



# STATE OF NORTH CAROLINA

## NORTH CAROLINA DEPARTMENT OF INSURANCE FISCAL CONTROL AUDIT

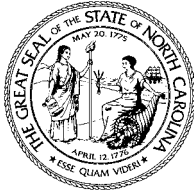
OFFICE OF THE STATE AUDITOR

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STATE AUDITOR

**NORTH CAROLINA DEPARTMENT OF INSURANCE**

**FISCAL CONTROL AUDIT**



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**AUDITOR'S TRANSMITTAL**

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October 22, 2009

The Honorable Beverly E. Perdue, Governor  
The General Assembly of North Carolina  
The Honorable Wayne Goodwin, Commissioner of Insurance

This report presents the results of our fiscal control audit at the North Carolina Department of Insurance. Our work was performed by authority of Article 5A of Chapter 147 of the *North Carolina General Statutes* and was conducted in accordance with the performance audit standards contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. The objective of a fiscal control audit is to identify improvements needed in internal control over selected fiscal matters, such as financial accounting and reporting; compliance with finance-related laws, regulations, and provisions of contracts or grant agreements; and/or management of financial resources.

The results of our audit disclosed deficiencies in internal control, instances of noncompliance or other matters that are considered reportable under *Government Auditing Standards*. These items are described in the Audit Findings and Responses section of this report.

*North Carolina General Statutes* require the State Auditor to make audit reports available to the public. Copies of audit reports issued by the Office of the State Auditor may be obtained through one of the options listed in the back of this report.

A handwritten signature in cursive script that reads "Beth A. Wood".

Beth A. Wood, CPA  
State Auditor

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# **OBJECTIVES, SCOPE, METHODOLOGY, AND RESULTS**

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## **OBJECTIVES, SCOPE, AND METHODOLOGY**

As authorized by Article 5A of Chapter 147 of the *North Carolina General Statutes*, we have conducted a fiscal control audit at the North Carolina Department of Insurance. There were no special circumstances that caused us to conduct the audit, but rather it was performed as part of our effort to periodically examine and report on the financial practices of state agencies and institutions.

The objective of a fiscal control audit is to identify improvements needed in internal control over selected fiscal matters, such as financial accounting and reporting; compliance with finance-related laws, regulations, and provisions of contracts or grant agreements; and/or management of financial resources. Our audit does not provide a basis for rendering an opinion on internal control, and consequently, we have not issued such an opinion.

Management is responsible for establishing and maintaining effective internal control. Internal control is a process designed to provide reasonable assurance that relevant objectives are achieved. Because of inherent limitations in internal control, errors or fraud may nevertheless occur and not be detected. Also, projections of any evaluation of internal control to future periods are subject to the risk that conditions may change or compliance with policies and procedures may deteriorate.

To accomplish our audit objectives, we gained an understanding of internal control over matters described below and evaluated the design of the internal control. We then performed further audit procedures consisting of tests of control effectiveness and/or substantive procedures that may reveal significant deficiencies in internal control. Specifically, we performed procedures such as interviewing personnel, observing operations, reviewing policies, analyzing accounting records, and examining documentation supporting recorded transactions and balances. Whenever sampling was used, we applied a nonstatistical approach but chose sample sizes comparable to those that would have been determined statistically. As a result, we were able to project our results to the population but not quantify the sampling risk.

As a basis for evaluating internal control, we applied the internal control guidance contained in *Internal Control Integrated Framework*, published by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). As discussed in the framework, internal control consists of five interrelated components, which are (1) control environment, (2) risk assessment, (3) control activities, (4) information and communication, and (5) monitoring.

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.

## **OBJECTIVES, SCOPE, METHODOLOGY, AND RESULTS (CONCLUDED)**

Our scope covered the period July 1, 2008 through January 31, 2009, and considered internal control related to the following accounts and control objectives:

*Travel* – Our audit included expenditures for transportation, subsistence, reimbursement for home internet use, and other travel related costs for all divisions. The Department reported approximately \$709,000 of these expenditures during our audit period. We examined internal controls designed to ensure that the Department properly approved and reimbursed these expenditures in accordance with the *North Carolina State Budget Manual*.

*Personal Services* – Our audit included expenditures made to compensate employees for services rendered in all divisions. The Department reported approximately \$13.6 million during our audit period. We examined internal controls designed to ensure that the Department properly approved and accounted for salary expenditures and that the Department’s administration of salaries was in compliance with the State Personnel Manual.

*State-Owned Cell Phones* – Our audit included expenditures for the use of state-owned cell phones. The Department reported approximately \$54,000 of these expenditures during our audit period. We examined internal controls designed to ensure that cell phones issued to employees were necessary and only used for state business purposes.

### **RESULTS**

The results of our audit disclosed deficiencies in internal control and/or instances of noncompliance or other matters that are considered reportable under generally accepted government auditing standards. These items are described in the Audit Findings and Responses section of this report.

## AUDIT FINDINGS AND RESPONSES

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### 1. QUESTIONABLE REIMBURSEMENTS FOR HOME INTERNET USE

The Department reimbursed employees for home internet use with questionable justification. As a result, the Department may have paid unreasonable and unnecessary costs.

We identified 53 employees where justification for reimbursement is questionable:

- Thirty-six employees were listed as those who telework, but there is no documentation to support if or why they telework and that it is justified. (The agency's policy says employees may be eligible for reimbursement if they telework two or more days a week on an ongoing basis.)
- Eleven employees were approved for travel status reimbursement (hotel usage charges) while on overnight travel, but they were actually reimbursed for their home internet use.
- Three employees were reimbursed simply because they were designated as senior staff.
- Three employees were reimbursed because they were on the Emergency Response Team.

In accordance with internal policy, the Department keeps a list of employees authorized for internet reimbursement. However, the list was not kept up-to-date and also failed to document the "reimbursement category," as required by the policy. The reimbursement category provides justification for the reimbursement for home internet use.

*Recommendation:* The Department should implement controls to ensure that it only reimburses an employee for internet use at home if it is essential for successful performance of the employee's duties.

*Response:* The Department of Insurance has two major groups of employees that receive a reimbursement for part of their cost of internet use at home. One group is comprised of those employees that have their home designated as their "Duty Station" since the employees perform investigations, inspections, or audits and they are located throughout North Carolina. Thus it is significantly cheaper for the employees to be assigned to work out of their homes. These persons are only at the Raleigh location for infrequent meetings and for training. These persons use their home as full-time offices and most of the employees require the use of internet to transmit reports and access data bases. The second group of employees that may qualify for partial reimbursement for internet use at home are those that participate in the agency's Teleworking Program. The Department of Insurance's Teleworking Program was implemented a number of years ago and was based upon the recommendations of the Office of State Auditor. The program has been extremely cost effective, with the only costs being the ISP reimbursements.

## AUDIT FINDINGS AND RESPONSES (CONTINUED)

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The Department of Insurance has been able to carry out this program with very few costs since all DOI teleworkers have personally paid for any personal computers, printers, fax machines, desks, and other office equipment that might be needed in order to telework. Consequently, the Department implemented a modest reimbursement program by paying for a portion of the monthly internet usage. DOI agrees with the recent Auditor's recommendations and, to exercise more control over this program, the Department has decided to implement changes to its telework program. The changes include: (1) As desktop computers in state offices of teleworking employees need to be replaced, they will be replaced with laptops that can be used at the central office and then can be taken home and to work sites by employees. The teleworking employee will be required to use the DOI laptop rather than a personally owned computer for teleworking. At the point that DOI furnishes the laptop for teleworking use, DOI will no longer partially reimburse internet service providers. (2) DOI employees who telework will still be required to pay for any printers, faxes, desks, etc., that they may need to work from a home office. (3) The Department procedures already require that the division head approve, on an annual basis, the employee's participation in the Teleworking Program. Based upon the Auditor's recommendation, this annual approval of the Employee's Teleworking Plan will also require specific certification that the computer is needed for the teleworking assignment, and that the ISP reimbursement is authorized. The agency Teleworking form will be modified to incorporate suggestions included in the Auditor Report and the Department agrees with the Audit Report and will take steps to implement the other recommended controls and changes.

### 2. DEFICIENCIES IN INTERNAL CONTROL OVER STATE-OWNED CELL PHONES

The Department did not have adequate controls in place to ensure that cell phones issued to employees were necessary and used for state business purposes only.

According to the *North Carolina Budget Manual*, all state agencies should perform an annual review to re-justify the business need for each state-owned mobile communication device that has been issued. The Department did not perform an annual review.

Controls were not in place to ensure all division heads reviewed and approved the cellular phone bills each month to verify that phone usage was for official state business purposes only. We reviewed all approved phone bills turned in to the Controller's Office during our testing period and found that 8 out of the 18 departments did not consistently approve the phone bills. We also found that certain division heads within the Department were approving their own cell phone bills or had no approval at all.

*Recommendation:* The Department should implement proper policies and procedures to ensure cell phone expenditures are necessary and for state business use only.

*Response:* The Department has always maintained written records to document the assignment of cell phones to employees. However, the Department has modified their procedures to require more frequent review and approval of those employees who are



## AUDIT FINDINGS AND RESPONSES (CONTINUED)

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assigned cell phones to ensure that the cell phone assignments and their use are documented as being necessary. On a separate issue, the Department currently requires that each division head approve of the monthly phone invoice but some invoices were not being approved in a timely manner. Special emphasis is being placed on divisions to adhere to agency procedures to approve and return the phone invoices to the accounting office within 30 days from when they initially receive the invoice. A spreadsheet has been used to track the approved invoices.

### 3. NONCOMPLIANCE WITH STATE TRAVEL POLICIES

The Department did not consistently comply with state travel policies. As a result, there were reimbursements paid to employees without proper documentation and employees were overpaid for mileage reimbursements when using personal vehicles.

#### *Personal Telephone Calls*

The *North Carolina Budget Manual* allows for an employee in travel status to receive reimbursement for one personal long distance telephone call made for each two nights out of town on official state business, not to exceed \$3 for in-state travel and \$5 for out-of-state travel; however, documentation of the phone call is required for reimbursement. We examined 34 reimbursement requests for personal phone calls. None of the items examined had the required documentation.

#### *Transportation by Personal Vehicle*

We examined 76 reimbursements made to employees for use of their personal vehicles for round trips that exceeded 100 miles and found that 74 out of the 76 reimbursement amounts were questionable. These potential overpayments, totaling \$9,412, were the result of paying at the IRS mileage rate or a rate above the standard state rate of 33 cents per mile.

The *North Carolina Budget Manual* allows for mileage to be reimbursed at the IRS mileage rate for personal vehicle travel for state business when the round trip does not exceed 100 miles or when a state-owned vehicle is not available. However, payments at the higher rate should be supported by documentation indicating when a state-owned vehicle is not available.

*Recommendation:* The Department should update their internal policy to reflect *North Carolina Budget Manual* requirements. The Department should also implement control procedures to ensure reimbursements comply with state policy.

*Response:* Telephone Calls -- The Department has paid employees in a travel status the correct amounts per the *North Carolina Budget Manual*. In the past, the agency also has required employees to identify the phone number called and the date and time of the calls as support for the reimbursements. However, effective immediately the Department will

## **AUDIT FINDINGS AND RESPONSES (CONTINUED)**

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not make any payment to employees unless the employee provides an original phone bill/invoice to support the payments to be made to the employee.

Transportation by Personal Vehicle -- Employees using their own vehicle for travel for state business will be paid the minimum reimbursement rate unless the employee provides a written document from Department of Administration (Motor Fleet Management) stating that no state vehicle is available for the dates of travel.

#### **4. DEFICIENCIES IN INTERNAL CONTROL OVER PAYROLL**

We identified a number of deficiencies in internal control over payroll, which result in an increased risk of error or fraud occurring without detection. Specifically, we noted the following:

- Inadequate segregation of duties over the human resource function – The Human Resources Personnel Technician had the ability to add new employees, make changes to employee salaries, and terminate employees in the BEACON payroll system without management approval, independent checks, or verification. These functions should be segregated so that the duties of one employee automatically provide a cross-check on the work of other employees.
- Payroll Disbursing Account not adequately reconciled – The Department did not complete monthly reconciliations of their payroll disbursing account in a timely manner. In addition, outstanding items were not identified, researched, and corrected timely. Also, the account had an unreconciled balance totaling \$89,467.49 as of January 31, 2009.
- Lack of Authorization over Employee Pay Rates - The Department does not maintain adequate documentation for authorization of employee pay rates. Lack of adequate authorization could result in fictitious employees or employees being paid at unauthorized rates. We examined a sample of 60 employees who received a change in salary (promotions, salary increase, terminations, new hires, etc.) and identified eight instances where there was no documented authorization for the change in salary.

*Recommendation:* The Department should strengthen internal control by segregating the incompatible duties within its business processes. In situations where segregation of duties is not feasible, the Department should implement effective compensating monitoring controls. The Department should ensure that the payroll disbursing account is properly reconciled each month and that authorizations for employee pay rates are documented and retained.

*Response:* (1) During implementation of the BEACON HR/Payroll System, the Department of Insurance expressed concerns to the BEACON implementation staff about the inadequate procedures incorporated with the BEACON system for segregation of duties. Under the old PMIS/Central Payroll system, the segregation of duties was built

## **AUDIT FINDINGS AND RESPONSES (CONCLUDED)**

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into the system. The Department of Insurance agrees with the State Auditor's Report and the Department is addressing the issues identified. The changes will include: modifying the Department's Personnel Action Request Form, separating some duties while segregating others for more control. (2) The Payroll Disbursing Account (actually a Clearing Account) was not reconciled at the time of the audit due to the lack of necessary reports from the recently implemented BEACON system. The required detailed reports were subsequently provided to the Department and the account has been reconciled as required. 3) The Auditor's Office identified several instances where they felt that the Personnel Division (HR) had not kept sufficient written documentation of changes in pay and the details of several separations. HR contacted the senior managers who had originally authorized the changes in pay and they obtained copies of the missing required documentation. HR has now provided to the Auditor's Office copies of the written documentation, supporting authorization for the pay changes. Two records supporting pay changes could not be obtained since the supervising manager was deceased and the records/documents could not be found. In the future, the HR Department will make sure that sufficient written documentation/support is maintained in the HR offices.

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## **ORDERING INFORMATION**

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