



## NEBRASKA AUDITOR OF PUBLIC ACCOUNTS

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January 29, 2016

Bruce Ramge, Director  
Department of Insurance  
941 O Street  
Lincoln, Nebraska 68501

Dear Mr. Ramge:

In planning and performing our audit of the financial statements of the governmental activities, the business-type activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the State of Nebraska (State) as of and for the year ended June 30, 2015, in accordance with auditing standards generally accepted in the United States of America and standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, we have issued our report thereon dated December 17, 2015. In planning and performing our audit, we considered the State's internal control over financial reporting (internal control) as a basis for designing audit procedures that are appropriate in the circumstances for the purpose of expressing our opinions on the financial statements of the State, but not for the purpose of expressing an opinion on the effectiveness of the State's internal control. Accordingly, we do not express an opinion on the effectiveness of the State's internal control.

In connection with our audit described above, we noted certain internal control or compliance matters related to the activities of the Department of Insurance (Agency) or other operational matters that are presented below for your consideration. These comments and recommendations, which have been discussed with the appropriate members of the Agency's management, are intended to improve internal control or result in other operating efficiencies.

Our consideration of internal control included a review of prior year comments and recommendations. To the extent the situations that prompted the recommendations in the prior year still exist, they have been incorporated in the comments presented for the current year. All other prior year comments and recommendations (if applicable) have been satisfactorily resolved.

Our consideration of internal control was for the limited purpose described in the first paragraph and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations during our audit, we did not identify any deficiencies in internal control that we consider to be material weaknesses or significant deficiencies. However, material weaknesses or significant deficiencies may exist that were not identified.

Draft copies of this letter were furnished to the Agency to provide management with an opportunity to review and to respond to the comments and recommendations contained herein. All formal responses received have been incorporated into this letter. Responses have been objectively evaluated and recognized, as appropriate, in the letter. Responses that indicate corrective action has been taken were not verified at this time, but they will be verified in the next audit.

The following are our comments and recommendations for the year ended June 30, 2015.

**1. Deposits with Third-Party Administrator**

Neb. Rev. Stat. § 44-4225(2) (Cum. Supp. 2014) states the following:

*The Comprehensive Health Insurance Pool Distributive Fund is created. Commencing with the premium and related retaliatory taxes for the taxable year ending December 31, 2001, and for each taxable year thereafter, any premium and related retaliatory taxes imposed by section 44-150 or 77-908 paid by insurers writing health insurance in this state, except as otherwise set forth in subdivisions (1) and (2) of section 77-912, shall be remitted to the State Treasurer for credit to the fund. The fund shall be used for the operation of and payment of claims made against the pool. Any money in the fund available for investment shall be invested by the state investment officer pursuant to the Nebraska Capital Expansion Act and the Nebraska State Funds Investment Act.*

A good internal control plan requires policies and procedures to ensure deposits with vendors are properly reflected in the accounting system, bank accounts are approved by the State Treasurer, and balances held by third-party administrators are properly collateralized above the Federal Depository Insurance Corporation (FDIC) coverage.

The Agency's Comprehensive Health Insurance Pool (CHIP) program uses a third-party administrator (Administrator) that processes insurance claims for the program. Prior to June 2014, the Administrator maintained \$5,000,000 in State funds in a bank account in the Administrator's name. The balance was held by the Administrator to ensure claims could be processed timely. During June 2014, the Agency decreased the funding on hand to \$1,000,000, due to decreased enrollment and claims processing in the CHIP program. In August 2014, the Administrator remitted the excess funds of \$4,700,000 back to the Agency.

During testing, we noted the following:

- The CHIP fund balance held by the Administrator was not recorded in the State's accounting system as a deposit with vendor. The State's financial statements were adjusted to properly reflect the \$1,178,526 balance as of June 30, 2015, in the State's Comprehensive Annual Financial Report.
- State funds are required to be held by the State Treasurer in accordance with Neb. Rev. Stat. § 84-602(1) (Reissue 2014). There was no record of approval from the State Treasurer for the State funds to be held by the Administrator.

Neb. Rev. Stat. § 77-2301(1) (Reissue 2009) says the following, in relevant part:

*The State Treasurer shall deposit, and at all times keep on deposit for safekeeping, in the state or national banks, or some of them doing business in this state and of approved standing and responsibility, the amount of money in his or her hands belonging to the several current funds in the state treasury.*

Furthermore, in Op. Att’y Gen. No. 15-010 (Aug. 10, 2015), the Attorney General has stated the following:

*The State Treasurer is charged with the duty of establishing the banking relationship for the State of Nebraska and its agencies. This is a statutory duty that cannot be delegated and is one of the “core functions” of the Nebraska State Treasurer.*

- The Administrator was unable to provide documentation of collateral sufficient to cover the State’s deposits in excess of FDIC coverage of \$250,000. The balance was under collateralized by \$195,394 at June 30, 2015.

Neb. Rev. Stat. § 77-2395(1) (Reissue 2009) states the following:

*If a bank, capital stock financial institution, or qualifying mutual financial institution designated as a depository furnishes securities pursuant to section 77-2389, the custodial official shall not have on deposit in such depository any public money or public funds in excess of the amount insured or guaranteed by the Federal Deposit Insurance Corporation, unless and until the depository has furnished to the custodial official securities, the market value of which are in an amount not less than one hundred two percent of the amount on deposit which is in excess of the amount so insured or guaranteed.*

When deposits with vendors are not recorded in the accounting system, there is an increased risk of material misstatement of financial statements. Furthermore, when bank accounts are held by third-party administrators instead of the State Treasurer, and balances are not adequately collateralized, there is an increased risk for loss of State funds.

We recommend the Agency ensure deposits with third-party administrators are properly recorded in the accounting system for financial statement presentation. Additionally, we recommend the Agency work with the State Treasurer to eliminate the balances held with the third-party administrator and, until the deposit is eliminated, the Agency should ensure the balances held by the third-party administrator are properly collateralized.

*Agency Response:*

*Regarding the items noted:*

- *The Agency has been in contact with State Accounting to discuss the issue of the Nebraska Comprehensive Health Insurance Pool (NECHIP) balance not being recorded in the State’s accounting system. We are working with State Accounting to have the balance correctly reflected on the Agency records for the June 30, 2016 fiscal year end.*
- *The Agency has met with the State Treasurer’s office in regard to the deposits held by third parties. Currently, we are still discussing this matter and do not have a resolution at this time. We will keep your office apprised of the outcome.*
- *The Agency will continue communications with the NECHIP Board and the appropriate third party regarding this matter.*

**2. Premium Tax Distribution**

Neb. Rev. Stat. § 77-912 (Cum. Supp. 2014) states the following, in relevant part:

*The Director of Insurance shall transmit fifty percent of the taxes paid in conformity with Chapter 44, article 1, and Chapter 77, article 9, to the State Treasurer, forty percent of such taxes paid to the General Fund, and ten percent of such taxes paid to the Mutual Finance Assistance Fund promptly upon completion of his or her audit and examination and in no event later than May 1 of each year . . . .*

A good internal control plan requires procedures to be in place to review journal entries to ensure they are accurate and are proper.

The Agency is required to distribute the premium and retaliatory taxes collected in the Insurance Cash Fund to various funds by May 1 of each year, in accordance with Neb. Rev. Stat. § 77-912. The Agency uses the OPTins system to account for the taxes collected.

The Agency made the first distribution on April 30, 2015, for \$18,928,927, which was later determined to be incorrect. The Agency reversed the original distribution on May 29, 2015, and a correcting distribution was made; however, again, the Agency determined that this distribution was incorrect. The final distribution was made on June 22, 2015, for a total of \$16,201,572. The final distribution was 52 days past the May 1 requirement per State statute.

According to the Agency, issues within the OPTins system was part of the cause for these incorrect distributions.

When distributions are not made in accordance with State statute, the amounts transferred to receiving funds will be inaccurate and untimely.

We recommend the Agency ensure distributions are made in accordance with State statute.

*Agency Response: The Agency is reviewing and updating its procedures and personnel assigned to the premium tax area. We concur that the distributions need to be made in accordance with state statute.*

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Our audit procedures are designed primarily on a test basis and, therefore, may not bring to light all weaknesses in policies or procedures that may exist. Our objective is, however, to use our knowledge of the Agency and its interaction with other State agencies and administrative departments gained during our work to make comments and suggestions that we hope will be useful to the Agency.

This communication is intended solely for the information and use of the Agency, the Governor and State Legislature, others within the Agency, Federal awarding agencies, pass-through entities, and management of the State of Nebraska and is not intended to be, and should not be, used by anyone other than the specified parties. However, this communication is a matter of public record, and its distribution is not limited.



Don Dunlap, CPA  
Assistant Deputy Auditor