



STATE OF NORTH CAROLINA

NORTH CAROLINA DEPARTMENT OF INSURANCE

FINANCIAL RELATED AUDIT

JUNE 2012

OFFICE OF THE STATE AUDITOR

BETH A. WOOD, CPA

STATE AUDITOR

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**THE HONORABLE WAYNE GOODWIN, COMMISSIONER OF INSURANCE
AND STATE FIRE MARSHALL**

JIM NEWMAN, CONTROLLER



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AUDITOR'S TRANSMITTAL

June 14, 2012

The Honorable Beverly Eaves Perdue, Governor
The General Assembly of North Carolina
The Honorable Wayne Goodwin, Commissioner of Insurance/State Fire Marshall

This report presents the results of our financial related 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 results of our audit disclosed a deficiency in internal control that is considered reportable under *Government Auditing Standards*. This item is 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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BACKGROUND, GENERAL OBJECTIVES, AND METHODOLOGY

BACKGROUND

As authorized by Article 5A of Chapter 147 of the *North Carolina General Statutes*, we have conducted a financial related 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 General Assembly created the North Carolina Department of Insurance in 1899. The Department of Insurance provides services to the people of North Carolina by regulating the insurance industry, licensing insurance professionals and others, educating consumers about different types of insurance, handling consumer complaints, and more. The Commissioner must approve any insurance business in the State, and companies and agents must meet required standards before they receive a license to do that business.

The Department also houses the Office of State Fire Marshal. Other services provided by the Department include:

- a. licensing bail bondsmen;
- b. overseeing motor clubs and collection agencies;
- c. protecting consumers from fraud and illegal behavior with a staff of sworn law enforcement officers in the Investigations Division;
- d. educating North Carolinians about safety issues such as child safety seats, fire protection, natural disaster preparation and other family safety issues;
- e. interpreting the state's building codes and suggesting new and improved codes to further protect citizens;
- f. obtaining and maintaining insurance coverage for all state-owned buildings, including such items as the Battleship North Carolina in Wilmington and the campuses of the state university system;
- g. assisting the elderly and others with Medicare and Medicaid questions through the Seniors' Health Insurance Information Program.

GENERAL OBJECTIVES

The general objective of this financial related audit was to identify improvements needed in internal control over selected fiscal matters. The specific fiscal matters included in the audit are described in the Scope and Specific Objectives section of this report.

Management is responsible for establishing and maintaining effective internal control. Internal control is a process designed to provide reasonable assurance that relevant objectives

BACKGROUND, GENERAL OBJECTIVES, AND METHODOLOGY (CONCLUDED)

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. Our audit does not provide a basis for rendering an opinion on internal control, and consequently, we have not issued such an opinion.

METHODOLOGY

To accomplish our audit objectives, we gained an understanding of internal control over matters described in the Scope and Specific Objectives section of this report 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 provide evidence about our audit objectives. 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 professional auditing standards. As discussed in the standards, 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 audit in accordance with generally accepted government auditing standards applicable to performance audits. 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.

SCOPE, SPECIFIC OBJECTIVES, AND RESULTS

SCOPE AND SPECIFIC OBJECTIVES

Our audit scope covered the period July 1, 2011 through October 31, 2011 and included selected internal controls in the following organizational units:

Department of Insurance – Controller’s Office

This organizational unit is responsible for the general accounting functions of the Department and accounts for and issues financial reports that cover all Departmental operations.

Office of the State Fire Marshall

This organizational unit is responsible for fire and rescue related operations, including but not limited to training fire and rescue personnel, administering the state building code, securing property insurance for state-owned buildings in the State Fire Protection Fund, reviewing construction plans for state building projects, and administering the Volunteer Fire Department Fund and the Volunteer Medical Emergency Services Fund.

Department of Insurance – Agent Services Division

The Agent Services Division regulates all licensed agents, brokers, limited representatives, appraisers, adjusters, premium finance companies, collection agencies, motor clubs, bail bondsman, surety bondsman, and bail bond runners authorized to do business in North Carolina. This includes pre-licensing education, continuing education, agency examinations, and administrative actions such as collecting fees, issuing licenses, and imposing fines.

During our audit, we considered internal control related to the following accounts and control objectives:

Insurance Regulatory Fund – Fees collected by the Department of Revenue from insurance companies operating in the State are used to reimburse the state General Fund for appropriations. The expenditures from this fund, in effect, make the Department self-supporting. The expenditures are restricted to repayment of certain expenses of the Department by *North Carolina General Statute Chapter 58-6-25*. We examined internal controls designed to ensure that the collections of fees were as authorized by statutory authority and to ensure compliance with these requirements.

Volunteer Fire Department Fund – The Volunteer Fire Department Fund is an interest bearing, non-reverting fund in the Department to provide matching grants to volunteer fire departments to purchase equipment and make capital improvements. It is funded by the gross premium tax on Homeowners Insurance policies. Expenditures from this fund are restricted in purpose and amount by *North Carolina General Statute Chapter 58-87-1*. We examined the controls designed to ensure compliance with these requirements.

SCOPE, SPECIFIC OBJECTIVES, AND RESULTS (CONCLUDED)

Volunteer Rescue/EMS Fund – The Volunteer Rescue/EMS Fund is to provide grants to volunteer rescue units, which provide rescue and emergency medical services, to purchase equipment and make capital improvements. This Volunteer Rescue/EMS Fund is funded by a portion (\$.18) of each North Carolina Division of Motor Vehicle Inspection fee. Expenditures from this fund are restricted in purpose and amount by *North Carolina General Statute Chapter 58-87-5*. We examined the controls designed to ensure compliance with these requirements.

State Fire Protection Fund – The State Fire Protection Fund provides compensation to local fire districts for coverage of state-owned property within their jurisdiction. The Fund's revenues are appropriations from the State's General fund and Highway Trust Fund, as well as receipts from the University of North Carolina system. *North Carolina General Statute Chapter 58-85A-1* restricts revenues from each funding source to only be used for state-owned property supported by that individual source. We examined the controls designed to ensure compliance with these requirements.

Fees, Licenses and Fines – Fees, Licenses, and Fines are revenues collected on behalf of the Department by the Department of Revenue, the Division of Motor Vehicles, the National Insurance Producer Registry (a third party contractor), and the Department itself for business licenses; registration/certification fees; inspections/exam fees; fines, penalties, and assessment fees as authorized by *North Carolina General Statute Chapter 58*. At October 31, 2011, the Department reported \$4.7 million in this account. We examined internal controls designed to ensure that collections of fees were as authorized by statutory authority and that revenues were properly recognized and accounted for by the Department.

State-Owned Mobile Communications Devices – *North Carolina Session Law 2011-145* placed certain restrictions on the issuance and usage of mobile communications devices, as well as the justification for their need. In addition, agencies are required to conduct periodic audits of usage to ensure that state employees and contractors are complying with agency policies and state requirements for their use. We examined the controls designed to ensure compliance with this requirement.

RESULTS

The results of our audit disclosed a deficiency in internal control that is considered reportable under generally accepted government auditing standards. This item is described in the Audit Findings and Responses section of this report.

AUDIT FINDINGS AND RESPONSES

JOURNAL ENTRIES NOT CONSISTENTLY REVIEWED PRIOR TO RECORDING

Department senior staff prepares and record journal entries that have not been subjected to independent review and approval. As a result, there is an increased risk of errors in the accounting records. Responsibilities for transactions should be assigned so that the duties of one employee automatically provide a cross-check on the work of other employees.

During our review of the processing for the Insurance Regulatory Fund and the Fees, Licenses, and Fines accounts, we noted that there was no documented independent review and approval of journal entries before they were recorded in the accounting system. The Department allows key members in the Controller's office to both authorize and process transactions.

Recommendation: The Department should strengthen its internal control by requiring a documented independent review and approval of all journal entries prior to entry into the accounting system.

Department Response: The Department of Insurance concurs with the finding. Due to the small staff size in the Department of Insurance's accounting department it is necessary for senior staff to prepare and record journal entries to ensure that all transactions are properly recorded in the North Carolina Accounting System on a timely basis.

The Department of Insurance will strengthen its internal control by requiring the Controller to review and approve all journal entries prepared and recorded by senior staff.

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