

Executive Summary

Board of Governors Meeting, July 14, 2021

THE OFFICE OF THE INTERNAL AUDITOR

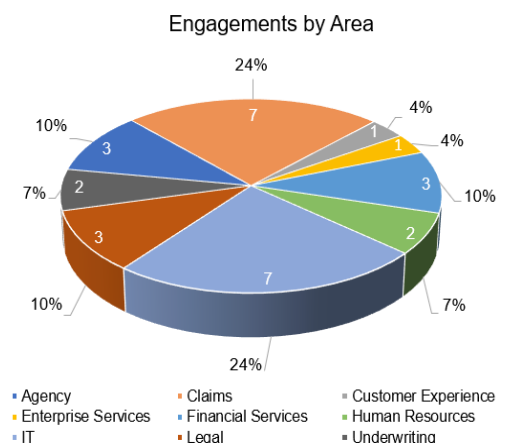
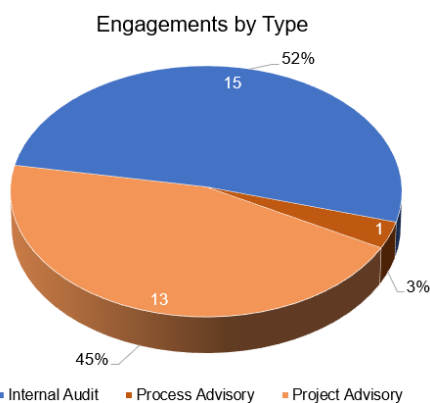
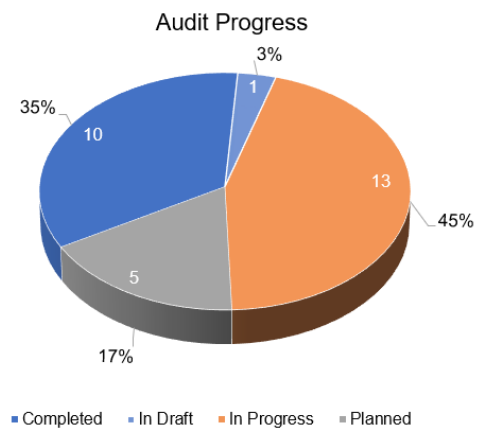
At the Audit Committee meeting, the Chief of Internal Audit presented progress to the 2021 plans for audit, internal control, and enterprise risk.

Internal Audit

Overview of Audit Progress

Internal Audit follows a risk-based quarterly rolling plan approach in developing engagements and monitoring progress. As we review risks and consider operational challenges, we re-examine our plan and confirm that it continues to provide the expected assurance and that audit resources remain appropriately focused.

Internal Audit Plan (January 1, 2021 to December 31, 2021)	
Completed	10
In Draft	1
In Progress	13
Planned	5
Total Projects	29



Audit Engagements Completed

Following the last meeting we completed work on eight (8) audit engagements:

- **Appraisal Process** - Results from our audit work indicated that appraisal and mediation claims handling processes are adequate and in alignment with Citizens' policy language and Florida Statutes. Internal Audit noted an opportunity to enhance

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metrics reporting for accuracy and transparency and a process improvement was also noted and shared with management.

- **Centerpoint Configurations** - We validated that Centerpoint configuration settings are generally aligned with settings commonly used and are appropriate for Citizens. Internal Audit noted some configuration settings for the Financial module which differed from settings commonly used. These settings were discussed with management and determined to present only a low risk due to the existence of compensating controls. We also noted that there are effective controls and processes related to making changes to Centerpoint configuration settings and implementing the Oracle quarterly updates for the application.
- **Claims Legal Services Transfer** - Internal Audit evaluated observations and improvement opportunities made by EY in a report issued December 15, 2020 and considered implications associated with the potential transfer of the Claims Legal Services unit, currently attached to the Legal Department, under the purview of the Claims Department. Additional information and advisory guidance was provided to management for consideration of this initiative.
- **Commercial Underwriting Compliance** - The audit confirmed that an adequate control structure is in place to ensure commercial lines underwriting activities, underwriting rules, guidelines, and procedures are in compliance with Florida statutory requirements. Internal Audit observed that the Commercial Underwriting staff has extensive underwriting knowledge and experience with assessing complex risk; there is a dedicated compliance champion who is responsible for monitoring and certifying 16 rules, laws and regulations as a part of the Citizens Compliance Annual Certification process; and quality assurance reviews are conducted monthly by the Quality Assurance Team to ensure compliance with underwriting rules, guidelines and state statutory requirements.
- **Escheatment** - Results from our audit work indicated that processes and procedures developed to manage unclaimed property and the escheatment of funds are generally well designed and operating effectively. Internal Audit noted two opportunities to strengthen the control structure which include monitoring system administrator activity in the escheatment compliance system and process segregation of duties. The enhancements have been shared with management and segregation of duties remediation has been completed and administrator activity monitoring development is underway.
- **EY Implementation Progress** - Internal Audit is monitoring the progress of the working plan and initiatives developed by Claims Management in response to EY's observations and improvement opportunities, as well as the implementation of the initiatives. Twenty-eight (28) initiatives were developed and distributed amongst the corresponding business units. Internal Audit has provided additional information for management consideration through four (4) advisories issued in connection with

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these initiatives. There are a number of initiatives that will be reviewed or initiated once the new litigation management platform is implemented. The report provides an overview of the initiatives and a summary of their progress for the second quarter of 2021.

- **Independent Adjusters vs. Full Time Employees** – As part of our monitoring of initiatives developed by Claims Management in response to EY’s observations we also advise on some of the actions taken. This advisory pertains to one of the twenty-eight (28) initiatives developed by Claims Management, specifically initiative number four (4), Staffing Model: Staff Adjuster vs. Independent Adjusters (IA’s) - Claims Litigation. Internal Audit examined the analysis made by Claims Litigation Management and provided additional information for management consideration as well as alternative options/approaches to optimize the ratio of FTE’s vs. IA’s. Claims Management in general agreed with Internal Audit’s observations and provided detailed response to the alternative options/approaches presented.
- **Legal Billing Review Team Transfer** - The objective of this advisory was to provide insights on the proposed initiative of transferring the Legal Billing Review Team from the Legal Department to the Claims Department. Internal Audit examined observations made by CLM Advisors and EY in previous assessments and provided management with additional information for the consideration of this initiative.

Work in Progress

There are fourteen (14) audit engagements in progress:

- **Agent Model Market** The objective of this project is to partner with agency management to provide as needed, ad hoc market research surrounding agent and commission models being utilized in the property & casualty insurance marketplace.
- **Cancellation Moratorium** Following COVID-19, Citizens placed a moratorium on policy cancellations to assist policyholders with any financial hardships experienced during the pandemic. The objective of this audit is to evaluate the adequacy and effectiveness of billing and accounting processes and controls related to Citizens’ cancellation moratorium.
- **Citizens Insurance Services** The internal agency services over 5,000 policies. In addition, the internal agency evaluates renewals and certain endorsements for acceptability in accordance with company guidelines and standards, utilizing underwriting and risk management techniques. Internal Audit will evaluate the adequacy and effectiveness of controls related to the internal agency processes.
- **Claims Consultant** EY was engaged by Citizens to perform an operational assessment to assist with improving the efficiency and effectiveness of its claims

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- Recommendation Implementation litigation process. The objective of the engagement was to complete a current state assessment and gap analysis of the litigated claims management process against industry leading practices. Internal Audit will be providing advice and support during the design and implementation phases of the project.
- Claims Litigation Management System Procurement Citizens issued an Invitation to Negotiate (ITN) to request competitive sealed replies from firms capable of providing a web-based Software-as-a-Service (SaaS) Litigation Management System (System). The proposed System will be utilized to manage Citizens' litigated and disputed claims activity and other legal matters customary to property and casualty insurance carriers.
 - Cloud Migration Program Migration to cloud services and solutions means reliance upon service providers for applications and infrastructure along with some support services. When migrating critical applications and infrastructure to the cloud, ineffective cloud implementation processes may lead to business disruption, unnecessary expenses and/or unauthorized access to confidential data. IT management requested that Internal Audit support this project in an advisory capacity. Internal Audit will provide insight related to risks and controls associated with migration of applications and infrastructure to cloud services. Internal Audit will also validate that governance processes appropriately support the project and perform new controls implementation testing where requested.
 - Compliance Program Following an audit completed in 2016 of Citizens' operational compliance governance framework, enhancements were developed and implemented to strengthen and align the program with leading practice. Internal Audit will evaluate the adequacy of processes supporting the efficiency of the compliance framework.
 - Financial Services Payables Process With the recently implemented system enhancements in the financial module of Oracle's integrated ERP solution (Centerpoint), there is an opportunity for Internal Audit to evaluate the payables process and related controls. The payables process has inherent risk associated with financial misstatement and potential for monetary loss through duplicate payments, unauthorized payments, and payments made on non-received goods or services.
 - Identity and Access Management Citizens' IT Security and Risk department is in the process of implementing an enterprise-wide strategy to consolidate and centralize user identity and access management processes and technology capabilities. Complexity will continue to increase as new

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cloud solutions, systems and applications are adopted and integrated into the current environment. These complexities should be understood and appropriate controls for authentication and authorization should be implemented to mitigate risks associated with user access/privileged access, segregation of duties, oversight and monitoring and reporting capabilities. Internal Audit will assess project progress, and corresponding processes, during this multi-year implementation.

- In-House Counsel

EY recommended defining the roles and responsibilities associated with senior counsel to promote consistency in tasks as well as to assist with the promotion of suit avoidance measures, including handling lower-severity litigated claims, holding that this would allow for greater efficiencies, as well as help manage legal spend. In response Claims Management's position was that if Claims Legal was to adjust claims, attorney client privilege would be lost. Claims Management also holds that in order to have Citizens' attorneys litigate on behalf of the policyholder, a separate captive firm would need to be established. Also, Claims Legal Management is of the opinion that In-House Counsel cannot be staffed under a company staffing model as there may be concerns regarding the unauthorized practice of law. Internal Audit examined the subject of In-House Counsel to provide additional information on models for consideration. We provided our draft results to management for their review and response.
- House Bill 1079 Implementation

Internal Audit has been requested to provide advisory services in support of Citizens' implementation and compliance of HB 1079 requirements. The Bill includes several provisions for the evaluation, management, and oversight of contractual service agreements.
- Logging and Monitoring

System and application logging is required to provide an audit trail of business and system transactions to monitor access and correlate events that may require additional research and follow-up. Absent appropriate logging practices being implemented, there is a risk for lack of accountability for system changes and potentially an inability to surface information to detect or reconstruct system events and/or possible threats when required. We will assess the implementation of system and application logging and monitoring to ensure that operational and security risks have been identified, corresponding logging practices have been implemented and

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- appropriate event monitoring is occurring. We will also validate that logging fully supports the incident response process.
- **Senate Bill 76 Implementation** Internal Audit is providing advisory services with regards to the implementation of processes and procedures necessary to comply with the requirements of Senate Bill 76, which was recently signed into law and became effective July 1, 2021. This bill impacts several business units, including Claims, Claims Litigation and Claims Legal Services.
- **Underwriting Staffing Analysis** Internal Audit was requested to participate in Enterprise Operations' analysis of current underwriting staffing models and provide advice and project support where appropriate.

The OIA continues to provide regulatory support to the Auditor General with the completion of their audit.

Work Planned

The following audit engagements are scheduled to be completed during Q4 2021:

- **Application and Infrastructure Standards and Conformance** - IA will review elevated risk applications and infrastructure components against IT security and hardening standards to validate compliance.
- **Clearinghouse** - The Clearinghouse process and system have not been reviewed since implementation. The audit will evaluate the effectiveness and adequacy of key business processes and control functions related to the Clearinghouse operations.
- **Employee Benefits** - A follow-up audit is planned to assess the management of Citizens' Medical Aid programs specifically focusing on vendor involvement.
- **IT Service Management** - MyService is a SaaS platform which has several modules that provide the ability to create digital workflows to process and approve requests. IA will evaluate the adequacy and effectiveness of processes developed for handling service requests, IT incidents, problems and other digital work flows as well as data integrity and user access controls.
- **myAgency Post Implementation** - The audit will evaluate the adequacy and effectiveness of controls related to the Agency Management processes and application.

Control Deficiency Resolution

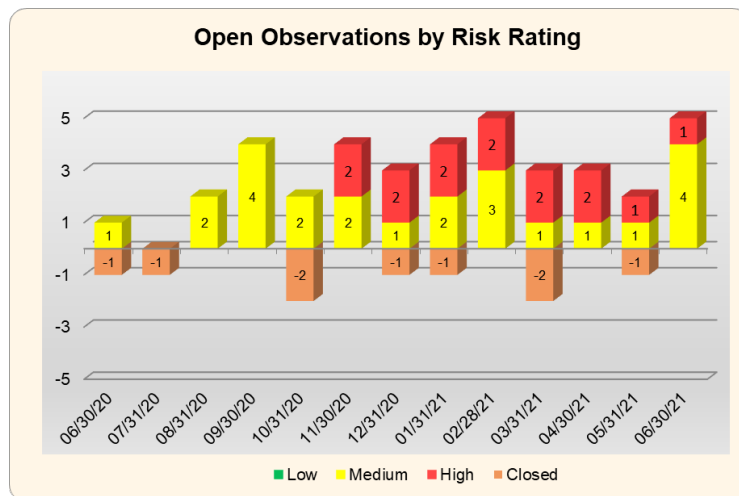
Internal Audit maintains a database containing reported audit observations, recommendations, management action plans and target completion dates originating from audits, reviews performed by the external auditors and regulatory exams conducted by the Office of Insurance Regulation and the Auditor General. Open items receive priority focus from management and are generally addressed within an agreed period. We are currently

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tracking 5 open observations of which one (1) is rated as high impact. The high rated open item relates to the recent OFAC (Office of Foreign Assets Control) completed by Internal Audit and focuses mainly on developing a formal OFAC Sanctions Compliance Program and tightening the OFAC screening practices at Citizens.

The chart below provides information on the number of current open observations over a period including the observation ratings, source of observation and year reported.



Observations by Year Reported		
2020	2021	TOTAL
2	3	5

Observation Source	
Internal Audit	5
External Auditor	0
OIR Market Conduct	0
Auditor General	0
Total	5

Internal Control

Citizens' Internal Control Framework (ICF) is designed to strengthen the governance, oversight, and accountability of Citizens' control environment. Based on the COSO Internal Control Integrated Framework, Citizens' ICF provides management with leading internal control practices that support the achievement of operational, financial, and compliance goals and objectives. Through ongoing maintenance, monitoring, and enhancements to the Citizens' ICF, the Internal Controls (IC) team continues to refine the program to evolve and strengthen the maturity level of the organization's internal control environment.

2021 Annual Control Self-Assessment

As part of the ICF, Control Champions or management perform annual control self-assessments (CSAs) to ensure that Citizens' primary controls are properly designed and continue to operate effectively. Primary controls are key activities that play a significant role in ensuring objectives are met and mitigate high rated inherent risks. Through performance of the CSA, management validates whether their primary controls are working as intended or identifies areas that may need improvement. The CSA results are utilized to continuously improve processes and enhance our control environment.

As of June, 119 primary controls have been identified and recorded. Management CSAs are currently in progress for 107 of the primary controls while 12 require a refresh by the

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IC team. The number of primary controls may vary based on changes in business processes and results from ICF quality assurance reviews. Depending on the type of primary control and sample necessary to confirm the effectiveness, the CSAs may be completed early or may need to be assessed through the due date at the end of November. During Q2, Facilities Management completed the 2021 CSAs for their primary controls.

Through various touchpoints with the business areas and ICF quality assurance reviews, the Internal Controls team ensures that the Citizens' ICF standards are followed and that control assessments continually add value and strengthen Citizens' control environment.

Enterprise Risk

The Enterprise Risk Management (ERM) Framework provides a consistent approach across the organization in the identification, assessment, and mitigation of strategic, operational, project and emerging risks. Enterprise Risk (ER) facilitates, enables, and partners with business areas to deliver forward-looking and insightful risk perspectives that enhance the decision-making process and strategic performance of Citizens.

Strategic Risk Management

Citizens' ERM Framework defines strategic risk as the uncertainty of an event, or action, leading to a consequence which may result in an adverse impact on Citizens' ability to achieve strategic objectives and key strategic initiatives over the next 12-18 months.

During the first quarter, ER facilitated the completion of the 2021 strategic risk assessment with the Executive Leadership Team (ELT). The annual assessment was preceded by individual interviews with each member of the ELT to identify strategic risks. Results from these interviews were discussed at the February ELT strategic risk assessment where the strategic risks were assessed and prioritized. The specific ratings for each risk are listed in Appendix I and the overall strategic risk ratings are depicted in the graph below.

2021 Strategic Risk Results

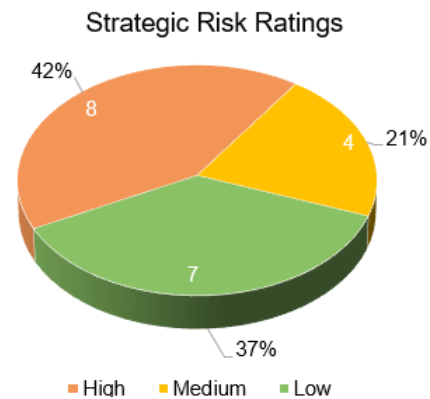
A total of 19 strategic risks were identified and assessed (refer to Appendix 1):

- 17 risks carried over from the 2020 Strategic Risk Profile. Risk descriptions and ratings were updated as needed.
- 2 newly identified risks were added. (Market Instability and Workforce Transformation)
- The risks were assessed by estimating the potential impact or severity level the risk event may have to Citizens if the event occurs and considering the probability of occurrence:

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- 42% (8) were rated high; 21% (4) rated medium; and 37% (7) rated low.
- The 8 high rated risks may be impacted by external and internal factors contributing to the complexity of these risks. (Market Instability, Rate Differential, Claims Abuse, External Influences, Litigation Management System, Market Dependence on Reinsurance, CAT Response, and Data Security and Privacy.)



Mitigation plans are available and will be executed, as necessary. ER, ELT and Risk Owners periodically monitor the risks and mitigation plans to ensure the risk descriptions, ratings and plans reflect any changes that may occur throughout the year.

Operational Risk Management

Operational risks are events or circumstances that can affect the achievement of operational initiatives or goals. ER facilitates interactive operational risk assessments that enable Risk Champions and management to self-identify and assess risks that may impact the ability to achieve business objectives and to determine the effectiveness of mitigation activities to reduce risks. Operational risks are periodically updated through ER facilitated sessions and input from Risk Champions. Currently, a total of 372 operational risks have been identified across the organization. As of June, there are no operational risks with a high-risk residual rating. The total number of operational risks fluctuate as risks are added, removed, and consolidated.

Project & Scenario Risk Assessments

Upon request, Enterprise Risk facilitates cross-functional project and scenario risk assessments designed to enable risk-based decisions and the proactive mitigation of risks.

- *HB 1079*: In June, ER facilitated a pre-implementation risk assessment to identify and assess risks and mitigation plans for the upcoming implementation of HB 1079 requirements. The assessment focused on the Vendor Management Office's responsibilities for the evaluation, management and oversight of contractual services contracts. A post-implementation risk assessment is planned for Q3.
- *Market Conditions and Policy Growth*: ER continues to partner with the Strategic Evaluation Group (SEG) on a cross-functional identification and assessment of key risks that may impact Citizens' operations as a result of market changes and the uncertainty related to the timing and quantity of policy fluctuations, as well as provide insights and recommended actions for planning and addressing any future impacts across the organization, as necessary.

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Appendix 1 – Strategic Risk

2021 Strategic Risks		
Risk Title	Risk Description	Rating
Market Instability	Unstable market conditions may adversely impact private carriers continued participation in the Florida insurance market or geographic locations due to capital limitations or insolvency resulting in fluctuations in Citizens' costs, exposure, and number of policies in force.	High
Rate Differential	As a result of Citizens' current rate making efficiencies and increasing litigation causing other Florida insurers to increase rates, Citizens' competitive position in the market is not aligned with being a residual market.	High
Claims Abuse	Failure to identify and stay in front of claims abuse schemes that increase litigation costs for Citizens.	High
External Influences	Uncertainty related to external events, including new or changing laws and/or regulations, and changing market conditions that require rapid adjustments where Citizens' mission and operations are disrupted resulting in potentially significant financial and operational impacts.	High
Litigation Management System	The outcome of the solicitation of the mission critical litigation management system, which is required to effectively manage litigation cases, may result in data conversion challenges and significantly impact internal and external resources.	High
Market Dependence on Reinsurance	The financial model of the Florida domestic property insurance market has a high dependence on the pricing and capacity available in the reinsurance market.	High
CAT Response	Failure to have adequate vendor resources to respond to a catastrophic event to meet customer expectations.	High
Data Security and Privacy	The growing sophistication and variety of cyberattacks may adversely impact organizations' performance and reputation.	High
Workforce Transformation	Inability to sustain Citizens' culture and high levels of employee engagement as well as attract, retain, and develop critical talent to achieve organization's strategic initiatives in a distributed workforce environment.	Medium
COVID-19	COVID-19 continues to create significant organizational, economic, and societal impacts for our employees, policyholders, agents, and vendors.	Medium

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Appendix 1 – Strategic Risk

2021 Strategic Risks		
Risk Title	Risk Description	Rating
Vendor Management/Oversight	Given Citizens' reliance on vendors, it is critical to ensure an appropriately right-sized vendor base, validate a vendor's capability to fully perform the contract, and adequately monitor vendor relationships, performance, and contract compliance.	Medium
Managed Repair Program	Legal challenges may impair the effectiveness or feasibility of the Managed Repair Program as an acceptable alternative customer solution.	Medium
Product Offerings	Failure to have insurance products that balance the needs of the market, consumers, and Citizens' statutory requirements.	Low
Leveraging Data and Technology	The ability to leverage data and new technology in pace with market demands and expectations of Citizens by its stakeholders to ensure delivery of strategic initiatives.	Low
Assignment of Benefits	Legal challenges to House Bill 7065, AOB Reform, may result in reputational damage.	Low
Ability to Adapt to Changing Revenue	Ability to recalibrate and reprioritize administrative expenses to adjust to premium fluctuations, while maintaining required capabilities.	Low
Compliance with Laws & Regulations	Unintentional acts or decisions by the company that are not in accordance with rules and regulations may result in regulatory, civil or criminal penalties and reputational damage.	Low
Ethics, Integrity, Conflicts of Interest	Violation of Citizens' code of ethics, commitment of illegal and unauthorized acts, management fraud, employee fraud or situations where multiple, conflicting interests could possibly corrupt motivation or decision-making may result in criminal charges, reputational damage or financial loss.	Low
Underwriting Data Integrity	Inaccurate assessment or classification of the risk caused by either out of date or inaccurate underwriting information, or not reviewing renewal risks periodically resulting in incorrect underwriting decisions or unintended consequences on depopulation.	Low

Note: The risk rating is an estimate of the potential impact or severity level the risk event may have to Citizens if the event occurs