Department of Banking and Insurance

July 1, 2002 to March 31, 2004

Richard L. Fair
State Auditor
The Honorable James E. McGreevey
Governor of New Jersey

The Honorable Richard J. Codey
President of the Senate

The Honorable Albio Sires
Speaker of the General Assembly

Mr. Albert Porroni
Executive Director
Office of Legislative Services

Enclosed is our report on the audit of the Department of Banking and Insurance for the period July 1, 2002 to March 31, 2004. If you would like a personal briefing, please call me at (609) 292-3700.

James Patterson
Assistant State Auditor
June 9, 2004
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Department of Banking and Insurance

Scope

We have completed an audit of the Department of Banking and Insurance for the period July 1, 2002 to March 31, 2004. Our audit included financial activities accounted for in the state’s General Fund, the Mutual Workers’ Compensation Security Fund, the New Jersey Automobile Insurance Guaranty Fund, the New Jersey Insolvent Health Maintenance Organization Assistance Fund, the Real Estate Guaranty Fund, the Stock Workers’ Compensation Security Fund and the Unsatisfied Claim and Judgment Fund.

The prime responsibility of the department is to regulate the banking, insurance, and real estate industries in a professional and timely manner that protects and educates consumers and promotes the growth, financial stability, and efficiencies of those industries. Total expenditures and revenues of the department during fiscal year 2003 were $374 million and $308 million, respectively. The major components of revenue were annual assessments of insurance companies and license fees collected from individuals engaged in insurance, consumer finance, or real estate businesses within New Jersey.

During fiscal year 2003, revenue and expenditures of the Unsatisfied Claims and Judgment Fund (UCJF) amounted to $197 million and $237 million, respectively. This fund was included in the scope of our audit. However, in accordance with P.L. 2003, c. 89 approved June 9, 2003, the UCJF was abolished and its functions, powers and duties including its assets, liabilities, and balances were transferred to the New Jersey Property-Liability Insurance Guaranty Association (NJPLIGA). NJPLIGA is a private, nonprofit, unincorporated, legal entity created in accordance with N.J.S.A. 17:30A-6. We did not audit NJPLIGA.
**Objectives**

The objectives of our audit were to determine whether financial transactions were related to the department’s programs, were reasonable, and were recorded properly in the accounting systems. We also tested for resolutions of significant conditions noted in our prior audit report dated June 12, 2000.

This audit was conducted pursuant to the State Auditor's responsibilities as set forth in Article VII, Section 1, Paragraph 6 of the State Constitution and Title 52 of the New Jersey Statutes.

**Methodology**

Our audit was conducted in accordance with *Government Auditing Standards*, issued by the Comptroller General of the United States.

In preparation for our testing, we studied legislation, administrative code, circular letters promulgated by the State Comptroller, and policies of the department. Provisions that we considered significant were documented and compliance with those requirements was verified by interview, observation, and through our samples of financial transactions. We also read the budget message, reviewed financial trends, and interviewed department personnel to obtain an understanding of the programs and the internal controls.

A nonstatistical sampling approach was used. Our samples of financial transactions were designed to provide conclusions about the validity of transactions as well as internal control and compliance attributes. Sample populations were sorted and transactions were judgmentally selected for testing.

To ascertain the status of findings included in our prior report, we identified corrective action, if any, taken by the department and performed tests on the system to determine if the corrective action was effective.
Conclusions

We found that the financial transactions included in our testing were related to the department’s programs, were reasonable, and were recorded properly in the accounting systems. In making this determination we noted certain internal control weaknesses and a matter of compliance with laws and regulations meriting management’s attention. We also found that the department has resolved one of the two significant issues noted in our prior report. The matter relating to the timeliness of deposits has been restated in our current report.
Internal Controls - Cash Receipts

The department maintains similar but separate cash receipt systems to account for fees collected by the Division of Banking, Division of Insurance, and the Real Estate Commission. During the audit period, these units processed approximately $30 million in receipts through these cash receipt systems. The purpose of the cash receipts systems is to record, inquire, and report on monetary transactions pertaining to license applications/renewals, fines/penalties, and other miscellaneous items. Each payment and any forms received must be stamped with a cash receipt number and date using stamp machines located in the various units.

Receipts and forms are not always stamped when received and not all cash receipt numbers are entered into the system. In some instances, checks and documents are stamped and then returned to the payee and not entered into the system. In other instances, blocks of cash receipts numbers are stamped on blank paper to be hand written on checks and documentation at a later date.

We selected three blocks of 500 sequential numbers (1500 total) used by each unit between December 24, 2003 and January 21, 2004 and found that 134 numbers (8.9 percent) had not been recorded in the cash receipts system as of March 29, 2004. Additionally, individuals processing cash receipts have access to the various licensing systems. There is a risk that licenses can be issued without the proper depositing of receipts. However, our tests of transactions disclosed no impropriety. These functions should be properly segregated to reduce the risk of error or inappropriate actions.

Recommendation

We recommend that the department establish procedures to ensure that all receipts are stamped and properly entered in the cash receipt systems in a
timely manner. Furthermore, the cash receipt processing and licensing functions should be properly segregated and restricted.

Auditee Response

The department has conducted a thorough review of this finding. All staff has been instructed to stamp all checks and steps are underway to modify computer systems to record all cash receipts numbers.

The problem of cash receipts numbers not being entered into the cash receipts systems stems from those remittances that are returned because the proper amount has not been remitted, that there is a deficiency noted on the documentation included with the remittance, or the applicant does not qualify for licensing. In those circumstances, those items are not entered into the cash receipts system.

A new procedure will be implemented where all cash receipts will be entered into the cash receipts system, including those that have been returned to the remitter. Those remittances entered into the cash receipts system that have been returned to the remitter will be assigned a unique code that will account for the sequential cash receipt number, but will not be included as an amount deposited. The unique code will provide an audit trail that the remittance has been returned to the remitter and the reason why it was returned.

Timeliness of Deposits

We tested receipts related to selected revenue sources amounting to $52 million and found that 130 of 185 sampled checks were not deposited timely. Supporting documentation could not be provided for an additional 25 transactions selected. Treasury Circular Letter 94-24-OMB requires the deposit of receipts on the same day as received. The average
time from the date received to the date of deposit was five days. Generally, we noted that checks remained with applications and forms during processing. This condition increases the risk that checks could be lost, misplaced or stolen.

**Recommendation**

We recommend that the department revise procedures to ensure that checks are deposited in a timely manner and that documentation be retained to support processed transactions.

**Auditee Response**

Within the last six months the department has merged several of the licensing units into the Central Administrative area to improve efficiency. The prior units were too small and did not allow for proper segregation of duties. The merger has made proper segregation of duties possible and the function of processing receipts and issuing licenses have been properly segregated.

Processing of checks for Banking Licensing has been reassigned within the Administrative area. Checks are now processed every day.

All senior staff has been reminded about the importance of the timely processing of checks. Procedures are being updated and will be distributed to all other staff responsible for processing checks. The department is exploring options such as online payment to reduce the number of checks being processed and further centralization to improve the processing time.