



## Office of the Internal Auditor



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# AUDIT REPORT

## Treasury Cash Management Audit

February 24, 2016

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# Executive Summary

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## Background

The Finance Department oversees approximately \$13.3 billion in total surplus assets, as of October 23, 2015 and \$1 billion of these assets are managed internally to meet day to day and short term cash needs. The remaining \$12.2 billion surplus is distributed among 15 external money managers for investment. Responsibility for the short term and long term investments are managed by the Treasury and Investment units.

Treasury Unit's primary objectives are:

- To ensure that Citizens has adequate cash on-hand to meet its operational business needs while minimizing idle excess funds committed to cash balances.
- To ensure Citizens has the banking services and account structure in place to facilitate the cash inflows and outflows required for the Company.
- To ensure the security of Citizens financial assets using fraud prevention services and techniques.
- Ensuring compliance with the Citizens indentures and collateral agreements.
- Staying informed and current on economic, financial market, legal, and treasury industry trends and news as it relates to the Company.

To facilitate these objectives Treasury personnel manage the daily and monthly cash liquidity position by ensuring adequate account diversification, check clearing, deposit verification, wire initiation, and managing banking relationships. The Treasury Unit invests internally managed surplus funds in short-term cash equivalent securities until needed for operational expenses. Analysis of cash flow needs, and forecast reports are provided to management to aid in the decision making of cash movements. When expenses are higher than revenues and when operating funds need to be replenished from externally managed funds, the Treasury Unit will notify the Finance Management of the need for cash. The Treasury Investment Unit will then instruct the external money managers to liquidate investments and transfer funds back to operational accounts managed by the Treasury Unit. The Treasury Investment Unit provides oversight of the external investment management vendors by tracking daily yields, performing portfolio compliance monitoring, tracking investment performance, and monthly assessment/score card of the external investment manager vendors.

## Audit Objectives and Scope

Internal Audit reviewed the effectiveness of the Treasury Unit cash management and forecasting functions and verified that statutory and regulatory obligations are appropriately achieved.

The objective was to thoroughly assess cash management within Citizens which involved:

- Verify the Sources and Uses report effectively meets management's needs and process controls are appropriately performed and documented.
- Review the effectiveness and reliability of the Treasury Department's forecasting models.
- Review how the Treasury Department manages and optimizes the banking relationships, fee structure, and banking tools to meet Citizens obligations.
- Review Treasury oversight of third party vendors.
- Verify that fraud prevention controls for disbursements are consistently performed and operating as intended.
- Review and assess End User Computing controls.

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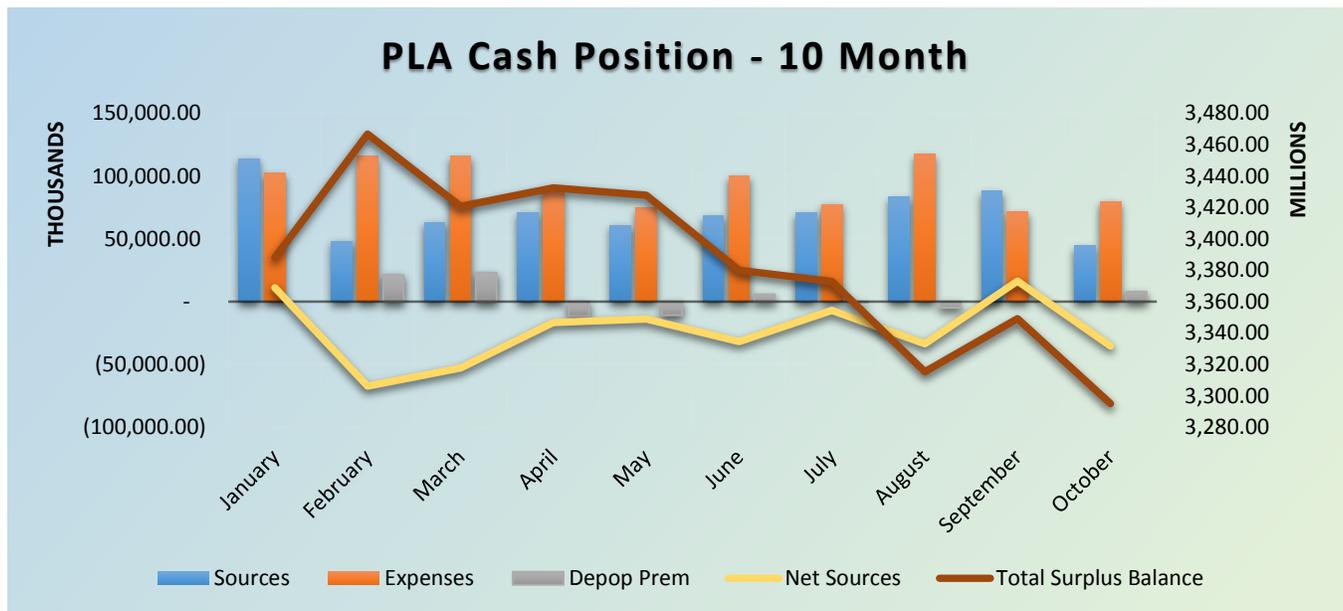
- Verify statutory and regulatory obligations are appropriately controlled.
- Review OFAC compliance to ensure applicable Treasury disbursements are monitored by the Legal department.
- Review Treasury Department policies and procedures to ensure documentation is current and key processes are addressed.

### Audit Opinion

The overall effectiveness of the processes and controls with regards to the Treasury Unit’s responsibilities evaluated during the audit is rated as **Satisfactory**.

The Treasury Unit has managed the cash needs on an ongoing basis, providing the Finance department with updates on the organization’s cash position. Historically income from premiums has resulted in positive cash flows contributing to annual increases in surplus funds. Beginning in 2013 a strategic push to depopulate policies and escalating claim litigation expenses has reversed the cash flow position in the Personal Lines Account (PLA) and Coastal Lines Account (CLA). Citizens has a strong surplus position in all three accounts as evidenced in Citizens debt ratings, however the changing cash flow environment has increased operational risk and requires enhanced levels of monitoring, management and controls.

As an example of the current cash flow environment the following chart illustrates the revenues and expenses of the PLA account for the first 10 months of 2015 and the combined balances of the internally and externally managed surplus accounts.



We did note the following observations that could enhance the Treasury Units process and controls:

- **Cash forecasting needs improvement.** The current manual cash forecasting process, which lacks robust tools, needs to be improved to ensure the most efficient and effective utilization of cash. The current process results in very conservative cash targets, thereby foregoing potential investment income. The Treasury Unit should establish forecasting objectives, benchmarks, identify acceptable variance limits for short term, near term and long term periods. Improved

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forecasting of current and future cash positions will improve internal funding decisions, resource utilization and strategic planning. In addition, the Treasury Unit should assess, and if possible, leverage internal resources within the Enterprise Risk & Analytic Department to enhance forecasting capabilities.

- **End User Computing Controls need improvement.** We noted that the Treasury Unit does not review access to their critical spreadsheets on a regular basis. As of December 2015, 19 system accounts, 31 Information Technology individuals and 24 Finance and Treasury personnel have access to modify the critical spreadsheets. The spreadsheets are not password protected, formulas are not locked and there is no version or change control. Unintended changes to the spreadsheets can result in inaccurate reporting of Citizens Treasury operations and inefficient management of assets. End user computing tools such as critical spreadsheets must be appropriately protected with regards to access control, security and integrity of data.
- **Evidence of review of the Sources and Uses report by management is not documented.** Internal Control Framework (ICF) testing has identified the need for management to document its review of the weekly and monthly Sources and Uses report. This finding will be managed and remediated as part of the ICF process. The ICF finding is noted in the audit executive summary as acknowledgment of the coordinated assurance work and to maintain a record for Internal Audit.

The Treasury Unit is performing their stated responsibilities, however we are of the opinion that there are opportunities to expand the Treasury Unit's capabilities and provide additional value to the organization. Accordingly we have identified the following strategic improvement opportunities that should be considered to better align the Treasury Unit with industry best practices, increase the value to the organization and enhance the visibility of cash flows to management.

- **Acquire an integrated Treasury Management system.** An integrated Treasury Management system will automate manual processes, reduce or eliminate Treasury's dependence on spreadsheets, enhance the analysis of cash activity and improve cash forecasting and assist the Treasury Unit with establishing key performance indicators. The Treasury Unit determines the amount of cash needed by taking the average uses for three months times two and incorporate large planned expenditures such as reinsurance or depopulation payments. Improving the efficiency of managing cash needs can potentially increase the cash in investments by \$20 million which at current conservative interest yields could result in \$200 thousand in additional revenue a year.
- **Communication with business partners needs improvement.** The Treasury Unit requires input from all revenue and expense related business areas to effectively manage the organizations cash needs. However, the Treasury Units communication with pertinent business areas is limited to data inputs through informal communication. Establishing formal communication on regular intervals will strengthen the Treasury Unit's visibility and relations with germane business areas. In addition, the formal lines of communication will improve operational awareness, improve understanding and impact of revenue and expense inputs and provide the Treasury Unit with timely insight on changes to the business that will impact cash needs.

We would like to thank management and staff for their cooperation and professional courtesy throughout the course of this audit.

# Appendix 1

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## Definitions

### Audit Ratings

#### Satisfactory:

Critical internal control systems are functioning in an acceptable manner. There may be no or very few minor issues, but their number and severity relative to the size and scope of the operation, entity, or process audited indicate minimal concern. Corrective action to address the issues identified, although not serious, remains an area of focus.

#### Needs Improvement:

Internal control systems are not functioning in an acceptable manner and the control environment will require some enhancement before it can be considered as fully effective. The number and severity of issues relative to the size and scope of the operation, entity, or process being audited indicate some significant areas of weakness. Overall exposure (existing or potential) requires corrective action plan with priority.

#### Unsatisfactory:

One or more critical control deficiencies exist which would have a significant adverse effect on loss potential, customer satisfaction or management information. Or the number and severity of issues relative to the size and scope of the operation, entity, or process being audited indicate pervasive, systemic, or individually serious weaknesses. As a result the control environment is not considered to be appropriate, or the management of risks reviewed falls outside acceptable parameters, or both. Overall exposure (existing or potential) is unacceptable and requires immediate corrective action plan with highest priority.

## Appendix 2

### Issue Classifications

Control Category	High	Medium	Low
<i>Financial Controls (Reliability of financial reporting)</i>	<ul style="list-style-type: none"> <li>• Actual or potential financial statement misstatements &gt;USD 5 million</li> <li>• Control issue that could have a pervasive impact on control effectiveness in business or financial processes at the business unit level</li> <li>• A control issue relating to any fraud committed by any member of senior management or any manager who plays a significant role in the financial reporting process</li> </ul>	<ul style="list-style-type: none"> <li>• Actual or potential financial statement misstatements between USD 2.5 million to 5 million</li> <li>• Control issue that could have an important impact on control effectiveness in business or financial processes at the business unit level</li> </ul>	<ul style="list-style-type: none"> <li>• Actual or potential financial statement misstatements below USD 2.5 million</li> <li>• Control issue that does not impact on control effectiveness in business or financial processes at the business unit level</li> </ul>
<i>Operational Controls (Effectiveness and efficiency of operations)</i>	<ul style="list-style-type: none"> <li>• Actual or potential losses &gt;USD 2.5 million</li> <li>• Achievement of principal business objectives in jeopardy</li> <li>• Customer service failure (e.g., excessive processing backlogs, unit pricing errors, call center non responsiveness for more than a day) impacting 10,000 policyholders or more or negatively impacting a number of key corporate accounts</li> <li>• Actual or potential prolonged IT service failure impacts one or more applications and/or one or more business units</li> <li>• Actual or potential negative publicity related to an operational control issue</li> <li>• An operational control issue relating to any fraud committed by any member of senior management or any manager who plays a significant role in operations</li> </ul>	<ul style="list-style-type: none"> <li>• Actual or potential losses between USD 0.5 to 2.5 million</li> <li>• Achievement of principal business objectives may be affected</li> <li>• Customer service failure (e.g., processing backlogs, unit pricing errors, call center non responsiveness) impacting 1,000 policyholders to 10,000 or negatively impacting a key corporate account</li> <li>• Actual or potential IT service failure impacts more than one application for a short period of time</li> </ul>	<ul style="list-style-type: none"> <li>• Actual or potential losses below USD 0.5 million</li> <li>• Achievement of principal business objectives not in doubt</li> <li>• Customer service failure (e.g., processing backlogs, unit pricing errors, call center non responsiveness) impacting less than 1,000 policyholders</li> <li>• Actual or potential IT service failure impacts one application for a short period of time</li> </ul>

## Appendix 2

Control Category	High	Medium	Low
	<ul style="list-style-type: none"> <li>Any operational issue leading to death of an employee or customer</li> </ul>	<ul style="list-style-type: none"> <li>Any operational issue leading to injury of an employee or customer</li> </ul>	
<i>Compliance Controls (Compliance with applicable laws and regulations)</i>	<ul style="list-style-type: none"> <li>Actual or potential for public censure, fines or enforcement action (including requirement to take corrective actions) by any regulatory body which could have a significant financial and/or reputational impact on the Group</li> <li>Any risk of loss of license or regulatory approval to do business</li> <li>Areas of non-compliance identified which could ultimately lead to the above outcomes</li> <li>A control issue relating to any fraud committed by any member of senior management which could have an important compliance or regulatory impact</li> </ul>	<ul style="list-style-type: none"> <li>Actual or potential for public censure, fines or enforcement action (including requirement to take corrective action) by any regulatory body</li> <li>Areas of non-compliance identified which could ultimately lead to the above outcomes</li> </ul>	<ul style="list-style-type: none"> <li>Actual or potential for non-public action (including routine fines) by any regulatory body</li> <li>Areas of noncompliance identified which could ultimately lead the above outcome</li> </ul>
<i>Remediation timeline</i>	Such an issue would be expected to receive immediate attention from senior management, but must not exceed 60 days to remedy.	Such an issue would be expected to receive corrective action from senior management within 1 month, but must be completed within 90 days of final Audit Report date.	Such an issue does not warrant immediate attention but there should be an agreed program for resolution. This would be expected to complete within 3 months, but in every case must not exceed 120 days.

## Appendix 3

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### Distribution

Addressee(s) Jonathan Norfleet, Manager Treasury/Investments  
Joshua Bruce, Senior Treasury Investment Analyst

Copies **Business Leaders:**  
Barry Gilway, President/CEO/Executive Director  
Jennifer Montero, Chief Financial Officer  
Dan Sumner, Chief Legal Officer & General Counsel  
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The Honorable Adam Putnam, Commissioner of Agriculture  
The Honorable Andy Gardiner, President of the Senate  
The Honorable Steve Crisafulli, Speaker of the House of Representatives

The External Auditor

### Audit Performed By

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Auditor in Charge Anthony Huebner

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Audit Director John Fox

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*Under the Direction of* Joe Martins  
*Chief of Internal Audit*

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