

MINUTES OF THE MEETING OF THE
AUDIT SUBCOMMITTEE OF THE LEGISLATIVE COMMISSION
Legislative Building
401 South Carson Street, Room 4100
September 21, 2006

This is the fourth meeting of the 2005-2006 Interim.

A meeting of the Audit Subcommittee of the Legislative Commission (NRS 218.6823) was called to order by Assemblywoman Sheila Leslie, Chair, at 9:39 a.m., Thursday, September 21, 2006, in room 4100 of the Legislative Building, Carson City, Nevada, with a simultaneous video conference to room 4412 of the Grant Sawyer State Office Building, 555 East Washington Avenue, Las Vegas, Nevada.

AUDIT SUBCOMMITTEE MEMBERS PRESENT:

Carson City:

Assemblywoman Sheila Leslie, Chair
Assemblyman John Marvel, Vice-Chair
Senator Dean A. Rhoads

Las Vegas:

Assemblyman Morse Arberry Jr.
Senator Bob Coffin

LEGISLATIVE COUNSEL BUREAU STAFF PRESENT:

Paul Townsend, Legislative Auditor
Stephen Wood, Chief Deputy Legislative Auditor
Donna Wynott, Office Manager
Jane Bailey, Audit Supervisor
Tim Brown, Audit Supervisor
Rocky Cooper, Audit Supervisor
Shawn Heusser, Deputy Legislative Auditor
Dennis Klenczar, Deputy Legislative Auditor
Doug Peterson, Information Systems Audit Supervisor
Lee Pierson, Deputy Legislative Auditor
Shannon Ryan, Deputy Legislative Auditor
Mike Spell, Audit Supervisor

Assemblywoman Sheila Leslie, Chair, called the meeting to order at 9:39 A.M. The roll was taken. A quorum was present.

Item 1—Approval of minutes of the meeting held on May 16, 2006.

ASSEMBLYMAN MARVEL MOVED TO APPROVE THE AUDIT SUBCOMMITTEE MINUTES OF MAY 16, 2006. THE MOTION WAS SECONDED BY ASSEMBLYMAN ARBERRY AND CARRIED UNANIMOUSLY.

Item 2—Presentation of audit reports (NRS 218.823).

A. Department of Education.

Paul Townsend, Legislative Auditor, introduced Tim Brown, Audit Supervisor; and Shawn Heusser, Deputy Legislative Auditor, to present the report.

Mr. Heusser began the presentation with background information. He stated the Department was created in 1956 to execute policy set forth by the State Board of Education which includes the responsibility for statutory compliance, implementing Board policy, and administering state and federal education programs.

Mr. Heusser noted that statewide growth in student enrollments had increased from 340,000 in fiscal year 2001, to over 400,000 in fiscal year 2005. The Department had revenues and expenditures of approximately \$1.2 billion in fiscal year 2005. Close to 80% of all revenues for the Department were from state funds.

Audit objectives were to assess the Department's efforts to ensure the accuracy and reliability of data; comply with pertinent state and federal laws, rules, regulations, and guidelines; and monitor certain educational programs.

Mr. Heusser reported the Department did not always ensure the accuracy and reliability of data received from school districts. In addition, weaknesses allowed non-compliance with some state and federal laws, rules, regulations and guidelines, and the monitoring of certain educational programs needed to be improved.

Mr. Heusser reported that better control over special legislative funding was needed. During the past several legislative sessions, the Legislature authorized additional funding to assist school districts in meeting their responsibilities. Special funding had been appropriated to improve teacher retention and recruitment, purchase textbooks, and to meet rising utility and health care costs. Auditors found the Department could improve its control over the issuance and accountability of this funding.

To help address teacher shortages, the Legislature established incentive programs to assist schools in the recruitment and retention of teachers. These incentives included teacher signing bonuses and retirement credits for teachers in at-risk schools and hard to fill positions.

Mr. Heusser stated between fiscal years 2002 and 2005, school districts received over \$35 million in special funding for teacher incentive programs. During fiscal years 2006 and 2007, these same programs would receive over \$66 million. With the increase in funding for these and other programs, there is a need for stronger controls to ensure the funds are safeguarded and used as intended.

Mr. Heusser noted that controls over the teacher signing bonus could be improved. It was found that the Department did not have a database for tracking which teachers had received the signing bonus. Auditors discussed the Department's decision to provide the signing bonus to all teachers, as long as they had at least one year of separated service from the State. The audit identified 115 teachers who had received a total of \$230,000 in signing bonuses in fiscal year 2004, who had previously taught in the state. During the 2005 Legislative Session, the Department requested an additional \$436,000

to cover new teacher signing bonuses above the appropriated \$10 million. The Department needs to ensure the decision to pay teachers with prior experience in the State a signing bonus is in line with the intent of the funding.

Mr. Heusser discussed the Department's processes for retirement credits. The Department reimbursed school districts based on the estimated costs of retirement credit purchases. Based on analysis of the actual amount the school districts paid to PERS for retirement credit purchases, some districts received less than they should have, while other districts received more.

The approval of over \$171 million in special legislative funding during the 2001 and 2003 Legislative Sessions included additional funding for employee healthcare costs, unbudgeted energy costs, and textbooks. Policies have been developed for the administration of this funding, but do not include processes to ensure the funding was properly used. Final reports on the use of special funding lack necessary information for comparisons between projected and actual costs, and had not been reviewed to ensure funding received was needed. Recommendations were made to address concerns with controls over special legislative funding.

The Department's process over teacher license revocations included revocation of licenses for criminal acts such as driving under the influence, theft, and sexual related crimes, as well as, non-criminal cases dealing with test security. Policies and procedures over revocation proceedings have not been adequately developed. Areas that could be improved included the investigation and documentation process and the documentation of the Superintendent's decision to proceed or not proceed with a case to the State Board of Education. Criminal processes could be improved through the implementation of a tracking database similar to the one used by the Department for monitoring non-criminal cases. Recommendations were made to improve the processing and tracking of potential license revocation cases.

Mr. Heusser noted that Department policies and procedures do not provide adequate detail to ensure special education due process hearings were properly carried out and documented. Specifically, procedures lack detail on the random or rotational assignment of hearing and review officers, the evaluation of hearing and review officers, and controls to ensure hearing and review officer hourly rates are documented. One recommendation was made to improve the policies and procedures governing special education due process hearings.

The report discussed the need to improve controls over class-size reduction information. Each year the Department receives information from Nevada's 17 school districts on class-size reduction efforts. However, the Department only verifies the calculations of the student to teacher ratios, and not the accuracy of the reported student and teacher information. While the Department had developed a funding formula for the distribution of class-size reduction funding, it does not compare the number of class-size reduction teachers reported by each district, with the estimated number that was funded per the Department's funding formula. It was noted that the Department was unsure of the cause of one district receiving funding for 30 class-size reduction teachers, but only reporting 20 actual class-size reduction teachers.

Recommendations were made that the Department should implement controls to ensure the reasonableness of class-size reduction information.

Mr. Heusser reported the Department did not conduct employee evaluations in compliance with state law. Specifically, of 50 employee personnel files tested, 39 had not received an annual evaluation during the preceding year. It was recommended that the Department complete performance evaluations in accordance with state law.

Mr. Heusser reported the Department accepted the 10 audit recommendations.

Chair Leslie asked for clarification that recommendations from the previous audit were implemented.

Mr. Heusser answered two recommendations were within the scope of the current audit and had been fully implemented.

Chair Leslie asked for additional information about the license revocation process. She asked if it was correct that no requirement existed that the Department be notified of criminal behavior. She stated the report noted the process was informally followed. She asked for an explanation and clarification of the informal process. She asked how the Committee could be confident that the Department was receiving the information from around the state.

Mr. Heusser responded the process was not written down. He added the Department relies on outside sources such as newspapers to be informed when there has been a problem with a teacher. He added the Department relies on this information to begin work on license revocation cases.

Chair Leslie stated relying on information in newspapers seemed like a weakness as this information might be missed or it might not get in the newspapers.

Assemblyman Marvel asked if the Department accessed the Criminal History Repository.

Mr. Heusser responded the Department utilized systems in regard to teacher licensing to check criminal backgrounds and to see if individuals had been arrested, charged, or convicted of crimes in Nevada or in other states.

Chair Leslie stated the problem was the Department does not check it every day. She added the Department may utilize the Repository when individuals apply for their original license but not after that time.

Assemblyman Marvel asked about requirements for a teacher to receive a teaching bonus.

Mr. Heusser replied the requirements state that a teacher must teach in the state for 30 days to be eligible to receive a bonus.

Senator Rhoads asked about districts receiving more or less funding. He asked if the Department would make that up the next year.

Mr. Heusser stated the report noted the amount received by each district. He added the Department was working on implementing procedures to ensure when a district

received more money in one year than another, that the district would make up and ensure they are receiving the amount they are entitled to.

Senator Rhoads asked about the school district that received additional funding for class size reductions.

Mr. Heusser responded the Douglas County School District received the additional funding. An audit recommendation was made to ensure the Department follows up upon receiving information such as this.

Chair Leslie called for an agency representative to testify.

Ms. Gloria Dopf, Deputy Superintendent, Instruction, Research and Evaluation Services, represented the Department. She explained Keith W. Rheault, Ph.D., Superintendent of Public Instruction, was absent due to attending a meeting out-of-state. She also introduced James Wells, Deputy Superintendent, Administrative and Fiscal Services.

Chair Leslie asked for information in regard to the teacher revocation process. She expressed concerns about whether the process was adequate.

Ms. Dopf answered the revocation process when received by the State Board could be invoked either for criminal or non-criminal purposes. Once at the revocation level the sequence in the process is the same in regard to the State Board's action and engagement with the Attorney General's Office and the ultimate decision to revoke a license with due process to the candidate. The issue of the audit report pertained to the documentation of the revocation process. She believed the report indicated that a process was in place. The audit report dealt with the amount of detail, the check lists, and sequencing to ensure all files were complete.

Chair Leslie interjected she had asked the auditor and was informed that the process was not written down. She asked if Ms. Dopf was reporting that a written process actually existed.

Ms. Dopf answered that a process was followed, whether it was or was not outlined from beginning to end. She stated the issue was whether a check list existed that tracked and assured the accuracy and completeness of the files. She added that was the corrective action that would be taken by the Department. She stated a procedure existed that generated from a typical revocation of non-criminal acts dealing with test irregularity. She indicated the process was handled by the testing office and documentation was located at that office. Ms. Dopf stated revocation files were located in the superintendent's office along with documentation from the Department. Ms. Dopf stated the Department was now following a similar pattern with a check list and verification of the file and follow-up on corrective action on revocation files. The pieces were in place. Ms. Dopf explained they needed to be systematically linked together and assign a staff person in the Department to ensure the file was complete with all necessary documentation in one setting where it could be tracked from beginning to end. She stated the Department had completed modification of that process.

Chair Leslie asked for written verification of the process and information regarding who was responsible for the process implementation.

Ms. Dopf agreed to provide the Committee with the requested information.

Assemblyman Marvel asked who had the authority for the license revocation process.

Ms. Dopf replied the State Board of Education had the revocation authority over teacher and educator licenses. She added the school district had its own process of discipline. She explained many actions, particularly non-criminal offenses, had a sequence of disciplinary action in place depending on the nature of the offense. She added the State Board handles license revocations through State Board meetings. The meeting is posted as a formal hearing, and the individual subject to revocation is able to present evidence. She emphasized that was an action of the State Board of Education.

Assemblyman Marvel asked if guidelines existed for minor infractions at the school district level.

Ms. Dopf stated disciplinary actions, unless prescribed in statute, were part of the association collective bargaining process which included a series of disciplinary actions for various offenses in each individual school district within their contract or agreement with the association.

Assemblyman Marvel noted the disciplinary action could vary between school districts.

Ms. Dopf agreed in certain cases, with test irregularity, and issues of disciplinary action there were a series of actions stated in statute, however, the actual disciplinary action remains part of a district's prerogative.

Chair Leslie expressed concern about whether the Department of Education would be informed about all of the cases.

Ms. Dopf stated the recommendation included two separate issues based upon the audit findings. One issue involved if the Department would have access to information of a candidate's prior criminal history that would impact a licensing decision. Ms. Dopf explained the Department had access to the Criminal History Repository through the Department's licensure office. Ms. Dopf stated the individual would have to be convicted in order to be a part of the Criminal History Repository system. The second issue involved the case of dealing with an individual already licensed in the state, who is under some kind of an investigation. The Department does not have a required formal process of notice to the Department of Education and ultimately to the State Board when something was amiss. For this information the Department depends on the media. The school district informs the Department, but the Department would not be in a position to know officially and formally until a case was determined. Therefore no requirement existed for the Department to receive information from a school district or any other source.

Chair Leslie thanked Ms. Dopf for clarifying the issues. She expressed concern over the current process and stated she would pursue it for a better solution. Chair Leslie noted substantial damage could be done before the criminal justice system had time to complete its task.

Chair Leslie asked if the Repository automatically notified the Department about the conviction of a teacher.

Ms. Dopf stated the Department had access on a daily basis to the information at the Repository. She stated no automatic signaling device existed that would notify the Department in the case of a teacher being convicted.

Chair Leslie would like to see the automatic notification of these convictions. She asked if the Department's tracking process would enable them to look for conviction activity if they were aware that something was amiss. Chair Leslie asked if the Department was confident that convictions were being noted by the Department.

Ms. Dopf stated at the licensing juncture staff utilized the Repository database to check for convictions. She emphasized this was only applicable during the licensing process.

Ms. Dopf stated the current process does not include any type of tracking however, she assured the Committee when the Department was made aware that something was amiss with a licensed individual, the Department would access information from the Repository database. She stated the Department would include this in its protocol.

Assemblyman Marvel asked if school districts were in hold-harmless provisions.

Ms. Dopf answered in regard to the basic support and the 2-year process she stated the Department does have some. She deferred the question to Mr. Wells.

Mr. Wells offered to provide the information to the Committee. He stated several districts were included in this provision.

Assemblyman Marvel stated this could impact class size reduction. He added the Department might have more teachers than needed in a hold-harmless situation.

Mr. Wells stated continuing circumstances occurred with reductions to individual school districts that even the hold-harmless impact was seeing a decrease in several districts.

Assemblyman Marvel discussed the hold-harmless provisions with Mr. Wells.

Mr. Wells added that four of six northern counties are experiencing decreases in their 2007 enrollments. He stated only Eureka and Elko had increased enrollments.

Chair Leslie commented about the audit finding regarding employee evaluations. She stated this was one of the worst ones she had noted in a while. Chair Leslie explained the Committee for years had been following, tracking, and asking the audit staff to make sure that employee evaluations were current at the agencies. Auditors reviewed 50 employee records at the Department and 78% had not received an annual evaluation during the preceding year. She asked for an explanation from the Department.

Ms. Dopf answered the Committee did have Dr. Rheault's response within the audit report which acknowledged the Department was at fault. She added this was an area the Department was working toward improving. The Department had reinstated a notification to supervisors to indicate the status of the work performance standard and a pre-notice of the evaluation due date on each employee on a quarterly basis to the respective offices. Along with reinstating the process a quarterly report format had been developed. She reported the issues noted in the audit report with the 50 staff

members had been updated. Ms. Dopf assured the Committee that the Department would ensure that all staff had current work performance standards and that evaluations were completed timely.

Chair Leslie commented the Department has had a reputation for good management and so she was surprised by this finding.

Ms. Dopf assured the Committee the Department will be in compliance. She added there have been many programs the Department had been required to manage without additional staff. She stated the Department took full responsibility for the finding.

Chair Leslie called for questions from the Committee.

Ms. Dopf commended Audit staff and added the Department agreed with the ten audit recommendations.

ASSEMBLYMAN MARVEL MOVED TO ACCEPT THE REPORT ON THE DEPARTMENT OF EDUCATION. THE MOTION WAS SECONDED BY ASSEMBLYMAN ARBERRY AND CARRIED UNANIMOUSLY.

B. Department of Business and Industry, Division of Insurance.

Mr. Townsend introduced Jane Bailey, Audit Supervisor; and Dennis Klenczar, Deputy Legislative Auditor, to present the report.

Mr. Klenczar began the presentation with background information about the Division of Insurance (DOI). The agency is responsible for protecting the rights of the consumer in dealing with the insurance industry and ensuring the financial solvency of insurers. DOI fulfills its mission by advancing a sound regulatory environment that is responsive to the insurance needs in Nevada. DOI's organizational structure in fiscal year 2005 included 72 full-time positions. Operating expenditures of approximately \$10.4 million included about \$1.7 million in intra-agency transfers. Mr. Klenczar explained the scope of the audit was to review the Division's financial and administrative activities for fiscal year 2005, and activities through February 2006 for certain audit issues. The audit objective was to evaluate DOI's financial and administrative activities, including whether activities were carried out in accordance with applicable state laws, regulations, and policies.

Mr. Klenczar reported DOI could improve its oversight of financial solvency for domestic companies. DOI did not always ensure required financial reports were submitted and reviewed timely. If problems related to financial solvency are not detected timely, there is an increased risk the insurer will become insolvent. Claims against an insolvent insurer may be paid by a guaranty fund, which is funded by assessments to licensed insurers. These assessments may be passed on to consumers in the form of higher insurance costs. He noted accounts receivable processes needed strengthening to minimize the risk accounts would not be collected. Further, controls over certain administrative functions were not adequate.

Mr. Klenczar stated findings included the need to improve the monitoring of required industry reports. DOI's corporate and financial affairs section did not always take timely action when domestic companies did not submit reports, review reports in a timely

manner, or obtain proper approval when companies requested an exemption from filing. Tests on the submittal and review of four reports significant to evaluating financial solvency found 14 of 20 annual reports were either not reviewed or had not been reviewed timely. Mr. Klenczar reported 9 of 17 submitted audited financial statements were either not reviewed or had not been reviewed timely. The audit revealed three instances when exemptions from filing were not properly approved by the Commissioner. The report noted a total of 52 exceptions, most of which were for either no review or untimely review of submitted reports. According to the National Association of Insurance Commissioners, a system of effective solvency regulation would provide crucial safeguards for insurance customers.

Mr. Klenczar reported DOI's monitoring process for the submittal and review of financial reports for captive insurers needed improvement. The number of captives had grown beyond expectations and therefore, the need to monitor this emerging market had increased. A captive insurer can be defined as a form of self insurance by which an entity forms a company to insure its own risks. The testing of 15 captives and 3 required reports revealed a total of 43 exceptions, which included a significant number of exceptions for non-submittal as well as untimely review. He noted the annual statement was required by statute and the other two reports were required by regulation.

Mr. Klenczar stated DOI did not always schedule required financial examinations and issue orders accepting or rejecting examination reports as required. Further, monitoring was not performed to ensure examiners complied with state law. These examinations are to be conducted in accordance with procedures and guidelines prescribed by the NAIC for the purpose of determining a company's financial condition. Therefore, timely detection and correction of financial concerns is crucial to safeguarding consumers.

DOI did not always monitor the timely submittal and review of other types of reports. Instances were found when reports were not reviewed as required. For example, the Producer Licensing Section is responsible for Third Party Administrator (TPA) annual financial reports. From 50 TPA reports selected, 6 were not submitted and 3 were exempt from filing. For 15 of the 41 submitted reports, auditors could not verify timely review because the review date was not documented. Of the remaining 26 reports, 25 were not reviewed by the required date. Recommendations were made to improve the monitoring of required industry reports.

Accounts receivable processes need strengthening to minimize the risk accounts will not be collected. Collection efforts for examination fees and other types of fees were not always timely. He explained insurance companies were examined by contract examiners who bill DOI at different times during the year. DOI pays the examiner when invoices are received and then bills the examinee for reimbursement plus an administrative fee. A majority of accounts receivable from these fees represented cash paid by the State that had not been reimbursed. DOI reported over \$700,000 in accounts receivable from examination fees in March 2005, and that more than 68% of the receivables were over 60 days past due. Some of the accounts dated back to 2001. Mr. Klenczar acknowledged that the agency had begun to take corrective action.

Mr. Klenczar reported when entities do not pay the annual renewal fee timely, they are operating without a license. The report found 66 companies had not paid fees due on March 1, 2005. As of November 1, 2005, collection efforts were not made for these fees. Subsection 2 of NRS 680A.180 states if the fee is not paid timely, the insurer's certificate of authority expires at midnight on May 31. DOI procedures for accounts receivable do not include timeframes for when internal collection efforts should be taken. DOI did not write off bad debt or submit a complete list of accounts for outside collection. Recommendations were made to improve the accounts receivable process.

Mr. Klenczar stated weak controls were noted in areas related to fixed assets, performance measures, complaints, deposits, and personnel. DOI does not have sound record keeping or inventory practices. DOI did not perform a complete physical count of assets or update the state's records, asset tags were not always attached, and 3 of 20 assets could not be located.

DOI did not retain records used in computing performance measures, therefore, auditors could not verify performance measures reported in the Executive Budget as reliable. Recommendations were made to strengthen controls over certain administrative functions.

DOI accepted the 15 audit recommendations.

Chair Leslie commented the audit and the recommendations were clear and appropriate. She did not have any questions.

Assemblyman Marvel asked how many insurance companies were insolvent during the audit period.

Mr. Klenczar was not aware of any Nevada companies that had become insolvent, although since completing the audit field work there had been one.

Chair Leslie called for agency representation to testify.

Ms. Alice A. Molasky-Arman, Commissioner of Insurance, commented with respect to domestics the Commission had one insolvent insurer for approximately four years which was still under receivership by the court in the State of Nevada, with the Commissioner as receiver. Since the audit the Commissioner noted there were no other insolvent companies.

Assemblyman Marvel asked about the procedure for collection of receivables as it was disturbing that such an accounts receivable amount existed.

Ms. Molasky-Arman deferred the question to John R. Orr, Deputy Commissioner of Insurance.

Mr. Orr stated the receivables process for the Division was not as clear-cut as the audit report would indicate. For example the audit report cited the Division for several instances of failure to collect reimbursements from companies that had been examined. He stated in the past companies had been allowed to challenge the report of examination and request a hearing which, in the past, suspended collection efforts. The Division had revised the process to provide when the Division pays an examiners billing

the company was immediately invoiced. The Division does not wait until the end of the examination and therefore collection is not dependent upon the final examination order.

Assemblyman Marvel asked if the examiners were in-house or contracted.

Mr. Orr stated almost all of the examinations were performed by contract examiners. He stated in the past the Division had an in-house examiner for title companies. He added the position was vacant and the Division had suggested the position be removed in the next budget request. The Division was pleased with the contract examiners. He noted contract examiners were not always timely in submitting their bills which could result in a delay in processing the bills to accounting for payment which also delayed the billing process.

Assemblyman Marvel asked for information about the appeals procedure if the examinee does not agree with the examination.

Mr. Orr stated for action taken by the Division an effected party had the right to request a hearing. He added the hearing docket was backlogged months and in some cases years.

Assemblyman Marvel asked how much the backlog was costing the State.

Mr. Orr did not believe it was costing the State anything. He explained funds that support the Division's examination processes were isolated in budget account 3817, which is a self-funded account. He stated there is no State money in it. It is funded by reimbursements from the examined parties plus an administrative fee.

Assemblyman Marvel asked if the funds were used by the Division.

Mr. Orr replied the funds were used by the Division to off-set the General Fund.

Ms. Molasky-Arman provided an example explaining that a hearing held the previous day was for a \$3,000 bill. She anticipated it would not be paid even though four parties were jointly liable for payment. She inserted in the order if the amount of \$3,000 was not paid within 60-days the account would be referred to the Office of the Controller for collection. She stated the examination was on an applicant the Division had no authority over and who the Division refused to provide a certificate of authority. She added the four entities were scattered. It was likely the amount was uncollectible. She stated another account was still in the legal process. She explained when Mr. Orr referred to the backlog in the hearing process, that was for hearings overall. She added hearings were not just to enforce payment of examination fees.

Assemblyman Marvel asked if the Division utilized the Attorney General for collections.

Mr. Orr stated the Division had utilized the Attorney General's Office in the past but the Attorney General's Office had expressed dissatisfaction with the process.

Assemblyman Marvel asked for the grounds on which the Attorney General's Office expressed dissatisfaction with the Division's process

Mr. Orr replied after two contracts the state entered into with a professional collection agency, the Attorney General's Office stated they would like to get out of the collection business. That is why the Division utilizes professional collection agency resources.

Assemblyman Marvel asked about a statute of limitations in regard to the collection of fees.

Mr. Orr stated it depended on the nature of the debt. If the debt was due as a result of an order of the Commissioner he was not aware of any statutory limits.

Assemblyman Marvel asked if the audit addressed this area.

Mr. Klenczar replied that area was not in the scope of the audit.

Chair Leslie stated this would be an area of interest to receive further information on.

Chair Leslie stated when she was reviewing the audit she noted the Division was responsible for reviewing a lot of reports. She asked if the Division had reviewed whether some reports were antiquated or was the Division reviewing items that the Division should not be asked to review. She asked if staff priorities been reviewed in terms of reporting and monitoring.

Ms. Molasky-Arman stated the Division reviews a number of reports, adding some are required by statute. She stated one report referenced in the audit report, the audited financial statement, was required to be submitted by third party administrators. She explained the industry reported the cost of providing the reports was prohibitive for smaller businesses. She explained the report provision was inserted in the law as a result of the Commissioner's request. Ms. Molasky-Arman asked staff why the provision was requested and was informed that premium monies held by a third party administrator would not appear on a balance sheet.

Chair Leslie stated this was the point of her question to the Commissioner. She asked if that was part of a bill presented to the Legislature every session.

Ms. Molasky-Arman agreed it was the same bill. She agreed items were being reviewed to determine the necessity of maintaining them. She added some of the reports were for Division records to being able to confirm whether a filing or data exists or not.

Chair Leslie encouraged the Commissioner to look at the report issue.

Chair Leslie asked for clarification that the Commissioner accepted the audit recommendations.

Ms. Molasky-Arman answered the Division had addressed items that would be addressed in the response letter in so far as what the Division could accomplish. She stated the Division was placed by the National Association of Insurance Commissioners (NAIC) on quarterly reporting as to whether the Division was completing financial analyses timely, particularly with respect to companies which are domestics and are doing business on a multi-state basis, and companies with questionable financials. She stated the Division was released in the past week from quarterly reporting and was informed by the NAIC that the Division's work had reached a new level of higher quality than had been demonstrated in the last 9 to 12 months.

Chair Leslie congratulated the Commissioner on this accomplishment.

Chair Leslie stated employee evaluation deficiencies were noted in the audit report. She asked if the finding was being taken seriously by the Division.

Ms. Molasky-Arman stated the Division took this finding very seriously, admitting to this as a deficiency. She stated the Director of the Department of Business and Industry consistently reminded the agency when the Division was overdue. Ms. Molasky-Arman stated the Division had established a system to remind supervisors and continue to remind supervisors of evaluation due dates. She believed the Division was caught up with one possible exception.

Chair Leslie called for questions from the Committee.

Senator Coffin declared he had been a licensed insurance agent since 1969. He had followed the actions of the Department for almost 40 years because of that. He congratulated the Division for being taken off the quarterly reporting list. He asked about the market place and captive insurers. He asked if the Commissioner had seen a trend toward more captive insurers coming in. He noticed some of them were not reporting. Senator Coffin expressed concern for the people that are supposed to be insured by these captive insurers. He asked how many of these captive insurers were locally based.

Ms. Molasky-Arman replied the Division had seen a remarkable growth in the captive industry in the State of Nevada. She explained the Division would have 80 captives soon, which was a significantly higher number than anticipated when the Commissioner appeared before the 2005 Legislature. She explained people were using captive insurers as an alternative for unavailable or unaffordable markets. The Division had seen a trend of major businesses moving toward captive businesses. Ms. Molasky-Arman noted groups were finding that premiums were not affordable, particularly where they have good risks. The Division had noted auto dealerships, attorneys, and doctors were establishing their own captive insurance programs. Ms. Molasky-Arman thought the Senator might be referring to risk retention groups. She noted national review had occurred subsequent to a report by the GAO and the NAIC reviewing to determine which, if any, accreditation standards should apply to risk retention groups. She explained risk retention groups were enabled under the Federal Risk Retention Act. The Division's act mimics the Federal Risk Retention Act which enables risk retention groups. Because of the nature of the retention groups the Division's ability to domesticate captives in Nevada means that domestic risk retention groups are captive insurers and are monitored in the same manner as insurers in regard to solvency. Ms. Molasky-Arman stated risk retention groups were not only owned by the insureds, but all owners must be insureds and all insureds must be owners.

Senator Coffin commented about the report. He requested the Commissioner provide the Committee with a list of the captives and all information pertaining to them.

Chair Leslie concurred with the request.

Ms. Molasky-Arman commented about the types of coverage that captive insurers provided. She stated it was possible that a captive insurer could form for the purpose of

providing health insurance but added there were federal and IRS restrictions and they must have federal approval prior to being certified by the Commissioner.

Senator Coffin stated he was licensed only for health and life insurance and was not licensed for casualty insurance. He was familiar with casualty insurance and the complaints from various industries for the inability to get coverage. He thanked the Commissioner for the presentation. He further discussed aspects of the insurance industry.

Chair Leslie called for questions from the Committee.

ASSEMBLYMAN MARVEL MOVED TO ACCEPT THE REPORT ON THE DEPARTMENT OF BUSINESS AND INDUSTRY, DIVISION OF INSURANCE. THE MOTION WAS SECONDED BY SENATOR RHOADS AND CARRIED UNANIMOUSLY.

C. Department of Taxation.

Mr. Townsend introduced Tim Brown, Audit Supervisor; and Shannon Ryan, Deputy Legislative Auditor, to present the report.

Ms. Ryan began the presentation with background information regarding the Department. The Department expended about \$31.5 million in 2005, and collected about \$4.2 billion in revenues for fiscal year 2005. One of the taxes collected by the Department, the insurance premium tax, was originally enacted in 1933 and is assessed on the net direct premiums and considerations at a rate of 3.5%. Ms. Ryan stated the rate of real property transfer tax assessed by each county is governed by NRS 375. The Department became responsible for this tax in October 2003.

The scope and objective for the audit included a review of the insurance premium tax and the real property transfer tax. The audit focused on fiscal year 2005 but included a review of some insurance premium tax returns submitted prior to that time. The audit objective was to determine if the Department implemented procedures to ensure that taxes were collected accurately, equitably, and in accordance with all applicable laws and regulations.

Ms. Ryan reported current processes and controls utilized by the Department for the administration of the insurance premium tax and the real property transfer tax do not ensure the taxes are collected accurately, equitably, and in accordance with all applicable laws and regulations. Significant improvements are needed to ensure insurance premium taxes are properly collected. The Department failed to collect about \$16 million in taxes for tax years 2000 to 2004. In addition, control deficiencies allowed another \$1.1 million to be inappropriately refunded or lost due to the statute of limitations.

Ms. Ryan stated, of the 57 annual returns reviewed, 49 returns included at least one error. Further, taxes were calculated incorrectly on 14 of the returns resulting in millions of dollars of uncollected and lost taxes. Errors in reporting annuities accounted for \$11 million of the \$16 million discrepancy. Ms. Ryan reported companies select the method

in which they are taxed on annuity amounts. Because the Department does not verify if companies are reporting consistent with their election, some companies changed their method of accounting for annuities without authorization, thereby deferring taxes.

Ms. Ryan noted that 9 of 14 schedules regarding annuity reporting reviewed were wrong. Companies did not report amounts they should have, completed schedules incorrectly, included inappropriate amounts, and deducted items inappropriately. In one instance, a company excluded over \$46 million in annuity premiums from the annuity schedule and about \$195 million since reporting year 2000. Because this error was not corrected, the Department is unable to collect over \$4 million in taxes due.

Ms. Ryan reported errors on returns not related to annuity reporting were also found. Total gross premiums did not always contain all taxable amounts, penalty and interest were not always assessed, and interest was not calculated properly. These errors accounted for about \$5 million of total uncollected taxes. For example, the Department did not ensure a company reported 'other considerations' on their tax returns. About \$154 million in premiums were excluded on their returns, resulting in about \$5.4 million in taxes, of which, the Department can collect about \$2 million for 2003 and 2004. In addition, of the 14 returns subject to penalties and interest, the Department incorrectly calculated interest on nine returns and failed to assess penalty and interest on five returns.

The Department had inadequate oversight of industrial insurance returns. The Department has not reviewed certain quarterly and no annual industrial insurance returns for reporting years 2003 and 2004. While many industrial insurers do not owe taxes because credits offset amounts due, one insurer in our sample was deficient in tax payment by \$9,300. In addition, the Department applied credits to quarterly returns incorrectly for 9 of the 10 returns reviewed. The Department applied credits to quarterly returns and not the return in which the insurer paid the related assessment. This allowed some credits to be applied against taxes before payments were actually made. Ms. Ryan reported some industrial insurers remitted funds to the state even though taxes were not due. This resulted in payments equaling about \$650,000 being submitted that were not due which occurred because industrial insurance credits were not taken on returns when they should have been. Tax forms and instructions provided by the Department are insufficient to ensure amounts reported are accurate, provide taxpayer assistance, or gather necessary information. The Department could model its forms after those used in other states. These forms request information be segregated and provided instructions for each line item.

Controls over other insurance premium tax administration could be strengthened. The Department issued refunds without investigation into the circumstances creating the overpayment, memorandums for deficient payment and interest and penalty assessments were not issued in a timely manner, and incorrect credits were allowed to be taken on property and casualty returns. These errors resulted in \$1.1 million being inappropriately refunded or forfeited by the Department. The Department issued refunds without reviewing the circumstances in which the overpayment was created, resulting in about \$465,000 being inappropriately refunded and another \$272,000 issued where it is questionable whether the refund should have been processed at all.

The Department did not issue memorandums for deficient payment in a timely manner resulting in about \$566,000 in amounts owed the state being forfeited. Review of Department records showed 375 memorandums, some relating to reporting year 2001, were waiting for management approval. Because some of these memorandums were for periods beyond the 3-year statute of limitations, the Department has lost the ability to collect these amounts.

Credits applied against taxes were not always correct. Inaccurate credits resulted in \$137,000 more being refunded to insurers than should have been. Credit statements prepared by the Nevada Insurance Guaranty Association allowed 20% of the assessment to be taken in the year paid, one year earlier than allowed by law.

The Department needs to address concerns regarding insurance premium tax and needs to ensure the tax is administered appropriately. For example, the audit identified four types of licenses issued by the Division of Insurance that the Department considers to be non-taxable license types. However, the Department collected about \$1.8 million in taxes from some of these licensees but not others. Recommendations were made to help the Department improve its oversight of the insurance premium tax.

Ms. Ryan discussed findings and recommendations related to the real property transfer tax. She stated consistency is needed among counties. Exemptions requiring supporting documentation vary between counties. The Department has not developed comprehensive guidelines for counties to follow for granting exemptions. Supporting documentation is not required by statute in order to claim an exemption from real property transfer taxes. In order to substantiate the applicability of certain exemptions, supporting documentation is necessary. The Department should determine those exemptions needing support and request counties review appropriate documentation.

Two counties had reached contradictory conclusions regarding one exemption to the real property transfer tax. The Department should obtain clarification on which legal opinion was correct so the inequity in some paying taxes and others not is corrected. The Department has not formalized processes and procedures for audits of real property transfer tax at the counties. The Department should determine the timing and frequency in which each county will be audited. Further, the Department should develop auditing criteria and procedures and sampling methodologies. Recommendations were made to assist the Department in administering the real property transfer tax. The Department accepted the 14 audit recommendations.

Senator Coffin asked how long the Department had been responsible for collecting the insurance premium tax.

Ms. Ryan believed it was around ten years.

Senator Coffin stated the problem noted was probably generated by the Legislature. He saw difficulties based upon the fact that it is difficult for the Department to understand how the insurance industry works. He was never in favor of switching the responsibility for the collection of taxes to the Department of Taxation. He asked for auditor comments about the issue.

Ms. Ryan responded the audit included a recommendation to communicate with the Division of Insurance regarding insurance premium tax issues and other areas where they could assess. The audit process revealed areas the Division of Insurance could have provided insight to the Department of Taxation in administering this tax.

Chair Leslie stated the issue would be followed up.

Chair Leslie stated the audit noted monies not collected and significant amounts that cannot be collected due to the statute of limitations. Another area involved the RPTT. The audit stated that supporting documentation was not required by statute in order to claim an exemption. She stated the report noted that some counties implemented one way, and other counties implemented another way, and District Attorney's had differing opinions, but an Attorney General final legal opinion was not requested. She was concluding that if that much interpretation existed, perhaps the law was not clear enough and should be revised. She asked if supporting documentation was not required by statute regarding exemptions, should it be.

Mr. Townsend commented he was not sure it needed to be required by statute. He stated it needs to be available and perhaps could be addressed at the local level. He added if that proved inadequate then it would be open to debate whether it should be clarified in law.

Chair Leslie stated it was disturbing that the audit report revealed the tax was not being implemented fairly and equitably. She added the mission of the Department of Taxation was to be fair and equitable. She asked for comments.

Ms. Ryan stated the Department assumed responsibility for the tax in October 2003. Prior to this date each county recorder administered the tax because the state did not receive a portion of it. The county recorders still collect the tax and in some instances they continue to do it their own way. The District Attorney opinions between the two counties started in 1985. Ms. Ryan stated long before the Department had the responsibility for the tax, and to date, the law states that a county recorder submits a question of law through their own District Attorney.

Chair Leslie commented that was a good explanation of the historical factors. She stated the Department could address how the issue would be resolved as it clearly needs to be resolved.

Assemblyman Marvel asked about dividends being used in life insurance policies to buy additional insurance. He gave an example of such policies and asked how the Department of Taxation tracks that.

Ms. Ryan stated each return the Department received included supporting documentation from the National Association of Insurance Commissioners (NAIC). Each insurer submits information on the form to NAIC which was also supplied with the return. She stated the Department does not physically go out and audit the companies to determine if amounts reported to NAIC were correct. The Department utilized the number from the report submitted to NAIC.

Chair Leslie asked if the figure of \$17.1 million was a projected number or based solely on the auditing sample.

Ms. Ryan stated that was based on the audit sample of the 57 returns reviewed.

Chair Leslie assuming that pattern would continue throughout the agency and concluded that the actual amount the Department was not collecting would be much higher than \$17.1 million.

Mr. Townsend stated the audit did not include a statistical sample which would be required to provide information in regard to a projection. The conclusion was therefore limited to the number of cases sampled.

Chair Leslie concluded the figure would be much higher than \$17.1 million.

Chair Leslie called for agency representation to testify.

Mr. Dino Dicianno, Executive Director, thanked the Audit staff for the recommendations to improve Department processes especially with respect to the insurance premium tax. He stated the real property transfer tax would be discussed later. Mr. Dicianno clarified the Department assumed responsibility of the insurance premium tax in 1993. At that time he understood the Department's responsibility was for the collection of the returns and the collection of the monies, in and of itself. The difficulty for the Department was that the Department does not have the expertise to audit insurance companies with respect to the insurance premium tax. It was his understanding that part of the responsibility was with the Insurance Commissioner. He stated the Department relied on information provided by the Division of Insurance as approximately 1,700 entities report to the Department of Taxation with respect to the insurance premium tax. He noted it was a self reporting document. The Department had one tax examiner to review the returns and the payments. He stated the auditors had provided the Department a road map in the development of phase 3 of the Unified Tax System (UTS). The recommendations would be a part of the process to ensure the Department notified taxpayers, properly reviewed those documents, issued proper credit reports, issued proper refunds, and billed the companies that owe money. He indicated the amount of insurance premium tax which goes to the General Fund was almost \$250 million every fiscal year. He understood that the deficiency noted by the auditor's review was from major insurance companies.

Chair Leslie commented that Mr. Dicianno's statement would confirm her assumption that much more money not collected was incorrect because auditors only reviewed the major companies. She asked if that statement was correct.

Mr. Dicianno stated he could not say that unequivocally.

Chair Leslie asked for comment from the Audit staff.

Ms. Ryan explained the audit sample consisted of 15 insurers selected judgmentally to ensure that 5 industrial insurers were included. The other 35 were random. Auditors randomly generated a number and selected the returns. Of the three returns that made up the largest portion of the \$16 million, almost all were in the random selections. Samples were not based on the largest returns.

Chair Leslie asked for additional comments from Mr. Dicianno.

Mr. Dicianno commented the Department was responsible for the state portion of the real property transfer tax as of October 2003. He addressed the Chair's concern that each district attorney had a different opinion with respect to a particular exemption. He explained the Department had attempted to implement a process that the counties use the Department as a conduit to the Attorney General's Office to request an opinion. The opinion would then be disseminated to the county recorders to ensure consistency state-wide. He acknowledged the Department was still working toward this process.

Chair Leslie asked for a timeline to completion.

Mr. Dicianno stated as soon as possible.

Chair Leslie asked when. She was concerned about the fairness for the citizens of Nevada as everyone needs to pay the tax in the same manner. She understood this was in development for a couple of years but wanted to see it resolved immediately.

Mr. Dicianno stated the Department would do its best to resolve the issue.

Assemblyman Marvel commented the state had spent millions of dollars on the ACES program and asked why this was not noted when the Department was implementing the ACES program.

Mr. Dicianno replied the insurance premium tax computer assisted system was not part of ACES. He explained it was on a stand alone system. That is why the Department was moving forward with the UTS project, to make it part of the entire system.

Assemblyman Marvel asked about the cost to implement the project.

Mr. Dicianno replied the initial fixed cost bid for UTS was \$40 million. He added that was for all taxes, not just the insurance premium tax.

Assemblyman Marvel asked if implementation of the system would correct most of the deficiencies the audit picked up.

Mr. Dicianno stated he believed so.

Assemblyman Marvel asked if the implementation date was June 2007. He asked if the implementation date could be sooner.

Mr. Dicianno stated that was correct. He stated an earlier implementation date was not probable.

Senator Rhoads stated the relationship between the state and the Department of Taxation and the counties should be pretty smooth and cooperative. He understood the relationship between White Pine County and the Department of Taxation was problematic and asked for comments.

Mr. Dicianno believed there was a misunderstanding with respect to the authority of the Department of Taxation when a county or city or a local government was being managed for a severe financial emergency. He thought this was a miscommunication issue with White Pine County and the city of Ely which was being addressed. He noted agenda items at the next county commission meeting that the Department of Taxation

would address to mitigate concerns. He explained the Department had a fiduciary responsibility to ensure an entity does not become insolvent. The Department was there to establish a foundation for the local government so there would not be a need for the Department of Taxation to intervene again.

Senator Coffin wanted to follow-up on an initial question in regard to the audit. During 1993 a lot of agencies were reorganized. At that time there had been problems with the premium tax collection by the Department of Insurance. He stated that a call from the Director of Taxation would not have the same impact that the Commissioner of Insurance would have. He stated a Commissioner of Insurance could cause a license to shake on the wall of an insurance company. He asked for comment.

Mr. Dicianno responded that was a policy decision of the Legislature, one that he could not respond to.

Senator Coffin understood the Director must remain neutral. He added this was something that could happen when change occurred. He would like to see the Legislature return this responsibility back to the Department of Insurance. The reason was because the Department of Taxation does not have the same authority as the Department of Insurance in regard to the licensing of insurance companies.

Chair Leslie expressed concern that the Department had an over reliance on a computer system targeted for completion in June 2007, that the Department would want to wait to implement recommendations until after the system was in place. Chair Leslie noted the report outlined taxes that were calculated incorrectly, and forms and instructions that were confusing and inadequate. She was disturbed about the loss of \$566,000, unrecoverable due to delays in processing timely. She stated the Committee would be following this issue closely. She asked what the Department was doing to implement the recommendations and resolve these problems.

Mr. Dicianno agreed the computer system was not a fix all. He explained the audit recommendations were being used in the design of the computer system to ensure the Department complied with the recommendations. In the interim the Department would be in contact with the Insurance Commissioner and the Division of Insurance to ensure that issues were addressed prior to implementation of the computer system in June 2007. One issue of the audit that could prove to be problematic was the Department did not have authority over the Guarantee Association. He explained the Department could only send letters which was part of the problem.

Chair Leslie stated the Committee would like to see a report sooner than the interim 6-month report. She commented about the loss of \$17 million dollars in the state and what could have been done with the funds. In the bigger scheme of the billions that the Department Taxation collected she understood the tax was minor compared to other areas. However, she would like to see more dedication to the audit recommendations from the report. She stated the recommendations could be implemented and the Department could improve forms which should not take six months. She asked Mr. Townsend to comment.

Mr. Townsend responded the audit follow-up process provided a requirement for a 60-day plan of corrective action which would be due by December 20, 2006. He offered to provide the information to the Chair and would also provide the information to the money committees and other committees during the Legislative Session.

Senator Coffin requested the Commerce Committee be provided the information.

Mr. Townsend explained six months after the 60-day date a 6-month report would be due and the agency would return to report to the Committee. That would occur in the fall of 2007. The plan of correction action would provide the Committee information on action the agency planned to take in regard to implementing the recommendations.

Chair Leslie agreed with the plan as presented by Mr. Townsend.

Mr. Dicianno added \$17 million was a substantial figure even though the Department collected \$4.2 billion or more each fiscal year. He stated there was no question that the role of the Department of Taxation was to collect monies due the State.

Chair Leslie added the collection was to be in a fair and equitable manner.

Mr. Dicianno agreed.

Assemblyman Marvel asked if the Department would need any legislation.

Mr. Dicianno was unsure at this time but would report back to the Committee.

Senator Coffin wanted to make sure that his comments were meant to be constructive and not critical of the actions of the Department of Taxation. He added this was the result of unintended consequences from changes made by the Legislature.

Chair Leslie agreed.

Senator Coffin complimented Mr. Dicianno for his efforts.

Chair Leslie responded that the Senators comments had been taken in the context of constructive and not critical.

ASSEMBLYMAN MARVEL MOVED TO ACCEPT THE REPORT ON THE DEPARTMENT OF TAXATION. THE MOTION WAS SECONDED BY SENATOR RHOADS AND CARRIED UNANIMOUSLY.

Senator Coffin related that Assemblyman Arberry asked to be excused from the remainder of the meeting.

D. Public Employees' Benefits Program.

Mr. Townsend introduced Rocky Cooper, Audit Supervisor; and Lee Pierson, Deputy Legislative Auditor, to present the report.

Mr. Pierson began the presentation with background information. The Public Employees' Benefits Program (PEBP) was established in 1999 to manage the state's group health insurance program. A nine-member board oversees operations. The Board appoints an executive officer to direct day-to-day activities. Mr. Pierson noted the audit covered fiscal years 2005 and 2006. Audit objectives were to evaluate the

effectiveness of PEBP's strategic planning process; determine the reliability and accuracy of PEBP's management information; and evaluate the adequacy of PEBP's contracting practices.

PEBP could improve its strategic planning in several areas. More effective planning would help address current and future health insurance issues facing employees and retirees. Mr. Pierson reported PEBP planning was inadequate when setting retiree rates. Beginning in plan year 2006, PEBP made three changes that significantly impacted Medicare retirees' costs. First, PEBP commingled the claims experience of all employees and all retirees to determine premium rates. This resulted in the same rate for early retirees and Medicare retirees even though PEBP is secondary insurance for Medicare retirees. Second, PEBP decreased the percentage the State pays on a Medicare retirees' monthly premium. Mr. Pierson reported these two actions, commingling and adjusting the percentage the State pays on the monthly premium resulted in large rate increases in 2006 for Medicare retirees. The third change impacting Medicare retirees involved the method PEBP's used to determine how much it will pay on a medical bill after Medicare pays. Mr. Pierson explained the impact this change would have. He stated in plan year 2005, after Medicare paid its portion of a \$1,000 bill, PEBP would pay \$160 of the remaining \$200 and the retiree would pay \$40. Due to PEBP changing its method for coordinating benefits in 2006, on a \$1,000 bill, PEBP would typically pay \$0 and the retiree would pay \$200. This action further increased Medicare retirees' out-of-pocket costs.

To mitigate the increases several rate reductions and a reimbursement check are available to Medicare retirees. PEBP decided to reimburse Medicare retirees 80% of their monthly federal Medicare Part B medical insurance premium. This resulted in Medicare retirees receiving a monthly check from PEBP in the amount of \$62.56 beginning in July 2005. When federal Medicare premiums increased in January 2006, the monthly check increased to \$70.80.

For plan year 2007, PEBP began providing Medicare retirees with a rate reduction of \$52 monthly through the Medicare Part D reimbursement which is the new federal prescription drug program for Medicare eligible individuals. Because PEBP provides prescription drug coverage to Medicare retirees, the federal government will reimburse the State a portion of the costs incurred. PEBP's consulting firm estimated the federal reimbursement to the State at about \$3.3 million in plan year 2007, or \$52 per retiree per month. Mr. Pierson also noted retirees may receive a rate reduction based on years of service. In plan year 2007, retirees with 20 years or more of service to the State receive an additional rate reduction of \$126.36 monthly.

At PEBP's request, the 2005 Legislature provided a temporary supplemental subsidy for those rate tiers most impacted by commingling, beginning in plan year 2006. The subsidy was designed to be cut in half in plan year 2007 and eliminated in 2008. For example, the supplemental subsidy for the retiree + spouse tier in 2006 was \$118.72 and dropped to \$59.36 in 2007.

The various rate changes and adjustments discussed resulted in a confusing rate structure. The 2007 monthly premium costs for a Medicare retiree in the retiree only tier

with 20 years of service shows a Medicare retiree receives a rate reduction based on years of service of \$126.36 and a \$52 reduction for Medicare Part D resulting in a monthly premium of \$0. The retiree also receives a \$70.80 monthly check from PEBP, representing 80% of the federal Medicare Part B premium. These rate changes and adjustments also impact the retiree + spouse coverage. The retiree also receives various rate reductions for years of service, Medicare Part D, and the supplemental subsidy. In addition, the retiree is paid by PEBP \$141.60 monthly which represents 80% of the Medicare Part D premium, a \$70.80 check for both retiree and the retiree's spouse.

Better planning could have resulted in a less confusing process for determining rates. Although PEBP knew in 2001 that commingling could result in problems with premiums, sufficient efforts were not made to meet with stakeholders to resolve the issue. Meetings with stakeholders could have resulted in a less confusing solution to commingling prior to the 2005 Legislative Session.

PEBP's plan for rate setting was not carried out. Although PEBP used predictive modeling to develop rates for plan years 2005 and 2006, it was not used when setting rates for each tier in 2007. Predictive modeling is a state-of-the-art methodology designed to set rates for the next plan year. It uses age, gender, claims information, and other factors to infer which medical problems are present for each individual and their likely effect on claims costs in the coming year. Predictive modeling was not used because the rate increase for one group was significantly higher than the other tiers. However, PEBP did not analyze claims data to determine the accuracy of predictive modeling.

PEBP's consulting firm calculated 2007 rate adjustments for each tier using predictive modeling; however, these calculations were not used to adjust rates for each tier. Instead PEBP increased all tiers by 12.7%, which represents the increase in total funding needed as determined by predictive modeling. Mr. Pierson reported increasing each tier by 12.7% results in a decrease in the rate for the participant only tier and an increase for the three remaining tiers. Because predictive modeling was implemented in 2005 to assign rates based on claims cost for each tier, not using predictive modeling may result in one tier subsidizing another. If predictive modeling is accurate the 2007 rate for the participant only tier is too low.

However, PEBP had not analyzed claims results from 2005 to determine predictive modeling's accuracy. The handling of this issue demonstrates the need for better planning. Improved planning would have included a thorough analysis of 2005 claims to determine predictive modeling's accuracy before rates were set for 2007.

Mr. Pierson indicated better planning could improve wellness utilization. PEBP has several wellness programs such as medical screenings and annual health fairs. These programs were designed to encourage participants to seek preventive care and maintain good health, and indirectly save the program money. Although PEBP increased the amount it would pay for wellness programs from \$600 to \$2,500 annually for each individual, utilization had not increased. In addition, only about 10% of participants attended wellness fairs. PEBP did not adequately publicize wellness

activities including not providing a complete listing of procedures covered or adequately explaining how to access wellness services.

Mr. Pierson stated PEBP's strategic plan was not fully developed. The report noted weaknesses in PEBP's strategic plan. First, the plan does not address key areas such as providing catastrophic coverage, wellness programs, and disease management. Second, the plan lacks objectives and strategies to help ensure goals are achieved. Third, performance measures lack valid benchmarks to help PEBP assess its progress at attaining goals. Finally, the plan lacks timeframes to accomplish goals and performance targets.

Mr. Pierson stated the second area covered by the report addresses management information. PEBP and its vendors did not always provide reliable, consistent, and accurate information to the PEBP Board and the Legislature. First, when discussing commingling PEBP represented that Medicare retirees use more prescription drugs than early retirees and employees combined. However, information provided by PEBP's prescription drug vendor indicated this was not correct. In fiscal year 2005 Medicare retirees used only about one-third of all prescription drugs. PEBP provided inaccurate information on the percentage of costs paid by employers and participants. PEBP indicated for plan year 2005 the employer paid 58% of all costs and the participants paid 42% of all costs. However, employers paid a larger percentage of program costs. For 2005, employers paid 63% of costs, and for state employees and retirees the State paid 67% of costs. Therefore, the program is more beneficial for participants than PEBP's information indicated.

Mr. Pierson reported claims numbers were not always accurate. PEBP and its consultant improperly reported reimbursement checks as medical claims. Claims numbers reported to the PEBP Board included Medical Part B reimbursement checks previously discussed. Based on information from PEBP, it was estimated these reimbursement payments overstate the number of claims by about 66,500 and claims cost by \$4.4 million for fiscal year 2006. Medicare Part B claims and costs should be identified separately so trends for actual claims and costs are clear.

Finally, the report states PEBP could improve its contracting process by providing individuals evaluating proposals with better guidance for scoring proposals, implementing a formula to score vendor costs, and by providing the Board with the evaluation committee's scores of vendor proposals.

Mr. Pierson stated the report contains six recommendations to improve strategic planning, management information, and contracting practices. In its response PEBP accepted the six audit recommendations.

Chair Leslie commented the audit was well organized and interesting.

Assemblyman Marvel asked about reserve funds at PEBP.

Mr. Pierson responded IFS reflects about \$94 million. Of that there is about \$20 million the Legislature approved for the incurred but not reported reserve, which is for future liability. The second reserve the Legislature approved in the 2005 Legislative Session is a rate stabilization reserve at about \$24 to 25 million. In addition, about \$21 million

was set aside to reduce prior services, which was included in the rate holiday that all employees and retirees received for July 2006, when they were not charged for a monthly premium. The state's allocation was also adjusted for the current year. Mr. Pierson reported based on what PEBPs had in reserve at this time and what they need, there will be a large surplus again.

Assemblyman Marvel asked if there was an unfunded liability.

Mr. Pierson indicated the new GASB requirements in terms of pre funding or having to carry a potential unfunded liability on the States financial records, is something that has been discussed and the 2007 Legislature would need to address.

Assemblyman Marvel mentioned the \$26 million bail out of PEBPs by the Legislature. He expressed concern that the situation could recur.

Chair Leslie stated that goes along with an audit recommendation for better planning.

Senator Rhoads asked what happened to the retiree school teachers that chose the option to go with the county instead of with the state retirement system. He added some school retirees saw a 300% to 400% increase in premiums a couple of years ago.

Mr. Pierson stated the audit did not specifically look at details for the non-state part of the program. He added a few years ago PEBPs had a lot of non-state retirees come into the system because of huge increases. That led to legislation in 2003 which required that non-state employers pay for the retirees at least as much as the state was paying for its retirees.

Senator Rhoads asked if that had been fixed or was it still a problem.

Mr. Pierson stated the requirement was passed in the 2003 Legislative Session. Non-state employers were required to pay that. That is about \$340 to \$350 a month. But whether those non-state employers chose to pay above that or not was up to them. He noted some non-state retirees might still have large premiums.

Chair Leslie understood an interim committee had been working for four years on this subject. She looked forward to their recommendations during the 2007 Legislative Session. She clarified that she was not a member of that committee.

Senator Coffin stated he was a member of the interim study committee. He requested that members of the committee be sent a copy of this report.

Chair Leslie asked that Mr. Townsend provide these committee members with a copy of the report.

Chair Leslie asked about inaccurate information provided to the Legislature. She was not suggesting that it was intentionally provided but noted the Legislature bases decisions on information provided by agencies. She asked for clarification in regard to claims information. She asked if the review of claims information identified that reimbursement checks were improperly reported as medical claims. These were the reimbursement checks described in the report as those sent to retirees.

Mr. Pierson stated that was correct.

Chair Leslie asked how they could be considered claims. The report also stated that based on the information PEBPs provided, the payments would improperly increase claims by \$4.4 million but were actually reimbursement checks.

Mr. Pierson stated that was correct. He said this was discussed with PEBP staff. He explained there was rather a long history behind this. In providing the reimbursement checks to Medicare retirees, initially there was a concern this would create a tax liability. In discussions with PEBP staff it was determined that if the checks were called a plan expense and processed as a medical claim that this could address the tax liability issue for the individual. And so PEBP had in its claims numbers all of these reimbursement checks. Discussions with PEBP staff and their consultant confirmed the fact that when reporting periodic numbers on the number of claims and the claims dollars they were including the reimbursement checks. And that could make a difference and the point was that PEBP staff needed to add a caveat about the numbers in regard to the number of reimbursement checks and provide the dollar amount. Mr. Pierson added people that obtain this information such as the PEBP Board, the Legislature, and participants, would have an accurate understanding of the numbers.

Chair Leslie agreed. She stated that some legislators might interpret the information was misrepresented on purpose. She was not suggesting that but it seemed the information was not presented as clearly or as accurately as it could have been. She asked Mr. Pierson about PEBP's response when presented with this finding.

Mr. Pierson stated this deals with fiscal 2006, but staff indicated the information was given to the Legislature. Auditors saw this as a problem because PEBP should be projecting medical claims costs based on actual claims. They need to project the amount needed for reimbursement checks based on the number of retirees and anticipated an increase in the Medicare premium.

Chair Leslie stated this was a point well taken by the auditors. She added, as presented by PEBPs this was confusing. She offered there should be a better way to handle this.

Mr. Pierson stated that was pointed out in the audit. He added with better planning PEBP could have come up with a better solution. Mr. Pierson stated PEBP had made progress. He was not aware of an intentional effort to provide inaccurate information.

Chair Leslie appreciated the comments. She stated that was important because people can be defensive. At the same time Legislators and the PEBP Board need to receive accurate information to make good decisions.

Assemblyman Marvel asked if the IRS viewed these payments as income.

Mr. Pierson stated the audit did not review this area.

Assemblyman Marvel asked if any clarification had been received from the IRS.

Mr. Pierson stated none had been received to his knowledge. When auditors discussed the issue, PEBP staff were unclear on this point. Auditors focused on the whole process and the various steps that were taken. He suggested with a different approach PEBP could have avoided the need for a reimbursement check.

Chair Leslie called for agency representation to testify and respond to the audit report and recommendations.

Ms. Leslie Johnstone, Chief Operating Officer, stated Mr. Woody Thorne would retire on October 2, 2006, and at time she would be the Executive Director. She represented the agency as the incoming executive officer. She stated the overwriting message received from the audit report was for better communication, whether through strategic planning, how the rates were set, or how claims expenses were projected. She noted that came down to involving stakeholder groups ahead of time and explaining a very complicated process in the simplest but complete terms possible. She emphasized the bottom line solution to most of the issues was to communicate better with the stakeholder group.

Chair Leslie agreed communication was important. She felt it might be a little deeper than that in terms of better planning. She recalled at the beginning of the 2005 Legislative Session the commingling issue when legislators received calls and emails from constituents whose premiums had tripled. She asked to hear about PEBP's plan to make changes in their strategic planning to avoid a huge reserve. She suggested PEBPs just reduce rates. She asked about changes PEBPs was planning to make.

Ms. Johnstone replied some of the planning went unnoticed due to a lack of communication. As pointed out in her opening statement PEBPs was working with stakeholders to attempt a different approach. PEBPs had multiple levels of subsidy that were provided. This included the unknowns with the Medicare Part D subsidy and whether or not that would come to fruition, making it difficult for that to be the end all solution. The claims expense and the use of predictive modeling appears to be accurate at the tier level so PEBPs would continue to pursue this as a basis for predicting claims. That being said, it clearly was not a perfect solution because PEBPs generated additional reserves this last year and strategic planning would not have predicted that would happen. Ms. Johnstone explained PEBPs was working with the actuary company to determine exactly what went wrong in the projection process to end up with the excess reserve. The consideration on the Medicare Part B reimbursement checks was not deemed to have effected the cost projections at all because predictive modeling was used and was based on the medical claims. She added there was different coding for the Medicare Part B reimbursement. That was not considered in the projections of the medical claims themselves. PEBPs would not see that as having contributed to the excess reserve generated or effect of the expense projection at all. The question about whether it should be treated as a reduction in the reserve or as a separate reimbursement, has been debated in PEBP public sessions and through the collective public process that addressing it through reimbursement checks was preferable. She added that was based upon public comment and the Board's overall consideration of the options.

Chair Leslie could understand auditor conclusions regarding the inclusion of the reimbursement checks into medical claims and how that could be misleading.

Ms. Johnstone agreed it was misleading. She explained that a point would be made in the future to identify the amounts included in the claims expense and how much of that was for the Medicare Part B reimbursement. She commented by attempting to

oversimplify what is being presented to the public in order to make it understandable, critical points might be missed.

Chair Leslie stated it was a complex situation which the interim committee was working on to come up with a resolution. She asked for comments on the vendor selection process. The auditors detailed the evaluation committee process and indicated the Board does not follow these guidelines. It does not seem to be well connected. Chair Leslie asked if PEBP agreed with this statement and asked what PEBPs was going to do to change the process.

Ms. Johnstone stated on the point about the instructions to the evaluation committee PEBPs had already addressed the issue and changed the RFP instructions along with more comprehensive instructions for the evaluation committee. In terms of the Board's authority to select a vendor that they deem appropriate, PEBP still respects the Board's decision to make vendor selections. PEBP will be adding additional information from the evaluation committee as background for the Board to evaluate. She offered PEBPs would assist the Board with detailed scoring from the evaluation committee. She explained PEBPs now makes a recommendation and would add additional rational from the evaluation committee.

Chair Leslie read that the Board selected an evaluation committee third choice vendor. She added the Board needs to justify their selections. She was not suggesting that anything improper was done but from the outside, the perception would be seen as an evaluation committee that goes through a whole process and then the Board picks the third ranked vendor. She pointed out the Board should re-evaluate the process to ensure they are not exposing themselves to ridicule.

Ms. Johnstone stated to be clear the evaluation committee forwards to the Board only the vendors that are qualified to do the job.

Chair Leslie stated she understood this.

Ms. Johnstone continued PEBPs ended up with a perfectly fine vendor. It was not the number one recommendation from the evaluation committee but was a qualified vendor.

Chair Leslie stated with a bifurcated process such as this and the people at the end select the third choice over the first, this could raise questions. It may be perfectly fine but it needs to be explained and maybe the process needs to be reviewed.

Assemblyman Marvel asked if the evaluators were in-house staff.

Ms. Johnstone responded evaluators consisted of a combination of an in-house staff, a Board member, and an outside representative on each evaluation committee.

Assemblyman Marvel asked about the criteria for the outside representative.

Ms. Johnstone stated the criterion was just knowledge of the industry.

Chair Leslie called for questions from the Committee. She looked forward to seeing the future report on how things were going at PEBP.

SENATOR RHOADS MOVED TO ACCEPT THE REPORT ON THE PUBLIC EMPLOYEES' BENEFITS PROGRAM. THE MOTION WAS SECONDED BY ASSEMBLYMAN MARVEL AND CARRIED UNANIMOUSLY.

Item 3—Presentation of six-month reports (NRS 218.8245).

Mr. Townsend introduced Steve Wood, Chief Deputy Legislative Auditor, to coordinate the presentation of the six-month reports.

Mr. Wood explained the process for six-month reports provides a review of the status of audit recommendations made in recent audits.

A. Department of Cultural Affairs, Director's Office.

Mr. Wood made the presentation.

Mr. Wood explained the audit was issued in October 2005. The Office filed its 60-day plan of corrective action in December 2005. In July 2006, the Department of Administration prepared the six-month report on the status of the one recommendation contained in the audit. The Department indicated the one audit recommendation had been fully implemented. Therefore, there were no questions for the Department.

ASSEMBLYMAN MARVEL MOVED TO ACCEPT THE SIX-MONTH REPORT ON THE DEPARTMENT OF CULTURAL AFFAIRS, DIRECTOR'S OFFICE. THE MOTION WAS SECONDED BY SENATOR RHOADS AND CARRIED UNANIMOUSLY.

B. Department of Cultural Affairs, Division of State Library and Archives.

Mr. Wood introduced Mike Spell, Audit Supervisor, to make the presentation.

Mr. Spell explained in October 2005, an audit report was issued on the Department of Cultural Affairs, Division of State Library and Archives. The Department filed its 60-day plan for corrective action in January 2006. The six-month report was prepared by the Department of Administration on the status of the eight recommendations contained in the audit report. The Department of Administration indicated that the eight recommendations have been fully implemented. Therefore, there were no questions for the Division at this time.

Assemblyman Marvel asked if the Audit staff followed up on this report.

Mr. Spell responded yes.

SENATOR RHOADS MOVED TO ACCEPT THE SIX-MONTH REPORT ON THE DEPARTMENT OF CULTURAL AFFAIRS, DIVISION OF LIBRARY AND ARCHIVES. THE MOTION WAS SECONDED BY ASSEMBLYMAN MARVEL AND CARRIED UNANIMOUSLY.

C. Department of Administration, Risk Management Division.

Mr. Wood introduced Jane Bailey, Audit Supervisor, to make the presentation.

Ms. Bailey explained in October 2005, an audit report was issued on the Department of Administration, Risk Management Division. The Department filed its 60-day plan for corrective action in January 2006. The six-month report was prepared by the Department of Administration on the status of the seven recommendations contained in the audit report. The Department of Administration indicated that all seven of the recommendations have been fully implemented. Therefore, there were no questions for the Division. She expressed appreciation for the Division's efforts and commended the management and staff for their timely implementation of the recommendations.

ASSEMBLYMAN MARVEL MOVED TO ACCEPT THE SIX-MONTH REPORT ON THE DEPARTMENT OF ADMINISTRATION, RISK MANAGEMENT DIVISION. THE MOTION WAS SECONDED BY SENATOR RHOADS AND CARRIED UNANIMOUSLY.

Chair Leslie noted that Senator Coffin was absent for the vote. A quorum was present.

D. Department of Business and Industry, Division of Industrial Relations.

Mr. Wood introduced Jane Bailey, Audit Supervisor, to make the presentation.

Ms. Bailey explained in October 2005, an audit report was issued on the Department of Business and Industry, Division of Industrial Relations. The Department filed its 60-day plan for corrective action in January 2006. The six-month report was prepared by the Department of Administration on the status of the fifteen recommendations contained in the audit report. The Department of Administration indicated that nine recommendations had been fully implemented, and six had been partially implemented. The Division had represented that two of the recommendations regarding procedures related to accounts receivable would be fully implemented by December 2006. The Audit Subcommittee may wish to obtain additional information regarding the status of the other four partially implemented recommendations. All four of the recommendations pertained to the first chapter of the audit report which addressed timeliness issues and worker's compensation programs.

Ms. Bailey continued, the Division did not always assess premium penalties to uninsured employers in a timely manner. In addition, the Division did not always provide timely notification of its decisions regarding subsequent injury claims. State law establishes the timeframes for notification of these decisions. And finally, worker's compensation complaint resolution did not always comply with statutory timeframes. Four recommendations were made to improve processes in the worker's compensation section. These included revising policies and procedures to help ensure that premium penalties are assessed timely. The procedures should establish timeframes for performing each step of the process and management reports for tracking the status of pending premium penalties. It was also recommended that the Division establish a

monitoring process to help ensure notification of decisions to accept or deny subsequent injury claims within the timeframe allowed in state laws and regulations. Recommendations were made to the Division to improve the monitoring process for complaints to help ensure that all worker's compensation complaints be processed within the timeframes allowed by state law and regulation and that it update policies and procedures for worker's compensation complaints.

Ms. Bailey stated the Department of Administration reported the Division believed an automated management control and reporting software system was required to complete recommendations one through three. The Division established guidelines for assigning and completing investigations and plans on establishing timelines for various steps. The Division planned on developing a tracking and review process using an automated review management control and reporting software system for notification of decisions for subsequent injury complaints. The Division anticipated completing procedures for the worker's compensation complaint program in December 2006. In a subsequent letter the Division had stated that its inability to fully implement certain recommendations was directly related to the lack of automated management controls. The Division added it fully recognized information and oversight deficiencies and would seek funding during the 2007 Legislative Session to integrate data management and related management reporting capabilities.

Ms. Bailey stated auditors had two questions noted in their letter to the Division.

Chair Leslie called for agency representation to testify.

Ms. Bailey stated the first question would be if the Division does not receive funding for an automated management control and reporting software system would it be unable to fully implement the four recommendations.

Mr. Roger Bremner, Administrator, stated the Division would be able to implement the recommendations, however, at the present time the Division had a series of databases spread throughout the worker's compensation section that needed to be completely integrated. The Division could change procedures but it would be difficult to track the procedures to see if they are fully implemented without the management information reports needed by the Division. He added that was the reason a fully integrated system was needed.

Assemblyman Marvel asked if the integration of the system would be included in the Division's budget request.

Mr. Bremner stated that a final meeting with representatives from both the executive and the legislative fiscal staff was scheduled for September 25, 2006, to prepare to present an anticipated cost of such a system to the Executive Budget Office by September 30, 2006.

Assemblyman Marvel asked for additional information regarding the backlog of complaints.

Mr. Bremner stated the Division does not really have a backlog of complaints and could not provide an exact list. He stated the Division needed to develop a management

report to track a complaint from the time it comes through the front door until it is completed. The Division cannot do that at the present time.

Chair Leslie commented the Division's needs would be falling into a gray area of needing more money, more computers, and then more staff. Chair Leslie appreciated that departments needed to be brought up to a certain level. She would be interested in pursuing the issue during the next Legislative Session, noting that at the present, these problems have been on the books for a long time. She commented that a report back to the Auditors would provide details of how the Division would address the specific audit recommendations. Assuming the Division does not receive additional resources, she asked what the Division would do to implement the recommendations.

Mr. Bremner stated the Division was rewriting the enforcement procedures and the audit procedures into one uniform process. He emphasized the Division needed a management report. He added the Division presently had databases spread out in many directions. He explained when the Division went from a two way system to a different two way system, the Division picked up new functions including enforcement, proof of coverage, a new collection system that was much more complicated, and a claims indexing system that they had never done before. He stated the Division had been through an evolutionary development process ever since then. He noted the Division needs to pull this all together. The Division needs the management report noted in the audit report.

Assemblyman Marvel asked if the Division did mine inspections.

Mr. Bremner responded yes, a mine safety and training section existed within the Division. He added the Division also runs the state OSHA program, the state worker's compensation program, and the consultation program.

Assemblyman Marvel asked if he was comfortable with the amount of personnel in the Division to perform these functions.

Mr. Bremner responded part of the budget request would be for an increase of personnel in every section. He added at one time the Division had 214 authorized FTE positions but the present total is 201 FTE positions. He gave examples of the Division's personnel needs.

Assemblyman Marvel commented the Division kept the mines from being red tagged by the federal government agencies.

Chair Leslie suggested the Division's request for additional personnel should be addressed through the budget process.

Ms. Bailey stated the second question would be to ask if the Division could utilize a manual tracking system or utilize currently available software to track premium penalty investigations, injury claims, and complaints, in order to ensure compliance with laws until such time as it may acquire a new information system.

Mr. Bremner stated the Division was in the process of reviewing that possibility. He was hopeful the Division could locate software off the shelf that could be adapted for the Division.

Chair Leslie did not want to see the Division stalling until next year at this time to see what happened. She asked Mr. Wood if the Committee would receive another status report on the partially implemented recommendations.

Mr. Wood stated the Committee could request the Division return to the December 2006, meeting to provide a status report.

Chair Leslie asked Mr. Bremner to provide the updated information and assure the Committee that the Division was progressing to implement the audit recommendations.

Mr. Bremner stated he understood the request from the Committee.

Chair Leslie called for questions from the Committee.

ASSEMBLYMAN MARVEL MOVED TO ACCEPT THE SIX-MONTH REPORT ON THE DEPARTMENT OF BUSINESS AND INDUSTRY, DIVISION OF INDUSTRIAL RELATIONS AND REQUESTED THE DIVISION REPORT BACK AT THE NEXT MEETING. THE MOTION WAS SECONDED BY SENATOR RHOADS AND CARRIED UNANIMOUSLY.

Mr. Bremner thanked Chair Leslie and the Committee members.

Item 4—Follow-up on six-month reports from prior meeting (NRS218.8245).

Mr. Wood explained these reports are follow-ups on six-month reports from prior meetings. This is where agencies that had not fully implemented all of their recommendations were asked to return to provide an update to the Committee.

A. Utilization and Security Over State Internet Sites (DoIT).

Mr. Wood introduced Doug Peterson, Information Systems Audit Supervisor, to make the presentation.

Mr. Peterson provided a brief recap of the history of this audit. He explained in October 2005, the six-month report was presented to the Committee. Based on that discussion the Audit Subcommittee requested the agency return in February 2006, to provide an update to the Committee. Mr. Peterson explained again there was more discussion. The agency returned again in May 2006, and at that meeting the discussion centered mainly around whether agencies had completed their disaster recovery plans or not. Auditors had requested an update from the Department in August 2006, on the number of agencies that had completed disaster recovery plans and information security plans. He added, specifically the Audit Subcommittee had requested a report identifying each agency that had completed less than 50% of their plans and the reasons for not completing those plans. In the response the Department provided a list of agencies that were 50% or less completed. However, there were no reasons provided and the Department indicated in their response they would have the requested information by this meeting. Mr. Peterson stated there are two questions for the Department to respond to the Audit Subcommittee.

Chair Leslie called for agency representation to testify. She stated it remains disturbing that some of the agencies are not in compliance.

Terry Savage, Director, introduced James Elste, Chief Information Security Officer. He deferred the update of the issue to Mr. Elste.

Mr. Elste explained this was his fourth day as the Chief Information Security Officer. He was prepared to answer questions from the Committee.

Chair Leslie stated prior to answering the auditor's questions the Committee had asked for a list of the reasons why the agencies were not in compliance by this meeting date. She asked if the information was available to the Committee.

Mr. Elste stated the Department did not have a list of reasons from the agencies as to why they had not completed their disaster recovery plans.

Chair Leslie asked Mr. Savage why the information had not been made available to the Committee.

Mr. Savage clarified the first phase of the disaster recovery planning was only for critical items, the items that need to be up and running within 48 hours. It was discovered that a significant number of the agencies that had not responded did not have critical items or applications that needed to be up within 48 hours.

Chair Leslie asked why they were included on the list.

Mr. Savage responded actually there would be later phases where the Department would address the rest of the applications that could wait a little longer but were still important to be brought up. Actually, he did have an updated list.

Chair Leslie asked that the list be provided to the Committee.

Mr. Savage responded absolutely.

Assemblyman Marvel asked if the Gaming Control Board had its own system.

Mr. Savage stated that was correct.

Assemblyman Marvel asked if the agency was in compliance with the security issues.

Mr. Savage deferred the question to Ms. Donna Crutcher, Deputy Chief.

Ms. Crutcher stated the updated information status had been requested from the Gaming Control Board on September 1, 2006. To date no response had been received. She provided an update to the Committee on the agencies that were 50% or less in compliance. She stated the Department originally noted 18 agencies on the list that were 50% or less in compliance with their disaster recovery plans. She stated the list would be reduced to 8 agencies primarily because Health and Human Services had boards and the Director's Office did not have critical applications that had to be recovered within the 48 hour timeframe. She added they would be removed from the list. Ms. Crutcher stated she was working with the Business and Industry, Athletic Commission, Employment Management Relations Board, and Transportation Services Authority points of contact. She anticipates the plans would be completed by January 2007.

Chair Leslie stated the Committee requested the information be presented in a complete report provided to the auditors, before the meeting, and not presented orally. From a previous meeting she thought the Committee was clear on the fact that the information should be provided in writing. She asked the Department and asked the auditing staff to put this item on the agenda one more time. She asked that the requested information be submitted in writing to the auditors on time for the next meeting.

Chair Leslie expressed frustration with the Department. She emphasized the Committee wanted to see the requested information.

Mr. Peterson stated he was unsure if he would need to go through the questions for the Department because they center around the requested information and the reasons why and the target dates for completion. Since the Department had not provided the requested information to the Committee, he requested that the questions be held until the next meeting.

Chair Leslie agreed. She asked that the auditors work with the Department to ensure that the information be provided in the format requested by the Committee.

Mr. Savage apologized for the delay. He explained the Security Unit had some challenges in the last several months. He added with the addition of Mr. Elste in the position of Chief Information Security Officer, he expected to provide the information timely. He stated the Committee would be provided the requested information without prompting from the auditors.

Chair Leslie stated the Committee looked forward to receiving the requested information and being assured that the auditors received the information timely. She emphasized the Committee preferred to review the information prior to the meeting.

Mr. Savage addressed the lingering question of the schedule and if the Department still anticipated all agencies completing their disaster recovery plans by the end of this calendar year. He stated there may be a month or two of delays for some of the information security plans. He added the Department intentionally had focused on the disaster recovery plans as the most important plan. And as indicated by Ms. Crutcher, out of the list of 60 or 70 agencies that we started with there are only eight within the 50% rate for noncompliance. The Department offered to provide written documentation to the Committee well ahead of time.

Mr. Peterson stated for clarification to the Department, auditors would be contacting the Department prior to the next Audit Subcommittee meeting requesting the list with the reasons for noncompliance. At that time auditors will provide the information to the Committee.

Chair Leslie agreed.

Mr. Savage stated the Department's intentions were to have no names on the list.

Chair Leslie stated the Department would be seen at the next meeting of the Subcommittee in December 2006.

ASSEMBLYMAN MARVEL MOVED TO ACCEPT THE FOLLOW-UP ON THE SIX-MONTH REPORT FROM PRIOR MEETING ON THE UTILIZATION AND SECURITY OVER STATE INTERNET SITES AND REPORT BACK TO THE SUBCOMMITTEE AT THE NEXT MEETING. THE MOTION WAS SECONDED BY SENATOR RHOADS AND CARRIED UNANIMOUSLY.

B. University and Community College System of Nevada, Capital Construction Projects and Contracting and Bidding Procedures.

Mr. Wood introduced Mike Spell, Audit Supervisor, to make the presentation.

Mr. Spell explained the six-month report on the implementation status of the six recommendations contained in the audit report of the Capital Construction Projects and Contracting and Bidding Procedures was presented at the February 2006, Audit Subcommittee meeting. The report indicated the System had partially implemented five of the six audit recommendations contained in the audit report. A follow-up report was presented at the May 2006, Audit Subcommittee meeting. As of that date, two audit recommendations remained partially implemented. Therefore another follow-up report was requested to be presented at the meeting today. Mr. Spell stated the two partially implemented recommendations addressed revising procedures to ensure construction contracts and change orders are properly approved; and finalizing an agreement regarding project management inspection responsibilities with the State Public Works Board. The current report presented to the Committee noted the System provided a draft of amended procedures addressing the use of purchase orders as construction contracts, required clauses, and the approval of contracts and change orders. Based on auditors review of these procedures, the recommendation will be fully implemented when they are approved by the Chancellor's Cabinet and codified in the System's procedures and guidelines manual. Therefore, auditors were going to ask when the procedures were going to be approved and codified. However, the System notified auditors this week that the procedures were approved on September 6, 2006, and will be codified on September 29, 2006. Therefore auditors have no questions at this time for this recommendation which will be fully implemented when codified.

Mr. Spell continued, regarding the agreement with the State Public Works Board, the System reported that the Public Works Board provided a draft of an inter-local agreement which is currently in the review process and is expected to be finalized before the close of calendar year 2006. Therefore, staff will continue to monitor the progress of this inter-local agreement and if need be, will request that they return to the next Subcommittee meeting. He proposed to wait to see how the process progresses.

SENATOR RHOADS MOVED TO ACCEPT THE FOLLOW-UP ON SIX-MONTH REPORT FROM PRIOR MEETING ON THE UNIVERSITY AND COMMUNITY COLLEGE SYSTEM OF NEVADA, CAPITAL CONSTRUCTION PROJECTS AND CONTRACTING AND BIDDING PROCEDURES. THE MOTION WAS SECONDED BY ASSEMBLYMAN MARVEL

Chair Leslie called for discussion.

Assemblyman Marvel commented Public Works was always changing the scope of things. He understood that some of the projects would not come under the purview of the Public Works Board.

Mr. Spell commented this was where the inter-local agreement would be so important. As NRS stands, the Public Works Board manager was responsible for all building projects on State property. He added this highlights the importance of the inter-local agreement.

Chair Leslie commented that activity would most likely be reviewed during the 2007 Legislative Session.

Chair Leslie asked for any further discussion from the Committee. She called for a vote on the motion

THE MOTION CARRIED UNANIMOUSLY.

C. University and Community College System of Nevada, Statewide Programs.

Mr. Wood introduced Jane Bailey, Audit Supervisor, to make the presentation.

Ms. Bailey stated in June 2004, an audit report was issued on the University System Statewide Programs. At the October 2005, Audit Subcommittee meeting the six-month report was presented on the status of the five recommendations in the audit report. At that time it was determined that two of the recommendations were fully implemented and three recommendations were partially implemented. The Audit Subcommittee requested that the System return to a future Subcommittee meeting to report on the status of the partially implemented recommendations. Since that Audit Subcommittee meeting it has been determined through discussion and correspondence with the System that two of the partially implemented recommendations have been fully implemented and one recommendation remained partially implemented. Since the date the letter in the Subcommittee meeting packet was written, auditors have received additional information from both universities regarding the outcome measures for their statewide programs. It was concluded that the universities have now fully implemented this recommendation. Ms. Bailey expressed appreciation for their efforts in the implementation of the audit recommendations. Therefore auditors have no questions for the university.

SENATOR RHOADS MOVED TO ACCEPT THE FOLLOW-UP ON THE SIX-MONTH REPORT FROM PRIOR MEETING ON THE UNIVERSITY AND COMMUNITY COLLEGE SYSTEM OF NEVADA, STATEWIDE PROGRAMS. THE MOTION WAS SECONDED BY ASSEMBLYMAN MARVEL AND CARRIED UNANIMOUSLY.

D. Western Interstate Commission for Higher Education (WICHE).

Mr. Wood introduced Jane Bailey, Audit Supervisor, to present the report.

Ms. Bailey stated the audit report on WICHE was issued in May 2005, with eleven recommendations. At the May 2006, meeting of the Audit Subcommittee it was reported that four recommendations were fully implemented, two were partially implemented, and no action had been taken on five recommendations. Ms. Bailey reported since the last Audit Subcommittee meeting auditors had reviewed documentation provided by WICHE and discussed the status of the recommendations with WICHE's staff. In August 2006, WICHE provided a letter updating the status of the remaining seven recommendations. Based on the information provided then and information provided since this letter was written, WICHE has now fully implemented six recommendations, partially implemented three recommendations, and taken no action on two recommendations. The Audit Subcommittee may wish to obtain additional information on the five recommendations that have not been fully implemented.

Ms. Bailey stated the first recommendation pertained to the finding that WICHE did not comply with state laws requiring Board of Examiners (BOE) approval when writing off debt. The Commission approved writing off debt in November 2001, without BOE approval. The audit report recommended that WICHE develop and implement procedures to help ensure compliance with statutory requirements, including obtaining Board of Examiners' approval to write off debt. WICHE is still in the process of obtaining detailed medical information from participants for the medical write off of some accounts. Ms. Bailey reported two participants had been asked to provide further medical information for the accounts to be considered for write off. This information had not yet been received and further requests had been made. Ms. Bailey stated the Audit Subcommittee may wish to ask WICHE for further information regarding this issue.

Chair Leslie called for an agency representative to testify.

Ms. Bailey stated questions for Mr. Sparks would be if the requested information was not received from these participants does WICHE still intend to write these accounts off.

Ron Sparks, Executive Director, stated the answer was no. WICHE would not write off the accounts if the requested information was not received. He explained WICHE was planning to write off the accounts due to information provided by the participants and the Commission agreed they should be written off. Before bringing it to the Board of Examiners, WICHE attorneys suggested obtaining additional information from the participants in the form of actual medical documentation. WICHE set a deadline of September 22, 2006, to provide the requested information or WICHE would recommend to rescind their action and that the accounts be forwarded for collections.

Chair Leslie stated the Committee would like to see a resolution to the issue. She stated the Committee would have preferred the deadline date to have been prior to this meeting so the Committee would know the outcome.

Assemblyman Marvel asked about the total amount owed to WICHE.

Mr. Sparks was not sure of the amount but offered to provide the information to the Committee.

Assemblyman Marvel asked if the uncollectible amount was in the millions.

Mr. Sparks stated that some accounts were at the collection agency to be resolved. He added the largest accounts were at the collection agency and WICHE was in the process to either secure judgments or some kind of action against the participants.

Assemblyman Marvel asked about the location of the participants, if they were currently in Nevada or elsewhere.

Mr. Sparks responded that the majority of the participants were out of the state.

Chair Leslie asked Ms. Bailey to continue the presentation.

Ms. Bailey stated the next two recommendations pertained to the finding that WICHE's regulations were last revised in 1984. At the time of the audit the regulations were outdated and contained inaccurate information. NRS does require agencies to review their regulations at least once every ten years to determine whether they should amend or revise the regulations. Two audit recommendations were made. One was to revise the regulations regarding loan and practice requirements. The second one was to periodically conduct a thorough review of regulations to ensure they were complete and current.

Ms. Bailey reported auditors had received a procedure from WICHE which does require periodic review of the regulations. However, the regulations had not been revised. She stated WICHE's response was that the regulations were still under review. Therefore she had two questions. WICHE reported in its 60-day plan for corrective action that it was in the process of reviewing this regulation and estimated implementing the recommendation by July 2006. She asked what had delayed this implementation.

Mr. Sparks responded basically the delay in the implementation of the recommendation was that before WICHE could do anything with the Nevada Administrative Code (NAC) the Department needed to revise all of their other procedures which WICHE had done so the process could be improved as far as collections were concerned. He declared WICHE was reviewing the NACs but stated it required time to go through the public process. He stated conversations with the Attorney General's Office were needed to begin that process. He added every time WICHE would begin this process it occurred right before the legislative session so the changes would become temporary. He stated WICHE will get the NACs updated and get them revised through the process.

Chair Leslie asked Mr. Sparks if WICHE's regulations in Chapter 397 were a page and a half in length and asked if some of the changes that were being requested were issues like changing the citation of the NRS because it was incorrect.

Mr. Sparks replied that was correct.

Chair Leslie asked Mr. Sparks why there was a delay in making the corrections.

Mr. Sparks stated he had to go through the process with the AG's Office.

Chair Leslie stated what you tell the AG's Office is that the citations are incorrect.

Mr. Sparks stated he would get them revised.

Chair Leslie stated this was not a difficult request.

Mr. Sparks stated what he was talking about was that they have others out there and WICHE needs to implement some new NACs as well. He stated as WICHE goes through this process all will be straightened out and updated. He apologized but stated WICHE consisted of a three person staff. He added they were doing the best they could.

Chair Leslie stated that excuse was wearing thin and that these are not complicated regulations. Chair Leslie stated, "Get it done."

Chair Leslie recognized Ms. Bailey.

Ms. Bailey stated the Commission had already answered the second question of whether WICHE intended to adopt temporary regulations or to wait until July 2007, to submit the revisions to the Legislative Counsel.

Mr. Sparks stated that was correct.

Chair Leslie asked for clarification.

Mr. Sparks stated it was correct that WICHE was going forward with the process to implement temporary regulations on the basic changes.

Chair Leslie stated at least get the basic changes.

Mr. Sparks stated on some they were going to need to do a full blown revision process.

Chair Leslie advised Mr. Sparks to get it moving and report back at the December 2006, Subcommittee meeting.

Chair Leslie recognized Ms. Bailey.

Ms. Bailey stated the remaining two recommendations pertained to the finding related to performance indicators. It was recommended that WICHE report its performance indicators to the Commission at least annually and that WICHE develop and implement procedures to ensure performance indicators showed performance accurately, were calculated using a consistent methodology, and were supported by documentation that was maintained for three years. Ms. Bailey stated auditors had received a copy of a procedure, but had not seen the actual calculated performance indicators. WICHE had responded to a letter from auditors indicating the procedures were being developed. WICHE anticipated implementation of this recommendation by September 30, 2006. Ms. Bailey had two questions for WICHE. She asked if WICHE had completed procedures for calculating performance indicators. She added, auditors had received a copy of them earlier in the week. The second question was to ask WICHE if they had calculated performance indicators for fiscal year 2006.

Mr. Sparks responded basically what WICHE was doing with their performance indicators, as requested by the Department of Administration and through the audit process, was that WICHE developed three brand new performance indicators to measure WICHE. He stated WICHE had provided the Budget Office, through the

Budget Process, with indicators and numbers. He added WICHE would provide Audit staff information on how the numbers were calculated and then the process would be completed.

Chair Leslie asked Ms. Bailey to comment.

Ms. Bailey stated yes, as soon as auditors were provided with the information the audit recommendation would be considered fully implemented.

Chair Leslie stated the Committee does not want to see WICHE return to the Subcommittee meetings, yet the motion would reflect a request for the Commission to return to the next Subcommittee meeting to report back to the Committee.

ASSEMBLYMAN MARVEL MOVED TO ACCEPT THE FOLLOW-UP ON THE SIX-MONTH REPORT FROM PRIOR MEETING ON THE WESTERN INTERSTATE COMMISSION FOR HIGHER EDUCATION AND REPORT BACK TO THE SUBCOMMITTEE AT THE NEXT MEETING. THE MOTION WAS SECONDED BY SENATOR RHOADS AND CARRIED UNANIMOUSLY.

Assemblyman Marvel asked for numbers of participants in the WICHE program who were from Nevada.

Mr. Sparks stated thousands had gone through the program, adding WICHE sees approximately 70 to 75 new participants go through the program each year. Mr. Sparks stated WICHE was in the process of conducting a study to illustrate the impact WICHE has on the economy.

Item 5—National State Auditors Association Report on Nevada Legislative Auditor's System of Quality Control.

Mr. Paul Townsend, Legislative Auditor, explained Audit Division audits are conducted in accordance with rigorous professional standards which are developed by the Comptroller General of the United States, who also serves as the head of the Government Accountability Office (GAO). A number of Audit Division practices and policies follow and mirror those performed by GAO when they report to Congress. The standards provide a framework for ensuring auditors have competence, integrity, objectivity; and independence in planning, conducting, and reporting on audits. One of the requirements of the standards is that an external peer review of Audit Division auditing practices be conducted once every three years by independent reviewers. The results of the review as presented to the Committee was performed by experienced auditors representing the states of New York, Missouri, Tennessee, and Arizona. The letter in the packet describes the results of the review indicating the effectiveness of the office's system of quality control. He noted appreciation for the support of the Legislature and the Committee as well as the Audit staff in achieving the successful outcome of this review. Mr. Townsend offered to answer questions from the Committee. He requested that the Committee accept the report.

Chair Leslie stated Audit staff deserve a great deal of thanks from the Committee and the Legislature. This report is an audit of the auditors which assures that the Committee and the Legislature can rely upon the audit work and that it is done in accordance with national standards. She noted this was apparent from the work presented to the Committee. She noted the Committee was pleased with the Audit staff. She added it is a high compliment to receive this kind of evaluation from an outside source. Chair Leslie stated it was appreciated that Mr. Townsend brought this report to the attention of the Committee. Chair Leslie called for a motion to accept the report.

SENATOR RHOADS MOVED TO ACCEPT THE NATIONAL STATE AUDITORS ASSOCIATION REPORT ON THE NEVADA LEGISLATIVE AUDITOR'S SYSTEM OF QUALITY CONTROL. THE MOTION WAS SECONDED BY ASSEMBLYMAN MARVEL AND CARRIED UNANIMOUSLY

Item 6—Public Comment.

Chair Leslie asked for public comment. There was none.

There being no further comments the meeting was adjourned at 12:56 P.M. The next meeting of the Audit Subcommittee was scheduled for December 6, 2006.

Respectfully submitted,

Donna Wynott, Audit Secretary

Assemblywoman Sheila Leslie
Chair of the Audit Subcommittee
of the Legislative Commission

Paul V. Townsend, Legislative Auditor
and Secretary to the Audit Subcommittee
of the Legislative Commission