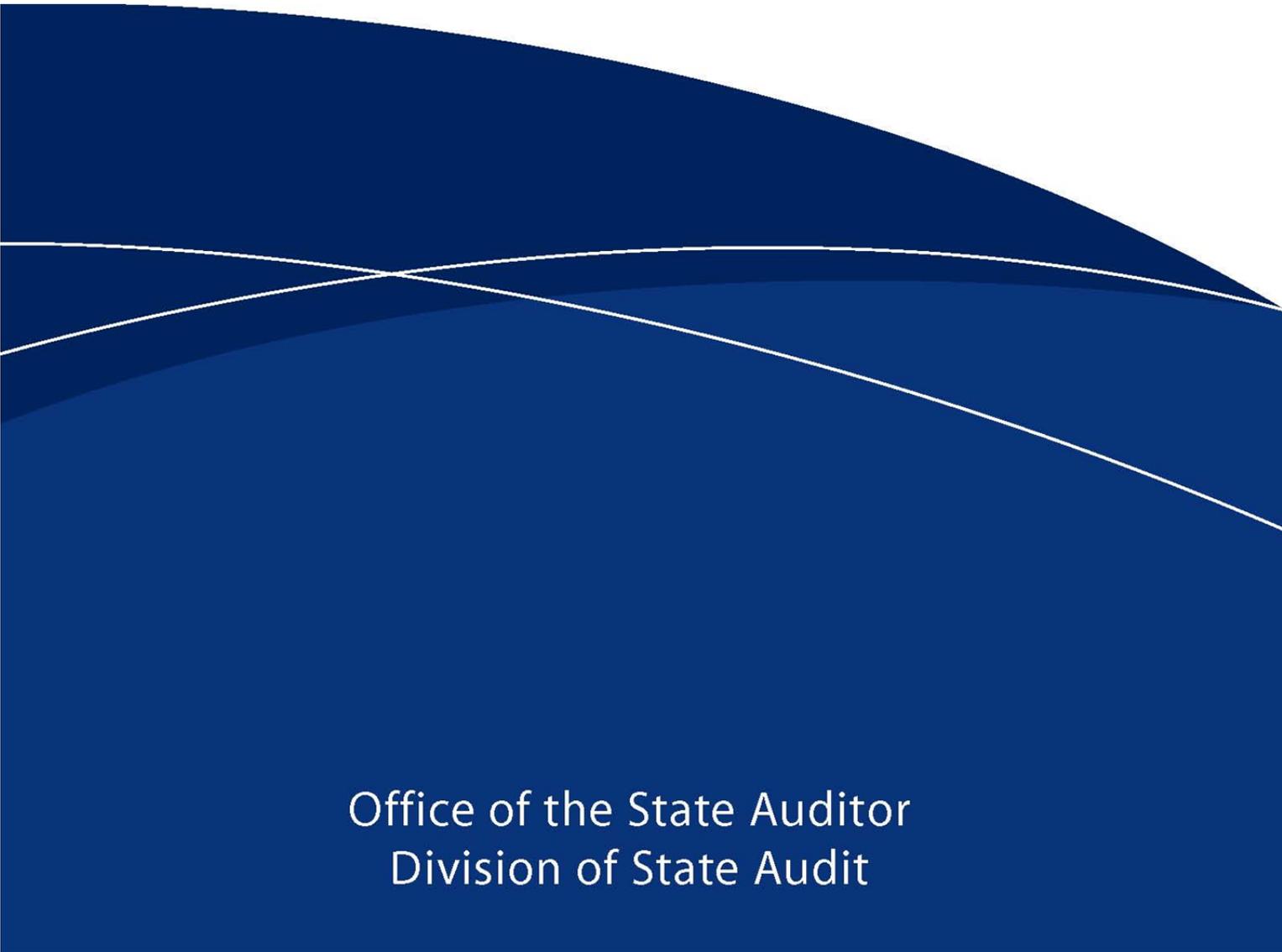


Insurance Department  
BISMARCK, NORTH DAKOTA

# Audit Report

For the Biennium  
June 30, 2011

ROBERT R. PETERSON  
STATE AUDITOR



Office of the State Auditor  
Division of State Audit

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**OFFICE OF THE STATE AUDITOR**  
STATE CAPITOL  
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BISMARCK, NORTH DAKOTA 58505

## *Transmittal Letter*

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August 2, 2012

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

We are pleased to submit this audit of the North Dakota Insurance Department for the biennium ended June 30, 2011. 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 Angela Klubberud. Jacqueline Castleberry was the staff auditor. 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*

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## ***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 Inspection Program, Senior Health Insurance Counseling Program, and Prescription Connection 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 responses 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 findings addressing "petroleum tank registration fees" (page 12) 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?*

Yes.

### *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?*

One of the two prior findings, "petroleum tank registration fees," was not implemented as shown on page 15.

### *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 16 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***

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## ***Audit Objectives***

The objectives of this audit of the Insurance Department for the biennium ended June 30, 2011 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, 2011. 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
- Company Licensing Department in north Bismarck
- Special Funds and Consumer Assistance 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.

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*

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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, 2011, 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. The majority of the investment balance is for the State Fire and Tornado Fund, however, investments are also held for 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 (NDCC) sections 26.1-22-04, 23-37-30, 26.1-01-07.2, and 26.1-21-05, respectively. The Investments decreased from \$28,734,737 for the year ended June 30, 2010 to \$21,907,264 for the year ended June 30, 2011. These investments are overseen by the State Investment Board and invested by the North Dakota Retirement Office.

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 were \$123,628 for each of the years ended June 30, 2010 and June 30, 2011. 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 tax collections. Other revenues during the audit period included regulatory fees, which are primarily premiums collected in the fire and tornado fund; licenses and fees for examinations, licensing agents, and insurance companies; and petroleum tank registrations. Total revenues were \$52,405,628 for the year ended June 30, 2010 as compared to \$50,963,344 for the year ended June 30, 2011. The majority of the decrease was due to a reduction in the fire and tornado premiums collected in fiscal year 2011.

Total expenses and other uses for the Insurance Department were \$15,604,513 for the year ended June 30, 2010 as compared to \$19,838,020 for the year ended June 30, 2011. The increase in total expenditures for the audited period reflects primarily transfers out, grants and claims, and professional services. Transfers out were made in accordance with NDCC 26.1-01-07.1 which stipulates that any amount in excess of one million dollars at the end of the fiscal year in the insurance regulatory trust fund be transferred to the general fund. Grants to fire districts and loss claims account for the majority of the grant expenditures during the fiscal years reviewed. The increase in expenditures for professional services is due to investigation and engineering fees related to the North Dakota State University Minard Hall building collapse. All other expenditures remained fairly constant.

### ***Analysis of Significant Changes in Operations***

The Patient Protection and Affordable Care Act was signed into law in March of 2010. The North Dakota Insurance Department is continually analyzing information on the law's effect on the insurance industry and consumers in North Dakota as well as the changes the Insurance Department can make to comply with and implement the Patient Protection and Affordable Care Act.

### ***Analysis of Significant Variances - Budgeted and Actual Expenditures***

The excess of salary and wages appropriations over actual expenditures (\$644,996 unexpended appropriations) were a result of the vacant positions that remained open during the biennium ended June 30, 2011. Several of the positions that remained open were higher paid positions and were filled at lower pay levels.

The excess of operating expenses appropriations over actual expenditures (\$672,188 unexpended appropriations) were a result of the cancellation of an update to the Fire and Tornado software system. Additionally, the anhydrous ammonia inspection program was transferred to the North Dakota Agriculture Department.

# Financial Statements

## Statement of Revenues and Expenditures

	<u>June 30, 2011</u>	<u>June 30, 2010</u>
<b><u>Revenues and Other Sources:</u></b>		
Insurance Premium Tax	\$36,686,392	\$35,893,903
Licenses and Fees	6,296,886	7,047,089
Regulatory Fees	3,639,646	6,547,934
Revenue from the Federal Government	252,672	236,500
Bonding Fund Claim Collections	79,373	21,497
Insurance Recoveries	5,410	84,628
Miscellaneous	8,094	7,606
Interest and Investment Earnings	1,532	912
Transfer In	3,993,337	2,565,559
<b>Total Revenues and Other Sources</b>	<u>\$50,963,344</u>	<u>\$52,405,628</u>
<b><u>Expenditures and Other Uses:</u></b>		
Salaries and Benefits	\$ 3,003,064	\$ 2,820,476
Major Operating Expenses:		
Grants and Claims	8,799,363	6,724,054
Insurance	2,455,799	2,455,340
Professional Services	777,739	218,117
IT Data Processing	168,985	124,113
Rentals/Leases – Building/Land	122,153	123,517
Travel	105,514	102,874
IT Software	48,246	45,243
Postage	38,753	45,598
IT Communications	33,623	35,291
IT Services	27,665	12,037
Printing	22,785	26,208
Professional Development	22,117	19,959
Equipment under \$5,000	10,960	25,993
Other Expenses	80,507	69,976
Transfers Out	4,120,774	2,755,717
<b>Total Expenditures and Other Uses</b>	<u>\$19,838,020</u>	<u>\$15,604,513</u>

## Statement of Appropriations

For The Biennium Ended June 30, 2011

<b>Expenditures by Line Item:</b>	<u>Original Appropriation</u>	<u>Adjustments</u>	<u>Final Appropriation</u>	<u>Expenditures</u>	<u>Unexpended Appropriation</u>
Salaries and Wages	\$ 6,335,607	\$ 132,866	\$ 6,468,536	\$ 5,823,540	\$ 644,996
Operating Expenses	2,563,264	(500,000)	2,063,264	1,391,076	672,188
Capital Assets	170,000		170,000	10,000	160,000
Technology Project Carryover		25,000	25,000	25,000	
Grants	6,990,000		6,990,000	6,974,486	15,514
<b>Totals</b>	<u>\$ 16,058,934</u>	<u>\$ (342,134)</u>	<u>\$ 15,716,800</u>	<u>\$ 14,224,102</u>	<u>\$ 1,492,698</u>
<b>Expenditures by Source:</b>					
Other Funds	\$ 16,058,934	\$ (342,134)	\$ 15,716,800	\$ 14,224,102	\$ 1,492,698
<b>Totals</b>	<u>\$ 16,058,934</u>	<u>\$ (342,134)</u>	<u>\$ 15,716,800</u>	<u>\$ 14,224,102</u>	<u>\$ 1,492,698</u>

### Appropriation Adjustments:

The \$132,866 increase in the Salaries and Benefits line item was for market equity increases for classified state employees. The appropriated funds were approved by House Bill 1015 of the 2009 Session Laws, section 18.

The \$500,000 decrease in the Operating Expenses line item was an emergency measure authorized by House Bill 1010 of the 2009 Session Laws, section 2, to transfer money to the state bonding fund from the insurance regulatory trust fund, which was done in May 2009.

The \$25,000 increase in the Technology Project Carryover line item was approved by North Dakota Century Code Section 54-44.1-11.

### Expenditures Without Appropriations Of Specific Amounts:

Bonding Fund – Claims-related expenditures have a continuing appropriation in accordance with NDCC section 26.1-21-02. (\$72,313 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. (\$13,044,468 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. (\$1,649,554 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. (\$6,300,521 of transfers for this biennium)

Insurance Tax Distribution Fund – Benefits paid out have a continuing appropriation as authorized by NDCC section 18-04-05. (\$151,104 of expenditures for this biennium)

## *Internal Control*

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In our audit for the biennium ended June 30, 2011, 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.
- Controls surrounding the State Based System(SBS) information 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 internal control was adequate.

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 did not identify any significant deficiencies in internal control. However, we noted other matters involving internal control that we have reported to management of the North Dakota Insurance Department in a management letter dated August 2, 2012.

## ***Compliance With Legislative Intent***

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In our audit for the biennium ended June 30, 2011, we identified and tested the Insurance Department's compliance with legislative intent for the following areas 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).
- Compliance with appropriations (2009 Session Laws, House Bill 1010, sections 2 through 8).
- Proper deposit into the firefighters' death benefit fund (NDCC section 26.1-03-17).
- Proper use of the following legally restricted funds:
  - Fire and Tornado Fund
  - Unsatisfied Judgment Fund
  - Petroleum Release Compensation Fund
  - State Bonding Fund
  - Insurance Tax Distribution Fund
  - Firefighters Death Benefit Fund
- Proper use of the State Treasurer (State Constitution, article X, section 12).
- Compliance with OMB's Purchasing Procedures Manual.
- Travel-related expenditures are made in accordance with OMB policy and state statute.
- Adequate blanket bond coverage of employees (NDCC section 26.1-21-08).
- Compliance with payroll-related laws including statutory salaries for applicable elected and appointed positions, and certification of payroll.

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.

### ***Petroleum Tank Registration Fees (Finding 11-1)***

#### **Condition:**

Documentation was not maintained to determine if the proper petroleum tank registration fees were collected in accordance with North Dakota Century Code (NDCC) Section 23-37-17.

Eight errors were noted out of a test of fourteen high-risk registration collections. Seven registration payments received by the Insurance Department were found to have no documentation as to how the fee collected was determined. An additional registration was found to have been calculated incorrectly.

**Criteria:**

North Dakota Century Code (NDCC) Section 23-37-17 stipulates that an owner or operator of a tank shall pay an annual registration fee of \$50 for each tank or if the amount of money in the Petroleum Release Compensation Fund is less than \$6 million, the annual registration fee is increased to \$100. The annual registration fee may be reduced to \$5 if the amount of money in the fund exceeds \$9 million. Additionally, an owner or operator shall pay \$75 for each aboveground tank and \$125 for each underground tank for each year that the tank was required to be registered for which a fee was not paid.

**Cause:**

Lack of controls to ensure records are maintained.

**Effect or Potential Effect:**

We are unable to determine if the Petroleum Tank Registration Fund is receiving the proper registration amounts as required by NDCC.

**Recommendation:**

We recommend the Insurance Department maintain documentation to ensure the proper amount of Petroleum Tank Registration fees are collected in accordance with North Dakota Century Code section 23-37-17.

***Insurance Department's Response:***

The agency agrees with this recommendation. We have addressed the issue and have implemented new business practices to correct the problem going forward. We will continually monitor the program to ensure the procedures are being followed.

## *Operations*

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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***

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

### **Petroleum Tank Registration Fees (Finding 09-2)**

#### **Recommendation:**

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

#### **Status:**

Not implemented. See reissuance of recommendation on page 12.

## ***Management Letter (Informal Recommendations)***

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August 2, 2012

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, 2011, 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.

### **REVENUE**

Informal Recommendation 11-1: We recommend the Insurance Department reconciliation of federal funds deposited into PeopleSoft is prepared by someone independent of the individual responsible for drawing down federal funds.

Informal Recommendation 11-2: We recommend the Insurance Department develop procedures to ensure a timely follow-up on all delinquent Bonding Fund accounts receivable.

## INFORMATION SYSTEMS

Informal Recommendation 11-3: We recommend the Insurance Department review controls surrounding the State Based System to ensure controls are adequate, including a separation of duties for access to cash and online access to accounting records and reconciliations of:

- Remittance list to deposit
- Credit card machine transactions by someone without access
- Licenses issued through online integration with money received

Informal Recommendation 11-4: We recommend the Insurance Department review and approve the annual reconciliation of the State Based System to the Company Licensing System.

## GENERAL

Informal Recommendation 11-5: We recommend the Insurance Department annually review estimates made in their annual financial reporting for reasonableness.

Management of the North Dakota 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,



Angela Klubberud  
Auditor in-charge

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or by contacting the  
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