



A REPORT
TO THE
ARIZONA LEGISLATURE

Financial Audit Division

Procedural Review

**Department of
Insurance**
As of May 15, 2002



Debra K. Davenport
Auditor General

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**STATE OF ARIZONA
OFFICE OF THE
AUDITOR GENERAL**

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AUDITOR GENERAL

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July 24, 2002

Charles R. Cohen, Director
State of Arizona
Department of Insurance
2910 North 44th Street, Suite 210
Phoenix, AZ 85018

Dear Mr. Cohen:

We have performed a procedural review of the Department's internal controls in effect as of May 15, 2002. Our review consisted primarily of inquiries, observations, and selected tests of internal control policies and procedures, accounting records, and related documents. The review was more limited than would be necessary to give an opinion on internal controls. Accordingly, we do not express an opinion on internal controls or ensure that all deficiencies in internal controls are disclosed.

Specifically, we reviewed cash receipts, cash disbursements, payroll, purchasing, journal entries, equipment, and statutory compliance.

As a result of our review, we noted a deficiency in internal controls that the Department's management should correct to ensure that it fulfills its responsibility to establish and maintain adequate internal controls. Our recommendation concerning this matter is described below.

The Department needs to improve accountability over license fees

Because cash is highly susceptible to potential theft or misuse, the Department needs to strengthen controls over license fees collections. For example, comparing licenses issued to monies collected and recorded as license fees helps to ensure that all monies collected are ultimately deposited. However, the Department did not perform that comparison. As a result, the Department would not be able to detect instances in which a license was issued and no money was received.

The Department should establish a procedure to reconcile, on a monthly basis, the sequences of licenses issued to the cash collected for license fees deposited with the State Treasurer. This amount should also be reconciled to the revenues recorded on the State's Arizona Financial Information System.

Charles R. Cohen, Director
July 24, 2002
Page Two

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Should you have any questions concerning our procedural review, please let us know.

Sincerely,

Dennis L. Mattheisen, CPA
Financial Audit Director



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State of Arizona**

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CHARLES R. COHEN
Director of Insurance

July 26, 2002

Ms. Debra Davenport
Auditor General
2910 North 44th Street, Suite 410
Phoenix, AZ 85018

Dear Ms. Davenport

Thank you for the opportunity to respond to the report of the procedural audit conducted by your office. We concur with the finding that accountability over license fees needs improvement.

In accordance with Arizona insurance laws, license fees are required to accompany license applications, and per A.R.S. § 20-167, once paid, fees are not refundable. To properly account for fees received, the Department needs to be able to reconcile license fees to license certificates issued, license applications withdrawn or denied and outstanding license applications.

In 1998, the Department developed a PC-based (Microsoft Access) database into which license applications, fees and license certificates (once issued) were logged. The Department was, for a short period, able to reconcile license certificates and license applications outstanding to cash. However, the enactment of licensing timeframes legislation, which became effective January 1, 1999, required us to build a system that could monitor multiple commencements and stoppages of elapsed days within a bifurcated process (administrative completeness review and substantive review), and to calculate days remaining for each half of the process. Without any additional resources, the Department was successful in implementing a sophisticated system that could track applications in accordance with the specific demands of the timeframes legislation. The Department has not since had the resources needed to develop a cash receipts subsystem that can be integrated with the timeframes system. However, the Department has steadily worked to improve internal controls.

1. The Department maintains physical controls over license certificates. Certificates are serialized and are stored in the Department's locked Supply Room. When the Licensing Section requires license certificates, a Licensing Section employee under the supervision of a Business Services Section employee takes approximately 500 certificates, logs the range of serial numbers in a log book, and initials in the log. The Business Services Section employee counter-initials the log. Licenses that are not used during the day are locked in the Supply Room safe and are retrieved the following morning. A license certificate that is produced with an error is voided (with the word "VOID" marked across the face of the certificate), and all voided license certificates are retained in a file.
2. The Department is improving accountability over license certificates. The Department added a field in the licensing timeframes database to enable license certificate numbers to be recorded. The Department is working on reports that will enable reconciliation between license certificates and license applications.
3. The Department is currently analyzing its business processes to facilitate software system decisions that contemplate the needs of the entire agency. After completing the business process analysis, the Department will need to evaluate the comparative costs of restructuring current software and purchasing new software. The Department will work with the Governor's

Office, the Legislature and the Government Information Technology Agency to try to secure necessary resources.

To have a system that offers all the features needed to minimize the potential for theft or misuse of license certificates, the Department either needs to make significant modifications to its existing computer database software or needs to replace the legacy software with new software. Specifically, the Department needs a computer system that

- allows cash receipts to be entered and allocated to various cost centers;
- enables cash receipt transactions to be related to license application transactions;
- continues to facilitate tracking of license applications in the manner prescribed by licensing timeframes laws;
- enables license application transactions to be related to license certificates issued or other license application dispositions (withdrawal, denial, etc.);
- enables the logging of voided license certificates and contemplates the issuance of replacement license certificates to customers whose certificates were lost or destroyed;
- restricts access to various parts of the system to prevent one person from having the ability to enter or change records affecting both cash receipts and license issuance; and,
- produces reports or other media to facilitate reconciliation of cash, license application dispositions and license certificates.

We would like to compliment the Auditor General's staff on their professional work during the procedural audit.

Sincerely,

Charles R. Cohen
Director

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