



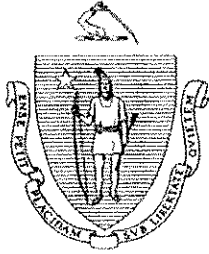
COMMONWEALTH OF MASSACHUSETTS
OFFICE OF CONSUMER AFFAIRS AND BUSINESS REGULATION
DIVISION OF INSURANCE

REPORT OF LIMITED SCOPE EXAMINATION OF
HEALTH NEW ENGLAND, INC.
&
HNE INSURANCE COMPANY, INC.
Springfield, Massachusetts

NAIC GROUP CODE 04756
NAIC COMPANY CODE 95673 & 14198
EMPLOYERS ID NO. 04-2864973 & 45-4462433

HEALTH NEW ENGLAND, INC.
& HNE INSURANCE COMPANY, INC.

| TABLE OF CONTENTS | <u>Page</u> |
|---|--------------------|
| Salutation | 1 |
| Scope of Examination | 2 |
| Background | 3 |
| Summary of Procedures | 4 |
| Understanding Audit Work Performed by Deloitte & Touche LLP | 4 |
| Meet with HNE Management | 6 |
| Exam Recommendation | 6 |
| Accounting Department Organizational Chart | 7 |
| Exam Recommendation | 7 |
| Perform Walkthrough of Journal Entry and Account Reconciliation | 8 |
| Exam Recommendation | 9 |
| Signature Page | 10 |



COMMONWEALTH OF MASSACHUSETTS
Office of Consumer Affairs and Business Regulation
DIVISION OF INSURANCE

1000 Washington Street, Suite 810 • Boston, MA 02118-6200
(617) 521-7794 • Toll-free (877) 563-4467
<http://www.mass.gov/doi>

CHARLES D. BAKER
GOVERNOR

KARYN E. POLITO
LIEUTENANT GOVERNOR

MIKE KENNEALY
SECRETARY OF HOUSING AND
ECONOMIC DEVELOPMENT

EDWARD A. PALLESCHI
UNDERSECRETARY OF CONSUMER AFFAIRS
AND BUSINESS REGULATION

GARY D. ANDERSON
COMMISSIONER OF INSURANCE

April 17, 2019

Honorable Gary D. Anderson
Commissioner of Insurance
Commonwealth of Massachusetts
Division of Insurance
1000 Washington Street, Suite 810
Boston, MA 02118-6200

Honorable Commissioner,

Pursuant to your instructions and in accordance with Massachusetts General Laws, Chapter 176G, Section 10, a limited scope examination has been made of the financial condition and affairs of

HEALTH NEW ENGLAND, INC.
&
HNE INSURANCE COMPANY, INC.

at its home office located at One Monarch Place, Suite 1500, Springfield, Massachusetts, 01144.
The following limited scope report thereon is respectfully submitted.

SCOPE OF EXAMINATION

We have performed this limited scope examination over the controls related to financial reporting of Health New England, Inc. and HNE Insurance Company, Inc. (hereinafter referred to as “HNE” or “the Company”). Our examination was conducted based on the procedures agreed upon with the Massachusetts Division of Insurance (“Division”) for the purposes of reviewing corrective actions implemented by HNE in response to a material internal control weakness and a significant deficiency identified by the Company and their independent auditor, Deloitte & Touche LLP (Deloitte) during the 2016 Model Audit Rule review and statutory financial statement audit.

The purpose of the exam was to:

1. Gain an understanding of the material weakness and significant deficiency related to the Company’s journal entry and account reconciliations processes, respectively.
2. Gain an understanding of the audit work performed by Deloitte related to the material weakness and significant deficiency, by:
 - Discussing with Deloitte the material weakness and significant deficiency identified during the 2016 statutory financial statement audit, and persistence of controls issues identified during the 2017 statutory financial statement audit.
 - Gaining an understanding of the level and extent of additional testing performed as a result of the control deficiencies.
 - Reviewing the testing performed during the 2017 statutory financial statement audit related to these control deficiencies.
3. Meeting with members of HNE’s Management in order to understand,
 - Causes of these control deficiencies.
 - Oversight of the corrective action implemented.
 - Involvement of the Compliance/MAR Department in implementing and assessing the corrective action.
4. Performing a walkthrough of the Company’s updated journal entry process.
5. Performing a walkthrough of the Company’s updated account reconciliation process.

This report is a limited scope examination and as such, it is not intended to communicate all matters of importance for an understanding of the Company’s financial position. The purpose of limited scope examinations are to review specific aspects of operational processes, perform specific procedures with respect to those aspects, and report as to the examiner’s findings thereon. By definition, limited scope examinations are less comprehensive than full scope examinations and generally focus on areas identified by the Division to be problem areas or potential problem areas.

BACKGROUND

A material internal control weakness and a significant deficiency were identified by the Health New England, Inc. & HNE Insurance Company (“HNE” or “the Company”) entities and their independent auditor, Deloitte & Touche LLP (“Deloitte”), during the performance of the 2016 Model Audit Rule (“MAR”) review and statutory financial statement audit, respectively, and included in the 2015 Examination Reports issued for HNE as a subsequent event. In addition, the Examination Report included the following recommendation:

“The Division recommends management continue to implement all identified internal control improvements to assure the noted material weaknesses and significant deficiencies are successfully mitigated. The effectiveness of these new internal controls should be tested and the controls should be incorporated into the annual MAR Controls Assessment process.”

In connection with its audit of the 2016 statutory basis financial statements, Deloitte issued an Internal Control Letter dated May 31, 2017, to the Board of Directors (“Board”), which reported the following material weakness and significant deficiency:

- Material Weakness: “The Company’s internal controls over manual journal entries did not operate effectively. Specifically, there were instances where recoded manual journal entries: (a) were prepared and approved by the same individual, (b) did not have evidence of reviewer approval, (c) were reviewed by an individual subordinate to the preparer, and (d) did not include supporting documentation in the journal entry binder in accordance with the Company’s internal control policy.”
- Significant Deficiency: “The Company’s internal controls over account balances include monthly account reconciliations of all balance sheet accounts. These reconciliations are prepared by the Accounting Manager and reviewed by the Controller or Director of Financial Reporting. The review includes, among other procedures, obtaining an understanding of the reconciling items between the subsidiary ledger balances and the general ledger balances and investigating any variances or unusual items, and posting adjusting entries to the general ledger on a timely basis to reflect the reconciled balance. During 2016, Deloitte noted instances where monthly account reconciliations were not prepared and reviewed timely and did not include adequate support for all reconciling items.”

The Internal Control Letter to the Board included management’s responses for corrective action.

SUMMARY OF PROCEDURES

Gain an understanding of the audit work performed by Deloitte related to the material weakness and significant deficiency.

Deloitte has been engaged as the Company's external auditors for a number of years including the years ending December 31, 2016 and December 31, 2017. In connection with their audit of the statutory-basis financial statements of the Company, as of and for the years ended December 31, 2016 and December 31, 2017, in accordance with generally accepted auditing standards, Deloitte considered the Company's internal controls over financial reporting as a basis for designing audit procedures; though not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting.

Deloitte communicated the above referenced material weakness and significant deficiency as a result of the procedures performed during the audit of the financial statements of the Company for the year ended December 31, 2016. Deloitte noted, through the audit of the financial statements of the Company for the year ended December 31, 2017, that while the material weakness has been remediated, the significant deficiency related to the internal controls over monthly account reconciliations of all balance sheet accounts had not been remediated.

Meeting with Deloitte Audit Team

The Examiners conducted a meeting with members of the Deloitte engagement team. During the meeting, the Examiners inquired as to the testing performed by Deloitte to identify the deficiencies and in response to them, the Auditor's opinion on why the deficiencies occurred, why they continued, and the expectation for the results of the testing related to these deficiencies within the 2018 Audit.

Deloitte indicated that contributing factors include management turnover; including the Chief Financial Officer ("CFO") position, an understaffed accounting department, and lack of a modern IT environment limiting the ability to automate aspects of, and/or the entire process which would have provided for more efficiency and effectiveness.

During our discussion with Deloitte, it was indicated that the Internal Controls Letter issued for the benefit of the Massachusetts Division of Insurance will indicate; pending remediation of the significant deficiency related to the internal controls over monthly account reconciliations, that there are no un-remediated internal controls issues as of December 31, 2018. Deloitte did not perform a test of the effectiveness for the new reconciliation software, FloQast implemented as part of the corrective action plan. Deloitte will perform control and substantive testing procedures over the reconciliation process through procedures designed for significant accounts.

Review of Deloitte Audit Work Papers

Account Reconciliations Testing

Deloitte's testing of the reconciliation process was incorporated into the substantive testing procedures related to material/significant accounts. Deloitte's testing, in addition to the substantive testing, included a determination that reconciliations were performed and reviewed timely and that any variances were researched and resolved. In order to understand the testing performed by Deloitte we reviewed the cash year end testing.

Our review disclosed that Deloitte noted that variances in the cash operating account were identified and investigated by the Controller. As a result, certain adjusting journal entries were proposed to reconcile the bank accounts to the cash operating account balance per the general ledger. It was noted that the Company planned to make these adjustments during 2018 to correct the balances as opposed to posting the entries as of December 31, 2017. Deloitte tested the adjusting journal entries proposed in order to determine accuracy and completeness of the reconciling items.

As a result of the review, Deloitte concluded that the reconciliation was not performed timely and support for the reconciliation was not evidenced. Giving consideration to prior audit period deficiencies noted as well as this current audit period testing conclusion; Deloitte determined the account reconciliation control exception resulted in a significant control deficiency.

Journal Entry Testing

Deloitte's Journal Entry Testing covered HNE and affiliated entities all of which utilize MAS90 as their general ledger system. Deloitte gained an understanding of the process, and performed an evaluation of the design and implementation of relevant controls over the journal entry process. The controls implemented includes posting of monthly adjusting journal entries to a monthly journal entry workbook ['Master File'] (i.e. an online file of adjusting journal entry support). Deloitte noted that the Company's Controller received the monthly Master File and was able to review the entries for the month as well as the electronically linked support. Preparer and reviewer sign-offs were indicated for each entry tested which indicated an appropriate segregation of duties. Supporting evidence for one of the entries was reconciled to the journal entry without exception and Deloitte noted evidence of the Controller's email to the CFO signifying approval of all journal entries. Deloitte's conclusion was that the design of the control was effective and that the control was implemented.

Deloitte also performed testing over the adjusting journal entry control review performed by the Company's Compliance/MAR Department, in which Deloitte verified the results of 60 journal entries tested by the Compliance Department. Deloitte reviewed the testing for 30 journal entries that were noted as no exceptions and 30 resulting in exceptions. The results of this review disclosed

that those entries with exceptions all resulted from the period prior to the date in which remediation action was implemented. Further, for the entries identified with control exceptions Deloitte verified the supporting detail to the entry and noted that no inappropriate journal entries were posted. Controls over the journal entry process subsequent to the implementation of the corrective action appears to be effective.

Deloitte also performed substantive detailed testing of adjusting journal entries. For the entries selected for testing, Deloitte determined the business rationale, that supporting documentation was complete and authentic, that the journal entry was posted in compliance with GAAP, and that the entry and support did not suggest fraud exists.

Meet with members of HNE's Management in order to understand the causes of the internal control deficiencies, the oversight of the corrective action implemented, and the involvement of the Compliance [MAR] Department in implementing and assessing the corrective action.

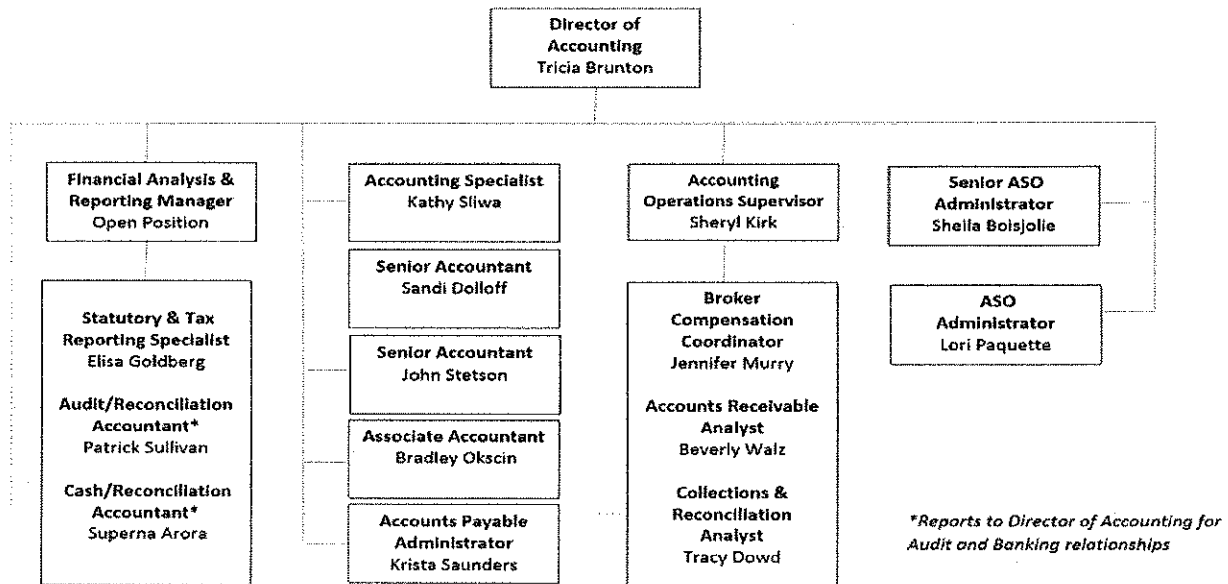
Causes of Deficiencies

A primary cause of the internal control deficiencies and the lack of timely remediation was the level of the Accounting Department staffing. Performing over 300 account reconciliations monthly as well as maintaining adequate segregation of duties within the journal entry process requires adequate staffing with experienced individuals. Also, as it relates to the account reconciliations, the lack of formal reconciliation process/procedures compounds the staffing issue.

Exam Recommendation: Understanding the Company's plan to respond to any vacancies experienced will provide context as to the length of time the Company is susceptible to additional control failures. We therefore recommend that the Division require the Company to provide periodic (e.g., quarterly) updates related to turnover within the organization, specifically related to those in Senior Management positions and those charged with Accounting/Financial Reporting responsibilities.

To rectify this issue, the Company restructured the Accounting Department. This included hiring a Director of Accounting. The prior head of the Accounting Department now holds the title of Director of Financial Reporting with responsibility for monitoring IBNR, risk sharing estimates, and general financial analysis.

The Accounting Department organizational structure is as follows:



In addition to restructuring the Accounting Department, the Company is creating formal, documented policies and procedures for the account reconciliations and adjusting journal entry processes. For example, an Accounting Handbook is being developed as a resource for the accounting staff and others within the Company to be able to fully understand the transactions of the Company and thus the entries being posted. At the time of review, it appeared that the policies and procedures related to account reconciliations and adjusting journal entries was substantially complete.

In addition, the Company plans to automate certain aspects of the account reconciliations and adjusting journal entry processes to reduce the risk of manual errors and potential for overriding of controls. While no timeline was provided for the automation of entries, it was indicated that this would be a priority following the effective implementation of the current corrective actions.

Risk of management override is persistent within these current manual processes. The Company disclosed an instance in which the current journal entry control process was overridden. Specifically, in 2018 a former employee would prepare entries and provide to a subordinate to post as the preparer; allowing for the individual who prepared the entry to post to the General Ledger as reviewer. The Company has implemented an attestation aspect to the process in response to this recent circumvention of the control.

Exam Recommendation: Automating the current manual journal entry process will reduce the risk of management override of controls and provide for a more efficient monthly close process. We therefore recommend that the Division require the Company set a timeline for automating this process, and provide the Division with periodic (e.g., monthly) updates on the progress.

Oversight

The Company's Compliance/MAR Department has been involved in the oversight and corrective action implementation in response to the control deficiencies. In this regard, the Compliance/MAR Department provides a sample selection of adjusting journal entries to the Audit/Reconciliation Accountant for review.

The Audit/Reconciliation Accountant is then responsible for determining that the entries selected exist and have been properly prepared and reviewed, that adequate segregation of duties exist between the preparer and reviewer, and that appropriate supporting documentation exists. On a quarterly basis, the Compliance/MAR Department performs a quality review to determine objectives were met and the controls are effective.

In addition, the Compliance/MAR Department reviews 100% of the reconciliations completed for the period for timeliness of completion, proper investigation of reconciling items and documented approval.

Compliance also performed a detailed review of the recently implemented reconciliation software, FloQast. In this regard, Compliance reviewed the administrative permissions to evaluate the ability for management override of reconciliation controls and made recommendations to mitigate this risk.

Overall, the process applied by the Compliance/MAR Department to validate these updated processes appear appropriate.

We also noted that the corrective actions taken by the Company have been reported to, and overseen by the HNE Board as well as the Audit Committee of the holding company, Baystate Health. We noted that regular updates have been provided to both the HNE Board the Audit Committee.

Perform a walkthrough of the Company's updated journal entry and account reconciliation processes

The Examiners performed a walkthrough of the Company's updated journal entry and account reconciliation processes.

Journal Entry Walkthrough

The process begins monthly with the creation of the monthly journal entry workbook. The detail included in the monthly workbook consists of entry details, entry owner, input date, approver, approval date, journal entry number, support link, and additional notes. The information within each monthly workbook is populated manually, though standard journal entries are listed in each workbook created and color coded yellow.

Various individuals within the Accounting Department will record entries into the monthly journal entry workbook related to the line of business they are primarily responsible for (i.e., Medicare, Medicaid, Commercial). The Accounting Department receives notifications of entries necessary for the month from the various departments within the organization. Information entered into the monthly journal entry workbook includes links to detailed documentation supporting the entry.

Once the journal entry workbook is completed for the month, the entries are reviewed and approved. The reviewer/approver, who is separate from the preparer, initials the detail and the entry in the monthly journal entry workbook to evidence review.

Account Reconciliation Walkthrough

As previously noted, the Company implemented a new reconciliation software tracking package, FloQast. FloQast allows the Company to provide a tracking function for the reconciliations performed manually by the Department. In addition, FloQast provides for time stamps of activities within the system so that timing of reconciliations and outstanding items can be evaluated. FloQast also allows for some formality around notifications within the reconciliation process; including notifications when a reconciliation is past due, when a review note was added to an account, or when there is a variance in the reconciliation amounts noted as complete.

On a monthly basis, the reconciliation process begins with a closing of the books and upload of Trial Balance information for the month into the newly implemented FloQast software. Once information is loaded into FloQast, the accounting staff can begin their review.

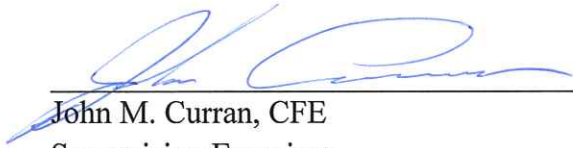
Accounting staff will prepare the reconciliations within an Excel File. Reconciliation support is maintained within a cloud storage account, in order to restrict access to support and monitor deleting of information; which ensures reconciliations and support are secure and maintain accuracy. Once a reconciliation is complete, the supporting documentation is linked to the account balance posted in FloQast.

As the Trial Balance for the month is finalized a re-upload is performed into FloQast. FloQast will send a warning message to each user if a balance has changed or if an account marked as signed off (i.e. reconciled) is out of balance. The staff accountants will not sign-off on account reconciliations within FloQast until the final Trial Balance has been uploaded and reconciliation amounts are confirmed.

Exam Recommendation: The account reconciliation process was still considered a significant deficiency as of December 31, 2017. We therefore recommend that the Mass DOI require the Company and Deloitte to provide a summary report of the results of the review of the account reconciliation process performed in conjunction with the 2018 audit.

SIGNATURE PAGE

Acknowledgement is made of the cooperation and courtesies extended by the officers and employees of the Company during the examination. In addition, the assistance provided by Philip G. Talerico and Lester Schott from the firm of Baker Tilly Virchow Krause, LLP is hereby acknowledged.



John M. Curran, CFE

Supervising Examiner

Examiner-in-Charge

Massachusetts Division of Insurance