



NEBRASKA AUDITOR OF PUBLIC ACCOUNTS

Mike Foley
State Auditor

Mike.Foley@nebraska.gov
P.O. Box 98917
State Capitol, Suite 2303
Lincoln, Nebraska 68509
402-471-2111, FAX 402-471-3301
www.auditors.nebraska.gov

February 10, 2014

Bruce R. Range, Director
Nebraska Department of Insurance
941 O Street, Suite 400
Lincoln, Nebraska 68508-3639

Dear Mr. Range:

We have audited the basic financial statements of the State of Nebraska (State) as of and for the year ended June 30, 2013, in accordance with auditing standards generally accepted in the United States of America and standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States and have issued our report thereon dated December 30, 2013. In planning and performing our audit, we considered the State's internal control over financial reporting (internal control) as a basis for designing audit procedures for the purpose of expressing our opinions on the basic financial statements of the State, but not for the purpose of expressing an opinion on the effectiveness of the State's internal control. Accordingly, we do not express an opinion on the effectiveness of the State's internal control.

In connection with our audit described above, we noted a certain internal control or compliance matter related to the activities of the Nebraska Department of Insurance (Agency) or other operational matters, which is presented below for your consideration. The comment and recommendation, which has been discussed with the appropriate members of the Agency's management, is intended to improve internal control or result in other operating efficiencies.

Our consideration of internal control included a review of prior year comments and recommendations. To the extent the situations that prompted the recommendations in the prior year still exist, they have been incorporated in the comments presented for the current year. All other prior year comments and recommendations (if applicable) have been satisfactorily resolved.

Our consideration of internal control was for the limited purpose described in the first paragraph and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and, therefore, material weaknesses or significant deficiencies may exist that were not identified.

Draft copies of this letter were furnished to the Agency's administrators to provide them with an opportunity to review and to respond to the comment and recommendation contained herein. All formal responses received have been incorporated into this letter. Responses have been objectively evaluated and recognized, as appropriate, in the letter. Responses that indicate corrective action has been taken were not verified at this time, but will be verified in the next audit.

The following is our comment and recommendation for the year ended June 30, 2013.

Internal Actuary Review

A good internal control plan requires procedures to verify that in-house actuarial calculations are accurate and properly supported.

The Department of Administrative Services State Accounting Division (State Accounting) requests information from the Agency for the calculation of the incurred but not reported (IBNR) Nebraska Hospital-Medical Liability for the Comprehensive Annual Financial Report (CAFR). The IBNR liability calculation is complex and requires an actuary to determine the amount to be reported. During fiscal year 2012, the Agency hired a new in-house actuary to perform the calculation. However, the Agency has not sought an external actuarial review to ensure the accuracy of its calculation since fiscal year 2009.

During our testing of the IBNR calculation for the fiscal year ended June 30, 2013, it was brought to our attention that the fiscal year ended June 30, 2012, calculation was erroneously understated by \$384,935. Additionally, incomplete spreadsheets served as supporting documentation for the fiscal year ended June 30, 2013, calculation. Upon the auditor's request, revised spreadsheets were provided. The calculations contained in that updated documentation agreed to the amounts reported to State Accounting.

When calculations for the financial statements are complex in nature, and both the procedures for reviewing those calculations prove inadequate and the supporting documentation is incomplete, there is an increased risk that amounts reported will be incorrect, resulting in a material misstatement in the financial statements.

We recommend the Agency obtain an external actuarial review of the IBNR liability calculation at a minimum of once every five years to ensure the accuracy of the in-house calculation. We also recommend the Agency establish procedures for ensuring the sufficiency of all documentation supporting the IBNR liability calculation.

Agency Response: The Agency has periodically obtained independent external actuaries' IBNR estimates, most recently as of fiscal year 2009. That report provided a basis for comparing methods, assumptions and estimated IBNR, but did not review the accuracy of in-house calculations or data preparation. The Agency never, in the past, has engaged an external

actuary to review the internal work product. As recommended, the Agency has approached the external actuary engaged in 2004, 2006, and 2009 about his availability in the second half of 2014 to review the in-house actuary's calculations, plus provide an independent estimate of the Fund's IBNR liability. Also in regard to the incomplete spreadsheets, in the Agency's view, one of two spreadsheets sent as supporting documentation for the calculation at fiscal year ended June 30, 2013 was incomplete. Upon the auditor's request, an updated spreadsheet was provided. As a result, the Department of Insurance has reviewed existing procedures for the IBNR liability calculation, supporting documentation, and transmission of support to the State Auditor. An appropriate adjustment in filing procedures was made to prevent sending the wrong spreadsheet to the State Auditor.

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Our audit procedures are designed primarily on a test basis and, therefore, may not bring to light all weaknesses in policies or procedures that may exist. Our objective is, however, to use our knowledge of the Agency and its interaction with other State agencies and administrative departments gained during our work to make comments and suggestions that we hope will be useful to the Agency.

This communication is intended solely for the information and use of management, the Governor and State Legislature, and others within the Agency and is not intended to be, and should not be, used by anyone other than these specified parties. However, this communication is a matter of public record, and its distribution is not limited.

SIGNED ORIGINAL ON FILE

Pat Reding, CPA, CFE
Assistant Deputy Auditor