



Department of Legislative Services
Office of Legislative Audits

Maryland Automobile Insurance Fund

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Presentation to
Joint Audit Committee

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Audit Overview

- The Maryland Automobile Insurance Fund (MAIF) operates under the provisions of Title 20 of the Insurance Article.
 - MAIF consists of two Divisions:
 - The Insured Division provides automobile liability and property damage insurance coverage primarily on personal vehicles to Maryland residents who are unable to obtain coverage from private insurance carriers.
 - The Uninsured Division is responsible for paying claims to eligible victims of traffic accidents caused by operators of uninsured or unidentified vehicles.
 - CY 2008 paid claims totaled \$108 million. Operating expenditures totaled \$50.6 million.
 - The audit report contained 5 findings.
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Key Audit Issues

- During CY 2008, MAIF's Board of Trustees approved changes to the employee bonus program for that year that allowed for the payment of employee bonuses totaling \$1.4 million, the majority of which would not have been paid without those changes.
- MAIF incurred certain expenditures that may not be consistent with MAIF's primary mission as a State-created insurer of last resort.
- MAIF did not follow its established procurement procedures for certain transactions, nor always maintain sufficient documentation for credit card expenditures.



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Employee Bonuses – Policy Issue

- During CY 2008, MAIF's Board of Trustees approved changes to certain critical requirements of MAIF's employee bonus program for that year. (Finding 1)
- Although within its authority, we question the timing and appropriateness of those changes. The changes occurred during the applicable year after it became apparent the original requirements would not be met. Also, MAIF incurred a net loss for the year.
- Changes allowed for the payment of bonuses totaling \$1.4 million, instead of \$250,000 that would have been paid under the original requirements.



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Employee Bonuses (continued)

- MAIF's bonus program, as initially established for CY 2008, required that certain financial and non-financial goals be met as a condition for paying bonuses to employees.
- In June 2008, the Board revised the financial goal, thereby allowing bonuses to be awarded for lower financial results than initially required, such as lower premium income, higher losses or expenses, or combinations thereof . (See Exhibit A – Combined Ratio Goal). This change accounted for 75 percent of the \$1 million in bonus payments made to *non-management* employees.



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Employee Bonuses (continued)

- In December 2008, the Board essentially waived another requirement that MAIF must have a net income gain* before paying bonuses to *management /executive* employees.
 - MAIF ended CY 2008 with a net loss of approximately \$19.6 million. (See Exhibit B – Calculation of CY 2008 Net Loss)
 - All management and executive employees (approximately 30) received bonuses totaling \$407,000. This amount was reduced from what would have been paid if MAIF had incurred a net income gain.
- * Based on the results of both insurance and investment activities.



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Employee Bonuses (continued)

- MAIF advised that these program changes were necessary and justified, in part, because current economic trends were competing and undercutting the appropriateness of the goals.
- MAIF also noted that the CY 2008 net loss was not the result of underperformance on the part of management employees, but the result of “deliberate decision making on the part of management in response to radically altered corporate imperatives” as well as the effects of the worldwide financial crisis.



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Disclosure of Certain Expenditures - Policy Issue

- Disclosure of certain expenditures should be made as part of the annual budget submission to legislative committees. (Finding 2)
 - MAIF incurred certain expenditures that appeared inconsistent with the primary mission of a State-created entity designated as an insurer of last resort.
 - During CY 2008 and 2009 (through May 31), MAIF expended approximately:
 - \$96,000 for strategic consulting services
 - \$81,000 for marketing, public relations, & advertising
 - \$74,000 for lobbying services
 - Expenditures were also incurred for producer appreciation events, such as \$15,000 for catering and space rental, and \$9,000 for corporate sponsorships.



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Disclosure of Certain Expenditures (continued)

- MAIF receives no general funds, and currently submits its budget to the General Assembly for informational purposes only. The budget submission does not include the type of detailed expenditure data noted here.

- State law does not prohibit these expenditures and MAIF considers such expenditures necessary to help it successfully fulfill its mission. While created as an insurer of last resort, State law does allow MAIF to provide coverage to preexisting customers, which effectively places a segment of MAIF's business in competition with private insurers.



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Procurements and Disbursements

Procurement transactions processed by MAIF were not always consistent with procedures established in its *Procurement Procedures Manual*. (Finding 3)

- Written documentation justifying the use of the sole source procurement method was not on file as required for 3 service agreements procured in this manner. Expenditures for these 3 contracts, which were for certain consulting and marketing services, totaled approximately \$287,000 between January 2007 and May 2009.
- A written contract was not on file for certain maintenance services which MAIF had been receiving for approximately 11 years. Payments to this vendor during CY 2008 totaled approximately \$20,000.



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Other Payment Issues

- Sufficient documentation was not always obtained to support credit card expenditures. For example, detailed supporting receipts were not on file for 51 of 61 credit card expenditures examined totaling \$14,100. These expenditures included, for example, restaurant billings totaling approximately \$4,000. (Finding 4)
- Certain payments to plaintiff attorneys were not reported in accordance with IRS regulations due to incomplete vendor coding information in MAIF's records. Our test of five such payments, totaling \$100,000, made by the Uninsured Division during CY 2008 disclosed that the required IRS Form 1099 had not been issued for any of the payments. Attorney payments by the Division totaled \$1.3 million during CY 2008. (Finding 5)



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Conclusion

- MAIF's Board of Trustees should not significantly revise or waive critical requirements of MAIF's employee bonus program to allow for the payment of bonuses after the requirements have been approved and the applicable year has begun.
 - MAIF should report to the legislative budget committees detailed budget and expenditure data for consulting and lobbying services, marketing and public relations costs, as well as expenditures for producer related events, corporate sponsorships, and similar outreach initiatives.
 - MAIF should ensure that all procurement transactions are consistent with its *Procurement Procedures Manual*.
 - MAIF should ensure that appropriate support is obtained for all expenditures, that its records of attorney payments are complete, and that IRS reporting requirements are met.
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Exhibit A - Combined Ratio Goal

The combined ratio goal equals the total underwriting expenses (losses + loss adjustment expenses + other underwriting expenses) divided by premiums earned. To be eligible for bonuses, the achieved percentage must be at or below the established goal percentage.

- Combined ratio goal approved in 12/07 for CY 2008 bonus program was:

$$111.6\% = \frac{\text{projected expenses } \$149.5 \text{ million}}{\text{projected premiums } \$134 \text{ million}}$$

- Goal was changed from 111.6 % to 120% in 6/08.
- Achieved combined ratio for CY 2008 was:

$$118.8\% = \frac{\text{actual expenses } \$144.4 \text{ million}}{\text{actual premiums } \$121.5 \text{ million}}$$



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Exhibit B - Calculation of CY 2008 Net Loss

MAIF's audited financial statements for CY 2008 indicated a net loss of approximately \$19.6 million.

- Insured Division;

Premiums earned	\$121,561,000
Total underwriting expense	(<u>144,467,000</u>)
Net underwriting loss	(22,906,000)
Total investment Income	2,109,000
Other income	<u>71,000</u>
Net loss	(\$20,726,000)

- Uninsured Division;

Total revenues	\$4,409,000
Total expenses	(<u>3,281,000</u>)
Net income	\$1,128,000

- MAIF Net Loss (\$19,598,000)
