

COMPLIANCE AND CONTROL AUDIT REPORT

INSURANCE DEPARTMENT

**A Report to the Legislative Post Audit Committee
By the Legislative Division of Post Audit
State of Kansas
October 1993**

Legislative Post Audit Committee

Legislative Division of Post Audit

The Legislative Post Audit Committee and its audit agency, the Legislative Division of Post Audit, are the audit arm of Kansas government. The programs and activities of State government now cost about \$6 billion a year. As legislators and administrators try increasingly to allocate tax dollars effectively and make government work more efficiently, they need information to evaluate the work of government agencies. The audit work performed by Legislative Post Audit helps provide that information.

We conduct our audit work in accordance with applicable government auditing standards set forth by the U. S. General Accounting Office. These standards pertain to the auditor's professional qualifications, the quality of the audit work, and the characteristics of professional and meaningful reports. These audit standards have been endorsed by the American Institute of Certified Public Accountants and adopted by the Legislative Post Audit Committee.

The Legislative Post Audit Committee is a bipartisan committee comprising five senators and five representatives. Of the Senate members, three are appointed by the President of the Senate and two are appointed by the Senate Minority Leader. Of the representatives, three are appointed by the Speaker of the House and two are appointed by the House Minority Leader.

As part of its audit responsibilities, the Division is charged with meeting the requirements of the Legislative Post Audit Act which address audits of financial matters. Those requirements call for two major types of audit work.

First, the Act requires an annual audit of the State's financial statements. Those statements, prepared by the Department of Administration's Division of Accounts and Reports, are audited by a certified public accounting firm under contract with the Legislative Division of Post Audit. The firm is selected by the Contract Audit Committee, which comprises three

members of the Legislative Post Audit Committee (including the Chairman and Vice-Chairman), the Secretary of Administration, and the Legislative Post Auditor. This audit work also meets the State's audit responsibilities under the federal Single Audit Act of 1984.

Second, the Act provides for a regular audit presence in every State agency by requiring that audit work be conducted at each agency at least once every three years. Audit work done in addition to the annual financial statement audit focuses on compliance with legal and procedural requirements and on the adequacy of the audited agency's internal control procedures in areas not covered by the annual audit. These compliance and control audits are conducted by the Division's staff under the direction of the Legislative Post Audit Committee.

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COMPLIANCE AND CONTROL AUDIT REPORT

INSURANCE DEPARTMENT

OBTAINING AUDIT INFORMATION

This audit was conducted by Randy Tongier, Financial-Compliance Audit Manager, and Tom Vittitow, Auditor, of the Division's staff. If you need any additional information about the audit's findings, please contact Mr. Tongier at the Division's offices.

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INSURANCE DEPARTMENT

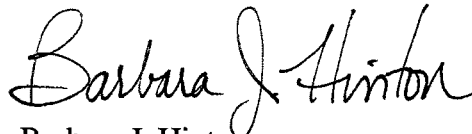
Summary of Legislative Post Audit's Findings

Legislative Post Audit conducted compliance and control audit work at the Kansas Insurance Department in partial fulfillment of the Legislative Post Audit Act's requirement that audit work be conducted at each State agency at least once every three years. This compliance and control audit addressed the areas of State property and purchases exempted from normal State purchasing requirements. The period covered by this audit was fiscal year 1992.

Did the Insurance Department follow adequate property management procedures and comply with applicable State requirements? We found that the Insurance Department followed appropriate property management procedures and had complied with applicable State requirements. The Department had adequate written property management procedures. The Department performed the required annual inspection of State property for fiscal year 1992 and submitted its required fiscal year 1992 property report on a timely basis. The Department's property listing appeared to be accurate.

Was the exemption of certain Insurance Department purchases from normal purchasing requirements reasonable? We found that the Insurance Department made one purchase that was exempt from the State's normal purchasing requirements. The Department adhered to procedures for requesting special purchase authority, and the exemption was reasonable.

We would be happy to discuss the findings presented in this report with any legislative committees, individual legislators, or other State officials.



Barbara J. Hinton
Legislative Post Auditor

INSURANCE DEPARTMENT

The Legislative Post Audit Act requires that audit work be conducted at each State agency at least once every three years. In partial fulfillment of that requirement, the Legislative Division of Post Audit has conducted compliance and control audit work covering fiscal year 1992 at the Insurance Department.

Compliance and control audits identify noncompliance with applicable requirements and poor financial management practices. Although the resulting audit findings usually do not result in significant program improvements or cost savings, they often identify needed improvements that can help minimize the risk of potential future loss or misuse of State resources.

To avoid duplication of audit work conducted as part of the statutorily required audit of the State's financial statements, our audit work focused on areas not covered by that audit. These areas included State property such as office equipment and furniture, and agency purchases exempted from normal purchasing requirements. This audit addresses the following specific questions:

- 1. Did the Insurance Department follow adequate property management procedures and comply with applicable State requirements?**
- 2. Was the exemption of certain Insurance Department purchases from normal purchasing requirements reasonable?**

To answer this question, we identified the applicable State requirements by reviewing relevant statutes, administrative regulations, and sections of the Division of Accounts and Reports' Policy and Procedure Manual. We also interviewed Insurance Department personnel, reviewed written procedures, and examined related supporting documents to identify the agency's procedures for handling State property. We then compared those procedures with the applicable legal and procedural requirements.

In addition, we identified the potential for loss or misuse of State property, and we evaluated the level of control provided by the Department's procedures in preventing and detecting loss or misuse of State property. Finally, we reviewed and tested property records, and tested a sample of property transactions.

To answer the second question, we reviewed statutes, regulations, and guidelines to identify the types of purchases that qualify for exemption from normal purchasing requirements. We then identified the agency purchases during the audit period that were exempted from those requirements. Finally, by reviewing supporting documents and interviewing appropriate personnel, we determined whether the exemption was reasonable.

In conducting this audit work, we followed all applicable generally accepted government auditing standards set forth by the U. S. General Accounting Office.

In general, we found that the Insurance Department followed adequate property management procedures and complied with applicable State requirements. The Department had appropriate property management procedures put in writing. Our testwork on the Department's fiscal year 1992 inventory found that Department personnel performed the required annual inspection of State property, maintained its State property listing accurately, and filed its annual property report on a timely basis.

We also found that the Insurance Department made one purchase that was exempted from the State's normal purchasing requirements. The basis for the exemption was that the services could be obtained from only one vendor. The Department adhered to procedures for requesting special purchase authority, and the circumstances of the special purchase reasonably warranted the exemption from normal purchasing requirements.

These findings are described following a background section on the Department.

Background on the Insurance Department

The Insurance Department was created in 1871 to regulate the insurance business in Kansas. The Department is supervised by the Insurance Commissioner, who is elected every four years. The Commissioner's and the Department's responsibilities for the supervision, control, and regulation of the Kansas insurance industry include:

- **Insurance Company Regulation**—The Department monitors the financial status of insurance companies, reviews and approves rate filings, examines annual statements of insurance companies, supervises the administering of agent examinations, issues agent and agency licenses, and ensures compliance with agents' continuing education requirements.
- **Insurance Company Examination**—The Department examines the financial status of all Kansas insurance companies and non-Kansas insurance companies doing business in Kansas, and examines other organizations, such as insurance holding companies, health maintenance organizations, group funded workers' compensation pools, and municipal group-funded pools.
- **Firefighters' Relief Fund Administration**—The Department provides funds to firefighters' relief associations and the Kansas State Firefighters' Association to be used to train firefighters, for benefits to injured firefighters, and to purchase insurance for firefighters. The fund is financed by a two percent tax on the total amount of premium for all fire and lightning insurance written in the State.
- **Workers' Compensation Fund Administration**—The Department pays approved workers' compensation claims to injured workers who had previous injuries, and pays other workers' compensation claims specified by law.
- **Health Care Stabilization Act Administration**—The Department provides Kansas health care providers with professional liability insurance coverage for claims exceeding \$200,000 through the Health Care Stabilization Fund.
- **Group-Funded Insurance Pools Oversight**—The Department reviews and approves applications for group-funded workers' compensation pools and municipal group-funded life, accident and health, and property and casualty insurance pools. The Department also reviews the financial status of the group pools and regulates their operations.

According to the Governor's Budget Report, the Insurance Department's fiscal year 1992 expenditures totaled \$58,484,106, funded primarily by fees, assessments, and taxes. About \$42.5 million (72.6 percent of the total) was spent for assistance payments—most of this amount was from the Workers' Compensation

Fund. Slightly more than \$3.7 million (6.4 percent of the total) was spent on aid to local units. About \$12.3 million (21.0 percent of the total) was spent for State operations, of which nearly \$4.9 million was for salaries and wages. The Department was authorized 156.2 full-time positions.

Did the Insurance Department Follow Adequate Property Management Procedures and Comply With Applicable State Requirements?

We found that the Insurance Department followed appropriate property management procedures and had put its property management procedures in writing. As a result, employees responsible for property management were more likely to be able to fulfill their responsibilities, and the risk of loss or misuse of State property was decreased. Our testwork on fiscal year 1992 found that the Department performed the required annual inspections of State property. In addition, the Department's State property listing appeared to accurately show property in the Department's possession. Finally, the Insurance Department filed its annual property report on a timely basis. These findings are described below, following a brief section on good property management practices.

A State Agency's Primary Objective In Managing State Property Is to Protect That Property From Loss or Misuse

To safeguard State property from potential loss or misuse, State agencies must follow a number of basic procedures. The following list includes the basic procedures necessary.

- ◇ For capital items such as furniture and equipment:
 - = List all State property owned by the agency with each item's location, cost, and property number. (The property number is required by the Division of Accounts and Reports.)
 - = Add property purchased to the list.
 - = Remove property sold or discarded from the list.
 - = Periodically inspect State property to check the accuracy of the property list, and identify missing items. (This step is required by the Division of Accounts and Reports. The Division also requires State agencies to send it a copy of their property list every year.)
 - = Periodically check the list to make sure that it includes all purchases, and does not include any property discarded or sold. (This step is required by the Division of Accounts and Reports. The Division also requires State agencies to report on this check every year.)

These procedures, if properly followed, should provide adequate protection against loss or misuse of State property. However, if the procedures are not followed,

the safeguards they provide will not be effective. To ensure that these procedures are followed, State agencies should take the following steps.

- ◇ Adopt specific steps for each procedure.
- ◇ Put those steps in writing.

- ◇ Assign to specific employees the responsibility for performing the steps.
- ◇ Establish a timetable for completing each procedure.
- ◇ Train the responsible employees.
- ◇ Require that the completion of procedures be documented.
- ◇ Provide for supervisory checks to ensure that procedures are adhered to.

Some of these procedures may be excessive for smaller agencies with a limited amount of State property in one location. Those agencies would have a lesser risk of loss or misuse than larger agencies with a greater amount of property in many different locations. To ensure cost-effective property management, State agencies should tailor their procedures and the amount of resources devoted to property management to match the risk involved. In any event, State agencies' procedures should meet the procedural requirements of the Division of Accounts and Reports.

Our Reviews and Tests of the Insurance Department's Property Management Procedures Found No Problems

We reviewed and evaluated the Insurance Departments property management procedures and we tested those procedures and the related records and reports. Our conclusions are listed below.

- **The Insurance Department had adequate written property management procedures.** Those procedures provide responsible employees the guidance needed to be able to fulfill their responsibilities, reducing the risk of loss or misuse of State property and noncompliance with State requirements.
- **The Insurance Department performed the required annual inspection of State property for Fiscal Year 1992.** As a result, the risk of State property being gone without responsible employees being aware of it, and the risk of missing property numbers, was reduced.
- **The Department's property listing appeared to be accurate.** We tested a sample of property acquired and disposed of and property on hand to make sure these items were properly shown in the Department's property records.

- **The Department submitted its required fiscal year 1992 property report on a timely basis.** The Division of Accounts and Reports requires all State agencies to submit a property report by September 30th of each year. This report includes the agency's property list and an accounting for property additions and deletions during the fiscal year.

Was the Exemption of Certain Insurance Department Purchases From Normal Purchasing Requirements Reasonable?

For fiscal year 1992, we found that the Insurance Department made one purchase that was exempted from the State's normal purchasing requirements. The basis for the exemption was that the services purchased could be obtained from only one vendor. We found that the Department adhered to procedures for requesting special purchase authority, and the circumstances of the special purchase reasonably warranted the exemption from normal purchasing requirements. These findings are described in more detail below.

The State Exempts Some State Agency Purchases From Its Normal Purchasing Requirements

The State's purchasing requirements are designed to ensure that State agency purchases result in the acquisition of quality goods and services at the most economical price. These requirements involve such things as competitive bidding, Statewide contracts, and the involvement of Division of Purchases staff in the procurement process.

Kansas statutes exempt certain types of purchases from these normal purchasing requirements. These types of purchases include the following:

- ◇ emergency purchases
- ◇ purchases for which competition does not exist; for example, when a product is sold by only one vendor
- ◇ purchases through a contract between State agencies, or between a State agency and other governmental or certain not-for-profit organizations
- ◇ purchases for which purchasing authority has been delegated to the State agency by the Division of Purchases
- ◇ negotiated purchases, as opposed to those made competitively
- ◇ purchases for use in laboratories or experimental studies
- ◇ purchases for which the normal requirement for publication of bid solicitation notice in the Kansas Register has been waived

Each purchase exempted from the State's normal purchasing requirements must be approved by the Division of Purchases and reported to the Legislative Coordinating Council, Senate Ways and Means Committee, and House Appropriations Committee.

For fiscal year 1992, our review showed that the special purchase of the Insurance Department reasonably warranted the exemption from the competitive bid requirements. The Division of Purchases granted the exemption based on its conclusion that the services needed could be obtained from only one vendor. The Insurance Department purchased forms which were prescribed for use by the National Association of Insurance Commissioners. According to the documentation we reviewed, the purchase of the forms was limited to a sole-source provider. The Division of Printing authorized the Department to purchase the specialized forms from the specialty printer. The Division of Purchases then approved the transaction as a sole-source purchase. The cost of the specialized forms was \$2,368.

Follow Up of Prior Audit Findings and Recommendations

The prior audit of the Insurance Department presented no audit findings and recommendations.

Appendix A

Agency Response

On September 13, 1993, we provided a copy of the draft audit report to the Insurance Department for its review and comment. The Department's response is included in this Appendix. In response to comments made by the Department, we made a number of changes to improve the accuracy and clarity of the audit report.



STATE OF KANSAS

KANSAS INSURANCE DEPARTMENT

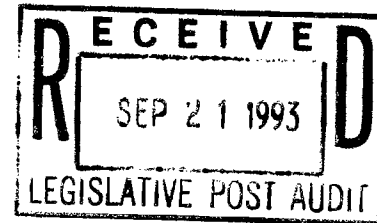
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RON TODD
Commissioner

September 21, 1993

Ms. Barbara J. Hinton
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Dear Ms. Hinton:

Thank you for allowing us the opportunity to review the draft copy of your compliance and control audit report on the Insurance Department covering FY 1992. We agree with your conclusions that our agency follows adequate procedures to ensure the safety of state property and that we adhere to established procedures when requesting authorization to make special purchases that are exempt from normal purchasing requirements.

We do, however, wish to provide some clarification to the narrative section contained in the report concerning the background of the Insurance Department. Those items needing to be clarified are as follows:

1. Pursuant to K.S.A. 40-241, the Insurance Department has contracted with an outside vendor to administer agents licensing examinations. Therefore, we believe it would be more appropriate for the report to state that the Department "supervises the administering of agents examinations" rather than "administers agents examinations."

2. To be consistent with K.S.A. 40-1703, we would recommend that the report state that the Firefighters Relief Fund is financed by "a two percent tax on the total amount of premium for all fire and lightning insurance written in the State" instead of saying a "two percent tax on all fire and lightning insurance premiums collected in the State."

3. Since K.S.A. 12-2619 authorizes municipalities to pool their liabilities not only for life and accident and health insurance but property and casualty insurance as well, we recommend that the audit report state that the Department reviews and approves applications for "municipal group-funded life, accident and health, and property and casualty insurance pools."

Ms. Barbara J. Hinton
September 21, 1993

Again, we appreciate the opportunity to review and respond to the draft copy of your audit report on the Insurance Department. If you have any questions concerning any of our comments, please do not hesitate to contact us.

Very truly yours,

A handwritten signature in cursive script, appearing to read "Ron Todd".

Ron Todd
Commissioner of Insurance

RT:rkn
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