Department of Insurance

Security Collateral Audit

Audit Period: July 2012 through January 2013

Results Summary:

Objective	Conclusion
Communication	**Well-Controlled with Improvement Needed**
Security Collateral Application Process	**Well-Controlled with Improvement Needed**
Monitoring	**Improvement Needed**

Executive Summary

Background

Ohio statute requires insurance companies conducting business in Ohio to pledge deposits with FDIC-insured financial institutions, which is administered by the Ohio Department of Insurance (ODI). Deposits are to be held as security for the insuring corporation's fulfillment of its obligations to its enrollees. The deposits can be held in the form of book entry or actual security and the amounts vary by type of insurance company. The deposits should be in the form of securities such as bonds, notes, CDs, and in some cases, mortgages. Acceptable securities should be rated single A or above by major rating agencies (Standard & Poor's, Moody's, and Fitch), and with a maturity longer than one year. There are currently 312 insurance companies in Ohio with total pledges of approximately $402.8 million.

During the audit, OIA identified opportunities for the ODI to strengthen internal controls and improve business operations. A summary, along with detailed observations, has been provided. This audit conforms with the *International Standards for the Professional Practice of Internal Auditing*. OIA would like to thank ODI staff and management for their cooperation and time in support of this audit.

This report is solely intended for the information and use of agency management and the State Audit Committee. It is not intended for anyone other than these specified parties.

Scope and Objectives

OIA staff was engaged to perform assurance work related to the security collateral process. This work was completed December 2012 through March 2013. The scope of this audit included the following areas of the security collateral process:

- Evaluate the design and effectiveness of controls over the communication of the security collateral requirements.

- Evaluate the design and effectiveness of controls over the security collateral application process.

- Evaluate the design of the controls over the monitoring of security collateral activities.

The scope does not include a review of the application controls over the SharePoint database or third party confirmations of the security collateral pledged. Third party confirmation procedures will be performed by the Auditor of State during their SFY2012 audit.

The intention of the security collateral pledge is to generate money to support the transition of a company to the Ohio Insurance Liquidators, if necessary. Ohio Insurance Liquidators is not a state agency and will not be a part of this audit.

Observations and Recommendations

The Observations and Recommendations include only those risks which were deemed high or moderate. Low risk observations were discussed with individual agency management and are not part of this report. However, the low risk observations were considered as part of the audit objective conclusions.

Observation 1. – SharePoint and Data

Organizations continue to increase their use and reliance on information technology tools. It is appropriate to fully utilize these tools in order to enhance the value and efficiency intended in their use. Also, key processes and controls are more effective when monitored by supervisory personnel since it increases the likelihood that the key processes are functioning as intended.

Within the last year, ODI has developed a SharePoint database to house security collateral data. The ODI performs annual reviews of each insurance company's security collateral data housed in SharePoint to confirm that the collateral is appropriately maintained at the financial institutions and accurately reported on the ODI database. Currently, ODI personnel export past years' monitoring reports from SharePoint and store them on the shared drive. ODI personnel maintain their notes made during the annual review on a printed list instead of maintaining them on SharePoint. In addition, it was noted that several ODI personnel review and update the ODI SharePoint database, but there was not a process whereby this annual review and update of the database was checked or monitored by an ODI employee outside of the process.

In our sample of 25 companies, we noted that one company had a partially called security that was not reported to ODI and was discovered during the annual review. Upon looking at prior year records, we noted this company had many partial calls on their collateral in recent years. We also noted in our review of the database as of January 31, 2013 that at least 22 insurance companies had securities reported which were past their maturity dates.

Not fully utilizing the SharePoint database functionality keeps ODI from having readily accessible, accurate information, such as prior year notes and issues, in one place. Housing notes in the database rather than on paper would increase ODI's ability to identify common and recurring issues, especially since multiple ODI staff verify the database. In addition, adding more data to SharePoint such as call information would aid ODI in proactively preventing some common issues such as not being aware of calls. In addition, periodically running a report to

check the maturity or call dates of the securities held would ensure the ODI has sufficient security collateral from the insurance companies at all times throughout the year.

Recommendation

Research the capabilities of the SharePoint site and fully utilize tracking functionality. Consider keeping notes from the review in SharePoint as well as collecting and housing additional information in SharePoint such as the call date. ODI should also periodically run a report from SharePoint to verify that no outstanding maturity or call dates exist and follow up with institutions in a timely manner. It will also be helpful if ODI continues to update the insurance company and financial institution contact information in SharePoint so they have that information ready to access. In addition, an ODI employee who does not update the ODI database should periodically review the database to ensure that updates are taking place and that securities are current. This review should be evidenced in SharePoint in some manner and also be documented in ODI's written policies and procedures.

Management Response

ODI intends to meet with internal IT staff to add auditing comments to companies currently under audit, as well as discuss SharePoint functionalities to pinpoint which companies had securities called in the past. In regards to securities being beyond, at, or near their maturity date, ODI currently has a report in SharePoint that can retrieve that information. Because there is limited staff primarily responsible for revenue, time for auditing/tracking purposes is limited. Also, two Accounts Receivable staff are new to ODI's audit process and the Fiscal Officer 2 is currently assisting. ODI hopes to remove the Fiscal Officer from the audit process and use them more for tracking purposes and monitoring of security maturity dates for the next audit cycle.

Risk*	Remediation Owner	Estimated Completion Date
Moderate	Fiscal Officer	June 2013

Due to the limited nature of our audit, we have not fully assessed the cost-benefit relationship of implementing the observations and recommendations suggested above. However, these observations reflect our continuing desire to assist your department in achieving improvements in internal controls, compliance, and operational efficiencies.

* Refer to Appendix A for classification of audit observations.

Appendix A – Classification of Conclusions and Observations

Classification of Audit Objective Conclusions

Conclusion	Description of Factors
Well-Controlled	The processes are appropriately designed and/or are operating effectively to manage risks. Control issues may exist, but are minor.
Well-Controlled with Improvement Needed	The processes have design or operating effectiveness deficiencies but do not compromise achievement of important control objectives.
Improvement Needed	Weaknesses are present that compromise achievement of one or more control objectives but do not prevent the process from achieving its overall purpose. While important weaknesses exist, their impact is not widespread.
Major Improvement Needed	Weaknesses are present that could potentially compromise achievement of its overall purpose. The impact of weaknesses on management of risks is widespread due to the number or nature of the weaknesses.

Classification of Audit Observations

Rating	Description of Factors	Reporting Level
Low	Observation poses relatively minor exposure to an agency under review. Represents a process improvement opportunity.	Agency Management; State Audit Committee (Not reported)
Moderate	Observation has moderate impact to the agency. Exposure may be significant to unit within an agency, but not to the agency as a whole. Compensating controls may exist but are not operating as designed. Requires near-term agency attention.	Agency Management and State Audit Committee
High	Observation has broad (state or agency wide) impact and possible or existing material exposure requiring immediate agency attention and remediation.	Agency Management and State Audit Committee