



An Audit Report on

Financial Processes at the Department of Insurance

July 2018
Report No. 18-039



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Overall Conclusion

The Department of Insurance (Department) had adequate controls to help ensure that it processed revenues, including revenues for conducting financial examinations. In addition, the Department processed expenditures in accordance with applicable statutes, rules, and Department policies and procedures.

Specifically, the Department had adequate controls to ensure that it:

- Collected and recorded revenues in accordance with applicable requirements.
- Prepared and processed examination billing invoices in compliance with requirements.
- Processed procurement and fuel card purchases, payments to unique vendors, and other non-travel expenditures, as well as travel expenditures, in accordance with applicable requirements.

However, it should improve certain controls in some areas. Specifically, the Department should:

- Strengthen its revenue review process by ensuring that deposits received were due to the Department.
- Consistently enforce the **required approval documentation prior to travelers' departures.**
- Strengthen its controls over user access, segregation of duties, and certain data fields.

Table 1 on the next page presents a summary of the findings in this report and the related issue ratings. (See Appendix 2 for more information about the issue rating classifications and descriptions.)

Background Information

The Department of Insurance (Department) **regulates the state's insurance industry, oversees the administration of the Texas workers' compensation system, performs the duties of the State Fire Marshal's Office, and provides administrative support to the Office of Injured Employee Counsel (a separate agency).**

For fiscal years 2017 and 2018, the Department was appropriated \$111 million and \$127 million, respectively.

The Department was authorized to have 1,374 full-time equivalent employees for fiscal year 2018.

Sources: The Department and the General Appropriations Acts (84th and 85th Legislatures).

Table 1

Summary of Chapters/Subchapters and Related Issue Ratings		
Chapter/ Subchapter	Title	Issue Rating ^a
1-A	The Department Had Adequate Controls to Collect and Record Revenues from Licenses, Fees, Permits, and Taxes	Low
1-B	The Department Had Adequate Controls Over Reimbursements for Financial Examinations	Low
2-A	The Department Had Adequate Controls Over Non-Travel Expenditures	Low
2-B	The Department Had Adequate Controls Over Travel Expenditures	Low
3	The Department Should Improve Certain Controls Over Information Systems Used to Administer Financial Transactions	Medium

^a A subchapter is rated Priority if the issues identified present risks or effects that if not addressed could critically affect the audited entity's ability to effectively administer the program(s)/function(s) audited. Immediate action is required to address the noted concern and reduce risks to the audited entity.

A subchapter is rated High if the issues identified present risks or effects that if not addressed could substantially affect the audited entity's ability to effectively administer the program(s)/function(s) audited. Prompt action is essential to address the noted concern and reduce risks to the audited entity.

A subchapter is rated Medium if the issues identified present risks or effects that if not addressed could moderately affect the audited entity's ability to effectively administer program(s)/function(s) audited. Action is needed to address the noted concern and reduce risks to a more desirable level.

A subchapter is rated Low if the audit identified strengths that support the audited entity's ability to administer the program(s)/function(s) audited or the issues identified do not present significant risks or effects that would negatively affect the audited entity's ability to effectively administer the program(s)/function(s) audited.

Summary of Management's Response

At the end of certain chapters in this report, auditors made recommendations to address the issues identified during this audit. The Department agreed with the recommendations in this report.

Audit Objective and Scope

The objective of this audit was to determine whether the Department has processes and related controls to help ensure that it administers financial transactions in accordance with applicable statutes, rules, and Department policies and procedures.

The scope of this audit covered the **Department's activities related to revenue**, non-travel and travel expenditures, financial examinations, and related information systems for fiscal year 2017 (September 1, 2016, through August 31, 2017) and a portion of fiscal year 2018 (September 1, 2017, through January 31, 2018).

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Detailed Results

Chapter 1

The Department Had Adequate Controls Over Its Processing of Revenue Transactions

The Department of Insurance (Department) had processes and related controls to ensure that it collects and records revenues in accordance with applicable statutes, rules, and Department policies and procedures.

Insurance Maintenance Taxes

Insurers licensed by the Department pay maintenance taxes based on the **insurers'** line of business. Rates, which are set by the Department, vary each year. **The Comptroller's Office** collects the taxes, and then it transfers the revenues to the Department.

Sources: The **Comptroller's Office's** Web site and the Department.

Auditors reviewed three types of revenues the Department receives: (1) revenues from fees, permits, and licenses, (2) insurance maintenance taxes paid by insurers licensed by the Department, and (3) reimbursements for conducting financial examinations of insurers and other entities that the Department regulates. The Office of the Comptroller of Public Accounts (Comptroller's Office) collects the insurance maintenance taxes and transfers those revenues to the Department (see text box for more information about insurance maintenance taxes). The Comptroller's Office also receives other payments for fees, permits, and licenses, which it forwards to the Department.

The Department generally had adequate controls over all three types of revenues tested; however, it should strengthen its reviews of fees that it receives and accepts from the Comptroller's Office.

Chapter 1-A

The Department Had Adequate Controls to Collect and Record Revenues from Licenses, Fees, Permits, and Taxes

Chapter 1-A
Rating:
Low ¹

The Department received \$270.1 million in revenues in fiscal year 2017 and \$37.0 million in the first five months of fiscal year 2018 (September 1, 2017, through January 31, 2018). Of that amount, \$143.9 million was for maintenance taxes that the Department assessed and the Comptroller's Office collected during fiscal year 2017.

For 30 (97 percent) of the 31 individual revenue transactions for licenses, fees, and permits tested totaling \$23.7 million, the Department:

- Had adequate supporting documentation.

¹ Chapter 1-A is rated as Low because the audit identified strengths that support the audited entity's ability to administer the program(s)/function(s) audited or the issues identified do not present significant risks or effects that would negatively affect the audited entity's ability to effectively administer the program(s)/function(s) audited.

- Processed the transactions with appropriate segregations of duties.
- Charged the correct fees.
- Used accurate calculations to determine the appropriate revenue amount to be collected.
- Accurately recorded the transactions in the Centralized Accounting and Payroll/Personnel System and the Uniform Statewide Accounting System.
- Appropriately processed daily summary level deposit amounts into its Cash Receipt System. Those amounts also had adequate supporting documentation.

However, the Department received and accepted a \$1.6 million transaction from the Comptroller's Office in error. That transaction, which the Department received and recorded in March 2017, was intended for another state agency. In addition to that one error, the Comptroller's Office later identified two other revenue transactions that the Department had accepted in error. Those two transactions that the Department received in April 2017 and May 2017 totaled \$3.2 million. The Department reversed all three transactions in May 2017. For this type of revenue it receives from the Comptroller's Office, the Department did not have a process to review the transactions to verify that it should receive that revenue.

For the \$143.9 million in maintenance tax revenues it received from the Comptroller's Office in fiscal year 2017, the Department recorded and appropriately approved the revenues.

Recommendation

The Department should strengthen its review process for revenues from fees that it receives and accepts from the Comptroller's Office to ensure that the deposits are due to the Department.

Management's Response

The Department is implementing a new cash receipts system on September 1, 2018. This new system will reduce the number of manual entries required by the Department's revenue staff. This will shorten the current time for revenue reconciliations and will facilitate quicker handling of monies received in error.

The Department Had Adequate Controls Over Reimbursements for Financial Examinations

Chapter 1-B
Rating:
Low ²

The Department recorded revenues related to financial examinations it conducted totaling \$5.0 million for fiscal year 2017 through the first five months of fiscal year 2018 (see text box for more information about the Department's financial examinations). Insurers and other entities the Department regulates reimburse the Department for salaries and travel expenditures related to its financial examinations of those entities.

The Department creates the examination billing invoices based on the billing information in its regulatory system. The salary amounts in that regulatory system are reviewed and updated each month based on a payroll schedule the Department's budget department prepares.

For the 29 financial examination revenue deposits tested, the Department prepared and processed the examination billing invoices in compliance with applicable statutes, rules, and Department policies and procedures. Those invoices captured the wages and travel-related expenses for 114 Department employees. Specifically, for all 29 deposits tested totaling \$213,532:

- Appropriate personnel recorded and approved the timesheets used to prepare the examination billing invoices.
- The invoices matched the deposits.
- The invoices were supported by travel vouchers, when applicable.

In addition, for all three monthly payroll schedules tested, the Department correctly calculated salary-related expenses in compliance with applicable Department policies and procedures.

Financial Examinations

The Department's Examinations Section performs examinations of insurance companies, health maintenance organizations, and other insurance-related entities to evaluate a company's financial condition and compliance with statutory requirements, including policyholder treatment. The Department performs the examinations on site at the company locations, which are typically in Texas, but they may occur anywhere in the continental United States.

An insurer must reimburse the Department for the related salary and examination expenses of each examiner.

Sources: Texas Insurance Code, Chapter 401, and the Department's 2017 Annual Report.

² Chapter 1-B is rated as Low because the audit identified strengths that support the audited entity's ability to administer the program(s)/function(s) audited or the issues identified do not present significant risks or effects that would negatively affect the audited entity's ability to effectively administer the program(s)/function(s) audited.

Overall, the Department Had Adequate Controls Over Expenditures

The Department had adequate controls over its non-travel expenditures. The non-travel expenditures that auditors tested at the Department complied with state statutes, rules, and Department policies and procedures. In addition, those expenditures were allowable, appropriately reviewed and approved, and adequately supported with documentation.

However, the Department did not consistently ensure that travel expenditures complied with its travel policy regarding approval prior to traveling. Eight (40 percent) of 20 travel expenditures tested did not contain the approvals required by the Department's policy.

Chapter 2-A

The Department Had Adequate Controls Over Non-Travel Expenditures

Chapter 2-A
Rating:
Low³

The Department had adequate controls over procurement and fuel card purchases, payments to unique vendors, and other non-travel expenditures. The Department recorded non-travel related expenditures totaling \$37.6 million for fiscal year 2017 and \$14.2 million for the first five months of fiscal year 2018.

For all 27 expenditures tested totaling \$474,325, the Department:

- Made purchases as allowed by state purchasing policies.
- Procured items in the appropriate manner as required by the *State of Texas Procurement Manual*, or it received an exemption from procurement requirements.
- Reviewed and approved payment vouchers before it made payments.
- Made payments in a timely manner.
- Had adequate support for payments.

³ Chapter 2-A is rated as Low because the audit identified strengths that support the audited entity's ability to administer the program(s)/function(s) audited or the issues identified do not present significant risks or effects that would negatively affect the audited entity's ability to effectively administer the program(s)/function(s) audited.

The Department Had Adequate Controls Over Travel Expenditures

Chapter 2-B
Rating:

Low ⁴

The Department had adequate controls over travel expenditures. The Department recorded travel expenditures totaling \$2.2 million for fiscal year 2017 and \$863,625 for the first five months of fiscal year 2018 (September 1, 2017, through January 31, 2018).

For all 32 travel expenditures tested totaling \$36,179, the Department:

- Made travel reimbursements within the allowable limits set by Department policy and Texas Government Code.
- Reviewed and approved payment vouchers.
- Correctly calculated payment vouchers.
- Had adequate support for payments.

However, the Department did not consistently ensure that travel expenditures were approved as required by the Department's policy. While 12 (38 percent) of 32 travel expenditures tested did not require prior approval because the travelers were appropriately documented as frequent travelers according to Department policy, 8 (40 percent) of the remaining 20 travel expenditures, totaling \$5,558, did not include all required approvals. Specifically, employees did not submit travel request forms for approval prior to departure as required by the Department's travel policy. The travel request form includes the reason for travel and a cost comparison (to determine the lowest costs regarding travel and lodging), and it is approved by a supervisor.

The Department's management asserted that for those eight travel expenditures above, the travelers were frequent travelers. According to Department policy, employees identified as frequent travelers do not have to submit a travel request prior to travel. However, the vouchers for those eight travel expenditures did not identify the employees as frequent travelers. To waive requirements for submitting a travel request form, Department policy requires that supervisors designate the employee as a frequent traveler on the completed travel voucher.

Not ensuring that travel requests are approved as required could lead to unnecessary/unapproved travel or greater travel costs.

⁴ Chapter 2-B is rated as Low because the audit identified strengths that support the audited entity's ability to administer the program(s)/function(s) audited or the issues identified do not present significant risks or effects that would negatively affect the audited entity's ability to effectively administer the program(s)/function(s) audited.

Recommendation

The Department should strengthen processes to consistently obtain required and appropriate approvals prior to travel and comply with its policy regarding designating employees as frequent travelers.

Management's Response

On July 1, 2018, the Department changed how travelers are designated as frequent travelers. Employees are required to fill out a frequent traveler form and get the form approved by their manager. Once approved the traveler sends a copy of the form to accounting. The frequent traveler designation allows employees to not submit a travel request for in-state travel that does not require airfare. By signing the new frequent traveler form, the employee takes the responsibility for maintaining compliance of all travel policies.

The Department Should Improve Certain Controls Over Information Systems Used to Administer Financial Transactions

Chapter 3
Rating:
Medium ⁵

The Department uses four information systems that support the financial processes audited. Those systems include the Centralized Accounting and Payroll/Personnel System (CAPPS), the Uniform Statewide Accounting System (USAS), the Department's Cash Receipt System (CARS), and the Department's regulatory system (Sircon). The Department should improve certain controls over those systems to ensure that it administers financial transactions in accordance with applicable statutes, rules, and Department policy and procedures. Specifically:

- For all four systems, the Department did not ensure that it restricted access based on user roles, job duties, or employment status.
- For CARS and Sircon, the Department did not have sufficient segregation of duties to minimize the risk of unauthorized transactions. It should be noted that auditors did not identify any errors that were a result of unauthorized transactions.
- For Sircon, the Department did not have controls in place, such as edit checks, to ensure that information entered in key data fields is appropriate. For example, users could enter more than 24 hours in a day or negative mileage. While auditors did not identify specific instances of this occurring, it is important for the Department to have adequate controls in place because it uses the information in those key data fields to calculate the reimbursements for conducting financial examinations.

To minimize security risks, auditors communicated details about certain issues directly to the Department's management in writing.

Recommendations

The Department should:

- Periodically review and modify access to its information systems as necessary based on user roles and job functions.

⁵ Chapter 3 is rated as Medium because the issues identified present risks or effects that if not addressed could moderately affect the audited entity's ability to effectively administer program(s)/function(s) audited. Action is needed to address the noted concern and reduce risks to a more desirable level.

- Implement sufficient segregation of duties to minimize the risk of unauthorized transactions in information systems used to process financial transactions.
- Implement applications controls for key data fields in Sircon.

Management's Response

During the transition to the HR module for Centralized Accounting and Payroll/Personnel System (CAPPS), the Department changed its payroll process which eliminated the need for additional roles in Uniform Statewide Accounting System (USAS). The Department has removed these additional roles.

The implementation of CAPPS HR also changed the Department's process for removing users from CAPPS. The Department has added additional steps in the process for reviewing and removing access for both USAS and CAPPS.

The Department was using a legacy system for cash receipts which limited the ability to implement segregation of duties in its cash receipts system. However, the Department is implementing a new cash receipts system on September 1, 2018 which will have adequate segregation of duties.

The Department requested and implemented additional edits with the SIRCON vendor to not allow more than 24 hours in a day and to also not allow negative mileage. The edits were both completed by April 3, 2018.

Appendices

Appendix 1

Objective, Scope, and Methodology

Objective

The objective of this audit was to determine whether the Department of Insurance (Department) has processes and related controls to help ensure that it administers financial transactions in accordance with applicable statutes, rules, and Department policies and procedures.

Scope

The scope of this audit covered the Department's activities related to revenue, non-travel and travel expenditures, financial examinations, and related information systems for fiscal year 2017 (September 1, 2016, through August 31, 2017) and a portion of fiscal year 2018 (September 1, 2017, through January 31, 2018).

Methodology

The audit methodology included collecting information and documentation; interviewing Department staff regarding financial and operational processes; identifying risk, conducting data analyses, and testing documentation related to revenue, financial examinations, non-travel expenditures, travel expenditures, and information technology; and analyzing and evaluating the results of the tests.

Data Reliability and Completeness

To determine the reliability of the Department's expenditure and revenue information in the Uniform Statewide Accounting System (USAS), expenditure data in the Centralized Accounting and Payroll/Personnel System (CAPPS), and revenue data in the Cash Receipt System (CARS), auditors reviewed the data for validity and completeness by (1) reviewing data query language, (2) performing a high-level review of data fields and their contents for appropriateness, and (3) comparing CAPPS data to information in the Department's annual financial report. In addition, auditors relied on previous State Auditor's Office audit work on USAS.

To determine the reliability of time and travel expenditures from the Department's licensing application, Sircon, auditors reviewed the data for validity and completeness by (1) testing travel vouchers, (2) reviewing history logs, and (3) reviewing the Statement on Standards for Attestation Engagements No. 18 report.

Auditors also tested (1) selected general controls for USAS, CAPPs, the Sircon application, and CARS and (2) selected application controls for CAPPs, the Sircon application, and CARS.

Auditors determined that the Department's revenue, expenditure, and financial examination data discussed above was sufficiently reliable for the purposes of this audit.

Sampling Methodology

Auditors selected a non-statistical sample of transactions related to travel expenditures, non-travel expenditures, and deposits from financial examination invoices primarily through random selection. In some cases, auditors selected additional items based on risk. The test results as reported do not identify which items were randomly selected or selected based on risk. The sample items were not necessarily representative of the population; therefore, it would not be appropriate to project the test results to the population.

Auditors selected a risk-based sample of transactions related to revenues for testing. The sample items were generally not representative of the population and, therefore, it would not be appropriate to project those test results to the population.

Information collected and reviewed included the following:

- Department policies, procedures, and guidelines.
- Department expenditure data from CAPPs, and revenue and financial examination data from CARS.
- Supporting documentation related to revenues.
- Invoices, travel vouchers, purchase requisitions, and supporting documentation for expenditures.
- User access data and supporting documentation related to the general controls and application controls over the Department's financial process systems.

Procedures and tests conducted included the following:

- Interviewed Department staff to identify the Department's financial and operational processes, including financial and administrative internal controls, and the information systems that support those processes.

- Tested a sample of Department revenues, expenditures, and financial examinations to determine compliance with the Department's policies and procedures and state laws and regulations.
- Reviewed supporting documentation related to the general controls and application controls over the Department's financial process systems.
- Reviewed third-party reports on the suitability of design and operating effectiveness of controls over information technology systems.

Criteria used included the following:

- Department policies and procedures.
- Texas Insurance Code.
- Texas Government Code, Chapters 660, 2155, 2251, and 2254.
- Office of the Comptroller of Public Accounts' *expendit* purchasing procedures, *State of Texas Procurement Manual*, *Manual of Accounts*, and *Textravel* (travel policies and procedures).
- Title 1, Texas Administrative Code, Chapter 202.

Project Information

Audit fieldwork was conducted from November 2017 through April 2018. 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 following members of the State Auditor's staff performed the audit:

- Eric Ladejo, MPA (Project Manager)
- Pamela A. Bradley, CPA, CFE (Assistant Project Manager)
- Arton Gray
- Keith Overton-Hadnot, MBA
- Cameron Scanlon, CFE
- Nathan Stein

- Ann E. Karnes, CPA (Quality Control Reviewer)
- Michael Simon, MBA, CGAP (Audit Manager)

Issue Rating Classifications and Descriptions

Auditors used professional judgement and rated the audit findings identified in this report. Those issue ratings are summarized in the report chapters/sub-chapters. The issue ratings were determined based on the degree of risk or effect of the findings in relation to the audit objective(s).

In determining the ratings of audit findings, auditors considered factors such as financial impact; potential failure to meet program/function objectives; noncompliance with state statute(s), rules, regulations, and other requirements or criteria; and the inadequacy of the design and/or operating effectiveness of internal controls. In addition, evidence of potential fraud, waste, or abuse; significant control environment issues; and little to no corrective action for issues previously identified could increase the ratings for audit findings. Auditors also identified and considered other factors when appropriate.

Table 2 provides a description of the issue ratings presented in this report.

Table 2

Summary of Issue Ratings	
Issue Rating	Description of Rating
Low	The audit identified strengths that support the audited entity's ability to administer the program(s)/function(s) audited <u>or</u> the issues identified do not present significant risks or effects that would negatively affect the audited entity's ability to effectively administer the program(s)/function(s) audited.
Medium	Issues identified present risks or effects that if not addressed could <u>moderately affect</u> the audited entity's ability to effectively administer program(s)/function(s) audited. Action is needed to address the noted concern(s) and reduce risks to a more desirable level.
High	Issues identified present risks or effects that if not addressed could <u>substantially affect</u> the audited entity's ability to effectively administer the program(s)/function(s) audited. Prompt action is essential to address the noted concern(s) and reduce risks to the audited entity.
Priority	Issues identified present risks or effects that if not addressed could <u>critically affect</u> the audited entity's ability to effectively administer the program(s)/function(s) audited. Immediate action is required to address the noted concern(s) and reduce risks to the audited entity.

Copies of this report have been distributed to the following:

Legislative Audit Committee

The Honorable Dan Patrick, Lieutenant Governor, Joint Chair

The Honorable Joe Straus III, Speaker of the House, Joint Chair

The Honorable Jane Nelson, Senate Finance Committee

The Honorable Robert Nichols, Member, Texas Senate

The Honorable John Zerwas, House Appropriations Committee

The Honorable Dennis Bonnen, House Ways and Means Committee

Office of the Governor

The Honorable Greg Abbott, Governor

Department of Insurance

Mr. Kent Sullivan, Commissioner of Insurance



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