



OFFICE OF THE STATE AUDITOR



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Contact: Stelios Pavlou (303) 869-2833
stelios.pavlou@state.co.us

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PINNACOL ASSURANCE FAILS TO TRACK EMPLOYEE EXPENSES OF ITS FOR-PROFIT SUBSIDIARY CAKE INSURE

DENVER—the Colorado Office of the State Auditor (OSA) has released its performance audit of Cake Insure, Inc. (Cake Insure), the for-profit subsidiary of Pinnacol Assurance (Pinnacol), the State’s workers’ compensation insurance provider. Cake and Pinnacol operate under a Master Service Agreement, which requires Cake to pay Pinnacol a monthly fee for management services. Auditors found that Pinnacol is hindered in its ability to determine whether it is over- or undercharging Cake Insure for the cost of services due to a lack of written policies and procedures. “Any gains or losses from the cost of services could have financial reporting or tax obligations for Pinnacol and Cake Insure,” Legislative Audit Manager, Monica Power, commented.

As a quasi-governmental entity, Pinnacol is unique from other workers compensation entities in that statutes indicate that it must operate like a mutual insurance company, yet it has the benefit of being exempt from certain state and federal taxes under the Internal Revenue Service. Statute bars Pinnacol from providing any other type of insurance except workers compensation, and cannot own or operate another insurance company. However, Pinnacol may sell services and may enter into agreements with public or private entities in order to carry out its duties and functions. To

DIANNE E. RAY, CPA
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STATE AUDITOR

OFFICE OF THE STATE AUDITOR
1525 SHERMAN STREET
7TH FLOOR
DENVER, 80203
COLORADO
303.869.2800

that end, Pinnacol created for-profit subsidiary Cake Insure in September 2017 and issued stock, with six Pinnacol employees holding 10 percent of the stock and Pinnacol holding 90 percent. The purpose of Cake Insure is to market, sell, and service workers' compensation insurance for small business policies with less than \$10,000 in annual premiums that are not high risk. All policies sold by Cake Insure are carried by Pinnacol. In order to defray the costs of Cake Insure and diversify risk, Pinnacol's management indicated that they are seeking to secure two investors or partnerships in Cake Insure from other state compensation insurance funds similar to Pinnacol by the end of 2018.

Auditors found that the monthly management services fee Cake Insure pays Pinnacol was estimated based on the initial cost calculation of employees' predicted time for providing services; however, Pinnacol did not require employees to track the actual time they spent providing these services to Cake Insure. Pinnacol does not have established written policies and procedures for the fee calculation, and management has not performed a detailed review of its cost calculation since the service agreement was put in place. As a result, Pinnacol could not determine if it was adequately recovering its costs.

The audit makes 1 recommendation and discusses a policy consideration on Cake Insure's status as a for-profit entity.

The full report is available @ www.colorado.gov/auditor.

Under the direction of the state auditor, the OSA is the state's nonpartisan, independent external auditor with broad authority to audit state agencies, departments, institutions of higher education, and the Judicial and Legislative Branches. The OSA's professional staff serve the people of Colorado by addressing relevant public issues through high-quality, objective audits and reviews that promote accountability and positive change in government. Performance audits address whether programs operate in compliance with laws and regulations and in a manner that accomplishes intended program goals. Financial audits include annual audits of the state's basic financial statements and federal grants on a statewide level. IT audits review procedures and technology to ensure the confidentiality, integrity and availability of the state's critical computer systems and taxpayer data. The OSA also tracks about 4,000 Colorado local governments for compliance with the Local Government Audit Law.

