

# Audit Report

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## **Maryland Insurance Administration**

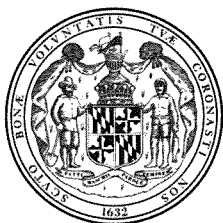
November 2014

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**OFFICE OF LEGISLATIVE AUDITS**  
**DEPARTMENT OF LEGISLATIVE SERVICES**  
**MARYLAND GENERAL ASSEMBLY**

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DEPARTMENT OF LEGISLATIVE SERVICES  
OFFICE OF LEGISLATIVE AUDITS  
MARYLAND GENERAL ASSEMBLY

November 20, 2014

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Executive Director

Thomas J. Barnickel III, CPA  
Legislative Auditor

Senator James C. Rosapepe, Co-Chair, Joint Audit Committee  
Delegate Guy J. Guzzone, Co-Chair, Joint Audit Committee  
Members of Joint Audit Committee  
Annapolis, Maryland

Ladies and Gentlemen:

We have conducted a fiscal compliance audit of the Maryland Insurance Administration (MIA) for the period beginning September 29, 2010 and ending August 4, 2013. MIA is responsible for licensing and regulating insurers, insurance agents, and brokers who conduct business in the State, and for monitoring the financial solvency of licensed insurers.

MIA did not comply with State procurement regulations and did not exercise appropriate oversight when obtaining professional services, including information technology (IT) consultant services pertaining to the implementation of a new information system to process and record premium taxes paid by insurance companies. While the system, which was implemented in February 2012, provided certain new capabilities, other functionality that was available in the former system was lost. Absent proper controls over the related manual processes, this lost functionality adversely impacted operations, including data security.

MIA conducted an improper procurement process to hire a contractor who originally was tasked to assist MIA's IT staff with development of the new premium tax system to process tax payments totaling over \$400 million annually. When the subsequent decision was made to abandon this project, MIA significantly changed the scope of the contractor's services without initiating a new competitive procurement process. The change required the same contractor to implement a proprietary premium tax system that the contractor had previously developed for another state. This project proceeded without the benefit of a project plan with related specifications and cost estimates. An MIA management employee who had experience with the contractor's work in that other state had exercised excessive control over the procurement process and was responsible for project monitoring and approving contractor invoices.

Proper controls were not established over desk audits of insurance company tax filings, which were required to be performed manually since the implementation of the new tax premium system, and proper controls were not established over the resulting tax refunds. For example, audit results and tax refunds were not always subject to independent review. Our tests of the audits conducted and refunds processed disclosed numerous errors that included the issuance of duplicate account credits and refunds and the failure to identify reporting discrepancies and assess interest and penalties for late tax payments or underpayments during the year. For example, our tests identified actual and potential duplicate account credits or refunds totaling \$764,000 and lost penalties and interest totaling \$439,000.

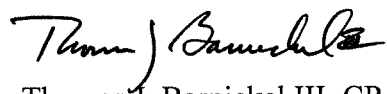
Furthermore, the premium tax system was not properly secured to restrict and control access. The contractor responsible for system implementation and ongoing operation and maintenance had complete control over the system and had unnecessary access to the remainder of the MIA network. In addition, MIA lacked assurance that any operational and security risks related to the insurance producer licensing and pre-licensing automated systems operated by service providers had been identified and corrected, as necessary. Specifically, MIA had not performed security reviews of the service providers' operations or, as an alternative, had not obtained any reports resulting from independent reviews conducted of either system.

Our review also disclosed that effective controls were not established over the processing of mail receipts, the purchasing of certain services, and the awarding of certain financial examination task orders.

As a result of the significance of our audit findings, we determined that MIA's accountability and compliance level was unsatisfactory, in accordance with the rating system we established in conformity with State law.

An executive summary of our findings can be found on page 5 of this report. MIA's response to this audit is included as an appendix to this report. We wish to acknowledge the cooperation extended to us during the course of this audit by MIA.

Respectfully submitted,

A handwritten signature in black ink, appearing to read "Thomas J. Barnickel III", is written over a horizontal line.

Thomas J. Barnickel III, CPA  
Legislative Auditor

## Table of Contents

<b>Executive Summary</b>	5
<b>Background Information</b>	7
Agency Responsibilities	7
Status of Findings From Preceding Audit Report	7
<b>Findings and Recommendations</b>	9
<b>Premium Tax System</b>	
Finding 1 – The Procurement of a New Premium Tax System Did Not Comply With State Procurement Regulations and the Project Was Not Adequately Planned	9
Finding 2 – An MIA Management Employee Exercised Excessive Control Over the Premium Tax System Procurement and Implementation	12
*   Finding 3 – The Premium Tax System Was Not Properly Secured and a Contractor Had Complete Control Over the System	14
Finding 4 – MIA Lacked Assurance That the Premium Tax System Was Properly Protected From External Threats and Unauthorized Changes	15
<b>Administration of Premium Tax Filings</b>	
Finding 5 – MIA Had Not Established Adequate Controls Over Audits of Premium Tax Filings and a Number of Errors Were Detected	18
Finding 6 – Procedures Were Not Sufficient to Ensure Certain Premium Tax Payments Were Received Timely	20
Finding 7 – MIA Had Not Established Proper Controls Over Premium Tax Refunds	21
*   Finding 8 – MIA Did Not Reconcile its Records of Premium Tax Revenues With the Corresponding State Accounting Records	22
<b>Financial Examination Services</b>	
Finding 9 – Sufficient Controls Were Not Established Over Financial Examination Services Task Order Awards and Modifications	24
<b>Cash Receipts</b>	
*   Finding 10 – MIA Lacked Accountability and Control Over Certain Cash Receipts	26
* <b>Denotes items repeated in full or part from preceding audit report</b>	

<b>Producer Licensing</b>	
Finding 11 – Sufficient Controls Were Not Established For the Issuance of Producer Licenses	27
*     Finding 12 – MIA Lacked Assurance That Producer Licensing and Pre-Licensing Services Systems Were Protected Against Operational and Security Risks	28
<b>Purchases and Disbursements</b>	
Finding 13 – Proper Internal Controls Were Not Established Over Purchases and Disbursement Transactions	30
<b>Information Systems Network</b>	
Finding 14 – Administrative Access to MIA’s Network Was Excessive	31
<b>Audit Scope, Objectives, and Methodology</b>	33
<b>Agency Response</b>	Appendix

\* Denotes items repeated in full or part from preceding audit report

# **Executive Summary**

## **Legislative Audit Report on the Maryland Insurance Administration (MIA) November 2014**

As a result of our audit, we determined that MIA's accountability and compliance level was unsatisfactory, in accordance with the rating system we established in conformity with State law.

- **The procurement of the new automated premium tax system did not comply with State procurement regulations governing competitive procurements and contract modifications. In addition, the system development and implementation proceeded without a plan and related specifications. While the new system provided certain new capabilities, other capabilities that were available in the former system were lost, which had adversely impacted operations (Finding 1). Furthermore, an MIA management employee exercised control over virtually all aspects of the procurement and implementation of the new premium tax system (Finding 2). MIA collected premium taxes totaling \$458 million during fiscal year 2014.**

MIA should ensure that future procurements comply with State procurement regulations; develop a comprehensive plan prior to system development including required functionality and cost estimates; and separate the procurement, contract monitoring, and invoice approval functions.

- **The premium tax system was not properly secured to restrict and control access. The premium tax system contractor had complete control over the system and unnecessary access to the remainder of the MIA network (Finding 3). In addition, MIA lacked assurance that the premium tax system was properly secured and configured to protect it from external threats and unauthorized changes (Finding 4).**

MIA should restrict access to the premium tax system, including the access provided to the contractor. MIA should also periodically obtain security vulnerability assessments and securely configure its servers and applications.

- **MIA had not established adequate controls over audits of premium tax filings, including a lack of independent supervisory review of audit results. Our tests of the results for 43 audits disclosed inaccuracies or documentation deficiencies with 11 audits, with premium tax payments totaling \$50.9 million, including the issuance of a duplicate account credit and failure to assess penalties and interest (Finding 5). In addition, procedures were not sufficient to ensure certain tax payments were received timely. Consequently, penalties and interest were not always assessed for late payments (Finding 6).**

MIA should establish controls to ensure premium tax audits are properly completed and that penalties and interest are assessed, as applicable.

- **MIA had not established proper internal controls over premium tax refunds. For example, certain refunds were approved and authorized for payment by the same supervisory employee and some refunds appeared to be duplicates (Finding 7). In addition, MIA did not reconcile its records of premium tax revenues with the corresponding State accounting records (Finding 8).**

MIA should establish controls to ensure independent supervisory personnel are responsible for approving refunds. In addition, MIA should reconcile its premium tax records with the corresponding State records.

- **Sufficient controls were not established for the issuance of producer licenses (Finding 11). MIA also lacked assurance that the outsourced producer and pre-licensing services systems were protected against operational and security risks (Finding 12).**

MIA should take the recommended actions to ensure the propriety of transactions recorded in the producer licensing system. In addition, MIA should seek to amend existing agreements to require service providers to obtain independent security assurance reports.

- **Effective controls were not established over financial examination services, cash receipts, purchases and disbursements, and IT network access (Findings 9, 10, 13, and 14).**

MIA should ensure that appropriate controls are established and followed.



## **Background Information**

### **Agency Responsibilities**

The Maryland Insurance Administration (MIA) operates under the authority of the Insurance Article, Title 2, of the Annotated Code of Maryland. MIA is responsible for licensing and regulating insurers, insurance agents, and brokers who conduct business in the State, and for monitoring the financial solvency of licensed insurers. MIA is also responsible for collecting taxes levied on all premiums collected by insurance companies within the State. According to MIA's records, as of June 30, 2014, there were 1,723 insurers authorized to conduct business in the State. MIA's records also indicated that direct premiums written by domestic and foreign companies operating in Maryland in calendar year 2014 totaled \$29.4 billion.

According to the State's records, during fiscal year 2014 MIA's revenues totaled \$489 million, including \$458 million of premium taxes, and its expenditures totaled \$29 million. As required by State law, MIA transferred \$338 million in revenue to the State's General Fund, \$123 million to the Maryland Health Care Rate Stabilization Fund, and \$28 million to the State's Insurance Regulation Fund in fiscal year 2014.

As the State's insurance regulator, MIA is responsible for overseeing and enforcing many of the requirements under the Patient Protection and Affordable Care Act (ACA). The federal ACA, as amended by the federal Health Care and Education Reconciliation Act of 2010, seeks to increase health insurance quality, reduce costs to individuals and the government, and lower the number of uninsured individuals by expanding public and private coverage options. During fiscal year 2013, MIA dedicated staff resources to the contract form and premium rate review of health insurance policies that are offered on the Maryland Health Benefit Exchange.

### **Status of Findings From Preceding Audit Report**

Our audit included a review to determine the status of seven findings contained in our preceding audit report dated June 22, 2011. We determined that MIA satisfactorily addressed three of the findings. The remaining four findings are repeated in this report.



## **Findings and Recommendations**

### **Premium Tax System**

#### **Background**

The Insurance Article of the Annotated Code of Maryland generally provides for the imposition of an annual tax on insurance companies for premiums derived from insurance business transacted in the State. According to Maryland Insurance Administration (MIA) records, premium taxes collected totaled approximately \$458 million during fiscal year 2014. Insurance companies are required to make estimated tax payments at specific intervals (quarterly) throughout the calendar year. By March 15 of each year, insurance companies are required to file a final tax return reporting premiums written during the preceding calendar year and remit any remaining premium taxes due to the State. Insurance companies that do not submit premium taxes by the due date are subject to interest charges and penalties in accordance with State law. Both the premium taxes and related interest and penalties are subject to subsequent audit by MIA.

For many years, MIA used a legacy premium tax system to record premium taxes reported by insurance companies on quarterly tax declaration forms and final returns that were mailed to MIA, along with their payments. In 2011, MIA's information technology (IT) staff began in-house development of a new system to provide additional automated capabilities, including allowing insurance companies to file the required tax declarations electronically and make statutorily required payments online. This in-house project was subsequently abandoned and, in February 2012, MIA implemented a new automated system created by a contractor under an agreement with MIA.

#### **Finding 1**

**The procurement of the new premium tax system did not comply with State procurement regulations and the project was not adequately planned.**

#### **Analysis**

MIA did not comply with State procurement regulations and did not exercise appropriate oversight when obtaining IT consultant services pertaining to the replacement of its legacy premium tax system. Specifically, in September 2011, MIA conducted an improper procurement process to hire a contractor to assist its IT staff with the in-house development of a new premium tax system. Furthermore, when the subsequent decision was made to abandon this project, MIA significantly changed the scope of the contractor's services without initiating a new competitive procurement process. The change required the same contractor to solely implement an entirely new proprietary premium tax system – a project that proceeded without the benefit of a project plan with related specifications and

cost estimates. While the new system had additional capabilities to allow insurance companies to electronically file the required tax forms and make statutorily required payments online, other capabilities that were available in the former legacy system were lost, which had adversely impacted operations. As of April 2014, MIA's contracts with this IT contractor were valued at approximately \$221,000 and related payments totaled \$210,300.

#### Improper Procurement of IT Consulting Services

MIA did not follow State procurement regulations when it solicited IT consulting services in September 2011 to create an online payment feature for the new premium tax system under development by MIA's IT staff. This would allow insurance companies to pay premium taxes through a web-based portal. Our review of the procurement process disclosed that the request for proposals did not identify the technical requirements and their relative importance for bid evaluation purposes, as required by regulations. MIA received two bids, including one from the aforementioned contractor. This contractor was subsequently awarded the contract even though two of the three employees who conducted the bid evaluations gave a higher rating to the unsuccessful bidder. The unsuccessful bidder also offered a lower hourly rate (\$68 per hour versus \$95 per hour). Furthermore, although both of those evaluators (who were MIA IT employees) indicated that neither bidder was technically qualified, the contract was awarded to the lower-rated and higher-cost bidder for \$25,000 without any documentation explaining the basis for the decision or the award amount as required by regulations. Since the contract did not exceed \$25,000, it was not subject to approval by the Department of Information Technology (DoIT).

#### Failure to Initiate New Procurement after Significant Scope Change

Shortly after the award, MIA decided to significantly change the scope of the contractor's services instead of soliciting a new procurement. Specifically, the contractor was directed to implement a new premium tax system using an insurance tax program developed and owned by the contractor and implemented in one other state. MIA advised that this decision was made because its internal premium tax system development project was not progressing, and the management employee overseeing the project was familiar with the contractor's product, having previously worked for this other state's insurance commissioner during the system's implementation. This decision was made despite the availability of other existing software applications, including one endorsed by the National Association of Insurance Commissioners. In addition, although the original procurement amount was increased, the change in scope was never documented or approved.

#### Lack of Formal Project Planning

A comprehensive development and implementation plan was not prepared for this new premium tax system, which became operational in February 2012 with basic functionality. Specifically, at the start of the project, MIA did not prepare documentation to outline the required system capabilities and features, including security safeguards, and did not establish maximum cost thresholds or deliverable dates. Consequently, MIA lacked assurance that the product would meet functionality requirements, including DoIT security requirements, and would facilitate its existing business operations. This may have contributed to a number of additional tasks and costs that were added to the project at various times over the 22 months following February 2012. While the system did enable insurance companies to report and pay taxes online, certain other capabilities of the former system were not implemented until 2013 or not at all. In our opinion, the implementation of the new premium tax system adversely affected operations and security controls as commented upon in Findings 3 and 5. For example, the capability of the previous system to automatically audit the premium tax information and to calculate amounts due based on prior year overpayments was lost.

#### Lack of Approval for Contract Modifications

MIA did not always justify and/or obtain appropriate approvals for related contract modifications. After the initial contract was executed for \$25,000, two modifications totaling \$24,940 were executed without justification for the modification and without seeking DoIT approval, which was required once the contract value exceeded \$25,000. After system installation and payment of the aforementioned \$49,940, MIA entered into a sole source contract for \$42,750 with the contractor to continue the implementation, which was approved by DoIT. While certain modifications to this sole source contract were approved by DoIT and the Board of Public Works (BPW), the last modification executed at the time of our review for \$48,100 was artificially split and entered into the State's records as two separate transactions in September and December 2013 and thus were not submitted for approval.

State procurement regulations generally require that all procurements over \$25,000 be competitively bid and that those exceeding \$200,000 be approved by BPW. State procurement regulations also require DoIT to approve all IT contract awards greater than \$25,000 and any modification that results in the cumulative contract amount exceeding \$25,000.

## **Recommendation 1**

**We recommend that MIA**

- a. comply with State procurement regulations governing competitive procurements and contract modifications and obtain BPW and DoIT approvals, as required;**
- b. ensure contract modifications are properly justified and not artificially split to avoid having to obtain required approvals; and**
- c. develop a comprehensive plan prior to further system development detailing the required functionality, planned deliverables, and cost estimates.**

## **Finding 2**

**An MIA management employee exercised excessive control over the procurement and implementation of the premium tax system.**

### **Analysis**

The MIA management employee who oversaw the premium tax system project discussed in Finding 1 influenced virtually all aspects of the procurement and implementation, and due to a familiarity with the contractor subsequently tasked with developing the new system, created the appearance of a conflict of interest. The management employee exercised excessive control over the procurement of the contractor initially hired to assist in the in-house development of a new tax system and authorized payments for work beyond the original scope, which resulted in the implementation of an existing proprietary premium tax system that this contractor had developed. The management employee was also responsible for monitoring the contractor's work, requesting contract modifications, and approving all contractor invoices for payment.

As previously mentioned, in September 2011, MIA procured the services of a contractor to assist its in-house IT staff with the development of an automated premium tax system. Prior to the decision to solicit these contractor services, this MIA management employee communicated with the contractor to obtain the contractor's hourly rate for similar services and referred the contractor to MIA management. While MIA decided it should conduct a formal solicitation, this contractor's financial proposal in response to the solicitation reflected the previously obtained hourly rate.

Furthermore, the management employee was on the three-member evaluation committee for this procurement. Although the other two evaluators, who were MIA IT employees, communicated to the management employee that neither bidder was qualified to assist with the in-house development project, the management employee recommended to the procurement officer, a direct

subordinate, that the contract be awarded to the other bidder. Certain documentation provided by MIA was insufficient to determine what ratings were given by the individual evaluators. MIA was also unable to provide us with documentation justifying the award except that, according to the procurement officer's solicitation summary, the winning bidder's technical proposal "was superior in the opinion of one evaluator," that evaluator being the management employee. The losing bidder's cost proposal was ranked higher (had a lower cost) by all three evaluators.

The original work set out in the contractor procurement was later abandoned, and this management employee recommended that the contractor instead install the contractor's proprietary premium tax system. The management employee was responsible for monitoring the contractor's work on this new system and for approving all contractor invoices for payment. The employee also initiated modifications to the scope of work and, as mentioned in Finding 1, several modifications did not include adequate justifications. These modifications were approved by the aforementioned procurement officer who was the management employee's subordinate.

The management employee advised us that knowledge of the premium tax system's capabilities and its successful implementation at the employee's former place of employment (another state) was what prompted the recommendation of this contractor and that the employee had only indirect knowledge of the contractor. According to this employee, the other state is the only state, other than Maryland, where this premium tax system is currently used.

Senior management personnel at the State Ethics Commission advised us that the aforementioned conditions could violate several of the State ethics laws. For example, Section 5-506 of the General Provisions Article of the Annotated Code of Maryland generally prohibits an employee from intentionally using the prestige of office or public position for that employee's private gain or that of another. Any final decision related to violations of the State ethics laws would ultimately be determined by the State Ethics Commission.

Furthermore, the Governor's Executive Order 01.01.2007.01 provides that State employees shall endeavor to avoid any actions creating the appearance that they are violating applicable laws or the ethical standards. This Order, dated February 14, 2007, requires that all departments and agencies of the State immediately report any instance of possible criminal or unethical conduct by an employee or contractor of the State to the Governor's Chief Counsel and to the Office of the Attorney General – Criminal Division.

## **Recommendation 2**

**We recommend that MIA**

- a. separate the duties over procurement functions, contract monitoring, and invoice approval functions, so that one individual does not maintain excessive control over each process; and**
- b. immediately refer this issue to the State Ethics Commission and comply with the Governor's Executive Order.**

**We advised MIA on accomplishing the necessary separation of duties using existing personnel.**

## **Finding 3**

**The premium tax system was not properly secured to restrict and control access. The premium tax system contractor had complete control over the system and unnecessary access to the remainder of the MIA network.**

## **Analysis**

The premium tax system was not properly secured to restrict and control access. The contractor responsible for the implementation and on-going operation and maintenance of the system had complete control over the system and had unnecessary access to the remainder of the MIA network.

- The contractor was responsible for program code development and placing the code into production without independent review or testing. The contractor, rather than MIA staff, was also responsible for database administration and server administration for the host server. As a result, the contractor could make unapproved changes to the production premium tax system and/or data without detection. In addition, the contractor and two MIA management operational employees (including the management employee mentioned in Finding 2) had unnecessary access to modify security settings in the premium tax system for themselves and other employees.
- The contractor was also defined as the primary administrator for the third-party online payment system (provided by a bank) used to process premium tax payments that automatically post to the premium tax system. Because of this capability, the contractor could issue credits through the payment system and alter the underlying records so that improper credits would not be readily detected. Our testing disclosed that no credits had been processed during our audit period through the third-party payment system.
- Finally, we noted that the contractor was improperly granted unrestricted access to the entire MIA internal network. Specifically, MIA allowed the



contractor access to the entire MIA network, over all ports, through a virtual private network (VPN). However, MIA's firewalls were not configured to limit this traffic to only devices and ports required by this contractor. A similar condition was commented upon in our preceding audit report with respect to the previous premium tax system.

The DoIT *Information Security Policy* states that agencies must ensure that the systems enforce separation of duties through assigned access authorizations. Agency systems must enforce the most restrictive access capabilities required for specified tasks. The *Policy* also mandates that agencies ensure that only authorized individuals (employees or agency contractors) have access to confidential information and that such access is strictly controlled, audited, and that it supports the concepts of "least possible privilege" and "need to know."

### **Recommendation 3**

**We recommend that MIA**

- a. establish appropriate review and testing procedures for program code developed by contractors, ensure only code approved by MIA supervisory personnel is placed into production, and ensure proper controls are maintained over database and server administration;**
- b. remove security modification access to the system from the contractor and MIA operational employees and assign it to appropriate MIA IT personnel;**
- c. immediately remove the contractor's administrator access to the premium tax third-party payment system and assign such access to an appropriate MIA employee; and**
- d. configure its firewalls to filter VPN traffic and limit contractor access to only those devices and ports involved with the contractor's support activities (repeat).**

### **Finding 4**

**MIA lacked assurance that the premium tax system was properly secured and configured to protect it from external threats and unauthorized changes.**

### **Analysis**

MIA did not adequately secure and configure the premium tax system application, host server, and database to protect against external threats and unauthorized changes.

- Web application vulnerability assessments had not been performed to help identify the existence of potentially serious security vulnerabilities within the premium tax system application's program code. In addition, a web

application firewall was not used to protect the application and the related database. As a result, the application could contain security vulnerabilities which, if exploited, could result in improper changes to and unauthorized disclosure of critical data.

- The premium tax system host server, database, and application were not configured securely. For example, the application was using the database default administrator account to connect to the premium tax system database and, as a result, the application had excessive privileges on the database and could even delete the database. In addition, all of the approximately 2,774 customer userids and passwords were stored in clear text and were not encrypted.
- The database was not configured to log any critical database security activity such as failed login attempts, direct changes to critical data tables, changes to database security settings, and use of certain critical privileges. These conditions could result in unauthorized or inappropriate activities affecting the integrity of the production database information going undetected by management.
- Neither the premium tax system database nor its host server was updated for numerous security-related patches. For example, as of December 2, 2013, our review disclosed that the server's operating system software had not been patched for a period of 964 days. Accordingly, the operating system was not updated for 144 operating system security-related software updates.
- MIA's account and password controls over the premium tax system application and database were not sufficient. Specifically, the database configuration did not require users to comply with database password rules. Additionally, certain account and password settings for both the application and the database were not in compliance with the DoIT *Information Security Policy*. For example, password length and complexity for both the application and database either were not enabled or were not set in accordance with DoIT requirements. In addition, both the application and database did not support the use of account logout.

The DoIT *Information Security Policy* states that agencies shall create and maintain system hardening procedures to ensure up-to-date security best practices are deployed at all levels of IT systems (operating systems, applications, databases, and network devices).

#### **Recommendation 4**

**We recommend that MIA**

- a. periodically obtain security vulnerability assessments for the application code, remediate all confirmed vulnerabilities identified by the assessments, document these processes, and retain this documentation for future reference;**
- b. use a web application firewall to gain additional security protection;**
- c. securely configure the premium tax system host server, database, and application;**
- d. configure the premium tax system database to log critical security activity, periodically perform independent reviews of these logs, document these reviews, and retain this documentation for future reference;**
- e. update the premium tax system database and host server for all security-related patches; and**
- f. implement strong controls over accounts and passwords that are in accordance with the requirements of the DoIT *Information Security Policy*.**

### **Administration of Premium Tax Filings**

#### **Background**

According to State law, insurance companies must file their final premium tax returns by March 15 of each year. In addition, companies are required to file quarterly estimated tax declarations and make quarterly payments if their total tax liability for the current year is reasonably expected to exceed \$1,000. MIA primarily accepts payments via electronic check or paper check. Electronic check payments are processed through a third-party online payment system, which automatically updates the payment history in the premium tax system. Paper checks are manually input to the premium tax system by MIA.

MIA conducts desk audits of each insurance company's annual tax return. The audits are conducted to ensure that premiums written as recorded on the tax return agree to premiums reported to a third-party database (National Association of Insurance Commissioners - NAIC) to ensure that both quarterly and final premium tax payments were made on time and for appropriate amounts, and to initiate refunds for tax overpayments. According to State law, MIA has up to three years from the tax return due date to audit the filed tax returns to assess any additional taxes owed and any penalties and interest. If payments exceed taxes owed, MIA issues a refund to the company. According to MIA records, as of October 2013, MIA completed 1,909 audits of 2011 and 2012 tax returns with taxes paid totaling \$488.4 million.

**Finding 5**

**MIA had not established adequate controls over audits of premium tax filings. Our tests of the audit results disclosed a number of errors, including the issuance of a duplicate account credit and failure to assess penalties and interest.**

**Analysis**

MIA had not established adequate controls over audits of premium tax filings. In addition, our tests of the audits conducted disclosed numerous errors that included the issuance of a duplicate account credit and the failure to identify reporting discrepancies and assess interest and penalties as provided by law. In our opinion, the loss of automated auditing capabilities, which were previously available in the former premium tax system, coupled with the failure to institute sufficient controls over the new manual audit process, contributed to the audit errors.

Our review of controls identified two MIA employees had the capability to record tax payments in the premium tax system and were also responsible for performing and finalizing tax audits without independent review. As a result, improper information could be recorded in the premium tax system which could lead to the issuance of inappropriate refund checks by MIA. Furthermore, one of these two employees both performed and finalized the same audits for a six-month period (January 2013 through June 2013). During this time, we noted audits of 91 tax returns with premium tax payments totaling \$113.8 million related to tax years 2011 and 2012 that were performed and approved by this employee. We were advised this was the result of an inadequate number of supervisory personnel available due to vacancies.

Additionally, we noted that certain limitations of MIA's premium tax system precluded adequate accountability over changes made to recorded data. Specifically, after audits were finalized, changes could be made to the tax records of individual companies maintained on the system without supervisory approval and a historical record of those changes.

We tested the audits conducted of 43 tax returns for tax years 2011 and 2012 for companies with premium tax payments totaling \$141.7 million. Our test disclosed inaccuracies or documentation deficiencies with 11 audits, with payments totaling \$50.9 million, of which 6 audits were not subject to independent supervisory review. (Some of these audits contained more than one deficiency.)

- Our review of the audit performed of one 2011 tax return disclosed that a credit was improperly applied to the account of one company, which resulted in a refund. Specifically, a \$403,000 refund was properly authorized to the

company for overpayments related to its calendar years 2008 through 2010 returns. However, these overpayments were also credited to the company during the 2011 calendar year audit. In this regard, the credit was applied against the 2011 tax liability for that year, which was \$190,000, and the balance of \$213,000 was refunded to the company. MIA personnel were unaware of this situation until we brought it to their attention.

- For 7 audits of premium tax returns with payments totaling \$41.6 million (6 of which were performed by the aforementioned employee without independent approval), MIA did not assess penalties and interest assessments totaling approximately \$158,000 for late tax payments and underpayments related to the final tax return. In addition, based on our expanded test of 5 other audits, we determined that MIA did not always ensure that companies remitted the proper tax amounts in their quarterly tax declarations in accordance with State law. Our test of 25 tax payments (quarterly and final payments by these 5 companies) totaling \$21.7 million, made for premiums written in calendar year 2011, disclosed that 7 payments totaling \$2.8 million did not include the proper amounts throughout the year or were paid late. These conditions should have resulted in penalties and interest totaling \$125,000 being assessed. No explanation regarding the failure to assess these penalties and interest, or documentation indicating the State Insurance Commissioner had waived the penalties and interest as allowed by State law, were provided.
- For 2 audits of premium tax returns with payments totaling \$14 million, MIA did not identify differences between the premiums written according to the tax returns and the companies' self-reported premiums recorded in NAIC's database. Because the tax payments are based on premiums written, differences could indicate improper premium tax remittances which could have resulted in penalties and interest being assessed. MIA was unaware of these differences until we brought them to its attention. Based on the premiums reported in the national regulatory database, these two companies underpaid taxes totaling \$70,200.

Unlike MIA's former premium tax system, the new system that was implemented in February 2012 could not perform the audit function. An automated audit function would help ensure that duplicate credits are not applied and the amounts of premiums written according to the tax returns agrees to those reported to the NAIC. As a result, the audit function was performed manually, which made the process more prone to errors.

## **Recommendation 5**

### **We recommend that MIA**

- a. ensure that the individuals responsible for auditing transactions do not have the capability to record tax payments in the premium tax system;**

- b. ensure that premium tax audits are reviewed by independent supervisory personnel;**
- c. ensure that changes to approved tax audits are approved by supervisory personnel and that a historical record of the changes is maintained;**
- d. impose penalties and interest unless a waiver is approved by the State Insurance Commissioner;**
- e. ensure that companies remit the proper quarterly tax payments and that penalties and interest are properly assessed, as applicable;**
- f. ensure that premiums reported on the tax filings agree with the NAIC's database and any differences are resolved; and**
- g. review the aforementioned discrepancies and take corrective action.**

#### **Finding 6**

**Procedures were not sufficient to ensure certain premium tax payments were received timely.**

#### **Analysis**

MIA had not established procedures to ensure certain premium tax payments were received by the due dates established in State law. Specifically, MIA had not established procedures to document the date of receipt of premium tax payments for payments received in the mail. State law requires estimated and final tax payments to be postmarked by the required filing dates. However, MIA used the date the premium tax payments were processed on the system rather than the postmark dates to determine whether taxes were paid timely. The former date was used, in part, because the premium tax system did not have a dedicated data field in which the postmark date could be entered for mailed-in payments.

Our test of 27 payments totaling \$7.4 million received in the mail between April 2011 and March 2013 disclosed that MIA did not record a postmark date for any of the payments in the premium tax system. We were able to verify that 5 of the payments were received timely because MIA had retained the envelopes; however, no documentation existed for the remaining 22 payments showing the postmark date. Nine of the 22 payments, totaling \$4.5 million, appear to have been received late based on the dates recorded by insurance companies on the tax declaration statements (that is, the dates on the documents were subsequent to the filing deadlines). Based on these dates, penalties and interest totaling \$156,000 could have been assessed.

Since the postmark date was not recorded, we were advised by MIA management that it had decided not to assess penalties and interest for tax returns processed within 10 days of the required filing date for all March 15, 2013 final tax returns and within 5 additional days of the required filing date for all subsequent

quarterly tax declaration payments. In January 2013, via postings on its website, MIA discouraged insurance companies from making payment by direct fund transfers (ACH credit payments) because of difficulties reconciling the related records. We noted the number of check payments received through the mail increased significantly from \$14.3 million in the month of June 2012 to \$39.8 million in the month of June 2013.

As a result of the aforementioned deficiencies, MIA did not maximize recoveries of penalties and interest due to the State for late payments made by insurance companies. Total penalties and interest assessed in fiscal year 2013 was \$930,000.

#### **Recommendation 6**

**We recommend that MIA**

- a. record the postmark date of premium tax payments so that a determination can be made regarding the timeliness of payments in accordance with law, and**
- b. assess penalties and interest for any late payments, as required.**

#### **Finding 7**

**MIA had not established proper internal controls over premium tax refunds.**

#### **Analysis**

MIA had not established proper internal controls over premium tax refunds determined by the related tax audits. As a result, improper refunds could be made without detection. Our test of 27 refunds totaling \$7.8 million issued during the period from December 2011 through July 2013 disclosed the following conditions:

- Ten refunds totaling \$4.1 million were approved and released for payment by the same supervisory employee between June and November 2012. Based on our tests, these ten refunds appeared proper. In December 2012, MIA changed its procedure to require that refunds be approved and released by different employees. However, procedures over premium tax refunds were still not adequate. Specifically, the supervisory employee who approved all refund request forms was not independent since the employee had full access to the premium tax system, including the ability to modify the mailing address where a refund would be sent. Although refunds were released for payment by a second supervisory employee, this employee did not review the approved audit results in the premium tax system on which the refunds were based to confirm that refunds were proper, but relied on the refund request form approved by the aforementioned employee.

- Five refunds totaling approximately \$146,000, issued between August and November 2012, appeared to be duplicates of previously issued refunds. Four of the five checks were cashed by the receiving insurance companies. MIA could not explain how the duplicate refunds occurred and, as of January 16, 2014, these overpayments had not been recovered. We expanded our review to all 930 refunds, totaling \$45.3 million, made during our audit period, and we identified a total of 28 potential duplicate payments (that is, same payment amounts and payees) totaling approximately \$361,000.

Beginning in March 2012 (final return filing for tax year 2011), MIA discontinued applying overpayments to future year tax assessments, resulting in a significant increase in refunds issued from \$6.4 million in fiscal year 2011 to \$21 million in fiscal year 2012.

### **Recommendation 7**

**We recommend that**

- an independent supervisory employee who does not have access to the premium tax system be responsible for releasing refunds for payment based on a review of the audit results, and**
- duplicate refunds issued be investigated and appropriate actions be taken to recover the overpayments.**

### **Finding 8**

**MIA did not reconcile its records of premium tax revenues with the corresponding State accounting records.**

### **Analysis**

MIA did not reconcile its records of premium tax revenues with the corresponding State accounting records. As a result, there was a lack of assurance that all revenues were properly reflected in the premium tax system and in the State's accounting records.

Premium tax checks received in the mail and direct fund transfers (ACH credits) are manually posted to the State's accounting records; MIA separately posts these transactions to the premium tax system. However, MIA did not reconcile these transactions in the State's records with the premium tax system. Our test of 64 payments totaling \$27.3 million reflected in the State's records that were received during the period between June 2012 and July 2013, disclosed 33 payments totaling \$15.7 million that were not recorded in the premium tax system as of September 12, 2013.



MIA also did not reconcile the receipt of electronic checks processed through its third-party online payment system with the State's accounting records. Payments processed online post automatically to the premium tax system, even if the payment ultimately fails to clear the paying bank. Failed payments are identified by the State Treasurer's Office and posted to the State's accounting records and are to be investigated by MIA personnel and then manually posted to the premium tax system as a chargeback. We tested five chargebacks posted in the State's accounting records totaling \$16.4 million, received in fiscal years 2012 and 2013; our test disclosed one chargeback totaling \$2.2 million recorded in the State's records on March 19, 2012 that was not recorded in the premium tax system as of January 2014. Although the chargeback was not reflected in the premium tax system, we determined that MIA subsequently identified the failed payment during the desk audit of the company's tax return and made appropriate adjustments.

Critical tax data posted to the premium tax system, such as amounts due and paid, are used when conducting periodic premium tax audits, and for collecting additional taxes due or issuing refunds for overpayments. Consequently, it is imperative that all such data be accurately recorded. The lack of comprehensive reconciliations has been commented upon in our six preceding audit reports dating back to November 1996.

#### **Recommendation 8**

##### **We recommend that MIA**

- a. reconcile its premium tax records with the corresponding State records (repeat), and**
- b. investigate the aforementioned differences and take appropriate action.**

## **Financial Examination Services**

### **Background**

The Insurance Article, Title 2, of the Annotated Code of Maryland requires MIA to conduct financial examinations of the approximately 70 insurance companies, health management organizations, and managed care organizations domiciled in Maryland at least once every five years. The purpose of these examinations is to ensure the continued financial solvency of the insurers and compliance with State law and requirements of the NAIC. MIA's Examinations and Audits (E&A) unit is responsible for these examinations.

To supplement E&A employees in conducting the financial examinations, MIA routinely contracted with certain pre-approved vendors for additional personnel. Specifically, in September 2011, the Board of Public Works approved a three-year master contract, valued at \$9.5 million, with six pre-approved vendors. The

contract included five different levels of assistance (staff employee, senior examiner, examiner-in-charge, senior management, and assistant chief examiner). Each vendor bid a specific hourly rate for each level of assistance, based on an estimated number of hours as stated in the related MIA solicitation. Work was awarded to the vendors as needed and a minimum level of work was not guaranteed.

Assistance for individual examinations was awarded using task order requests for proposals. All six of the pre-approved vendors are solicited for individual examinations. The requests for proposals include the actual prior audit time and, based on projected start and end dates of the examination, the number of staff and the levels of assistance needed to supplement MIA personnel. The vendors' responses include a technical proposal describing the experience levels of available personnel with the specific type of examination, and a financial proposal stating the number of hours needed by each level of assistance to complete the examination. The vendor with the highest overall rating is awarded the task.

The selected vendor performs the work described in the task order agreement in cooperation with and subject to the supervision of MIA personnel who are responsible for the planning and overall monitoring of the individual examinations. In addition, the MIA project manager coordinates and oversees all examination task orders and related billings. As of April 10, 2014, 18 task orders had been issued through this master contract with related payments totaling \$4.7 million.

#### **Finding 9**

**Sufficient controls were not established over financial examination services task order awards and modifications.**

#### **Analysis**

Controls over the awarding and modifying of task orders for financial examination services were not adequate and the MIA project manager exercised excessive control over these processes. Specifically, the project manager who monitored contract activity and authorized vendor payments was primarily responsible for evaluating task order proposals, compiling the evaluation results, recommending task order awards, and requesting any subsequent contract modifications. Effective independent oversight was not exercised to help ensure the integrity of the award and contract modification decision processes. The process for evaluating proposals for individual task orders was controlled by the project manager. The proposals submitted by the pre-approved vendors were rated by an evaluation committee consisting of the project manager and two subordinates. The project manager compiled the ratings of the evaluation

committee and notified the procurement officer of the results. However, the procurement officer did not perform an independent review of the evaluation results before awarding the task orders. Rather, the procurement officer relied on the project manager's recommendation without determining whether there was appropriate support. Our review of the ratings for the winning vendors for the 18 task order proposals totaling \$5.3 million disclosed that, in each instance, certain evaluations were missing, and 9 evaluations for task orders totaling \$2.3 million were not dated or signed by the evaluators. Furthermore, there was no documentation of the project manager's own ratings for any of the proposals. We also noted that certain proposals from winning vendors included services that were not originally requested. MIA was subsequently advised by legal counsel that such proposals should be disqualified by the evaluation committee.

In addition, task order modifications were approved without adequate justifications. Specifically, 5 of the 18 task orders were subsequently increased by \$1.3 million, representing an increase of 140 percent over the original 5 task order amounts. Our review disclosed that the project manager's requests for contract modifications did not sufficiently explain the need for the increases in cost, and the procurement officer accepted these requests when approving the modifications without obtaining additional details. For example, one task order that was originally issued for \$217,508 was later modified to \$800,000. The request did not specify what additional work was necessary or which levels of assistance would be increased.

#### **Recommendation 9**

**We recommend that MIA**

- a. establish effective independent oversight of the task order award and contract modification functions so that one individual does not maintain excessive control over the related decisions,**
- b. retain adequate documentation of the task order proposal evaluation ratings and decisions, and**
- c. ensure that task order modifications are adequately justified.**

## Cash Receipts

### **Finding 10**

#### **MIA lacked accountability and control over certain cash receipts.**

#### **Analysis**

MIA lacked accountability and control over cash receipts received at its office. According to the State's records, MIA's cash receipts totaled approximately \$154 million during fiscal year 2013, with the vast majority of these collections consisting of mail receipts of premium taxes, insurance company assessments, and licensing fees.

- Checks received in the mail were not recorded immediately upon receipt. Instead, the checks were forwarded to another employee before being recorded in a log. In addition, we noted that some checks were not recorded in the log but were instead posted directly to the State's accounting records. Our test of 15 deposits totaling \$52.7 million, received between September 2012 and June 2013, disclosed that the checks included in two deposits totaling \$12.5 million were not recorded.
- Collections were not always deposited timely. Our aforementioned test of 15 deposits noted 223 individual premium tax payments totaling \$21 million that were deposited from three to eight days after the dates received.
- Deposit verifications were performed by the employee who recorded the checks in the log, rather than by an employee independent of the receipt and deposit functions. Although MIA advised us that new procedures were established in July 2013 to ensure collections were deposited, our review of those procedures disclosed that the verification process was not sufficient.

Similar conditions regarding the lack of initial recordation and an independent verification of cash deposits were commented upon in our preceding audit report. As a result of the above-noted deficiencies, there is a lack of assurance that all receipts were deposited and properly accounted for.

#### **Recommendation 10**

**We recommend that MIA ensure that**

- a. cash receipts are immediately recorded when received (repeat),**
- b. collections are deposited in a timely manner, and**
- c. an employee independent of the cash receipts function performs and documents the deposit verifications (repeat).**

**We advised MIA on accomplishing the necessary separation of duties using existing personnel.**

## **Producer Licensing**

### **Background**

The Producer Licensing Unit issues licenses to qualified resident and nonresident individuals and business entities to act as insurance producers. Insurance producers sell, solicit, or negotiate insurance contracts and contract renewals for persons issuing such contracts for compensation. MIA is responsible for licensing producers who meet requirements set forth in State law, such as education and experience, and who pass an examination given by MIA. A producer must be licensed in each category of insurance (for example, life, accident) in which the producer transacts business. Most licenses are issued for a two-year period. In fiscal year 2013, 68,198 producer licenses were issued or renewed, with related collections totaling approximately \$2.1 million.

Since December 5, 2009, MIA has contracted with the NAIC to use its producer licensing system for all producer information, demographics, contacts, and license status. The vast majority of applicants for a producer license apply online through this system. For applicants who apply through the mail, MIA employees manually enter application and payment data and update licensee demographic data and qualifications into the system. MIA also contracted with a pre-licensing services vendor to provide a standardized electronic examination system to include application processing, online examinations, examination grading, and reporting. The contract provides for the vendor to be compensated with a portion of the exam fees paid by individual applicants. The vendor received approximately \$247,000 in fiscal year 2013 for the administration of approximately 9,900 pre-licensing exams.

### **Finding 11**

**Sufficient controls were not established for the issuance of producer licenses.**

### **Analysis**

Sufficient controls were not established for the issuance of insurance producer licenses. As a result, improper transactions could be recorded in the producer licensing system without detection and could result in the improper issuance of licenses.

- We were advised that the individual who recorded receipts in the producer licensing system from applicants who applied through the mail also reconciled licensing receipts recorded in the system with receipts recorded in the State's accounting records. This individual was not independent and the reconciliations performed were not documented and subject to supervisory review.

- Five employees had the capability to both process (edit) and approve license applications that were flagged during the online application process. Online applications are flagged under certain circumstances (such as when there are questions regarding eligibility). Although we were advised by MIA management that all licenses are subject to a supervisory review, this review is limited to a small number (such as less than one percent) of licenses and, therefore, would not necessarily include licenses processed by the aforementioned five employees. A total of 181 applications were reviewed for licenses issued in calendar year 2013.

#### **Recommendation 11**

**We recommend that MIA ensure that**

- a. reconciliations of all license fees as recorded in the State's accounting records with the fees recorded in the producer licensing system are performed by an independent employee and are documented, and**
- b. capabilities to process and approve licenses are separated.**

**We advised MIA on accomplishing the necessary separation of duties using existing personnel.**

#### **Finding 12**

**MIA lacked assurance that the insurance producer licensing and pre-licensing services systems were sufficiently protected against operational and security risks.**

#### **Analysis**

MIA lacked assurance that any operational and security risks related to the insurance producer licensing and pre-licensing systems had been identified and corrected, as necessary. Specifically, MIA had not performed security reviews of the service providers' operations, or as an alternative, obtained any reports resulting from independent reviews conducted of either system. Furthermore, the agreements between MIA and each of the two service providers did not require that comprehensive, independent reviews be performed of the systems. Consequently, there was no assurance that the service providers had established controls to secure MIA data, including personally identifiable information such as social security numbers. Appropriate controls would ensure that

- intrusion detection, malware prevention, vulnerability scanning, and patch management have been implemented;
- reports of authorized and unauthorized access attempts, and other security and audit events, are reviewed on a regular basis;

- policies and procedures for user account and password controls are in accordance with Maryland government or industry best practices;
- documented policies and procedures exist and have been implemented for business continuity and/or disaster recovery; and
- system data are backed up, encrypted, and stored offsite in an appropriate facility, and that such backup and storage procedures are tested regularly.

The American Institute of Certified Public Accountants has issued guidance concerning examinations of service organizations. Based on this guidance, service organizations (like the aforementioned service providers) may contract for an independent review of controls and the resultant independent auditor's report is referred to as a Service Organization Controls (SOC) report. There are several types of SOC reports, with varying scope and levels of review and auditor testing. One type of report, referred to as a SOC 2 Type 2 report, includes the results of the auditor's review of controls placed in operation and tests of operating effectiveness for the period under review and could include an evaluation of system security, availability, processing integrity, confidentiality, and privacy. Due to the nature and sensitivity of the information contained in the insurance producer licensing and pre-licensing systems, we believe a SOC 2 Type 2 report would be appropriate. A similar situation regarding the failure to address certain security and operational risks of the service providers was commented upon in our preceding audit report.

## **Recommendation 12**

### **We recommend that MIA**

- seek to amend the existing agreements and ensure that future agreements with service providers processing MIA data include provisions requiring the service providers to regularly obtain SOC 2 Type 2 reviews pertaining to their system operations (repeat), and**
- obtain and review copies of these SOC 2 Type 2 reports from the service providers and ensure that the related independent reviews adequately address critical security concerns over each system and that the service providers implement all critical report recommendations.**

## Purchases and Disbursements

### **Finding 13**

**MIA did not establish proper controls over purchases and disbursements and did not always comply with State procurement regulations.**

#### **Analysis**

Proper internal controls were not established over purchases and disbursements, and MIA did not always comply with State procurement regulations. Specifically, MIA did not establish approval paths for all purchases in the State's Financial Management Information System (FMIS), as one employee had the capability to initiate and approve purchase orders in two departments without independent approval. Within those two departments, we noted purchase orders processed without independent approval for which payments totaled approximately \$701,000 in fiscal year 2013. Furthermore, two employees responsible for approving purchase orders online through FMIS for all other departments, advised us that they did not review supporting documentation, such as requisitions, bidding quotes, and contracts, to verify the propriety of the purchases and compliance with State procurement regulations.

Our test of 15 contracts awarded during our audit period totaling \$749,000 found that, for 5 contract awards totaling \$298,000, MIA did not comply with certain procurement regulations. For example, MIA awarded two information technology (IT) services contracts totaling \$161,000 without obtaining DoIT approval, and Board of Public Works' (BPW) approval was not obtained for one of the two (valued at \$131,000) that was a sole source award. MIA also could not provide a sole source justification for that contract.

We also noted that temporary personnel services totaling \$390,000 were routinely procured without obtaining competitive bids and executing a written contract. We were advised by MIA that the chosen vendor had provided similar services since fiscal year 2011. Consequently, there is a lack of assurance that the State obtained these services at the best value.

Finally, the two employees responsible for approving all MIA disbursements advised us that they did not always verify that goods and services purchased were received prior to approving invoices for payment. Our test of 20 invoices totaling approximately \$661,000, paid between April 2012 and August 2013, disclosed that 10 invoices, totaling approximately \$397,000, lacked support evidencing that these individuals had determined that the goods or services had been received.

According to the State's accounting records, MIA processed disbursements totaling \$20.6 million through FMIS during fiscal year 2013. State procurement



regulations require that any IT contract award (hardware, software, and related services) over \$25,000 be submitted to DoIT for approval. In addition, the regulations require that all sole source contracts exceeding \$100,000 be presented to the BPW and that the reasons for sole source procurements be documented. Finally, State procurement regulations generally require that competitive bids be obtained for all procurements over \$5,000 and that written contracts be prepared.

### **Recommendation 13**

**We recommend that MIA**

- a. establish independent online approval requirements for all critical purchasing transactions;**
- b. ensure adequate supporting documentation is reviewed to verify the propriety of critical transactions such as purchase orders and invoices; and**
- c. comply with the requirements of the State procurement regulations and DoIT policies by obtaining the appropriate approvals, providing sole source justifications when needed, and conducting competitive procurements when required.**

## **Information Systems Network**

### **Background**

MIA's Management Information Systems Division manages the development, maintenance, and support of the MIA IT infrastructure including all related networking and telecommunications systems. The Division maintains a network which includes email, application and database services, and connectivity to the Internet. MIA's critical systems include the premium tax system, the producer licensing system, and the enterprise system which is used for licensing, complaints, and case tracking.

### **Finding 14**

**Administrative access to MIA's network was excessive.**

### **Analysis**

Administrative access to MIA's network was excessive. Specifically, we noted that six accounts (assigned to five different individuals) were improperly classified as domain administrators. Accounts that are domain administrators are the most powerful and privileged accounts in the system. As a result of this condition, these accounts had administrative control over all MIA domain resources and could make unauthorized modifications to critical data without detection.

The DoIT *Information Security Policy* states that each agency must establish an authorization process which specifically grants access to information ensuring that access is strictly controlled, audited, and that it supports the concepts of “least privilege possible” and “need-to-know.”

**Recommendation 14**

**We recommend that domain administrator privileges only be assigned to users requiring such privileges.**

## **Audit Scope, Objectives, and Methodology**

We have conducted a fiscal compliance audit of the Maryland Insurance Administration (MIA) for the period beginning September 29, 2010 and ending August 4, 2013. The audit was conducted in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

As prescribed by the State Government Article, Section 2-1221 of the Annotated Code of Maryland, the objectives of this audit were to examine MIA's financial transactions, records and internal control, and to evaluate its compliance with applicable State laws, rules, and regulations.

In planning and conducting our audit, we focused on the major financial-related areas of operations based on assessments of significance and risk. The areas addressed by the audit included purchases and disbursements, cash receipts, information systems security and control, accounts receivable, premium tax audits, and producer licensing and examinations. We also determined the status of the findings included in our preceding audit report.

To accomplish our audit objectives, our audit procedures included inquiries of appropriate personnel, inspections of documents and records, observations of MIA's operations, and tests of transactions. We also performed various data extracts of pertinent information from the State's Financial Management Information System (such as revenue and expenditure data). The extracts are performed as part of ongoing internal processes established by the Office of Legislative Audits and were subject to various tests to determine data reliability. We determined that the data extracted from these various sources were sufficiently reliable for the purposes the data were used during this audit. Finally, we performed other auditing procedures that we considered necessary to achieve our objectives. Data provided in this report for background or informational purposes was not assessed.

MIA's management is responsible for establishing and maintaining effective internal control. Internal control is a process designed to provide reasonable assurance that objectives pertaining to the reliability of financial records, effectiveness and efficiency of operations including safeguarding of assets, and compliance with applicable laws, rules, and regulations are achieved.

Because of inherent limitations in internal control, errors or fraud may nevertheless occur and not be detected. Also, projections of any evaluation of internal control to future periods are subject to the risk that conditions may change or compliance with policies and procedures may deteriorate.

Our reports are designed to assist the Maryland General Assembly in exercising its legislative oversight function and to provide constructive recommendations for improving State operations. As a result, our reports generally do not address activities we reviewed that are functioning properly.

This report includes findings relating to conditions that we consider to be significant deficiencies in the design or operation of internal control that could adversely affect MIA's ability to maintain reliable financial records, operate effectively and efficiently, and/or comply with applicable laws, rules, and regulations. Our report also includes findings regarding significant instances of noncompliance with applicable laws, rules, or regulations. Other less significant findings were communicated to MIA that did not warrant inclusion in this report.

As a result of our audit, we determined that MIA's accountability and compliance level was unsatisfactory. The primary factors contributing to the unsatisfactory rating were the significance of our audit findings, and the number of repeat audit findings from our preceding report. Our rating conclusion has been made solely pursuant to State law and rating guidelines approved by the Joint Audit Committee. The rating process is not a practice prescribed by professional auditing standards.

MIA's response to our findings and recommendations is included as an appendix to this report. As prescribed in the State Government Article, Section 2-1224 of the Annotated Code of Maryland, we will advise MIA regarding the results of our review of its response.

## APPENDIX

MARTIN O'MALLEY  
Governor

ANTHONY G. BROWN  
Lt. Governor



THERESE M. GOLDSMITH  
Commissioner

NANCY GRODIN  
Deputy Commissioner

200 St. Paul Place, Suite 2700, Baltimore, Maryland 21202  
Direct Dial: 410-468-2090 Fax: 410-468-2020  
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[www.mdinsurance.state.md.us](http://www.mdinsurance.state.md.us)

November 19, 2014

*Via Hand Delivery and Email*

Mr. Thomas J. Barnickel III, CPA  
Legislative Auditor  
Department of Legislative Services  
301 W. Preston Street, Room 1202  
Baltimore, Maryland 21201

RE: Maryland Insurance Administration Response  
To Draft Legislative Audit Report

Dear Mr. Barnickel:

Thank you for your letter dated October 31, 2014 regarding the draft audit report on the Maryland Insurance Administration (MIA) for the period beginning September 29, 2010 and ending August 4, 2013.

In accordance with the Joint Audit Committee's *Policy on Agency Responses to Reports Issued by the Office of Legislative Audits*, enclosed please find MIA's response as required.

Should you have any questions or need further information, please contact me at 410-468-2090.

Very truly yours,

A handwritten signature in black ink that reads "Therese M. Goldsmith". The signature is written in a cursive, flowing style.

Therese M. Goldsmith  
Insurance Commissioner

Enclosure

cc: Nancy Grodin, Deputy Commissioner, MIA

**Maryland Insurance Administration**  
**Response to Legislative Fiscal Compliance Audit Report**  
**November 19, 2014**

The Maryland Insurance Administration's ("MIA") responses to each finding and corresponding recommendation contained in the Legislative Fiscal Compliance Audit Report (the "Report") for the period beginning September 29, 2010 and ending August 14, 2013 are set forth below. The MIA takes seriously the findings in the Report and, as evidenced below, has corrected or is working to correct the issues noted. The Report contains 14 recommendations, which are comprised of 42 sub-recommendations. As of November 19, 2014, the MIA has implemented more than two-thirds of the 42 sub-recommendations, and is in the process of implementing the remaining sub-recommendations.

**Finding 1:**

The procurement of the new premium tax system did not comply with State procurement regulations and the project was not adequately planned.

**Recommendation 1:**

We recommend that the MIA

- a. comply with State procurement regulations governing competitive procurements and contract modifications and obtain BPW and DoIT approvals, as required;
- b. ensure contract modifications are properly justified and not artificially split to avoid having to obtain required approvals; and
- c. develop a comprehensive plan prior to further system development detailing the required functionality, planned deliverables, and cost estimates.

**MIA Response:**

The MIA agrees with Finding 1 and the corresponding recommendation. The MIA has implemented organizational changes, personnel changes, and new procedures to ensure compliance with all state procurement regulations and requirements governing competitive procurements and contract modifications. Specifically, the MIA has hired a new Procurement Officer, who shall work within the Office of the Commissioner and will report directly to the Deputy Commissioner. Beginning September 2014, the MIA also commenced monthly procurement meetings that include the Commissioner, Deputy Commissioner, Procurement Officer, the MIA's Principal Counsel, and an Assistant Attorney General with experience in procurement law. At each meeting, participants review the status of active procurements, identify the parameters of anticipated future procurements, and ensure compliance with all applicable legal and procedural requirements. All information technology system procurements must be supported by a comprehensive plan detailing the required functionality, planned deliverables, and cost estimates.

**Finding 2:**

An MIA management employee exercised excessive control over the procurement and implementation of the premium tax system.

**Recommendation 2:**

We recommend that MIA

- a. separate the duties over procurement functions, contract monitoring, and invoice approval functions, so that one individual does not maintain excessive control over each process; and
- b. immediately refer this issue to the State Ethics Commission and comply with the Governor's Executive Order.

**MIA Response:**

The MIA agrees with Finding 2 and the corresponding recommendation. The MIA's procurement function now resides in the Office of the Commissioner, and the Procurement Officer reports directly to the Deputy Commissioner. Contract monitoring functions reside with the contract manager in the division of the MIA requiring the procured goods or services, and the MIA's Fiscal Unit provides final approval of contract invoices for payment.

In accordance with Executive Order 01.01.2007.01, the Commissioner referred the issue raised in connection with Finding 2 to the Assistant Attorney General who serves as the MIA's Principal Counsel, and advised the Chief Legal Counsel to the Governor of that referral.<sup>1</sup> By letter dated October 1, 2014, the MIA's Principal Counsel, on behalf of the Maryland Insurance Commissioner, requested that the State Ethics Commission initiate an investigation to determine whether the actions of the management employee identified in connection with Finding 2 violated State ethics laws.

**Finding 3:**

The premium tax system was not properly secured to restrict and control access. The premium tax system contractor had complete control over the system and unnecessary access to the remainder of the MIA network.

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<sup>1</sup> Executive Order 01.01.2007.01 provides, in pertinent part:

O. All departments and agencies of the State shall immediately refer to the Assistant Attorney General of the Department or Agency or to the Deputy Attorney General with supervisory responsibility for the Attorney General's Criminal Investigations Division, any instance of possible criminal or unethical conduct by any employee or contractor of this State, for such action as the Office of the Attorney General deems appropriate. All departments and agencies shall also immediately advise the Chief Legal Counsel to the Governor of any such referrals.

### **Recommendation 3:**

We recommend that MIA

- a. establish appropriate review and testing procedures for program code developed by contractors, ensure only code approved by MIA supervisory personnel is placed into production, and ensure proper controls are maintained over database and server administration;
- b. remove security modification access to the system from the contractor and MIA operational employees and assign it to appropriate MIA IT personnel;
- c. immediately remove the contractor's administrator access to the premium tax third-party payment system and assign such access to an appropriate MIA employee; and
- d. configure its firewalls to filter VPN traffic and limit contractor access to only those devices and ports involved with the contractor's support activities (repeat).

### **MIA Response:**

With the exception of the following, as it relates to the premium tax system contractor's access to the MIA network, the MIA agrees with Finding 3 and the corresponding recommendation.

The MIA disagrees with the statement that the premium tax system contractor had unnecessary access to the remainder of the MIA network. While the premium tax system contractor had access to the server dedicated exclusively to the premium tax system, the contractor did not have the authentication authority (user ID and password) to access any MIA application or database server other than the server hosting the premium tax system. The contractor also did not have the administrative rights (user ID and password) to access the MIA network routers, switches or firewall.\*

On a going forward basis, all program code developed by contractors will follow MIA's standard procedures to ensure that a segregation of duties exists between the application developer and the code migration progress. The MIA also will conduct user acceptance testing on code changes to the premium tax system and all other applications, before changes are migrated into production.

As of May 30, 2014, the MIA removed the premium tax system contractor's access for security modifications; removed the contractor's administrative access to the third party payment system; and disabled the contractor's access to MIA's VPN service.

Effective September 14, 2014, the MIA transferred premium tax system access and user set-up responsibilities to the agency's Management Information Systems ("MIS") unit, to segregate these functions from employees who have premium tax payment posting, premium tax audit, or premium tax audit supervisory functions.

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\* **Auditor's Comment:** The MIA response, while correct, does not address the finding that MIA's firewalls were not configured to restrict this contractor's access to only specific devices over necessary ports. As a result, the contractor had access, at a network level, to all MIA network devices, thereby putting every device in MIA's internal network at risk if they were not properly secured.



**Finding 4:**

MIA lacked assurance that the premium tax system was properly secured and configured to protect it from external threats and unauthorized changes.

**Recommendation 4:**

We recommend that MIA

- a. periodically obtain security vulnerability assessments for application code, remediate all confirmed vulnerabilities identified by the assessments, document these processes, and retain this documentation for future reference;
- b. use a web application firewall to gain additional security protection;
- c. securely configure the premium tax system host server, database, and application;
- d. configure the premium tax system database to log critical security activity, periodically perform independent reviews of these logs, document these reviews, and retain this documentation for future reference;
- e. update the premium tax system database and host server for all security-related patches; and
- f. implement strong controls over accounts and passwords that are in accordance with the requirements of the DoIT *Information Security Policy*.

**MIA Response:**

The MIA agrees with Finding 4 and the corresponding recommendation. The MIA currently is working with DoIT's Security Office to schedule a security vulnerability test on MIA web applications. Once conducted, the MIA will remediate all vulnerabilities identified, document these processes and retain this documentation for future reference. In addition, the MIA requested and received approval for a FY15 budget amendment that will provide funds to purchase a web application firewall to gain additional security protection for all MIA web applications. This budget amendment also will provide funding to contract with a security consulting firm to conduct periodic security vulnerability tests on the MIA network infrastructure and web applications.

The MIA already has increased the security configurations on the premium tax system host server, database and application and applied all current security-related patches to both the premium tax system database and the Windows operating system installed on the host server.

The MIA will add logging features to its premium tax system database and a System Administrator (SA) account will be created to provide the MIA Database Administrators with access to the system logs for daily reviews. Documentation of these reviews also will be created as evidence for future audit verification. In addition, the MIA will strengthen the password capabilities in the premium tax system to comply with the requirements of the DoIT *Information Security Policy*.

**Finding 5:**

MIA had not established adequate controls over audits of premium tax filings. Our tests of the audit results disclosed a number of errors, including the issuance of duplicate account credit and failure to assess penalties and interest.

**Recommendation 5:**

We recommend that MIA

- a. ensure that individuals responsible for auditing transactions do not have the capability to record tax payments in the premium tax system;
- b. ensure that premium tax audits are reviewed by independent supervisory personnel;
- c. ensure that changes to approved tax audits are approved by supervisory personnel and that a historical record of the changes is maintained;
- d. impose penalties and interest unless a waiver is approved by the State Insurance Commissioner;
- e. ensure that companies remit the proper quarterly tax payments and that penalties and interest are properly assessed, as applicable;
- f. ensure that premiums reported on the tax filings agree with the NAIC's database and any differences are resolved; and
- g. review the aforementioned discrepancies and take corrective action.

**MIA Response:**

The MIA agrees with Finding 5 and the corresponding recommendation. The MIA wishes to clarify, however, that although its prior premium tax system had certain automated auditing capabilities, those capabilities were limited, unreliable, and required a 100% manual review.

The MIA has implemented, or is in the process of implementing, all aspects of Recommendation 5. Specifically, effective September 15, 2014, the premium tax audit function was reassigned to the MIA's Examination and Auditing Division ("E&A"), while the responsibility for posting premium tax payments remains with the MIA's Fiscal Unit. There is no overlap of staff in these two distinct areas of the Agency, and MIA E&A personnel have no capability to record tax payments in the premium tax system. Any changes to premium tax audits must be approved and documented by supervisory personnel who do not conduct premium tax audits. Adherence to this requirement is monitored by way of a quarterly report identifying the premium tax auditor and the approving supervisor for each premium tax audit. The MIA has amended its written premium tax audit procedure to make clear that in all cases, the auditor must compare the premiums reported on tax filings with those reported on the NAIC annual statement and resolve any discrepancies.

The MIA is conducting a review of the audits identified as deficient in connection with Finding 5. If the MIA's analysis confirms that penalties or interest could have been assessed, that finding

will be documented in the MIA's audit notes and the penalties and interest will be assessed or the rationale for waiving penalties and interest will be documented.<sup>2</sup>

**Finding 6:**

Procedures were not sufficient to ensure certain premium tax payments were received timely.

**Recommendation 6:**

We recommend that MIA

- a. record the postmark date of premium tax payments so that a determination can be made regarding the timeliness of payments in accordance with law, and
- b. assess penalties and interest for any late payments, as required.

**MIA Response:**

The MIA agrees with Finding 6 and the corresponding recommendation. The MIA has implemented procedures for receiving, sorting and distributing mail that require envelopes to be stapled to all mail received as a record of the date on which the item was postmarked. In addition, MIA staff who post payment information in the premium tax system now are required to record the postmark date of each payment received. The MIA will assess penalties and interest for late payments as appropriate, or will document the rationale for waiving such penalties and interest.<sup>3</sup>

**Finding 7:**

MIA had not established proper internal controls over premium tax refunds.

**Recommendation 7:**

We recommend that

- a. an independent supervisory employee who does not have access to the premium tax system be responsible for releasing refunds for payment based on a review of the audit results; and
- b. duplicate refunds issued be investigated and appropriate actions be taken to recover the overpayments.

**MIA Response:**

The MIA agrees with Finding 7 and the corresponding recommendation. The MIA has established and implemented a procedure pursuant to which an independent supervisory employee who does not have access to the premium tax system is responsible for releasing refunds for payment based on a review of the audit results.

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<sup>2</sup> The Commissioner may waive the penalty and interest on late payments if the insurer proves that it: (i) made a good faith effort to comply with the requirements of § 2-113 of the Insurance Article (related to the payment of taxes or fees in immediately available funds); and (ii) exercised due diligence to initiate payment correctly and on a timely basis.

<sup>3</sup> See footnote 2.

The MIA has investigated all 28 refunds identified in the Report as potential duplicate refunds. To date, the MIA has recovered approximately \$131,000 in duplicate payments, and is pursuing recovery of the additional \$15,000.

**Finding 8:**

MIA did not reconcile its records of premium tax revenues with the corresponding State accounting records.

**Recommendation 8:**

We recommend that MIA

- a. reconcile its premium tax records with the corresponding State records (repeat), and
- b. investigate the aforementioned differences and take appropriate action.

**MIA Response:**

The MIA agrees with Finding 8 and the corresponding recommendation. The MIA has implemented a policy requiring that all financial transactions must be posted in the premium tax application within 48 hours of deposit and reconciled with State accounting records on a monthly basis.

The MIA is in the process of investigating the differences identified in the report and will take any appropriate corrective action.

**Finding 9:**

Sufficient controls were not established over financial examination services task order awards and modifications.

**Recommendation 9:**

We recommend that MIA

- a. establish effective independent oversight of the task order award and contract modification functions so that one individual does not maintain excessive control over the related decisions;
- b. retain adequate documentation of the task order proposal evaluation ratings and decisions; and
- c. ensure that task order modifications are adequately justified.

**MIA Response:**

The MIA agrees with Finding 9 and the corresponding recommendation. The MIA has implemented organizational changes, personnel changes, and new procedures to help ensure compliance with all state procurement regulations and requirements governing competitive procurements and contract modifications. Specifically, the MIA has hired a new Procurement Officer, who shall work within the Office of the Commissioner and report directly to the Deputy Commissioner. Beginning September 2014, the MIA also commenced monthly procurement meetings that include the Commissioner, Deputy Commissioner, Procurement Officer, the

MIA's Principal Counsel, and an Assistant Attorney General with experience in procurement law. At each meeting, meeting participants review the status of active procurements (including task order awards and contract and task order modifications), identify the parameters of anticipated future procurements (including task order awards and contract and task order modifications), and ensure compliance with all applicable legal and procedural requirements, including proper segregation of duties.

In addition, the MIA has changed its staffing approach for financial examinations. With the exception of specialty financial examination services,<sup>4</sup> all financial examination services for financial examinations commenced on or after March 4, 2014 are being conducted by MIA-employed financial examiners. The MIA no longer is awarding task orders for those financial examination services.

**Finding 10:**

MIA lacked accountability and control over certain cash receipts.

**Recommendation 10:**

We recommend that MIA ensure that

- a. cash receipts are immediately recorded when received (repeat);
- b. collections are deposited in a timely manner; and
- c. an employee independent of the cash receipts function performs and documents the deposit verifications (repeat).

**MIA Response:**

The MIA agrees with Finding 10 and the corresponding recommendation. Specifically, the MIA agrees that all receipts should be deposited in a timely fashion. To that end, in November 2013, the MIA converted to an online remote deposit service system by which all mail receipts are electronically recorded and deposited on the day they are received. The MIA also has revised its procedures to ensure that an employee independent of the cash receipts function performs and documents deposit verifications. Further, the MIA is investigating the feasibility of purchasing a scanner for the mail room employee who opens envelopes and immediately restrictively endorses checks received, to enable that employee to create a log by scanning the check as a *.pdf* document, prior to providing the check to a second employee for deposit.

**Finding 11:**

Sufficient controls were not established for the issuance of producer licenses.

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<sup>4</sup> Specialty financial examination services include those services performed by specialists in the areas of information technology, actuarial science, investment, and reinsurance. Specialty financial examination services are performed on behalf of the MIA by a primary contractor or, if the primary contractor is unavailable or has a conflict, by a secondary contractor. No task orders are awarded in connection with these services.

**Recommendation 11:**

We recommend that MIA ensure that

- a. reconciliations of all license fees as recorded in the State's accounting records with the fees recorded in the producer licensing system are performed by an independent employee and are documented; and
- b. capabilities to process and approve licenses are separated.

**MIA Response:**

The MIA agrees with Finding 11 and the corresponding recommendation. The MIA has established and implemented a procedure requiring that an independent employee reconcile all license fees as recorded in the State's accounting records with the fees recorded in the producer licensing system on a monthly basis, document that reconciliation, and obtain written verification of that reconciliation by an MIA supervisory employee.

The MIA also has established a procedure segregating the producer license application processing function from producer license application approval function, and shall confirm adherence to that procedure based upon a monthly audit of approximately 20% of all applications processed.

**Finding 12:**

MIA lacked assurance that the insurance producer licensing and pre-licensing services systems were sufficiently protected against operational and security risk.

**Recommendation 12:**

We recommend that MIA

- a. seek to amend the existing agreements and ensure that future agreements with service providers processing MIA data include provisions requiring the service providers to regularly obtain SOC 2 Type 2 reviews pertaining to their system operations (repeat); and
- b. obtain and review copies of these SOC 2 Type 2 reports from the service providers and ensure that the related independent reviews adequately address critical security concerns over each system and that the service providers implement all critical report recommendations.

**MIA Response:**

The MIA agrees with the importance of ensuring that Producer Licensing services are protected against operational and security risk. On a going forward basis, the MIA will seek to include in producer pre-licensing and licensing vendor contracts a requirement that the vendor regularly obtain SOC 2 Type 2 reviews and provide the MIA with copies of those reviews.

The MIA obtained from its pre-licensing vendor a copy of its SOC 2, Type 2 audit for the period covering July 1, 2013 to June 30, 2014. The audit included review and testing of 34 functions. Only one exception was noted, and that exception was corrected. The MIA's licensing vendor, which provides services to every department of insurance in the United States, obtains SOC 1

audits conducted by a third party on an annual basis. That vendor provided and will continue to provide the MIA with copies of its independent audit results.

**Finding 13:**

MIA did not establish proper controls over purchases and disbursements and did not always comply with State procurement regulations.

**Recommendation 13:**

We recommend that MIA

- a. establish independent online approval requirements for all critical purchasing transactions;
- b. ensure adequate supporting documentation is reviewed to verify the propriety of critical transactions such as purchase orders and invoices; and
- c. comply with the requirements of the State procurement regulations and DoIT policies by obtaining the appropriate approvals, providing sole source justifications when needed, and conducting competitive procurements when required.

**MIA Response:**

The MIA agrees with Finding 13 and the corresponding recommendation. The MIA has updated its Fiscal Procedures to ensure that appropriate approval for all purchase and disbursement transactions is obtained, and that MIA employees approving such transactions document their review of supporting documentation.

The MIA also has implemented organizational changes, personnel changes, and new procedures to help ensure compliance with all state procurement regulations and requirements governing competitive procurements and contract modifications. Specifically, the MIA has hired a new Procurement Officer, who shall work within the Office of the Commissioner and report directly to the Deputy Commissioner. Beginning September 2014, the MIA also commenced monthly procurement meetings that include the Commissioner, Deputy Commissioner, Procurement Officer, the MIA's Principal Counsel, and an Assistant Attorney General with experience in procurement law. At each meeting, participants review the status of active procurements, identify the parameters of anticipated future procurements, and ensure compliance with all applicable legal and procedural requirements.

**Finding 14:**

Administrative access to MIA's network was excessive.

**Recommendation 14:**

We recommend that domain administrator privileges only be assigned to users requiring such privileges.

**MIA Response:**

The MIA agrees with Finding 14 and the corresponding recommendation, and has resolved this issue. As of May 30, 2014, MIS Technical Support personnel and infrastructure project resource staff have been removed from the MIA domain administrator account. As an aside, the premium tax system contractor never had domain administrator account privileges.



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