

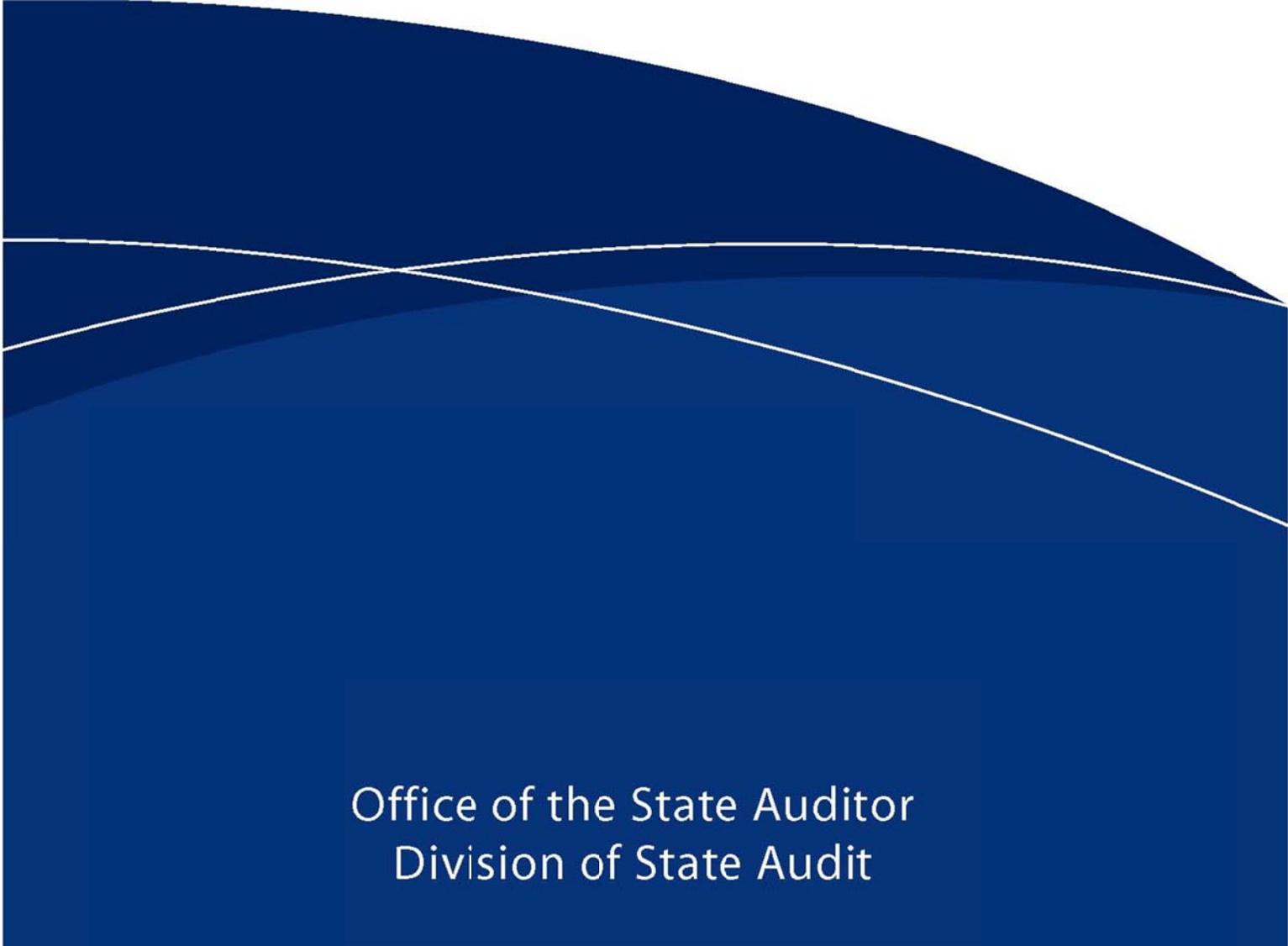


Insurance Department
BISMARCK, NORTH DAKOTA

Audit Report

For the Biennium Ended
June 30, 2009

ROBERT R. PETERSON
STATE AUDITOR



Office of the State Auditor
Division of State Audit

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BISMARCK, NORTH DAKOTA 58505

Transmittal Letter

May 18, 2010

The Honorable John Hoeven, Governor
Members of the North Dakota Legislative Assembly
The Honorable Adam Hamm, Commissioner, Insurance Department

We are pleased to submit this audit of the Insurance Department for the biennium ended June 30, 2009. This audit resulted from the statutory responsibility of the State Auditor to audit or review each state agency once every two years. The same statute gives the State Auditor the responsibility to determine the contents of these audits.

In determining the contents of the audits of state agencies, the primary consideration was to determine how we could best serve the citizens of the state of North Dakota. Naturally we determined financial accountability should play an important part of these audits. Additionally, operational accountability is addressed whenever possible to increase efficiency and effectiveness of state government.

The in-charge auditor for this audit was Andrea Wike. Michael Schmitcke, CPA, and Crystal Hoggarth were the staff auditors. Fred Ehrhardt, CPA, was the audit supervisor and Paul Welk, CPA, was the audit manager. Inquiries or comments relating to this audit may be directed to the audit manager by calling (701) 328-2241. We wish to express our appreciation to Commissioner Hamm and his staff for the courtesy, cooperation, and assistance they provided to us during this audit.

Respectfully submitted,

A handwritten signature in cursive script that reads "Bob Peterson".

Robert R. Peterson
State Auditor

Executive Summary

Introduction

The North Dakota Insurance Department is a state regulatory agency headed by the Insurance Commissioner. The Insurance Commissioner provides a variety of services including agent licensing and investigation, consumer protection, financial examinations, and company licensing services. The Insurance Commissioner administers various special funds and programs including the State Fire and Tornado Fund, State Bonding Fund, Petroleum Tank Release Compensation Fund, Boiler and Anhydrous Ammonia Facility Inspection Program, Senior Health Insurance Counseling Program, and Prescription Connection for ND Program.

The Legislative Audit and Fiscal Review Committee (LAFRC) requests that certain items be addressed by auditors performing audits of state agencies. Those items and the Office of the State Auditor's response are noted below.

Responses to LAFRC Audit Questions

1. What type of opinion was issued on the financial statements?

Financial statements were not prepared by the Insurance Department in accordance with generally accepted accounting principles so an opinion is not applicable. The agency's transactions were tested and included in the state's basic financial statements on which an unqualified opinion was issued.

2. Was there compliance with statutes, laws, rules, and regulations under which the agency was created and is functioning?

Other than our finding addressing "Petroleum Tank Registration Fees" (page 14), the Insurance Department was in compliance with significant statutes, laws, rules, and regulations under which it was created and is functioning.

3. Was internal control adequate and functioning effectively?

Other than our finding addressing the "Segregation of Duties Surrounding Accounts Receivable" (page 12), we determined internal control was adequate.

4. Were there any indications of lack of efficiency in financial operations and management of the agency?

No.

5. Has action been taken on findings and recommendations included in prior audit reports?

The Insurance Department has implemented all recommendations included in the prior audit report except Finding 07-2 "Segregation of Duties Surrounding Accounts Receivable" (page 17).

6. *Was a management letter issued? If so, provide a summary below, including any recommendations and the management responses.*

Yes, a management letter was issued and is included on page 18 of this report, along with management's response.

LAFRC Audit Communications

7. *Identify any significant changes in accounting policies, any management conflicts of interest, any contingent liabilities, or any significant unusual transactions.*

There were no significant changes in accounting policies, no management conflicts of interest were noted, no contingent liabilities were identified or significant unusual transactions.

8. *Identify any significant accounting estimates, the process used by management to formulate the accounting estimates, and the basis for the auditor's conclusions regarding the reasonableness of those estimates.*

The Insurance Department's financial statements do not include any significant accounting estimates.

9. *Identify any significant audit adjustments.*

Significant audit adjustments were not necessary.

10. *Identify any disagreements with management, whether or not resolved to the auditor's satisfaction relating to a financial accounting, reporting, or auditing matter that could be significant to the financial statements.*

None.

11. *Identify any serious difficulties encountered in performing the audit.*

None.

12. *Identify any major issues discussed with management prior to retention.*

This is not applicable for audits conducted by the Office of the State Auditor.

13. *Identify any management consultations with other accountants about auditing and accounting matters.*

None.

14. Identify any high-risk information technology systems critical to operations based on the auditor's overall assessment of the importance of the system to the agency and its mission, or whether any exceptions identified in the six audit report questions to be addressed by the auditors are directly related to the operations of an information technology system.

ConnectND Finance, Human Resource Management System (HRMS), Deposit System, Fire and Tornado, Fire District, and Boiler and Anhydrous Ammonia Inspection Program are high-risk information technology systems critical to the Insurance Department.

Audit Objectives, Scope, and Methodology

Audit Objectives

The objectives of this audit of the Insurance Department for the biennium ended June 30, 2009 were to provide reliable, audited financial statements and to answer the following questions:

1. What are the highest risk areas of the Insurance Department's operations and is internal control adequate in these areas?
2. What are the significant and high-risk areas of legislative intent applicable to the Insurance Department and are they in compliance with these laws?
3. Are there areas of the Insurance Department's operations where we can help to improve efficiency or effectiveness?

Audit Scope

This audit of the Insurance Department is for the biennium ended June 30, 2009. We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

The Insurance Department has operations in the following locations. Each location was included in the audit scope:

- The central office in the State Capitol.
- Special Funds Division located in south Bismarck.

Audit Methodology

To meet the objectives outlined above, we:

- Prepared financial statements from the legal balances on the state's accounting system tested as part of this audit and the audit of the state's Comprehensive Annual Financial Report and developed a discussion and analysis of the financial statements.
- Performed detailed analytical procedures including computer-assisted auditing techniques. These procedures were used to identify high-risk transactions and potential problem areas for additional testing.
- Tested internal control and compliance with laws and regulations which included selecting representative samples to determine if controls were operating effectively and to determine if laws were being followed consistently. Non-statistical sampling was used and the results were projected to the population. Where applicable, populations were stratified to ensure that particular groups within a population were adequately

- represented in the sample, and to improve efficiency by gaining greater control on the composition of the sample.
- Interviewed appropriate agency personnel.
 - Queried the ConnectND (PeopleSoft) system. Significant evidence was obtained from ConnectND.
 - Observed Insurance Department's processes and procedures.
 - Reviewed the bond coverage application process for state agencies and political subdivisions.

In aggregate there were no significant limitations or uncertainties related to our overall assessment of the sufficiency and appropriateness of audit evidence.

Discussion and Analysis

The accompanying financial statements have been prepared to present the Insurance Department's revenues and expenditures on the legal (budget) basis. The accompanying financial statements are not intended to be presented in accordance with generally accepted accounting principles (GAAP).

For the biennium ended June 30, 2009, operations of the Insurance Department were primarily supported by fees credited to the Insurance Regulatory Trust fund. This is supplemented by appropriations from the Insurance Tax Distribution Fund, federal funding, and other income credited to the agency's Petroleum Tank Release Compensation, Bonding, and Fire and Tornado Funds.

Financial Summary

The Insurance Department has significant investments held with the North Dakota State Investment Board. A majority of the investment balance is in the State Fire and Tornado Fund, but also in the Petroleum Tank Release Compensation fund, Insurance Regulatory Trust fund, and the State Bonding fund. These investments and the related activity are authorized by North Dakota Century Code sections 26.1-22-04, 23-37-30, 26.1-01-07.2, and 26.1-21-05, respectively. The Investments decreased from \$38,047,226 for the year ended June 30, 2008 to \$23,326,714 for the year ended June 30, 2009. The significant decrease is mainly due to the downturn in the economy and stock market.

The Insurance Department has deposits of securities held in custody for domestic life insurance companies in accordance with NDCC section 26.1-05-23. Amounts held in custody totaled \$2,261,894 for the year ended June 30, 2008 and \$114,679 for the year ended June 30, 2009. Activities surrounding these funds are not reported on the financial statements as the securities are held in a trust capacity for the insurance companies as agency funds.

Revenues consisted primarily of insurance premium taxes collections. Other revenues during the audit period included premiums collected in the fire and tornado fund and various fees for examinations, licensing agents and insurance companies, and petroleum tank registrations. Revenues decreased significantly from fiscal year 2008 to 2009. Total revenues were \$45,152,958 for the year ended June 30, 2009 as compared to \$54,604,118 for the year ended June 30, 2008. The majority of the decrease was due to insurance recovery receipts received in fiscal year 2008 from the tornado claim for the city of Northwood, ND.

Total expenditures and other uses for the Insurance Department were \$16,435,563 for the year ended June 30, 2009 as compared to \$23,041,500 for the prior year. A majority of the significant decrease was a result of the tornado claim paid in fiscal year 2008 to the city of Northwood, ND. Grants, benefits, and claims related to distributions to fire districts and loss claims, as well as legislative transfers to the general fund account for approximately 74% of total expenditures and other uses.

Analysis of Significant Changes in Operations

The 60th Legislative Assembly, Senate Bill 2183, Section 2 created the firefighters death benefit fund and provided for an appropriation up to \$50,000 from the insurance tax distribution fund to provide \$10,000 to a deceased firefighter's survivor upon the evidence of a line of duty death. There was one payment of \$10,000 that was paid during the audit period.

Analysis of Significant Variances Between Final Budgeted and Actual Expenditures

The excess of salary and wages appropriations over actual expenditures (\$903,730 unexpended appropriations) were a result of the vacant positions that remained open during the biennium ended June 30, 2009. Several of the positions that remained open were higher paid positions and were filled at lower pay levels.

Financial Statements

Statement of Revenues and Expenditures

	<u>June 30, 2009</u>	<u>June 30, 2008</u>
<u>Revenues:</u>		
Insurance Premium Tax	\$ 34,583,055	\$ 37,425,546
Licenses, Permits, and Fees	9,957,662	9,341,484
Insurance Recoveries	267,306	7,575,569
Revenue from the Federal Government	297,000	188,750
Miscellaneous	47,935	72,769
Total Revenues	\$ 45,152,958	\$ 54,604,118
<u>Expenditures and Other Uses:</u>		
Grants, Benefits and Claims	\$ 6,576,175	\$ 14,442,237
Salaries and Benefits	2,569,699	2,340,301
Insurance	1,833,981	1,690,463
Fees and Services	281,657	332,114
Supplies	189,210	137,300
Travel	123,820	151,709
IT Services	143,939	210,001
Rentals/Leases	116,627	121,743
Equipment	70,377	4,151
Transfers Out	4,530,078	3,611,481
Total Expenditures and Other Uses	\$ 16,435,563	\$ 23,041,500

Statement of Appropriations

For The Biennium Ended June 30, 2009

Expenditures by Line Item:	<u>Original Appropriation</u>	<u>Adjustments</u>	<u>Final Appropriation</u>	<u>Expenditures</u>	<u>Unexpended Appropriation</u>
Salaries and Benefits	\$ 5,786,747	\$ 26,983	\$ 5,813,730	\$ 4,910,000	\$ 903,730
Operating Expenses	2,178,377	550,000	2,728,377	2,014,743	713,634
Grants	6,490,000		6,490,000	6,490,000	
Totals	<u>\$ 14,455,124</u>	<u>\$ 576,983</u>	<u>\$ 15,032,107</u>	<u>\$ 13,414,743</u>	<u>\$ 1,617,364</u>
Expenditures by Source:					
Other Funds	\$ 14,455,124	\$ 576,983	\$ 15,032,107	\$ 13,414,743	\$ 1,617,364
Totals	<u>\$ 14,455,124</u>	<u>\$ 576,983</u>	<u>\$ 15,032,107</u>	<u>\$ 13,414,743</u>	<u>\$ 1,617,364</u>

Appropriation Adjustments:

The \$26,983 increase in the Salaries and Benefits line item was for market equity increases for classified state employees. The appropriated funds were approved by the 60th legislative assembly within Senate Bill 2189.

\$50,000 of the \$550,000 increase in the Operating Expenses line item was approved by the Emergency Commission to accept federal funds from the Centers for Medicare and Medicaid Services for services provided through the State Health Insurance Counseling (SHIC) program.

The remaining \$500,000 increase in the Operating Expenses line item was an emergency measure authorized by the 61st legislative assembly in Section 2 of House Bill 1010 to transfer money to the state bonding fund from the insurance regulatory trust fund.

Expenditures Without Appropriations Of Specific Amounts:

Bonding Fund – Claims-related expenditures have a continuing appropriation in accordance with NDCC section 26.1-21-02. (\$175,384 of expenditures for this biennium)

Fire and Tornado Fund – Claims-related expenditures have a continuing appropriation in accordance with NDCC section 26.1-22-13. (\$16,061,613 of expenditures for this biennium)

Petroleum Tank Release Compensation Fund – Claims paid out have a continuing appropriation as authorized by NDCC section 23-37-29. (\$2,465,304 of expenditures for this biennium)

Insurance Regulatory Trust Fund – Legislative non-appropriated transfers to the general fund authorized by NDCC section 26.1-01-07.1. (\$7,350,015 of transfers for this biennium)

Firefighters Death Benefit Fund – Benefits paid out have a continuing appropriation as authorized by NDCC section 18-05.1-02. (\$10,000 of expenditures for this biennium)

Internal Control

In our audit for the biennium ended June 30, 2009, we identified the following areas of the Insurance Department's internal control as being the highest risk:

Internal Controls Subjected to Testing:

- Controls surrounding the processing of revenues.
- Controls surrounding the processing of expenditures.
- Controls relating to compliance with legislative intent
- Controls surrounding the ConnectND (PeopleSoft) system.

The criteria used to evaluate internal control is published in the publication *Internal Control – Integrated Framework* from the Committee of Sponsoring Organizations (COSO) of the Treadway Commission.

We gained an understanding of internal control surrounding these areas and concluded as to the adequacy of their design. We also tested the operating effectiveness of those controls we considered necessary based on our assessment of audit risk. We concluded that internal control was not adequate noting a certain matter involving internal control and its operation that we consider to be a significant deficiency.

Auditors are required to report deficiencies in internal control that are significant within the context of the objectives of the audit. A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect (1) misstatements in financial or performance information, (2) violations of laws and regulations, or (3) impairments of effectiveness or efficiency of operations, on a timely basis. Considering both qualitative and quantitative factors, we identified the following significant deficiency in internal control. We also noted other matters involving internal control that we have reported to management of Insurance Department in a management letter dated May 18, 2010.

Segregation of Duties Surrounding Accounts Receivable (Finding 09-1)

Condition:

The individual assigned to post debits and credits to accounts receivable and prepare billings for the Petroleum Tank and Bonding funds collections also opens the mail, prepares remittance listing, reconciles deposits in the Company Licensing System to the State Bonding Fund, and performs data entry into the Insurance Department's Company Licensing System and Connect ND Financials.

The individual assigned to post debits and credits to account receivable and prepare billings for the Boiler Inspection Fund collections also restrictively endorses checks and has access to cash.

Effect:

Receipts received through the mail could be taken and go undetected as the same individual is responsible for posting to the system.

Cause:

This was a prior formal recommendation that was not implemented.

Criteria:

According to the Committee of Sponsoring Organizations (COSO) Internal Control - Integrated Framework Executive Summary, segregation of duties is a control activity used to ensure necessary actions are taken to address an entity's operating risks. Properly designed segregation of duties requires an individual independent of billing and maintaining accounts receivable records receive or handle revenue collections.

Recommendation:

We recommend the Insurance Department properly segregate duties surrounding accounts receivable by ensuring an individual, with no access to cash, maintain accounts receivable records and prepare billings.

Insurance Department Response:

The Insurance Department agrees with the finding.

Duties for the affected positions have been or will be reassigned. The Department is working on implementing the PeopleSoft Accounts Receivable module to allow the proper segregation of duties with the limited number of staff available in the Department.

Compliance With Legislative Intent

In our audit for the biennium ended June 30, 2009, we identified and tested the Insurance Department's compliance with legislative intent for the following areas that we determined to be significant and of higher risk of noncompliance:

- Fees, recovered expenses, and interest earned are properly deposited into the Petroleum Tank Release Compensation fund (NDCC 23-37-15 and 23-37-17).
- Properly calculated and deposited cost of examinations (NDCC 26.1-03-19.6).
- Proper deposit and withdrawal of securities of domestic life insurance companies (NDCC 26.1-05-23, 25).
- Proper use of the following legally restricted funds:
 - Unsatisfied Judgment fund
 - Bonding fund
 - Fire and Tornado fund
 - Petroleum Tank Release Compensation fund
 - Insurance Tax Distribution fund
 - Firefighter's Death Benefit fund
- Compliance with appropriations and related transfers (2007 North Dakota Session Laws chapter 37).
- Proper use of the State Treasurer (State Constitution, article X, section 12).
- Compliance with OMB's Purchasing Procedures Manual.
- Adequate blanket bond coverage of employees (NDCC section 26.1-21-08).

The criteria used to evaluate legislative intent are the laws as published in the *North Dakota Century Code* and the *North Dakota Session Laws*.

Government Auditing Standards requires auditors to report all instances of fraud and illegal acts unless they are inconsequential within the context of the audit objectives. Further, auditors are required to report significant violations of provisions of contracts or grant agreements, and significant abuse that has occurred or is likely to have occurred.

The results of our tests disclosed an instance of noncompliance that is required to be reported under *Government Auditing Standards*. The finding is described below. Other than this finding, we concluded there was compliance with the legislative intent identified above. We also noted certain inconsequential instances of noncompliance that we have reported to management of the Insurance Department in a management letter dated May 18, 2010.

Petroleum Tank Registration Fees (Finding 09-2)

Condition:

Petroleum tank registration fees were not collected for the proper amount in accordance with North Dakota Century Code (NDCC) section 23-37-17. Out of a test of ten petroleum tank registration fees collected by the Insurance Department, six were for an incorrect amount. The total error was \$1,421.

Effect:

The Petroleum Tank Fund is not receiving the proper registration amounts as required by NDCC 23-37-17.

Cause:

When registration fees are collected there is no process in place to ensure the proper fee was collected. Registration forms are completed by the company that is registering the tanks. Those forms are received by the Insurance Department but are not reviewed to ensure the company properly completed the form. In some instances checks are received with no registration form attached and the Insurance Department simply deposits the check with no way to verify if the amount remitted was proper.

Criteria:

NDCC 23-37-17 stipulates the proper fee that is to be collected for petroleum tank registrations.

Recommendation:

We recommend the Insurance Department implement procedures to ensure petroleum tank registration fees are collected in accordance with NDCC 23-37-17.

Insurance Department Response:

The Insurance Department agrees with this finding.

Additional procedures have been put in place to ensure the proper fees are collected from petroleum tank owners. The Department is also implementing additional internal audit procedures to ensure compliance with Department procedures and rules.

Operations

This audit did not identify areas of the Insurance Department's operations where we determined it was practical at this time to help to improve efficiency or effectiveness.

Prior Recommendations Not Implemented

Prior recommendations have been implemented with the exception of the following:

Segregation of Duties Surrounding Accounts Receivables (Finding 07-2)

Recommendation: We recommend the Insurance Department properly segregate duties surrounding accounts receivable by ensuring an individual independent of access to cash maintain accounts receivable records and prepare billings.

Status: Not Implemented. The individual responsible for posting debits and credits to accounts in the Petroleum Tank and Bonding funds is still performing data entry of revenue into the Company Licensing system and PeopleSoft and has access to cash. Recommendation will be reissued in Finding 09-1.



STATE OF NORTH DAKOTA
OFFICE OF THE STATE AUDITOR
STATE CAPITOL
600 E. BOULEVARD AVENUE - DEPT. 117
BISMARCK, NORTH DAKOTA 58505

Management Letter (Informal Recommendations)

May 18, 2010

The Honorable Adam Hamm
Insurance Commissioner
Insurance Department
600 E. Boulevard Avenue
Bismarck, ND 58505

Dear Mr. Hamm:

We have performed an audit of the Insurance Department for the biennium ended June 30, 2009, and have issued a report thereon. As part of our audit, we gained an understanding of the Insurance Department's internal control structure to the extent we considered necessary to achieve our audit objectives. We also performed tests of compliance as described in the same report.

Our audit procedures are designed primarily to enable us to report on our objectives including those related to internal control and compliance with laws and regulations and may not bring to light all weaknesses in systems and procedures or noncompliance with laws and regulations which may exist. We aim, however, to use our knowledge of your organization gained during our work to make comments and suggestions which we hope will be useful to you.

In connection with the audit, gaining an understanding of the internal control structure, and tests of compliance with laws and regulations referred to above, we noted certain conditions we did not consider reportable within the context of your audit report. These conditions relate to areas of general business practice or control issues that have no significant bearing on the administration of federal funds. We do, however, want to present our recommendations to you for your consideration and whatever follow-up action you consider appropriate. During the next audit we will determine if these recommendations have been implemented, and if not, we will reconsider their status.

The following present our informal recommendations.

ACCOUNTS RECEIVABLE/REVENUE

Informal Recommendation 09-1: We recommend the Insurance Department develop processes to ensure all amounts due to the State Bonding Fund related to bonding fund repayments and Game and Fish vendor license fees are deposited into the State Bonding Fund.

ACCOUNTS PAYABLE/EXPENDITURES

Informal Recommendation 09-2: We recommend the Insurance Department ensure that authorized purchase card holders receive the proper levels of delegated authority to coincide with their individual purchase limit.

Informal Recommendation 09-3: We recommend the Insurance Department look for ways to increase their usage of the P-card as a form of payment. We further recommend, if necessary, they meet with officials from OMB to facilitate this process by raising P-card limits, determining which of their vendors they could be making P-card payments to, or changing the accounting on their P-cards so as to limit or eliminate the need to re-allocate P-card expenditures.

GENERAL

Informal Recommendation 09-4: We recommend the Insurance Department review and approve transactions that have been processed by the Treasurer's Office and Office of Management and Budget to ensure all processed transactions are properly recorded in the Insurance Department's accounting records. We also recommend the Insurance Department include proper support for correcting entries completed in ConnectND.

Informal Recommendation 09-5: We recommend the Insurance Department ensure percentages used in calculating estimates for current/non-current fire and tornado claims and bonding allowance for doubtful accounts are properly supported with historical comparisons.

Management of Insurance Department agreed with these recommendations.

I encourage you to call myself or an audit manager at 328-2241 if you have any questions about the implementation of recommendations included in your audit report or this letter.

Sincerely,



Andrea Wike
Auditor in-charge

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