

Insurance Department
BISMARCK, NORTH DAKOTA

Audit Report

For the Biennium Ended
June 30, 2015



Office of the State Auditor
Division of State Audit

**LEGISLATIVE AUDIT AND FISCAL REVIEW
COMMITTEE MEMBERS**

**Senator Jerry Klein – Chairman
Representative Chet Pollert – Vice Chairman**

Representatives

**Patrick Hatlestad
Jerry Kelsh
Keith Kempenich
Lawrence R. Klemin
Gary Kreidt
Andrew G. Maragos
Bob Martinson
Corey Mock
Mike Nathe
Marvin E. Nelson
Robert J. Skarphol**

Senators

**Judy Lee
David O'Connell**

Contents

<i>Transmittal Letter</i>	<i>1</i>
<i>Executive Summary</i>	<i>2</i>
<i>Introduction</i>	<i>2</i>
<i>Responses to LAFRC Audit Questions</i>	<i>2</i>
<i>LAFRC Audit Communications</i>	<i>3</i>
<i>Audit Objectives, Scope, and Methodology</i>	<i>4</i>
<i>Discussion and Analysis</i>	<i>6</i>
<i>Financial Summary</i>	<i>6</i>
<i>Analysis of Significant Variances - Budgeted and Actual Expenditures</i>	<i>7</i>
<i>Financial Statements</i>	<i>8</i>
<i>Statement of Revenues and Expenditures</i>	<i>8</i>
<i>Statement of Appropriations</i>	<i>9</i>
<i>Internal Control</i>	<i>10</i>
<i>Compliance With Legislative Intent</i>	<i>12</i>
<i>Operations</i>	<i>14</i>
<i>Boiler Inspections</i>	<i>14</i>
<i>Company Licensing</i>	<i>16</i>
<i>Insurance Premium Tax Collections</i>	<i>17</i>
<i>Fire District Payments</i>	<i>18</i>
<i>Management Letter (Informal Recommendations)</i>	<i>19</i>



STATEAUDITOR
ROBERT R. PETERSON

PHONE
(701) 328 - 2241
FAX
(701) 328 - 1406

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

Transmittal Letter

July 19, 2016

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, 2015. 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 Lindsey Ressler. Elizabeth Rogers, Holly Robak, and Amanda Westlake were the staff auditors. Cindi Pedersen, 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, reading "Rob 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 Department provides a variety of services including agent licensing and investigation, consumer protection, financial examinations, and company licensing. The Insurance Department 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 the 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 unmodified 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 "insufficient verification of boiler violation resolution" (page 15), 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?

Yes.

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 19 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), National Producer Registry (NIPR), OPTins, and the State Based System (SBS) 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, 2015 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, 2015. We conducted our 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 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 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

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, 2015, 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 Department's Petroleum Tank Release Compensation Fund, Bonding Fund, and the Fire and Tornado Fund.

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 \$40,460,340 for the year ended June 30, 2014, to \$36,173,661 for the year ended June 30, 2015. The decrease in investments was due to the State Fire and Tornado Fund waiving premiums in fiscal year 2015. These investments are overseen by the State Investment Board and invested by the North Dakota Retirement Office.

Revenues consisted primarily of insurance premium tax, licenses and fees, and regulatory fees. Licenses and fees collections include revenues from the examination and licensing of agents and companies, as well as petroleum tank registration fees. Regulatory fees are primarily premiums collected in the Fire and Tornado fund. Total revenues and other sources were \$72,804,012 for the year ended June 30, 2015 as compared to \$69,432,993 for the year ended June 30, 2014. The difference was the result of an increase in premium tax collections and decrease in regulatory fees. The decrease was due to the waiver of State Fire and Tornado premiums. The increase was due to increased premium tax collections as a result of North Dakota's increased population and increased property values.

Expenditures and other uses for the Insurance Department were \$24,846,219 for the year ended June 30, 2015 and \$20,904,408 for the year prior. Grants and Claims, Insurance, and Transfers Out accounted for approximately 80% of total expenditures during the fiscal years reviewed. Grants and Claims consisted primarily of claims from the Fire and Tornado, Bonding, and Petroleum Tank Release Compensation Funds. Grant disbursements from the Insurance Tax Distribution Fund to the Fire Fighter's Association and fire departments were made in accordance with NDCC 18-04-05 and within appropriation authorized by Chapter 178, Section 3 of the 2013 Legislative Assembly. Insurance expenditures are related to the state's property insurance within the Fire and Tornado Fund. The majority of the transfers out were made up of legislatively mandated transfers of excess funds from the Insurance Regulatory Trust Fund to the state's General Fund in accordance with NDCC 26.1-07-07.1(3). All other expenditures remained fairly constant.

Analysis of Significant Variances - Budgeted and Actual Expenditures

The excess of salaries and benefits line appropriations over actual expenditures were due to the Insurance Department being unable to fill vacant positions. The excess in the operating expenses line was due to over-estimated expenses, mainly for the professional services line. The Department had budgeted for the potential of consultants being hired for healthcare reform, but none were hired.

Financial Statements

Statement of Revenues and Expenditures

	June 30, 2015	June 30, 2014
<u>Revenues and Other Sources:</u>		
Insurance Premium Tax	\$ 58,008,109	\$ 51,047,337
Licenses and Fees	7,458,512	7,994,458
Regulatory Fees	758,953	4,703,591
Fines and Forfeitures	685,321	1,175,393
Revenue from Federal Government	261,692	288,493
Insurance Recoveries	118,152	312,948
Bonding Fund Claim Collections	37,000	10,000
Unsatisfied Judgement Fees	30,000	11,975
Other Revenue	839	4,792
Transfers In	5,445,434	3,884,006
Total Revenues and Other Sources	\$ 72,804,012	\$ 69,432,993
<u>Expenditures and Other Uses:</u>		
Grants and Claims	\$ 11,504,927	\$ 9,504,798
Salaries and Benefits	3,588,665	3,422,354
Insurance	3,366,439	3,073,954
Professional Fees and Services	201,639	178,335
Rent of Building Space	187,854	175,760
IT Data Processing	148,413	142,537
Travel	119,281	138,641
Supplies	38,749	19,334
Operating Fees and Services	38,557	104,235
Postage	32,723	34,228
IT Communications	29,694	33,908
IT Software	26,878	33,469
Professional Development	25,567	23,223
Printing	13,090	23,826
Equipment under \$5000	5,528	13,458
IT Contractual Services	5,007	4,103
Transfers Out	5,513,208	3,978,245
Total Expenditures and Other Uses	\$ 24,846,219	\$ 20,904,408

Statement of Appropriations

For The Biennium Ended June 30, 2015

Expenditures by Line Item:	<u>Original Appropriation</u>	<u>Adjustment</u>	<u>Final Appropriation</u>	<u>Expenditures</u>	<u>Unexpended Appropriation</u>
Salaries and Benefits	\$ 8,019,514		\$ 8,019,514	\$ 6,967,600	\$ 1,051,914
Accrued Leave Payments	163,182		163,182	37,907	125,275
Operating Expenses	2,858,008		2,858,008	1,516,448	1,341,560
Grants	15,336,386		15,336,386	15,296,919	39,467
Totals	<u>\$ 26,377,090</u>	<u>\$0</u>	<u>\$ 26,377,090</u>	<u>\$ 23,818,874</u>	<u>\$ 2,558,216</u>
Expenditures by Source:					
Special Funds	\$ 24,996,065		\$ 24,996,065	\$ 23,267,985	\$ 1,728,080
Federal Funds	1,381,025		1,381,025	550,889	830,136
Totals	<u>\$ 26,377,090</u>	<u>\$0</u>	<u>\$ 26,377,090</u>	<u>\$ 23,818,874</u>	<u>\$ 2,558,216</u>

Expenditures Without Appropriations of Specific Amounts:

Bonding Fund has a continuing appropriation for claims-related expenditures in accordance with NDCC section 26.1-21-02 (\$108,929 of expenditures for this biennium).

Fire and Tornado Fund has a continuing appropriation for claims-related expenditures in accordance with NDCC section 26.1-22-13 (\$11,567,278 of expenditures for this biennium).

Petroleum Tank Release Compensation Fund has a continuing appropriation for claim reimbursements in accordance with NDCC section 23-37-29 (\$884,763 of expenditures for this biennium).

Insurance Regulatory Trust Fund has non-appropriated transfers to the general fund authorized by NDCC section 26.1-01-07.1 (\$9,291,639 of transfers for this biennium).

Insurance Tax Distribution Fund has continuing appropriation for transfers and disbursements as authorized by NDCC section 18-04-05 (37,801 of expenditures for this biennium).

Unsatisfied Judgment Fund has a continuing appropriation for judgments collected under NDCC 26.1-23 (\$12,269 of expenditures for this biennium).

Internal Control

In our audit for the biennium ended June 30, 2015, 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 effecting the safeguarding of assets.
- Controls relating to compliance with legislative intent.
- Controls surrounding the ConnectND (PeopleSoft) system.
- Controls surrounding the reconciliation of revenue on the remittance listing, ConnectND (Peoplesoft), and the State Based System (SBS) information system.
- Controls surrounding the revenue processed through the OptIns information system and ConnectND (Peoplesoft).
- Controls surrounding investments.
- Controls surrounding the processing of payroll.
- Controls surrounding the receipt and review of the Statement on Standards for Attestation Engagements No. 16- Reporting on Controls at a Service Organization for service organizations collecting and handling premium tax, company licensing and agent licensing filings, and related revenue collections.
- Controls surrounding the proper accumulation of annual fire district reporting for distribution of amounts due to certified city fire departments, rural fire departments, and fire protection districts in accordance with North Dakota Century Code 18-04-05.
- Controls surrounding the submission of insurance premium tax payments and collection of revenue.
- Controls surrounding licensing of insurance companies and collection of license revenue.

The criteria used to evaluate internal control is published in the publication *Standards for Internal Control in the Federal Government* issued by the Comptroller General of the United States (Green Book, GAO-14-704G). Agency management must establish and maintain effective internal control in accordance with policy of the Office of Management and Budget (OMB Policy 216) and, for programs receiving federal funds, the Code of Federal Regulation as set forth by the federal government (2 CFR 200.303).

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 a certain inconsequential or insignificant instance of control weakness that we have reported to management of the Insurance Department in a management letter dated July 19, 2016.

Compliance With Legislative Intent

In our audit for the biennium ended June 30, 2015, 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:

- Compliance with appropriation laws (2013 Session Laws, chapter 10), including:
 - \$1,552,929 from the fire and tornado fund for fire and tornado administrative expenses (section 3).
 - \$45,199 from the bonding fund for bonding administrative expenses (section 2).
 - \$28,690 from the unsatisfied judgment fund for unsatisfied judgment administrative expenses (section 4).
 - \$107,598 from the petroleum release compensation fund for petroleum release compensation administrative expenses (section 15).
- Proper use of the following legally restricted funds:
 - Unsatisfied Judgement Fund (NDCC 26.1-23-01).
 - State Bonding Fund (NDCC 26.1-21-17).
 - State Fire and Tornado Fund (NDCC 26.1-22-02).
 - Petroleum Release Compensation Fund (NDCC 23-37)
 - Insurance Tax Distribution Fund (NDCC 18-04-05).
- Proper payment of amounts due from the insurance tax distribution fund to certified city fire departments, rural fire departments, or fire protection districts in accordance with NDCC 18-04-05.
- Proper transfer of remaining fund balance in the insurance regulatory trust fund exceeding \$1,000,000 to the general fund in accordance with NDCC 26.1-01-07.1(3).
- Insurance Premium Tax fees were properly collected and companies pay a minimum of \$200 if no credits were available (NDCC 26.1-03-17).
- Proper waiver of state bonding fund premiums (NDCC 26.1-21-09).
- Proper collection of boiler inspection and certificate fees in accordance with NDCC 26.1-22.1-09.
- Proper completion of replacement cost appraisals for each state agency and institution once every 6 years (NDCC 26.1-22-06.1).
- Development of guidelines for determining insurable values of state-owned property and property belonging to an international peace garden or a winter show (NDCC 26.1-22-06).
- Maintenance of the reserve balance in the State Fire and Tornado Fund above \$12 million (NDCC 26.1-22-14).
- Proper reporting of all premiums and loses in the fund during the prior biennium to the Insurance Services Office for inclusion in rate calculations (NDCC 26.1-22-14).
- Fire and Tornado premiums are certified by the agency and interest is charged for any payments not received within 60 days of certification (NDCC 26.1-22-15).
- Proper approval of accreditation of continuing education courses and proper fee collected (NDCC 26.1-26-31.3).

- Application of proper statutory rates relating to revenue (NDCC Sections 23-37-17, 26.1-01-07, 26.1-03-19.6).
- Proper authorization of the Insurance Department funds.
- Proper authority for investments.
- Proper use of the State Treasurer (State Constitution, article X, section 12).
- Adequate blanket bond coverage of employees (NDCC 26.1-21-08).
- Proper use of the Bank of North Dakota as depository for credit card revenue in accordance with NDCC 54-06-08.2.
- Proper deposit of interest income.
- Compliance with fixed asset requirements including record-keeping, surplus property, and annual inventory.
- 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 require 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 no instances of noncompliance that are required to be reported under *Government Auditing Standards*. Thus, we concluded there was compliance with the legislative intent identified above.

While we did not find any items that were required to be reported in accordance with *Government Auditing Standards*, we noted certain inconsequential or insignificant instances of non-compliance that we have reported to management of the Insurance Department in a management letter dated July 19, 2016.

Operations

Our audit of the Insurance Department included a review of operations surrounding Boiler Inspections, Company Licensing, Premium Tax Collections, and Fire District Payments.

Boiler Inspections

Background

The state of North Dakota has 10,204 active boilers subject to inspection in the state. North Dakota Century Code chapter 26.1-22.1 requires that each boiler is inspected a minimum of once every 3 years; however, a majority are inspected annually. All inspections are conducted in accordance with the National Board Inspection Code Book published by the National Board of Boiler and Pressure Vessel Inspectors. Any violations identified are communicated with the boiler owners through a service letter. The service letter identifies the violation and the boiler owner must certify that repairs have been made, if repairs were necessary. An inspection certificate is issued allowing the boiler to operate in the state once the inspection, including any necessary certification of repairs, is complete.

Our audit of the Insurance Department's Boiler Inspection procedures was designed and conducted to meet the following objectives:

- Was professional competence upheld through hiring, training, and evaluating processes so as to ensure effective compliance with rules and regulations by all staff?
- Are regulated individuals/entities required to get and maintain an inspection certificate to certify that certain standards are met for operation?
- Has a systematic process been developed to monitor the activities of regulated individuals/entities to ensure applicable requirements are being followed so as to adequately protect the public?
- Is there appropriate follow-up for violations to ensure public safety?
- Is there a systematic process for analyzing program-related information, making appropriate adjustments to improve the effectiveness and efficiency of the program and reporting relevant summary information to the public and policy-makers about the results of the regulatory program?

We did identify one issue of non-compliance with North Dakota Century Code. This issue is explained in Finding 15-1. We did not note any additional inconsequential matters related to boiler inspections.

Insufficient Verification of Boiler Violation Resolution (Finding 15-1)

Condition:

The Insurance Department does not obtain proof that boilers are operating in a safe condition prior to issuing inspection certificates. When the Department identifies violations during an inspection, the boiler owner is only required to certify that repairs have been made, and then the inspection certificate is issued. This method is used for all violations regardless of the severity and includes situations that indicate a boiler should not be put back into operation until identified violations are fixed. Also, during our testing it was noted that in 2 of the 16 instances reviewed the boiler owner did not certify violations were corrected and an inspection certificate was still issued.

Criteria:

North Dakota Century Code 26.1-22.1-07 states “the chief boiler inspector shall inspect each boiler used or proposed to be used within this state. The inspection must be thorough as to the construction, installation, condition, and operation as providing by the rules adopted to implement this chapter. An exempt boiler may be inspected by the chief boiler inspector when the owner, owner’s agent, or the user of the boiler makes written request for inspection to the commissioner.”

North Dakota Century Code 26.1-22.1-10 states “the commissioner shall issue a certificate of inspection for each boiler inspected upon receipt of an inspection report certifying that the boiler is in a safe condition to be operated.”

In addition, five states were contacted to compare follow-up procedures. Per conversation with representatives of the five states, all of them require the boiler owner certify that repairs have been made. Three of these states have additional verifications which include conducting re-inspections. The verification method is dependent upon the identified severity of the violation.

Cause:

The Department conducts their inspections following the National Board Inspection Code Book which was published by the National Board of Boiler and Pressure Vessel Inspectors. It was indicated that the code book does not include information on follow-up procedures. In addition, the Department did not feel it was necessary to receive additional verifications other than the boiler owner’s certification that repairs are made.

Effect or Potential Effect:

Boilers may be operating in an unsafe condition which creates a potential threat to public safety.

Operational Improvement:

We recommend the Insurance Department incorporate verification methods into the boiler inspection process to ensure that identified violations are fixed and boilers are operating in a safe working condition prior to issuing inspection certificates.

Insurance Department Response:

The Department agrees with this recommendation. The issue is being addressed and the Boiler Inspection team is determining the best method to strengthen the process without significantly increasing program costs.

Company Licensing

Background

In order for an insurance company to do business in the state of North Dakota, they must be licensed through the Insurance Department. They are required to submit a fee and any necessary documentation to the Department. The required documentation varies based on the lines of insurance being provided. The company licensing division is responsible for receiving, verifying, and approving company licenses.

Our audit of the Insurance Department's company licensing procedures was designed and conducted to meet the following objectives:

- Are controls surrounding company licensing and fee collections properly developed and operating effectively?
- Did the Department collect the proper fee from individual insurance companies?
- Are reconciliation procedures in place to ensure all revenue was deposited on the state's accounting system?
- Did the Department develop a method to verify all necessary application were received?

Our audit did not identify any significant areas for improvement pertaining to company licensing. However, we noted a certain inconsequential matter involving operations that we have reported to management of the Insurance Department in a management letter dated July 19, 2016.

Insurance Premium Tax Collections

Background

Each insurance company that does business in the state of North Dakota is required to submit a quarterly premium tax filing. Each quarter, companies either make an estimate of premium taxes due or submit the total amount of premiums collected within the state for the quarter and calculate the amount of tax due. At that time, they are required to remit the quarterly payment to the Insurance Department. At the end of the year, a reconciled tax statement is submitted which shows all premiums collected, the total amount of quarterly payments submitted, and the total amount of tax due for the year. The Department reviews all filings and verifies that each company is submitting all reports and remitting payment.

Our audit of the Insurance Department's insurance premium tax collection procedures was designed and conducted to meet the following objectives:

- Are controls surrounding the collection of premium taxes properly developed and operating effectively?
- Are quarterly reports being submitted by insurance companies?
- Is the amount of premium taxes collected accurate?
- Did the Department require all companies to pay at least a minimum of \$200 for premium taxes?
- Are penalties properly assessed to companies?
- Are reconciliation procedures in place to ensure that the Department receives the proper amount of revenue from the OPTins system?
- Are revenues properly deposited into the Bank of North Dakota?

Our audit did not identify any significant areas for improvement pertaining to insurance premium tax collections. However, we noted a certain inconsequential matter involving operations that we have reported to the management of the Insurance Department in a management letter dated July 19, 2016.

Fire District Payments

Background

The Insurance Department has appropriated funds to distribute to certified city fire departments, certified rural departments, or certified fire protection districts. The distribution is based on the amount of premium tax collected for fire, allied lines, homeowner's multiple peril, farm owner's multiple peril, commercial multiple peril, and crop hail insurance collected for each individual fire district. The Department calculates the amount due to each fire district, verifies a certification was received from the fire district, and distributes the payment.

Our audit of the Insurance Department's insurance premium tax collection procedures was designed and conducted to meet the following objectives:

- Are controls surrounding the distribution of funds to fire districts properly developed and operating effectively?
- Is the amount distributed to each fire district properly calculated?
- Does the Department verify that the dollar amount of applicable insurance premium tax collected in each fire district was properly entered into the Access database?
- Does the process for distributing funds to the fire districts follow requirements set in North Dakota Century Code 18-04-05?
- Are payments properly coded in the state's accounting system?

Our audit did not identify any significant areas for improvement pertaining to fire district payments. However, we noted a certain inconsequential matter involving operations that we have reported to the management of the Insurance Department in a management letter dated July 19, 2016.

Management Letter (Informal Recommendations)

July 19, 2016

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, 2015, 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.

Internal Control

Informal Recommendation 15-1: We recommend the Insurance Department establish policies and procedures to ensure the control activities of outside service organizations are properly monitored, including the review of service organization audit reports of the National Producer Registry (NIPR) performed in accordance with Standards for Attestation Engagements No. 16.

Legislative Intent

Informal Recommendation 15-2: We recommend the Insurance Department submit Fire and Tornado premium and loss data to the Insurance Services Office by December 31 of each odd numbered year for inclusion in rate computations as required by North Dakota Century Code section 26.1-22-14.

Informal Recommendation 15-3: We recommend the Insurance Department collect interest at a rate of 6% per year, for any entity that does not pay their Fire and Tornado premiums within 60 days of the premiums being certified as defined by North Dakota Century Code section 26.1-22-15.

Informal Recommendation 15-4: We recommend the Insurance Department perform an annual inventory of fixed assets in accordance with North Dakota Century Code section 44-04-07.

Company Licensing

Informal Recommendation 15-5: We recommend the Insurance Department collect the proper premium based on the company's state of domicile in accordance with North Dakota Century Code section 26.1-11-06.

Insurance Premium Tax Collections

Informal Recommendation 15-6: We recommend the Insurance Department correctly assess penalties to companies that file their quarterly or annual premium tax statement after the deadline in accordance with North Dakota Century Code section 26.1-03-17(3).

Fire District Payments

Informal Recommendation 15-7: We recommend the Insurance Department transfer the remaining funds from the Tax Distribution Fund to the General Fund as required by Chapter 178, section 6 of the 2013 Legislative Assembly.

Management of the Insurance Department agreed with these recommendations.

I encourage you to call me 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,



Lindsey Ressler
Auditor in-charge

You may obtain audit reports on the internet at:

www.nd.gov/auditor/

or by contacting the
Division of State Audit

Office of the State Auditor
600 East Boulevard Avenue – Department 117
Bismarck, ND 58505-0060

(701) 328-2241