including forms and reports. We also conducted interviews with program staff, conducted site visits, and compiled laws, regulations, forms, reports and other information about programs responsible for regulating small consumer loans in twelve selected states. We also obtained information from officials at professional and research organizations, including the National Association of Consumer Credit Administrators and Conference of State Bank Supervisors.

This special examination was not conducted in accordance with generally accepted government auditing standards (GAGAS) given the timeframe in which the report was needed. However, it was conducted in accordance with Performance Audit Division policies and procedures for non-GAGAS engagements. These policies and procedures require that we plan and perform the engagement to obtain sufficient, appropriate evidence to provide a reasonable basis for the information reported and that data limitations be identified for the reader.

Appendix B: Type and Source of Revenue Collected by Program, Fiscal Year 2017

Type	Description	Authorization	Amount Charged	Amount Collected
		Enforcement		
Legal				
Fees	Document processing fees	§§ 33-4-3, 33-5-52, 33-15-120, 33-23-31	$14	$540
Penalties	Administrative fees for orders	§§ 33-2-24, 33-6-8, 33-6-9	Varies by type of order	$2,612,094
		Fire Safety		
Fire Safety				
Fees	Building certifications and plan reviews	§§ 25-2-1, 25-2-4 & 25-2-12	$100 to $220	$270,425
	Hazardous materials licenses and permits	§§ 25-2-1, 25-2-4, 25-2-16, 25-10-5, 43-25-3	$75 to $5,000	$536,736
	Industry licenses, filings, and permits	§§ 25-11-4, 25-11-5, 25-11-6, 25-11-7, 25-12-7, 25-12-8 Rule 120-3-23	$25 to $175	$173,700
	Manufactured housing inspections, permits and licenses	§§ 8-2-135, 8-2-161, 8-2-164	$15 to $440	$334,265
Penalties	Late payments, bank and other fees	§ 8-2-135	Varies	$4,780
Safety Engineering				
Fees	Permits, applications, and certifications	§§ 8-2-1, 25-2-4, 25-2-20, 25-15-1, 25-15-10, 25-15-50, 25-15-80	$25 to $5,000	$5,048,903
		Industrial Loan		
Industrial Loan				
Taxes	Monthly and quarterly tax on interest collected	§ 7-3-19	3% of interest collected	$3,037,927
Fees	Application and investigation fees	§§ 7-3-8 and 7-3-22	$500 per application; $250 per investigation	$33,000
	License renewal	§ 7-3-10	$500 annually	$473,500
Penalties	Late and fraudulent tax payments	§ 7-3-21	$5 or 25% of amount, whichever is greater for late payments; 50% of the amount due for fraudulent payments	$9,155
		Insurance Regulation		
Agent Licensing				
Fees	License, renewal, permit, and certification fees	§§ 33-8-1, 33-8-8 Rule 120-2-3	$5 to 150	$39,739,119
Penalties	Late fee for filings	§ 33-8-1	$15	$56,060
Administrative Procedures				
Fees	Photocopies for open records requests	§ 50-18-71	$0.10 per page or $5 per disc	$151
Captives & Limited Risk				
Fees	Captive license and filing fees	§§ 33-8-1 & 33-41-5	$50 to $500	$32,400
	Limited risk certification and renewal fees	§§ 33-8-1, 33-22-1, 33-23-100, 33-34-1, 33-35-1, 33-40-1, 33-45-1, 33-59-1, 33-61-1, 33-64-1, 38-8-1	$5 to $600	$273,715
Insurance Financial Oversight				
Fees	License, license renewal, filing and other fees	§§ 33-8-1	$0.25 to $5,000	$983,013

Insurance Product Review				
Fees	Insurance company filing fees	§§ 33-8-1 and 33-59-1	$10 to $1,000	$1,819,820
Premium Tax				
Taxes	State Premium Tax	§§ 33-5-31, 33-5-33, 33-8-4, 33-8-6, 33-40-5, 33-41-22	Based on the premium paid by insurance companies; due quarterly	$480,154,152
	Local Premium Tax	§ 33-8-8	Based on the premium collected; due annually by August 1st	$568,075,401
Assessments	Special Fraud Assessment	§ 33-1-17	Based on the premium written; due annually by September 1st	$4,358,117
Penalties	Late fees	§§ 33-5-32 & 33-8-6	10% of the amount due and interest of 1% per month or any portion of a month until payment	$3,553,081
Source: OCI and *Georgia Revenue and Reserves Report*				