

IN THE MATTER OF THE INDIVIDUAL	)	
HEALTH COVERAGE PROGRAM BOARD'S	)	IHC ADMINISTRATIVE ORDER
AGREED UPON PROCEDURES REVIEW	)	No. 09-IHC-01
OF PROTECTIVE LIFE INSURANCE	)	Amending and Supplementing
COMPANY'S NET PAID LOSSES FOR	)	Administrative Order No. 04-01
CALENDAR YEARS 1997/1998 AND	)	
PROTECTIVE'S FAILURE TO REMIT ITS 1996	)	
LOSS ASSESSMENT	)	

This matter has been opened by the New Jersey Individual Health Coverage (“IHC”) Program Board of Directors (“Board”) pursuant to its authority set forth at N.J.S.A. 17B:27A-2 et seq., and all the powers expressed or implied therein. This matter involves Protective Life Insurance Company’s (“Protective”) request for reimbursement of reported net paid losses, and its failure to pay adjusted assessments resulting from the 2006 reconciliation of the 1996 loss assessment. For the reasons set forth below, the IHC Board has determined that Protective has failed to meet the conditions for reimbursement of losses for the 1997/1998 calculation period, and the Board orders that Protective repay, with interest, monies that the Board remitted and credited to Protective in anticipation of Protective’s satisfaction of the conditions for reimbursement of Protective’s reported losses, plus audit costs, reduced by credits taken to date by the IHC Program against the amount Protective owes. The IHC Board also denies Protective’s request for reconsideration of AO 04-01. Further, the IHC Board has determined that Protective has failed to pay in full its assessment for losses incurred for the 1996 calculation period, and orders Protective to pay the assessed amount plus all related late fees.

**BACKGROUND**

**General Purpose and Actions of the IHC Program**

The IHC Board was created pursuant to N.J.S.A. 17B:27A-10 as part of the enactment of L. 1992, c. 161 (N.J.S.A. 17B:27A-2 et seq.) (the "IHC Act"), which was intended to address a crisis in the availability of individual health coverage. To increase availability of individual health coverage, the IHC Act provided two incentives for carriers to offer individual health

benefits plans: (1) reimbursement of losses; and, (2) exemptions from loss assessments.<sup>1</sup> The first incentive permitted carriers that wrote individual health benefits plans to seek reimbursement of some of the losses the carriers incurred for the individual health benefits plans written (N.J.S.A. 17B:27A-12a(1)(b)). Reimbursements for the losses were funded by assessments on members of the IHC Program (“loss assessments”). With rare exception, carriers that have inforce health benefits plans in New Jersey are IHC Program members, regardless of whether a carrier offers health benefits plans in the individual, small employer, and/or large employer markets.<sup>2</sup> In general, carriers bear some liability for loss assessments *whether or not they actively participate* in the individual market. The second incentive presented carriers with the option to seek an exemption from the loss assessment liability **if** the carrier enrolled an assigned number of individual lives in individual health benefits plans (N.J.S.A. 17B:27A-12d).<sup>3</sup>

The IHC Board promulgated regulations at N.J.A.C. 11:20 to implement the IHC Act pursuant to its authority at N.J.S.A. 17B:27A-11. The IHC Board set forth standards for reporting losses at N.J.A.C. 11:20-8. By regulation, every IHC Program member was required to file an Assessment Report no later than March 1 following the end of each calculation period,<sup>4</sup> providing information about the net paid losses asserted to have been incurred by each member.<sup>5</sup>

N.J.S.A. 17B:27A-11 authorizes the IHC Board to establish standards for determining whether reported unaudited net paid losses are appropriate for reimbursement. Thus, the IHC

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<sup>1</sup> It should be noted that references throughout are to versions of statutes and regulations effective for the 1997/1998 calculation period. P.L. 2008, c. 38, enacted July 8, 2008, specified that the loss reimbursement mechanism ended with the 2007-2008 calculation periods.

<sup>2</sup> N.J.S.A. 17B:27A-2 defines when a carrier is not considered to be a member of the IHC.

<sup>3</sup> Carriers had to elect an exemption prior to the calculation period in question. A carrier could not seek both reimbursement for losses and an exemption from loss assessments for the same time periods. (N.J.A.C. 11:20-9.2(b)3.)

<sup>4</sup> The loss calculation period was originally a one year period, but became a two-year cycle pursuant to P.L. 1997, c. 146. The Assessment Report for the 1997/1998 calculation cycle was due in March 1999.

<sup>5</sup> The Assessment Report is more commonly referred to as Exhibit K because it is found at Exhibit K of the Appendix to the IHC Board's regulations.

Board requires an audit of the information supporting the reported losses by independent auditors under contract with the Board (see, N.J.A.C. 11:20-8.8). Upon the conclusion of an independent loss audit, and based on the findings set forth in the independent loss audit report, the IHC Board will determine whether or not all or a portion of the net paid losses set forth in the a carrier's Assessment Report will be reimbursed. A carrier seeking reimbursement of losses is obligated to cooperate in the conduct of an audit, or, in the case of carriers seeking reimbursement of net paid losses of less than \$1,000,000, an "agreed upon procedure" (AUP). See N.J.A.C. 11:20-2.8.

### **Protective's 1997/1998 Reported Net Paid Losses and the AUP Report**

Because of the amount of Protective's reported net paid losses for the 1997/1998 calculation period (\$577,505), the IHC Board's contracted auditor, Deloitte & Touche (D&T), was to perform an AUP with respect to Protective's request for reimbursement of that amount. As it did with other carriers in the individual market seeking reimbursement for losses, the IHC Board advanced funds to Protective prior to the commencement of the AUP, subject to completion of the AUP, as acknowledged by Protective in a certification dated December 15, 1999. Protective eventually stated that it was unable to provide required records for 11 consecutive months of the 24-month period under review. Primarily because of the 11 months of missing premium records, D&T's draft AUP report indicated Protective's supporting documentation was inadequate to verify the amount of the losses Protective had reported. On August 5, 2004, the IHC Board demanded return of monies remitted or credited to Protective based on Protective's reported net paid losses via Administrative Order 04-01 ("AO 04-01"). The content of AO 04-01(attached for ease of reference), setting forth the facts from February 1999 through August 2004, in addition to the IHC Board's specific demands, is repeated herein and incorporated as a part of this Administrative Order.

On September 10, 2004, Protective requested an extension of the deadline for filing an appeal of AO 04-01, so that Protective could again try to get information from its former partner, American Chambers Life Insurance Company (American Chambers). American Chambers administered Protective's New Jersey Individual Health line of business (which was offered through Protective's group and dental division) and maintained and had possession of Protective's files when American Chambers was put into rehabilitation and then liquidation by the Ohio Commissioner of Insurance in May of 2000. The IHC Board granted Protective's request, but in a letter dated September 15, 2004 stated that the provisions of AO 04-01 remained in effect, with interest continuing to accrue on the amounts owed. Then, on January 11, 2005, the IHC Board sent a notice to Protective stating that the company had 20 days to provide adequate documentation and working papers to D&T so that the auditor could proceed with the AUP, or the IHC Board would take further action against Protective. In response, Protective provided materials to D&T on January 31, 2005, and followed-up with emails to D&T on April 4 and May 6, 2005. In the interim, Protective did not file an appeal, and the IHC Board did not enforce AO 04-01.

D&T considered the additional information from Protective, which included a report by an auditor hired by American Chambers, Topel Forman LLC ("Topel"), dated May 11, 1999. Topel performed a review of some of the underlying accounting records of Protective and American Chambers with respect to the IHC block of business. Protective proffered the Topel Report as a substitute for the 11 months of premium records that Protective had been unable to produce. D&T requested additional information regarding both the Topel Report and an investment income calculation included in Protective's Assessment Report.<sup>6</sup> D&T reviewed

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<sup>6</sup> Specifically, D&T asked: (1) whether the period from January through November 1997 (the time period for which records became unavailable) was included in the Topel report, and if so, whether it could be verified that specific

responses provided by two letters dated March 30, 2005, and May 5, 2005, from a Topel partner, but eventually advised the Board that D&T did not intend to alter the draft AUP report, originally dated November 6, 2002, based on any information provided. On June 29, 2005 the IHC Board issued a letter to Protective stating the IHC Board did not consider the Topel Report to be an appropriate substitute for the 11 months of missing information, and requested that Protective provide documents to address the open items in D&T's draft AUP Report no later than July 15, 2005.

By a letter dated July 15, 2005, Protective submitted documentation, and presented an argument on the doctrine of substantial compliance. In asserting that it had taken a series of steps to comply with the law and its purpose and to provide a reasonable explanation why strict compliance had not occurred, Protective essentially stated that: (1) without warning, Protective had lost access to the records in American Chambers' possession and had unsuccessfully and with great difficulty attempted to locate the information requested; (2) Protective's group and dental division was sold in 2001 to Fortis, so Protective no longer had direct access to the employees with knowledge of the business or the employee who oversaw the business, who had retired in 2000 (and passed away several years later); (3) Protective had offered explanations of the discrepancies between the 1997 and 1998 Annual Statements and the 1997-1998 Assessment Report via the affidavit of Ms. Rita Fulton,<sup>7</sup> submitted with the January 31, 2005 package of information; (4) although unable to produce a detailed listing by policy of the New Jersey individual business premium earned for 1997, Protective has produced the requested information

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selections were made from that time period; (2) whether Topel made their selections from a population detail that in total reconciled to the summary reports; and (3) whether the report represented the results of an attestation engagement in accordance with the standards established by the AICPA.

<sup>7</sup> Protective had previously produced an affidavit from William McMullen (a Vice President of Protective), and Rita Fulton (a Vice President and actuary for Protective), but for purposes of its July 15th letter and subsequent statements, referred solely to the affidavit of Rita Fulton.

for December 1997 through December 1998, and D&T has found no exceptions or discrepancies with respect to that information (citing, AUP Report, SA. 1-A.6); (5) Protective has produced a one-page summary-by-state report for all months of the calculation period, plus the Topel Report regarding earned premiums and claims paid included randomly-selected billing statements for the period in question, including the January through November 1997 period, and “did the same with respect to the report of Claims Paid, verifying that the summaries of claims paid matched the monthly claims journals”; and, (6) Topel confirmed through its May 5, 2005 letter that the May 1999 engagement was “an attestation engagement in accordance with the standards established by the AICPA”.<sup>8</sup>

Based upon the arguments in the letter, the Board assumed Protective wished to perfect its appeal, and issued a letter on August 10, 2005 requesting that Protective complete its appeal in accordance with N.J.A.C. 11:20-20.2(a) no later than August 30th by submitting a concise statement of the material facts in dispute and describing the basis(es) on which Protective believed the IHC Board’s finding of facts in AO 04-01 were erroneous. The IHC Board stated that AO 04-01 remained in effect, and that interest continued to accrue on the monies due. In addition, the IHC Board noted it had forwarded Protective’s documentation contained in and with Protective’s July 15, 2005 letter to D&T, and was awaiting formal input from the auditor.

Protective submitted the requested statements on August 29, 2005, articulating material facts in dispute in apparent furtherance of its substantial compliance argument as follows: (1)

Protective had produced policy-specific premium and claim information for the period of

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<sup>8</sup> Topel’s May 5, 2005 letter was a follow-up to a March 30, 2005 letter to Wayne Stuenkel, a Senior Vice President at Protective, both of which were submitted to the Board. The March 30th letter stated the following: “1) The year ended December 31, 1997 did include January 1997 through November 1997, which were included in the sampled population. 2) Our sample selection was from the entire population, which was reconciled in total to the summary reports. 3) Our report represented agreed-upon procedures as requested by the New Jersey Individual Health Program. Those procedures were disclosed within our report dated May 11, 1999.” The May 5th letter clarified that Topel had performed its review subject to an AUP with American Chambers, not the IHC Board, in addition to clarifying that the engagement was an attestation agreement in line with the AICPA standards.

December 1997 through December 1998 in support of its Exhibit K filing; (2) Protective and American Chambers engaged Topel in May 1999 to review the Exhibit K filing with respect to earned premium and claims paid through random sampling; (3) the Topel engagement was an attestation engagement in accordance with AICPA standards, thus establishing the veracity of the information reported in the Exhibit K; (4) through an affidavit, it had established that differences in the Exhibit K, Annual Statement and the draft AUP were the result of other lines of business included with the IHC policies in the premium and claims numbers set forth in the Annual Statements; and, (5) it had fully established its entitlement to reimbursement.

On September 30, 2005, D&T notified the IHC Board that the information Protective submitted on July 15, 2005 did not provide any additional information to support the items D&T had identified as exceptions in the draft AUP report. D&T went on to suggest that, if Protective would submit a signed management representation letter, D&T would proceed to issue the AUP Report as it then existed. D&T subsequently drafted a management representation letter and sent it to Protective.

Protective sent a letter to D&T, with a copy to the IHC Board, dated June 26, 2006, stating that certain of the proposed representations in the draft management representation letter were inappropriate and/or inaccurate. Specifically, Protective argued it would be inappropriate for it to acknowledge responsibility in accordance with paragraph 1 of the management representation letter “for the fair presentation in the statement of net paid losses for New Jersey individual business in conformity with accounting practices prescribed or permitted by the State of New Jersey Department of Banking and Insurance as set forth in N.J.A.C. 11:20-8.1-6” when there was a contested matter from Protective before the IHC Board. Protective also disagreed with the second numbered sentence in the management representation letter, which

acknowledged that Protective had not fully responded to certain specific inquiries from D&T. In addition, Protective disagreed with inclusion of a statement that it had “no knowledge of significant matters related to the net paid losses for New Jersey individual business that are contrary to [D&T’s] findings” because Protective believed its calculation of net paid losses in the 1997/1998 Exhibit K was fair and accurate. Protective further stated it was amenable to executing a revised management representation letter if D&T would be willing to amend the letter to reflect Protective’s concerns.

Following continued correspondence between D&T, Protective, and the IHC Board, in January 2007, Protective signed a revised management representation letter prepared by D&T, but appended substantial documentation to it. D&T could not accept the management representation letter until it evaluated the appended documentation. Following its review, D&T agreed to accept inclusion of the appended documentation if further revisions to the management representation letter could be made. D&T again attempted to engage in discussions with Protective to revise the management representation letter as well as the AUP Report.

On September 4, 2008, D&T sent an email to Protective suggesting final changes to the management representation letter and the AUP Report that would: (1) for purposes of the management representation letter, acknowledge that the AUP is not an audit; and, (2) for purposes of the AUP Report: (i) revise paragraph A.6 of the AUP to acknowledge that Protective offered the affidavit of Rita Fulton as an explanation of the differences in premium earned as reported in the Exhibit K and Protective’s Annual Supplements; and, (ii) state that Protective did not provide a detailed inventory of premiums including the IHC Program coverage.



Shortly afterwards, D&T requested help from the IHC Board's staff in contacting Protective, which was no longer returning calls from D&T. Following efforts by the IHC Board to discuss the matter more fully with Protective's local counsel, Protective sent a letter to the IHC Board, dated June 8, 2009, asserting that D&T's requested modifications are inappropriate under the circumstances, and unnecessary to the Board's evaluation of Protective's Assessment Report.

Protective's June 8th letter indicates that Protective's position is that it signed a management representation letter in January 2007. Protective does not reference the material appended to the management representation letter it signed and submitted. Protective states that the information D&T wishes to include (clarification that the review involves an AUP rather than an audit) is inappropriate for a management representation letter, since Protective has no control over what process or methods D&T uses. Further, Protective states that it is not required to agree to anything stated in D&T's AUP Report, and asserts that the change suggested by D&T involves a disputed material fact as set forth in Protective's August 29, 2005 letter supplementing its hearing request. Protective went on to request that the IHC Board reconsider AO 04-01 based on Protective's additional submissions following issuance of AO 04-01, and the unique circumstances involved, stating that Protective is "entitled to retain the loss reimbursements in question based on [Protective's] substantial compliance with the governing regulatory standards."

### **Reconciliation Activity and Change in Assessment Obligations**

From 2006 through 2008, the IHC Board performed several reconciliations of previously-performed assessments for losses and/or IHC Program administrative expenses that have an

impact upon Protective.<sup>9</sup> In 2006, the IHC Board performed a reconciliation of the loss assessments for the 1996 calculation period following resolution of litigation between the IHC Program and CIGNA, in which the Supreme Court found in favor of CIGNA.<sup>10</sup> The IHC Board's reconciliation determined that CIGNA owed substantially less money for reimbursable losses for the 1996 calculation period than previously assessed, and consequently, other carriers should have been assessed larger amounts. With respect to Protective, the IHC Board determined that Protective should have been assessed \$664,091.98, rather than the \$516,303.00 assessment Protective had already paid toward the reimbursable losses for the 1996 calculation period. The IHC Board issued invoices on March 9, 2006, to all carriers owing additional money to the IHC Program, including Protective. However, Protective has submitted no payment and has never responded to the IHC Board's invoice for \$147,788.98, or follow-up email, which included a warning that late fees were accruing, nor has Protective sought to appeal the change in the assessed amount.

In December of 2006, the IHC Board performed an interim reconciliation of assessments for the 1997/1998 and 1999/2000 calculation periods,<sup>11</sup> and issued invoices to carriers indicating whether the carrier owed additional sums to the IHC Program. Protective received notice of the IHC Board's action, but owed no additional money for these periods based on the interim reconciliation. Instead, the Board determined Protective owed \$86,503.36 less for the losses incurred in 1997/1998 calculation period and owed \$225.54 less for losses incurred in the 1999/2000 calculation period. At the IHC Board's April 17, 2007 meeting, after collection of

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<sup>9</sup> Protective ceased to be subject to assessments as of the 2001/2002 calculation period; thus, not all IHC Program assessment-related activity performed subsequent to 2002 has had any impact upon Protective.

<sup>10</sup> In re N.J. Individual Health Coverage Program's Readoption of N.J. 11:20-1 et seq., 179 N.J. 570 (2004).

<sup>11</sup> The interim reconciliations for these two calculation periods resulted from resolution of multiple events unrelated to the facts of this matter, including adoption of new rules, resolution of a dispute with a carrier, adjustments to net earned premium based on successful appeals by carriers, and adjustments to net earned premium based on completion of several audits and AUPs.

substantially all of the invoiced amounts had occurred, the IHC Board authorized distribution of refunds to those carriers whose liability had been reduced through the reconciliation process. However, the IHC Board voted not to distribute refunds to any carriers that had reported net paid losses if the carrier's audit or AUP report remained incomplete. Instead, the amount determined to be in excess of a carrier's liability (the refund amount) has been applied against sums the carrier has already received or been credited by the IHC Board, if any, in compensation of the carrier's specifically reported losses. The result is either: (1) a reduction of the amount the carrier will be required to return to the IHC Program if an audit or AUP report cannot be completed, or a completed report indicates that the carrier has received more funds than warranted; or, (2) a reduction in the actual cash payment the IHC Board makes to the carrier upon completion of an audit or AUP. In this instance, the IHC Board considers the total amount advanced and/or credited to Protective by the IHC Board (\$462,003.97) with respect to Protective's reported net paid losses for the 1997/1998 calculation period to have been reduced by \$86,728.90 (that is, \$86,503.36 for 1997/1998 plus 225.54 for 1999/2000).

In addition, in September 2008, the IHC Board reconciled the administrative assessments for fiscal years 1993 through 1999 following completion of administrative audits of the IHC Program for those years. The reconciliation shows that Protective's liability for administrative expenses of the IHC Program during that time period is \$4,587.01 less than Protective has paid, and thus, Protective is due a refund of that amount. Following the IHC Board's practice as outlined above, the amount that would otherwise be refunded to Protective is instead being used to reduce what has previously been paid by the Board to Protective for net paid losses reported for the 1997/1998 calculation period.

## DISCUSSION

The IHC Board has a fiduciary duty set forth by law to review all IHC Program members' reported losses to determine whether the reported losses are appropriate,<sup>12</sup> and to assure that losses are equitably distributed among IHC Program members.<sup>13</sup> N.J.S.A. 17B:27A-11 and 12. Accordingly, the IHC Board has promulgated regulations requiring that IHC Program members seeking reimbursements for losses respond to requests for additional information, and cooperate with audits, so that the IHC Board may accomplish its oversight activity and assure equitable distribution and payment of losses. See N.J.A.C. 11:20-2.8(c) and 8.8. Carriers are required to respond to requests for information in a timely manner. The IHC Board has always retained the option of terminating an audit in the event that a carrier being audited is not cooperative and the audit can not be completed. N.J.A.C. 11:20-8.8(b). Simply put, the Board must be assured that the reported losses are appropriate for reimbursement. If a carrier fails to fully cooperate with the audit, it is impossible for the Board to carry out its statutory and fiduciary responsibilities.

Although Protective has provided documentation to the auditing firm, Protective has not submitted supporting documentation sufficient for D&T to evaluate whether the reported losses for the 1997/1998 calculation period are properly allocated to the IHC block of business in accordance with the Board's regulations, and thus, proper for the Board to authorize

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<sup>12</sup> IHC Program members are eligible to receive reimbursement of losses incurred with respect to individual health benefits plans offered in New Jersey, which are only available to defined eligible persons. Additional requirements are set forth at N.J.A.C. 11:20-8.5(c) with respect to those claims that should (and should not) be included on the Assessment Report. Among other things, claims should only be included if paid in accordance with the terms and conditions of the individual health benefits plans. (See N.J.A.C. 11:20-8.8(c)). For example, if a carrier pays a claim for an uncovered service, such as cosmetic surgery, the claim would not be reimbursable.

<sup>13</sup> Even IHC members entitled to reimbursement of losses bear some liability for their losses; hence claims paid for all health benefits plans during the two-year calculation period must exceed 115% of the net earned premium and any investment income thereon for the two-year calculation period before being considered eligible for reimbursement.

reimbursement. Protective acknowledges that 11 months of detailed premium data is missing. Protective believes the IHC Board should accept the Topel Report as a substitute for submission of data for the 11-month period in question, a position the IHC Board has previously rejected. The Board's position on this matter has not changed. The Board cannot accept the Topel Report in lieu of access to the underlying accounting records (which would be evaluated by D&T under the AUP) for the 11-month period because N.J.A.C. 11:20-8.8(b) specifies that the Board, not anyone else, shall *select and direct* the independent auditor. Certainly, the IHC Board did not select Topel, nor did the Board define the terms of the engagement that produced the Topel Report.<sup>14</sup>

By selecting and directing the independent auditor, the IHC Board assures: (1) that the selected auditor understands the IHC Program and its governing rules; (2) the performance of the audits and AUPs is relatively consistent across carriers; (3) that guidance which may be required regarding the rules is issued by the entity vested with the authority to interpret the rules of the IHC Program; and, (4) that guidance is applied consistently across audits and AUPs. Protective implies that performance and reporting of an AUP by one auditor can substitute for the performance and reporting of an AUP of another auditor, but this is not necessarily so. Because the needs of the parties involved in an AUP can vary widely, the nature, timing and extent of the AUP may vary as well.<sup>15</sup> When the IHC Board selects and directs the independent auditor, the Board is assured that there is adequate subject matter knowledge, and that the engagement is suitable for the purposes of the needs of the IHC Program.

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<sup>14</sup> Although Topel addressed its May 11, 1999 report to the IHC Program, the IHC Board did not commission nor correspond with Topel regarding performance of any AUP. Rather, Topel states it was engaged by American Chambers (see Topel letter of May 5, 2005), while Protective indicates both it and American Chambers engaged Topel (see Protective's letter of August 29, 2005). Regardless, the IHC Board does not know the precise nature of the working agreement between the parties.

<sup>15</sup> AT section 201.03 from the AICPA's *Attestation Standards*.

Protective has argued that the information it has been able to provide, including the Topel Report, constitutes substantial compliance with the Board's audit regulations. Specifically, Protective believes it has explained all asserted discrepancies between its Exhibit K filing and its Annual Statements for 1997 and 1998, and has provided a reasonable explanation for its inability to produce 11 months' worth of the requested materials. The Board, however, disagrees. The IHC Board is unaware of any explanation by Protective of what efforts Protective has made to obtain the American Chambers records; Protective has only stated that it has encountered great difficulty in locating the information necessary to respond to D&T. The Board notes that, although American Chambers went into liquidation in 2000, that situation in and of itself may not have prevented Protective from obtaining the records in 2000 or 2001. Even today, the American Chambers Estate in Liquidation continues to exist. Protective also references the acquisition in 2001 by another carrier of Protective's division responsible for selling the IHC Program plans. Nevertheless, the IHC Program audit rules were in place well before 2000 and 2001; thus, Protective was on notice regarding the data that would be requested prior to either of these events occurring, and arguably could and should have secured it.<sup>16</sup>

Use of the doctrine of substantial compliance "is meant to ameliorate the harsh consequences of actions that meet the spirit of a law but technically fall short." Sroczyński v. Milek, 197 N.J. 36, 44 (2008). Protective's inability to provide D&T with 11 months of data is not a mere technical violation, nor is the Topel Report an acceptable substitute for the missing data. In addition, by design, any determination regarding the reimbursable losses of one carrier

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<sup>16</sup> In addition, Protective received specific notice of the rules on three early separate occasions: in May 1999, when the IHC Board acknowledged receipt of Protective's 1997-1998 Exhibit K; in December 1999, when Protective signed the certification agreeing to conditions for the monies advanced and credited to Protective; and then again in September 2000, when the Board announced the award of the auditing services contract to D&T.

has an impact upon all members of the IHC Program responsible for assessments; a finding of substantial compliance would prejudice the interests of other IHC Program members.

D&T suggested it could issue its AUP Report if Protective would sign a management representation letter. A management representation letter is a necessity to issuance of an audit or AUP report.<sup>17</sup> Indeed, the failure of management to provide a management representation letter “constitutes a limitation on the scope of the audit sufficient to preclude an unqualified opinion and is ordinarily sufficient to cause an auditor to disclaim an opinion or withdraw from the engagement.”<sup>18</sup> Protective’s letter of June 8, 2009 indicates that Protective’s position is that it signed the management representation letter in January 2007, and there is no good reason the AUP Report has not been finalized. Protective fails to mention, however, that the signed letter Protective submitted to D&T in January 2007 was not the same management representation letter D&T had given to Protective in April 2006. Protective substantially changed the D&T-prepared management representation letter of 2006 by appending documentation to it. Protective now criticizes D&T for suggesting more changes to the management representation letter and the AUP Report to accommodate the documentation that Protective appended to the January 2007 letter, even though Protective should have known appending documentation to the letter would require the auditors to engage in further evaluation of the representations by management.

Protective is dismissive of the 2008 proposed changes by D&T to the management representation letter clarifying that D&T performed agreed upon procedures. Protective states that the management representation letter serves to confirm the representations made by Protective with respect to documents and data provided by Protective to D&T, and that Protective has no obligation to assent to procedures D&T used to audit or analyze the data.

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<sup>17</sup> See, for instance, AT section 601.68 of the AICPA’s *Attestation Standards*.

<sup>18</sup> AU section 333.13 from the AICPA’s *Professional Standards*, and AT section 201.39 from the AICPA’s *Attestation Standards*.

Protective also objects to D&T's request to modify the AUP Report, stating that D&T's proposed modification involves a disputed material fact. Protective does not explain what material fact is at issue, or why Protective believes agreeing with the modification would have an impact. Protective's concern is not readily apparent to the IHC Board. D&T suggests replacing the current statement in the AUP Report that says Protective provided no explanation for the differences in reported premium with two statements: one acknowledging submission of the affidavit of Protective's employee, Rita Fulton, as an explanation of the differences; the second noting Protective did not provide a detailed inventory of the premium unrelated to the IHC Program. The proposed D&T language is factual, and makes no conclusions.

It appears to the IHC Board that Protective is merely delaying finalization of the D&T AUP Report. Protective suggests that the only reason it signed the management representation letter in 2007 was because the IHC Board threatened enforcement action, which would require return of the monies advanced and credited to Protective, with interest. However, even in signing the management representation letter, Protective's actions resulted in more delays, because Protective appended documentation to the letter, which D&T then had to review and accept or reject in whole or in part. Now that D&T is willing to accept the appended documents, subject to minor modification to the management representation letter and some reference in the AUP Report, Protective is again unwilling to sign the modified management representation letter.

Protective suggests in its June 8, 2009 correspondence that the IHC Board and Protective might engage in dialogue. However, what little communication has occurred between Protective and the IHC Board has been generally unproductive. Protective has become unresponsive with respect to the AUP Report issues, except when legal action is mentioned. Given the history and



Protective's June 8, 2009 letter, the IHC Board does not believe the AUP Report can ever be successfully issued. Even if D&T were in a position to issue the AUP Report, Protective's reported reimbursable losses for the 1997/1998 calculation period would remain unverified. Accordingly, the IHC Board finds that Protective is not entitled to reimbursement for net paid losses as set forth on the Assessment Report for the 1997/1998 calculation period, and thus, is not entitled to either the monies advanced by the IHC Board to Protective or the credits against assessments afforded to Protective pending completion of the audits.

Further, Protective has failed to respond to the IHC Board regarding the \$147,788.98 Protective owes for the 1996 reimbursable losses pursuant to the 2006 final reconciliation of the losses for the 1996 calculation period. Protective has not paid the bill, responded to inquiry or disputed that the money is owed. Even if Protective wished to appeal the assessment produced by the reconciliation, Protective is required by regulation to submit the amount owed to the IHC Board, which the IHC Board would place into a segregated interest bearing account upon Protective's request, pending resolution of the matter. (See, N.J.A.C. 11:20-2.17(f)2.) Protective understands the process for making an appeal, since it has done so already with respect to the AUP Report. Protective seems to simply be ignoring the IHC Board entirely with respect to the 1996 reconciliation, and thus, requiring the IHC Board to take action against Protective on the matter.

**ORDER**

NOW THEREFORE, pursuant to the authority granted to the IHC Board by N.J.S.A. 17B:27A-2 et seq., N.J.A.C. 11:20-1 et seq., and all powers expressed or implied therein,

IT IS on this 29th day of June, 2009, ORDERED that:

1. Protective's request for reconsideration of AO 04-01 is denied.

2. Protective's request for reimbursement for losses for the 1997/1998 calculation period is hereby denied.

3. No later than July 31, 2009, and without regard to any other action Protective may take or intend to take in this matter, Protective shall submit payment as specified in paragraph 4, in an amount totaling \$621,965.01, which is the sum of the following: advanced cash (\$344,507.59) and assessment credits (\$117,496.38) minus the refunds resulting from the reconciliation of assessments for IHC Program administrative expenses for FY1993-1999 (\$4,587.01), and the interim reconciliation of the loss assessment for the 1997/1998 calculation period (\$86,503.36), and the interim reconciliation of the loss assessment for the 1999/2000 calculation period (\$225.54); plus, interest accrued (\$87,312.43) through December 8, 2008 related to the cash advances and credits provided by the IHC Board;<sup>19</sup> plus, Protective's portion of the audit fees (\$8,460.50) billed by D&T through September 15, 2004; plus, Protective's additional liability (\$147,788.98) for reimbursable losses resulting from the reconciliation of the 1996 loss assessment; plus, the interest accruing at 1.5% per month in accordance with N.J.A.C. 11:20-2.17(f) for the amount remaining unpaid for the 1996 loss assessment as reconciled, accruing from March 2006.

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<sup>19</sup> Interest in this instance is based on what the money in question would have earned had it been in the Board's accounts, and is reported based on funds held in Wachovia until December 8, 2008. After that date, all but a nominal amount of the funds held by the Board were transferred to accounts held by the New Jersey Department of Treasury. The New Jersey Treasury reports interest annually. Greater detail is available upon request.

4. Protective shall comply with paragraph 3 by:
  - a. Issuing a check payable to “Treasurer – State of New Jersey/Individual Health Coverage Program” and mailing the payment to the IHC Program at 20 West State Street, 11th Floor, P.O. Box 325, Trenton, NJ 08625-0325; or
  - b. Submitting the funds by wire transfer to Wachovia Bank, N.A. (P.O. Box 7618, Philadelphia, PA 19101-7618), instructions for which can be obtained by contacting Rosaria Lenox, Program Accountant, Individual Health Coverage Program by fax at (609) 633-2030, by email at [rosaria.lenox@dobi.state.nj.us](mailto:rosaria.lenox@dobi.state.nj.us), or by phone at (609) 633-1882 ext. 50304.
5. Consistent with N.J.A.C. 11:20-8.8(b), Protective is responsible for audit expenses that D&T may bill for the AUP for Protective’s reported 1997/1998 losses subsequent to the date of this Order.
6. Protective shall have the right to request a hearing in accordance with the procedures of N.J.A.C. 11:20-20.2.
7. If Protective files an administrative appeal of this Order pursuant to N.J.A.C. 11:20-20.2, the IHC Board shall place the monies remitted by Protective to the IHC Board in a segregated interest-bearing account until such time that the matter shall be resolved.
8. This Order amends and supplements AO 04-01, issued August 5, 2004.
9. This Order shall serve as notice in accordance with N.J.A.C. 11:20-2.14 to the Commissioner of the New Jersey Department of Banking and Insurance of Protective’s failure to pay its assessment as determined by the 2006 final reconciliation of the losses for 1996, with the IHC Board’s recommendation that the Commissioner take action against Protective as permitted by the terms of the IHC Act.

10. Nothing in this Order shall be construed to limit the rights of the Commissioner of Insurance to take other action against Protective as may be available to the Commissioner under law.

/s/ Mary Taylor, Chair  
Individual Health Coverage Program Board of Directors