

North Dakota Office of the State Auditor

North Dakota Insurance Department

Audit Report for the Biennium Ended June 30, 2019

Client Code 401



North Dakota State Auditor
Joshua C. Gallion



Why We Conducted this Audit

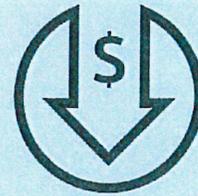
The purpose of this audit was to determine financial transactions including expenditures were made in accordance with law and appropriation requirements.

What We Found

The North Dakota Insurance Department collects insurance premium tax money paid by citizens to insurance companies annually. During our audit, we found that not all the premium money is going back to fire districts, rather some of it is put into the General Fund.

The state legislature limits how much money can be allocated to fire districts each year. Once that cap has been hit, the dollars exceeding the limit are legislatively required to be transferred to the General Fund.

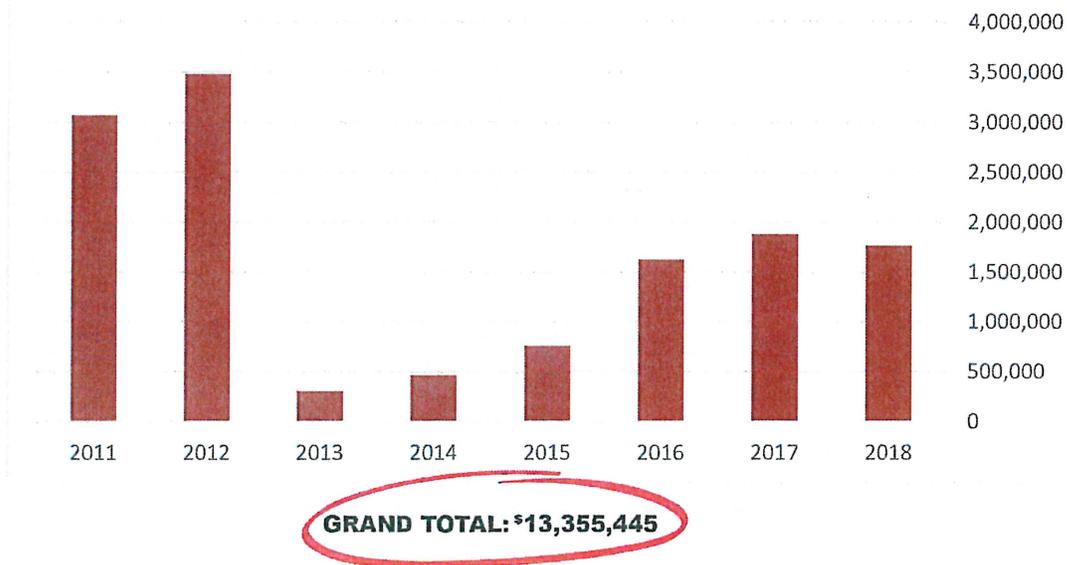
Over 20% of the amount collected was put into the General Fund, totaling \$3,648,941 during the biennium ended June 30, 2019.



Citizen Premiums Could Go Down

Citizen's property insurance premiums could potentially be lowered with increased funding to fire districts for updating or improving fire equipment, buildings, services, etc...in the community.

Fire Insurance Premium Tax Deposited into General Fund - Past 8 Years



KEY PERSONNEL

State Auditor's Office Staff

Robyn Hoffmann, CPA, Audit Manager
Dustin Walcker, Audit Supervisor
Delan Hellman, Senior Auditor
Alandra Kist, Auditor

Client Staff Contacts

Jon Godfread, Commissioner
Jeffrey Ubben, Deputy Commissioner
Rachel Kriege, Administration Division Director

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STATE OF NORTH DAKOTA
OFFICE OF THE STATE AUDITOR
STATE CAPITOL
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BISMARCK, NORTH DAKOTA 58505

Transmittal Letter

August 12, 2019

The Honorable Jon Godfread, Insurance Commissioner

We are pleased to submit this audit of the North Dakota Insurance Department for the biennium ended June 30, 2019. This audit resulted from the statutory responsibility of the State Auditor to audit or review each state agency once every two years. The same statute gives the State Auditor the responsibility to determine the contents of these audits.

The primary consideration in determining the contents of these audits is to produce informative audits to improve government. Statutory audit requirements are an important part of these audits and are addressed by our standard audit objective. Additionally, whenever possible additional audit objectives are included to increase responsiveness and effectiveness of state government.

Robyn Hoffmann, CPA was the audit manager. Inquiries or comments relating to this audit may be directed to the audit manager by calling (701) 239-7291. We wish to express our appreciation to Commissioner Godfread and his staff for the courtesy, cooperation, and assistance they provided to us during this audit.

Respectfully submitted,

/S/

Joshua C. Gallion
State Auditor

cc: Legislative Audit and Fiscal Review Committee
Chris Kadrmas, Legislative Council Fiscal Analyst

Audit Results

Statutory Audit Requirements

The objective related to our statutory audit requirements is:

Are there any exceptions to report relating to statutorily required audit testing?

Statutorily required audit testing includes: performing the post audit of financial transactions, detecting and reporting any defaults, determining that expenditures have been made in accordance with law, appropriation acts, and emergency commission action, and evaluating blanket bond coverage. Defaults are defined as failures to do something required by duty or law. Bonding coverage provides insurance to state agencies for any default or wrongful act on the part of any public employee or public official.

Conclusion

No exceptions to our statutorily required audit testing were identified.

Background Information and Results

The North Dakota Insurance Department (Insurance Department) is a state regulatory agency headed by the Insurance Commissioner. The Insurance Department provides a variety of services including agent licensing and investigation, consumer protection, financial examinations, and company licensing.

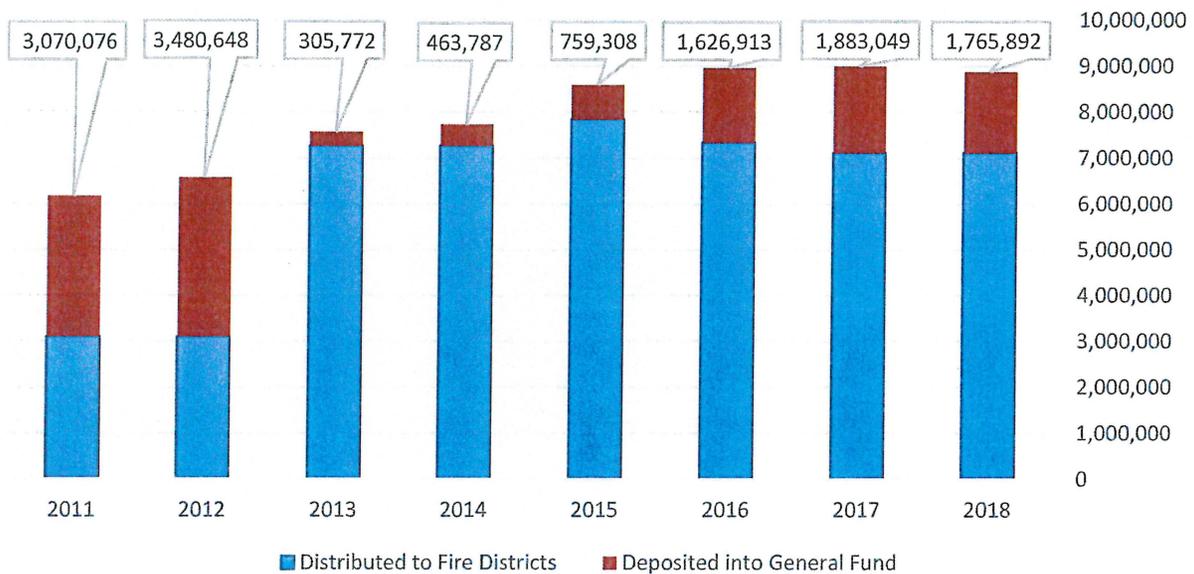
The biggest source of revenue for the Insurance Department is insurance premium tax. This is a tax the Insurance Department collects every year on the gross amount of premiums, assessments, and fees that insurance companies received from North Dakota policyholders during the year. Over \$131 million was collected during the 2019 biennium. The types of insurance premiums that are involved include life, accident, health, property, casualty, and surplus lines of insurance. For fire insurance, the tax rate is one and three-fourths percent of the premiums paid which is then submitted to the Insurance Department.

Annually, in December of each year the Insurance Department pays the fire insurance tax money collected back out to certified city fire districts, certified rural fire departments, or certified fire protection districts. This is paid out in the same proportion as the amount of premiums received by insurance companies for fire policies on property within the city, certified rural fire protection district, or area served by the certified rural fire department to the total premiums for those policies in the state. The total amount that can be allocated back out each year is limited to the amount appropriated by the state legislature for this purpose, with the amount exceeding the limit required to be transferred to the General Fund.

We noted over the last eight years the amount collected by the Insurance Department for fire insurance tax always exceeded the amount that was allocated back to the fire districts each year, therefore, there was always fire insurance tax money put into the General Fund rather than going to the fire districts. During the biennium ended June 30, 2019 there was \$3,648,941, or over 20% of the amount collected, that was put into the General Fund. Over the past eight fire insurance premium tax distributions, a total of \$13,355,445, or over 21% of the amount collected, went into

the general fund rather than going back to the fire districts where the funds could be utilized to update or improve fire equipment, buildings, services, etc... in the community.

Fire Insurance Premium Tax Distributions



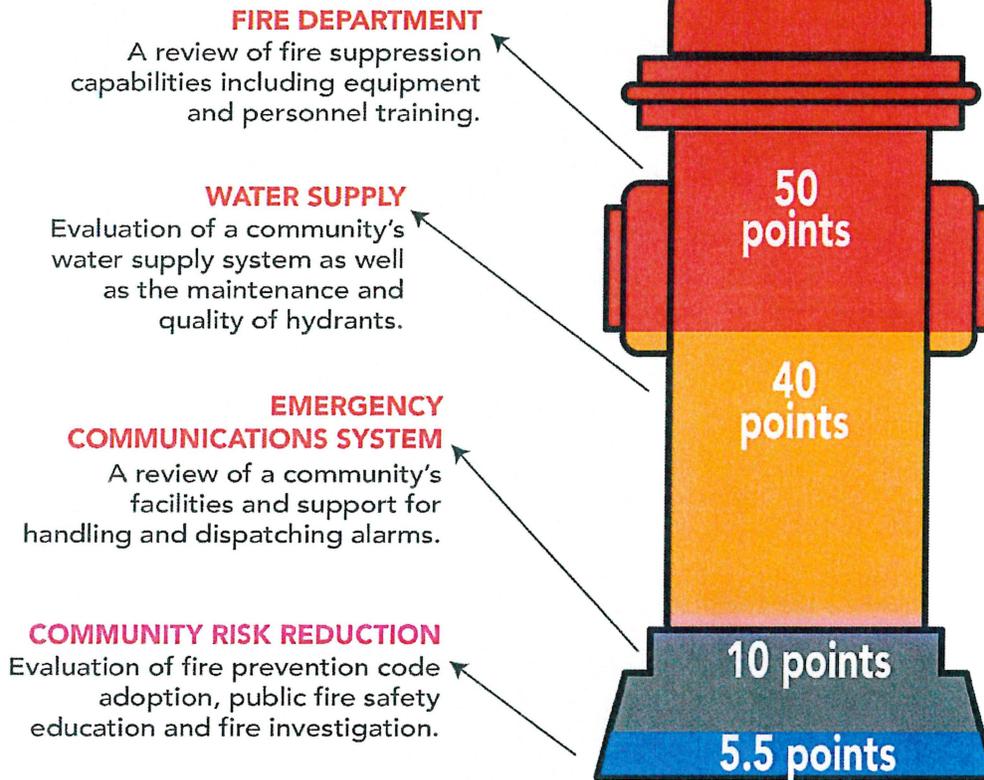
Source: Connect ND

North Dakota taxpayer’s property insurance premiums are affected by a rating that is given to communities in the state by Insurance Services Office Mitigation (ISO), a private company.

ISO is an organization that is considered the leading source of information about property/casualty insurance risk. Through a program they have titled Public Protection Classification (PPC) Program, ISO evaluates municipal fire-protection efforts in communities throughout the United States. For ISO’s purposes, there can be more than one community included in a North Dakota fire district. ISO performs their evaluations as a service to the insurance industry and does not charge a fee to the communities. The insurers may use ISO information as they see fit in their own business. A community’s investment in fire mitigation is a proven and reliable predictor of future losses. Insurance companies use PPC information to help establish fair premiums for fire insurance – generally offering lower premiums in communities with better protection. Many communities use the PPC as a benchmark for measuring the effectiveness of their fire-protection services. The PPC program is also a tool that helps communities plan for, budget, and justify improvements.

ISO collects information on municipal fire-protection efforts in communities throughout the United States. In each of those communities, ISO analyzes the relevant data using their Fire Suppression Rating Schedule (FSRS). The FSRS is a manual containing the criteria ISO uses in reviewing the fire prevention and fire suppression capabilities of individual communities or fire protection areas. There are four major areas that get evaluated. Each area is weighted differently using a point system, with 105.5 being the maximum total points that a community could receive.

CRITERIA USED TO EVALUATE A COMMUNITY'S PUBLIC PROTECTION CLASSIFICATION



Source: ISOMitigation.com

ISO then assigns a PPC rating from 1 to 10. Class 1 generally represents superior property fire protection, and Class 10 indicates that the area's fire-suppression program doesn't meet ISO's minimum criteria.

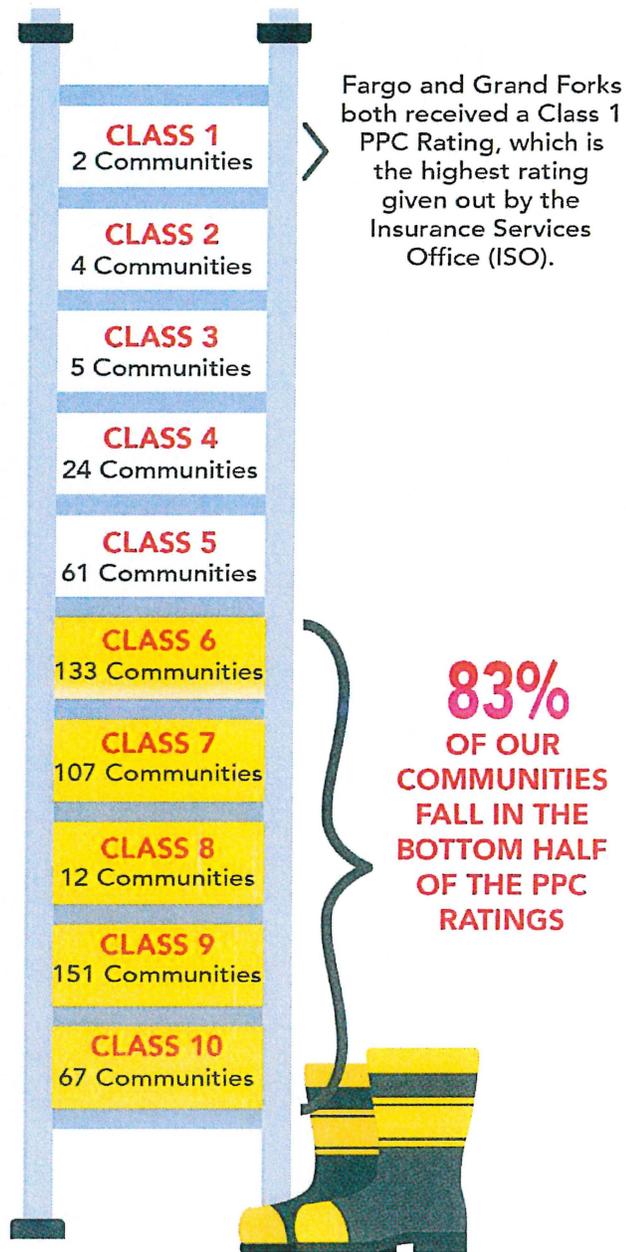
By classifying a community's ability to suppress fires, ISO helps communities evaluate their public fire-protection services. The program provides an objective, countrywide standard that helps fire departments in planning and budgeting for facilities, equipment, and training. And by securing lower fire insurance premiums for communities with better public protection, the PPC program provides incentives and rewards for communities that choose to improve their firefighting services.

According to ISO, most United States insurance companies including the largest ones use PPC information to offer coverages and establish deductibles for individual homes and businesses. Insurance companies, not ISO, establish the premiums they charge to policyholders. They use PPC information to help establish fair premiums for fire insurance – generally offering lower premiums in communities with better protection. Assuming all other factors are equal, the price of property insurance in a community with a good PPC is lower than in a community with a poor PPC. By offering economic benefits for communities that invest in their firefighting services, the program provides an additional incentive for improving and maintaining public fire protection.

The PPC ratings in the state of North Dakota vary from two communities that have the best class 1 rating and 67 communities with the lowest class 10 rating. The highest number of communities have the class 9 rating, as seen in the graph.

Each community's individual PPC rating and report is available to the fire chief or chief administrative official of that community by request directly from ISO.

ND COMMUNITIES BY PPC RATING



Source: ISOMitigation.com; 2017 Annual Report. Retrieved from <https://www.grandforks.gov/government/city-departments/fire/annual-report>; City of Fargo website. Retrieved from <http://fargond.gov/city-government/departments/fire/about>.

Internal Control

We gained an understanding of internal control and concluded as to the adequacy of their design. We also tested the operating effectiveness of those controls we considered necessary based on our assessment of audit risk.

Auditors are required to report deficiencies in internal control that are significant within the context of the objectives of the audit. A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect: misstatements in financial or performance information, violations of laws and regulations or impairments of effectiveness or efficiency of operations, on a timely basis. Considering both qualitative and quantitative factors, we did not identify any deficiencies in internal control that were significant within the context of our audit objectives and based upon the audit work performed.

Scope

This audit of the Insurance Department is for the biennium ended June 30, 2019.

The Insurance Department has operations in the following locations. Each location was included in the audit scope:

- The central office in the State Capitol.
- An offsite location in Bismarck which houses the Consumer Assistance Center and the Special Funds Division.
- An offsite location in Bismarck which houses the Examinations and Company Licensing Division.

Methodology

To meet this objective, we:

- Performed detailed analytical procedures including computer-assisted auditing techniques. These procedures were used to identify high-risk transactions and potential problem areas for additional testing.
- Non-statistical sampling was used and the results were projected to the population. Where applicable, populations were stratified to ensure that particular groups within a population were adequately represented in the sample, and to improve efficiency by gaining greater control on the composition of the sample.
- Interviewed appropriate agency personnel.
- Queried the ConnectND (PeopleSoft) system for data analysis. Significant evidence was obtained from ConnectND.
- Observed the Insurance Department's processes and procedures.
- Inspected documentary evidence.
- Tested compliance with appropriation laws and regulations including related transfers. Where necessary, internal control was tested which included selecting representative samples to determine if controls were operating effectively and if laws were being followed consistently.

- Reviewed adequacy of blanket bond coverage by comparing coverage to state bonding guidelines.
- Performed an analysis of fire district premiums collected and amounts paid out to fire districts.
- Performed an analysis and selected a sample of high-risk transactions, including administrative expenses, for further testing.

In aggregate, there were no significant limitations or uncertainties related to our overall assessment of the sufficiency and appropriateness of audit evidence.

Authority and Standards

This biennial performance audit of the Insurance Department has been conducted by the Office of the State Auditor pursuant to authority within North Dakota Century Code Chapter 54-10.

We conducted this performance audit in accordance with *Generally Accepted Government Auditing Standards* issued by the Comptroller General of the United States. 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 criteria used to evaluate internal control is published in the publication *Standards for Internal Control in the Federal Government* issued by the Comptroller General of the United States (Green Book, GAO-14-704G). Agency management must establish and maintain effective internal control in accordance with policy of the Office of Management and Budget (OMB Policy 216).

Financial Statements

Statement of Revenues and Expenditures

	<u>June 30, 2019</u>	<u>June 30, 2018</u>
<u>Revenues and Other Sources:</u>		
Insurance Premium Tax	\$ 68,567,677	\$ 63,273,934
Licenses and Fees	10,272,939	9,260,899
Fire and Tornado Collections	5,560,797	5,257,714
Revenue from Federal Government	250,951	286,986
Insurance Recoveries	137,958	158,749
Fines and Penalties	46,877	126,402
Other Revenue	2,017	1,231
Bonding Fund Collections	1,270	19,020
Total Revenues and Other Sources	\$ 84,840,486	\$ 78,384,935
<u>Expenditures and Other Uses:</u>		
Grants and Claims	\$ 12,337,757	\$ 9,992,766
Salaries and Benefits	4,040,709	3,965,047
Insurance	3,266,460	3,220,290
Professional Services	545,594	258,536
Rentals and Leases	191,844	181,242
IT Services	170,291	171,515
Travel	115,759	91,631
Operating Fees and Services	86,141	47,124
Supplies	63,376	70,848
Professional Development	30,389	18,780
Equipment	19,465	18,564
Other Expenditures	2,582	1,429
Transfers Out	32,706	79,759
Total Expenditures and Other Uses	\$ 20,903,073	\$ 18,117,531

Source: ConnectND Financials

Statement of Appropriations

For the Biennium Ended June 30, 2019

Expenditures by Line Item:	Final Appropriation	Expenditures	Unexpended Appropriation
Salaries and Wages	\$ 8,549,567	\$ 8,005,756	\$ 543,811
Operating Expenses	2,179,777	1,656,355	523,422
Grants	<u>15,064,086</u>	<u>15,047,562</u>	<u>16,524</u>
Total	<u>\$25,793,430</u>	<u>\$24,709,673</u>	<u>\$1,083,757</u>
Expenditures by Source:			
Other	<u>\$25,793,430</u>	<u>\$24,709,673</u>	<u>\$1,083,757</u>
Total	<u>\$25,793,430</u>	<u>\$24,709,673</u>	<u>\$1,083,757</u>

Source: ConnectND Financials

You may obtain audit reports on the internet at:

www.nd.gov/auditor

or by contacting the Office of the State Auditor at:

Email: ndsao@nd.gov

Phone: (701) 328-2241

Office of the State Auditor

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