

Audit Report

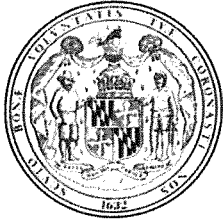
Maryland Health Insurance Plan

April 2012



OFFICE OF LEGISLATIVE AUDITS
DEPARTMENT OF LEGISLATIVE SERVICES
MARYLAND GENERAL ASSEMBLY

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Karl S. Aro
Executive Director

DEPARTMENT OF LEGISLATIVE SERVICES
OFFICE OF LEGISLATIVE AUDITS
MARYLAND GENERAL ASSEMBLY

April 25, 2012

Bruce A. Myers, 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 audited the Maryland Health Insurance Plan (MHIP) for the period beginning January 1, 2008 and ending June 5, 2011. MHIP is an independent unit of State government that was formerly part of the Maryland Insurance Administration. Its primary responsibilities are to provide comprehensive health benefits to medically uninsurable residents of the State and to subsidize the out-of-pocket costs of certain enrollees in Medicare Part D prescription drug coverage.

MHIP did not obtain an independent review of the claims management system used by its Administrative Service Organization (ASO) to provide various services such as determining client eligibility and paying healthcare claims. Furthermore, MHIP did not routinely conduct reviews to monitor the ASO's compliance with the terms of its contract. Finally, MHIP made payments to a vendor totaling approximately \$367,000, without documentation of competitive bids being obtained or the existence of a current written contract.

MHIP'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 MHIP.

Respectfully submitted,

A handwritten signature in black ink that reads "Bruce A. Myers". The signature is written in a cursive, flowing style.

Bruce A. Myers, CPA
Legislative Auditor

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Background Information

Agency Independence and Responsibilities

The Maryland Health Insurance Plan (MHIP) operated within the Maryland Insurance Administration (MIA) until it became an independent unit of State government effective October 1, 2008 pursuant to Chapter 259, Laws of Maryland 2008. MHIP activities were previously subject to audit during our audits of MIA. Our audit period begins January 1, 2008 to coincide with the end of the last audit of MIA that included MHIP activities.

MHIP is governed by a Board of Directors, and operates the High-Risk Pool Insurance Plan (the Plan) and the Senior Prescription Drug Assistance Program (SPDAP). The Plan's goal is to provide access to affordable, comprehensive health benefits to medically uninsurable residents of the State. The Plan is funded primarily by assessments from both net patient revenues of acute care hospitals in the State and certain nonprofit health service plans, and by premiums paid by certain members. SPDAP provides subsidies to reduce out-of-pocket costs for low and moderate income Medicare recipients enrolled in the Medicare Part D prescription drug coverage. SPDAP is special funded by a nonprofit health service plan entity (in lieu of the entity paying premium taxes) as provided for in State law. All funds are non-lapsing and the financial activity is subject to an annual audit by an independent accounting firm. According to the audited financial statements, fiscal year 2011 receipts totaled \$231 million and disbursements were \$210 million.

Financial Statement Audits

MHIP engaged an independent accounting firm to perform audits of its statutory financial statements for the fiscal years ended June 30, 2008, 2009, 2010, and 2011. In the related audit reports, the firm stated that MHIP's financial statements presented fairly, in all material respects, its admitted assets, liabilities and net assets and results of its operations and cash flows for the years then ended in conformity with accounting practices prescribed or permitted by the Maryland Insurance Administration.

Potential Impact of the Federal Affordable Care Act

In March 2010, the Governor created the Health Care Reform Coordination Council (HCRCC) to develop a plan for implementing the federal Affordable Care Act in the State. According to the Council's final report and recommendations dated January 1, 2011, it anticipates that beginning January

2014, MHIP will be phased out as a state-run high-risk pool and will no longer be needed, as insurance carriers will be required to enroll all individuals seeking coverage in at least a basic benefit package.

Status of Findings From Preceding Audit Report

Our audit included a review to determine the status of three findings from our audit report on MIA, dated December 8, 2008, which related to MHIP. We determined that MHIP satisfactorily addressed these findings.

Findings and Recommendations

Administrative Service Organization

Background

The Maryland Health Insurance Plan (MHIP) contracts with an Administrative Service Organization (ASO) to provide benefit management services, including enrollment, premium billing and collection, and the payment of provider claims. The current contract is for a term beginning on July 1, 2007 and ending on June 30, 2014. According to MHIP records, during fiscal year 2011, the ASO paid medical claims totaling \$179.5 million, and for its services, MHIP paid the ASO \$10 million.

Finding 1

MHIP had not obtained an independent review of its ASO claims management system to ensure that the related internal controls were designed and operating effectively.

Analysis

MHIP had not obtained an independent review of the ASO's automated claims management system. Specifically, although the ASO transferred the processing of MHIP's activity to a different automated system effective July 1, 2010, the system had not been subject to an independent review as of February 14, 2012. Furthermore, the ASO advised MHIP that it did not have any plans to have the current system independently reviewed. Reviews had been performed of the system that had previously been used to process MHIP activities. The purpose of the review was to provide assurances to all of the ASO's customers, including MHIP, concerning the design and effectiveness of internal controls related to its processing of transactions for clients including its eligibility and claims management and payment services.

Consequently, the system's operational integrity could not be ensured and the system could be vulnerable to a variety of exposures, such as third-party access to critical system data. In this regard, the system contains demographic information for individuals, including name, address, and date of birth, as well as sensitive personal health information, including medical diagnosis codes and prescribed medications.

Recently, the American Institute of Certified Public Accountants issued guidance concerning examinations of service organization controls (SOC) pertaining to security, availability, processing integrity, confidentiality, and privacy. Based on this guidance, customers, such as MHIP, who seek to obtain assurances about

controls over their data, may now obtain from service organizations, such as the ASO, an independent auditor's report referred to as a SOC 2, type 2 report. Such a report, which should be conducted at least annually, contains the service organization's description of its system and the results of the auditor's examination of the suitability of the system design and operating effectiveness of the controls.

Recommendation 1

We recommend that MHIP obtain annual independent reviews of the ASO's claims management system (such as a SOC 2, type 2 examination) to ensure the system's internal controls are suitably designed and operating effectively.

Finding 2

MHIP did not routinely conduct independent reviews of its ASO to determine if the ASO was operating in compliance with its contract.

Analysis

Although the contract with its ASO allows MHIP to conduct annual or other formal audits of the ASO's performance, during the period January 1, 2008 to June 5, 2011, only one independent formal review of the ASO's performance was conducted. This review covered member enrollment and premium transactions during the period July 1, 2008 through March 31, 2009. The report, dated March 24, 2010, disclosed instances in which the ASO did not terminate members' coverage in accordance with the plan's operating provisions for failure to pay premiums for 60 days. In August 2010, MHIP's independent auditor, in conjunction with the ASO, confirmed that finding and estimated that the failure to timely terminate membership resulted in the improper payment of claims and related ASO administrative fees totaling \$1.3 million, for which the ASO reimbursed MHIP.

Independent reviews of member eligibility, enrollment, premium collections, and claims processing are MHIP's primary method to determine if the ASO is operating in compliance with the terms of its contract.

Recommendation 2

We recommend that MHIP

- a. conduct periodic (such as, annually) independent reviews of its ASO to determine if member eligibility, enrollment, premium collections, and claims processing are being performed in accordance with the contractual requirements; and**

- b. take timely corrective action (such as, obtaining reimbursement for improperly paid claims and removing ineligible members) when deficiencies are identified by the independent reviews.**

Procurement

Finding 3

MHIP made payments to a vendor totaling approximately \$367,000, without documentation of competitive bids being obtained or of the existence of a current written contract.

Analysis

During the period from January 2008 through February 2011, MHIP made payments to a vendor totaling approximately \$367,000 for information technology services, without documentation that competitive bids were obtained or the existence of a current written contract, as required by its procurement policy. Consequently, there is no assurance that MHIP received the best price for the services purchased. Furthermore, an executed written contract would stipulate the scope of work to be performed and provisions (such as, withholding payment) to address contractor non-compliance or failure to perform work satisfactorily.

We were advised by MHIP management that, while much of the original documentation could not be located, it was assumed that the vendor operated under the scope of an agreement that was executed before MHIP became independent of MIA. We were further advised by MHIP management that disputes subsequently arose regarding the vendor unjustifiably increasing its billable hours and not satisfactorily performing the agreed-upon work. As a result, MHIP terminated its relationship with the vendor in February 2011 and determined that approximately \$140,000 is in dispute with the vendor. Specifically, MHIP determined that the vendor owed the State approximately \$90,000 for overcharges previously paid by MHIP. Additionally, as of November 2011, MHIP had also withheld payment of several vendor invoices dated from November 2010 to February 2011, totaling \$50,000. MHIP is currently negotiating a settlement with the vendor.

Although exempt from State procurement regulations, MHIP was required by State law to establish written procurement policies and procedures that were to be approved by its Board of Directors. According to its approved procurement policies and procedures, contracts with an annual cost in excess of \$100,000, are to be competitively bid and supported by an executed written contract.

Recommendation 3

We recommend that MHIP

- a. execute written contracts and obtain competitive bids prior to obtaining the related services, as required by its procurement policy; and**
- b. in consultation with legal counsel, take appropriate action to resolve the aforementioned dispute and collect any amounts due.**

Audit Scope, Objectives, and Methodology

We have audited the Maryland Health Insurance Plan (MHIP) for the period beginning January 1, 2008 and ending June 5, 2011. 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.

MHIP was established by law as an independent unit of State government effective October 1, 2008. Previously, MHIP was an independent unit which operated within the Maryland Insurance Administration (MIA). The scope of this audit included MHIP activities beginning January 1, 2008 to September 30, 2008 when MHIP activities were under MIA. The audit also included MHIP activities since its creation as an independent unit of State government through June 5, 2011.

As prescribed by the State Government Article, Section 2-1221 of the Annotated Code of Maryland, the objectives of this audit were to examine MHIP's financial transactions, records and internal controls, and to evaluate its compliance with applicable State laws, rules, and regulations. We also determined the status of the findings included in our audit report on MIA dated December 8, 2008, which related to MHIP.

In planning and conducting our audit, we focused on the major financial-related areas of operations based on assessments of materiality and risk. The areas addressed by our audit included MHIP's monitoring of the administrative service organizations contracted to administer the high risk insurance pool and the senior prescription drug assistance program, contract procurement and disbursements, and payroll. Our audit procedures included inquiries of appropriate personnel, inspections of documents and records, and observations of MHIP's operations. We also tested transactions and performed other auditing procedures that we considered necessary to achieve our objectives. Data provided in this report for background or informational purposes were deemed reasonable, but were not independently verified.

Our audit did not include a review of certain support services provided to MHIP by MIA during a portion of the audit period. These support services (such as processing of invoices and payroll) were included within the scope of our audits of MIA.

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

MHIP'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 MHIP regarding the results of our review of its response.

APPENDIX
MARYLAND HEALTH INSURANCE PLAN



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Board of Directors

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Acting Executive Director
Maryland Health Care Commission

VACANT
Minority Business Owner

April 24, 2012

Mr. Bruce A. Myers, CPA
Legislative Auditor
Office of Legislative Audits
301 West Preston Street
Room 1202
Baltimore, MD 21201

Dear Mr. Myers-

On behalf of the Board of Directors of the Maryland Health Insurance Plan, I wanted to thank you for this opportunity to respond back to the draft report audit for the time period beginning on January 1, 2008 and ending on June 5, 2011. In order to formulate our response, we briefly restated the findings and recommendations, which are followed by our response.

You requested that MHIP provide its official comments back not later than April 25, 2012. We wish to commend OLA's audit team for their level of cooperation and professionalism during this audit.

If you have any questions please don't hesitate to call me at (410) 576-2053.

Best regards,

Kent McKinney
Executive Director

Enclosure

cc: Sec. Eloise Foster
Sec. Joshua Sharfstein
Mr. Ben Steffen
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Ms. Debora Kuchka-Craig
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Ms. Tate Showers
Mr. Tony Armiger
Ms. Jamie Seward, esq.
Mr. Don Tannenbaum

THE MARYLAND HEALTH INSURANCE PLAN

Finding 1

MHIP had not obtained an independent review of its ASO claims management system to ensure that the related internal controls were designed and operating effectively.

Recommendation 1

We recommend that MHIP obtain annual independent reviews of the ASO's claims management system (such as a SOC 2, type 2 examination) to ensure the system's internal controls are suitably designed and operating effectively.

MHIPs Response

MHIP concurs with the audit finding. MHIP agrees with the importance of an independent review of the internal controls of the ASO's medical claims management system. Currently, the ASO does obtain such a review on their pharmacy claims system. We requested that the ASO perform a SOC 2, Type 2 examination on the medical claims system and they subsequently declined our request. The ASO estimates that the external cost of a SOC 2, Type 2 examination to be several hundred thousand dollars, plus several months of internal resource commitments from their staff. Since there is no contractual obligation for the ASO to perform this work on MHIPs behalf, costs to perform the OLA recommended audit will be borne by MHIP.

At the April MHIP Board of Directors meeting the Board approved the funds to perform the audit. It should be noted that the ASO will arrange for all aspects of the audit, including procurement of an independent audit firm, overseeing the scope of work and reporting the results to MHIP. MHIP will request that a contract be administered with the ASO prior to the release of any funds by MHIP to cover the audit.

Even in the presence of our insistence with the ASO to conduct the audit, they may still persist in their denial of any formal request from MHIP to perform the audit on our behalf.

Finding 2

MHIP did not routinely conduct independent reviews of its ASO to determine if the ASO was operating in compliance with its contract.

Recommendation 2

We recommend that MHIP

- 1. conduct periodic (such as, annually) independent reviews of its ASO to determine if member eligibility, enrollment, premium collections, and claims processing are being performed in accordance with the contractual requirements; and**

APPENDIX

- 2. take timely corrective action (such as, obtaining reimbursement for improperly paid claims and removing ineligible members) when deficiencies are identified by the independent reviews.**

MHIPs Response

MHIP concurs with this audit finding and recommendation. MHIP will hire an outside audit firm to conduct a thorough independent compliance audit of the ASO. The audit work will examine the ASO's performance under the contract and applicable insurance laws. This will include timely and accurate processing of eligibility determinations, enrollment, premium collection, claims and other ASO duties under the contract. Although the Auditors have pointed out actions for improvement, MHIP pursues recoveries due to overpayments of claims and other performance standards as part of its day-to-day oversight of the ASO's administration of the Program. For example, under the terms of the Administrative Services Agreement, the ASO is obligated to meet specified performance standards. In the event the ASO does not meet those standards, liquidated damage penalties may be imposed. To date, MHIP has recovered \$227,803 in liquidated damages under these provisions of the Agreement.

Finding 3

MHIP made payments to a vendor totaling approximately \$367,000 without documentation of competitive bids being obtained or of the existence of a current written contract.

Recommendation 3

We recommend that MHIP

- 1. execute written contracts and obtain competitive bids prior to obtaining the related services, as required by its procurement policy; and**
- 2. in consultation with legal counsel, take appropriate action to resolve the aforementioned dispute and collect any amounts due.**

MHIPs Response

MHIP concurs and will comply with Recommendation No. 3. MHIP maintained three, separate and distinct agreements with the vendor over the duration of three years. Each agreement pertained to a narrowly defined scope of work. In 2008, MHIP became an agency independent of the MIA. Shortly thereafter, MHIP adopted a procurement policy which was amended in December of 2011. MHIP's procurement policy requires competitive bidding prior to engaging vendors when the projected expense of services exceeds certain dollar amounts. MHIP's procurement policy also requires written contractual agreements. MHIP has resolved the issue with the vendor and will pay all outstanding invoices. The matter has been resolved.

AUDIT TEAM

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