

Special Review

**Maryland Insurance Administration
Follow-up Review**

February 2016



OFFICE OF LEGISLATIVE AUDITS
DEPARTMENT OF LEGISLATIVE SERVICES
MARYLAND GENERAL ASSEMBLY

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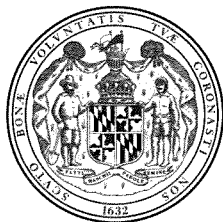
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DEPARTMENT OF LEGISLATIVE SERVICES
OFFICE OF LEGISLATIVE AUDITS
MARYLAND GENERAL ASSEMBLY

Warren G. Deschenaux
Executive Director

Thomas J. Barnickel III, CPA
Legislative Auditor

February 10, 2016

Senator Guy J. Guzzone, Chair, Joint Audit Committee
Members of Joint Audit Committee
Annapolis, Maryland

Ladies and Gentlemen:

We have conducted a follow-up review of the actions taken by the Maryland Insurance Administration (MIA) to address the findings in our November 20, 2014 audit report. In that report, we concluded that MIA's accountability and compliance rating was unsatisfactory.

MIA provided a status report, as of May 20, 2015, indicating the implementation status of each finding as well as its corrective action plan, including timelines and processes to monitor the implementation of the plan. In summary, MIA's status report indicated that 11 findings had been corrected, substantial progress had been made to correct 1 finding, and additional actions were still required to address the 2 remaining findings.

We performed certain procedures to evaluate the actions taken by MIA for 9 findings for which MIA's status report indicated were corrected or for which substantial progress had been made. Our review, which was performed during the period from July to October 2015, disclosed that MIA had corrected 5 findings and had made progress but had not resolved 4 other findings.

Conclusion on Implementation Status	Number of Findings
Corrected	5
In Progress	4

Exhibit 1 identifies MIA's assessed implementation status for all 14 findings, according to its status report, as well as the results of our review for the 9 findings. Exhibit 2 describes, in detail, the 4 findings we determined that MIA had not corrected.

MIA's response to this report is included as an Appendix.

To improve its accountability and compliance rating, MIA should continue to implement its corrective action plan for all findings and ensure that other areas do not deteriorate. We will review the status of all of the audit findings during our next audit of MIA. We wish to acknowledge the cooperation extended to us by MIA during this review.

Respectfully submitted,

A handwritten signature in black ink, appearing to read "TJ Barnickel III".

Thomas J. Barnickel III, CPA
Legislative Auditor

Exhibit 1

Implementation Status of Findings in the November 2014 MIA Audit Report

Prior Finding	Status as Determined by MIA as of May 2015 ¹	Status Based on Auditor's Review
Premium Tax System		
1. The procurement of a new premium tax system did not comply with State procurement regulations and the project was not adequately planned.	In Progress	In Progress (See Exhibit 2)
2. An MIA management employee exercised excessive control over the premium tax system procurement and implementation.	Corrected	Corrected
3. The premium tax system was not properly secured and a contractor had complete control over the system.	Corrected	Corrected
4. MIA lacked assurance that the premium tax system was properly protected from external threats and unauthorized changes.	In Progress	N/A ²
Administration of Premium Tax Filings		
5. MIA had not established adequate controls over audits of premium tax filings and a number of errors were detected.	Substantial Progress	In Progress (See Exhibit 2)
6. Procedures were not sufficient to ensure certain premium tax payments were received timely.	Corrected	In Progress (See Exhibit 2)
7. MIA had not established proper controls over premium tax refunds.	Corrected	Corrected
8. MIA did not reconcile its records of premium tax revenues with the corresponding State accounting records.	Corrected	In Progress (See Exhibit 2)
Page 1 of 2		

N/A – Not applicable since we did not review the implementation status of this finding

¹ MIA's detailed implementation status for each finding is based upon MIA's status report, as of May 20, 2015, as well as MIA's additional clarification of the actions taken to resolve the findings. The overall conclusion by finding presented in Exhibit 1 was discussed with, and agreed to, by MIA management personnel.

² The premium tax system to which this finding relates is no longer in use by MIA; accordingly, we excluded this finding from our review.

Exhibit 1

Implementation Status of Findings in the November 2014 MIA Audit Report

Prior Finding	Status as Determined by MIA as of May 2015 ¹	Status Based on Auditor's Review
Financial Examination Services		
9. Sufficient controls were not established over financial examination services task order awards and modifications.	Corrected	Corrected
Cash Receipts		
10. MIA lacked accountability and control over certain cash receipts.	Corrected	N/A
Producer Licensing		
11. Sufficient controls were not established for the issuance of producer licenses.	Corrected	N/A
12. MIA lacked assurance that producer licensing and pre-licensing services systems were protected against operational and security risks.	Corrected	N/A
Purchases and Disbursements		
13. Proper internal controls were not established over purchases and disbursement transactions.	Corrected	N/A
Information Systems Network		
14. Administrative access to MIA's network was excessive.	Corrected	Corrected
Page 2 of 2		

N/A – Not applicable since we did not review the implementation status of this finding

¹ MIA's detailed implementation status for each finding is based upon MIA's status report, as of May 20, 2015, as well as MIA's additional clarification of the actions taken to resolve the findings. The overall conclusion by finding presented in Exhibit 1 was discussed with, and agreed to, by MIA management personnel.

Exhibit 2

Detailed Comments on the Findings for Which the Office of Legislative Audits Deemed the Implementation Status to be “In Progress”

Premium Tax System

Prior Finding 1

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

Prior Report Recommendation 1

We recommended that MIA

- a. comply with State procurement regulations governing competitive procurements and contract modifications and obtain Board of Public Works and Department of Information Technology 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.

Auditor’s Assessment of Status – In Progress

MIA has established procedures to monitor compliance with State procurement regulations, which include monthly meetings attended by MIA management in which all current procurement activity is reviewed to ensure required oversight approvals are obtained. Our testing of selected procurement activity for the period from November 20, 2014 through June 30, 2015, during which there was only limited procurement activity, disclosed that justifications for contract modifications were documented and contract modifications were not artificially split to avoid additional approvals.

Following various setbacks associated with its premium tax system implemented in February 2012, including the deficiencies noted in the audit report, MIA discontinued its use of this system in November 2014. MIA is currently in the process of preparing a comprehensive plan for the development of a new premium tax system. MIA initially prepared documents, as of January 14, 2015, detailing the required functionality of a new system to be administered by the National Association of Insurance Commissioners (NAIC), which would be available to MIA at no cost by virtue of its membership in the NAIC. However, based upon advice from its legal counsel, MIA decided to conduct a procurement for the new

premium tax system. In this regard, the solicitation for services is currently planned to occur during fiscal year 2016 through a task order request for proposal under a Statewide information technology master contract; the contract award is expected to occur in fiscal year 2017. A total cost estimate of \$250,000 for the first year plus an ongoing annual maintenance cost of \$25,000 has been approved by the Commissioner and, as of October 7, 2015, the agency is in the process of drafting the project scope details and minimum qualifications for any potential bidders. Once the request for proposal has been finalized, it will be forwarded to the Department of Information Technology for approval.

Administration of Premium Tax Filings

Prior 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.

Prior Report Recommendation 5

We recommended 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.

Auditor's Assessment of Status – In Progress

MIA has established adequate controls over premium tax audits to ensure that access capabilities are properly segregated and individuals who audit premium taxes do not have the ability to record payments in the manual tax records. (As previously mentioned, the premium tax system in use during the audit has been discontinued.) In addition, controls are in place to ensure completed tax audits and any changes to approved audits are adequately documented and approved by

independent supervisory personnel. MIA has also established procedures to ensure companies remit the proper quarterly tax payments and that premiums reported on the tax filings are compared with the NAIC database for agreement.

We noted, however, that MIA did not document its rationale for not always imposing penalties and interest when quarterly tax payments were received late. Our test of 12 audits of taxes paid on calendar year 2014 premiums disclosed one instance where a company made two late quarterly payments; however, MIA's rationale for only assessing penalties and interest for one of the late payments was not documented. According to MIA management, an unwritten policy exists which allows for late penalties to be limited to one penalty per insurance company per tax year even if multiple late payments are received.

Finally, at the time our review began, MIA had only completed its review of the discrepancies identified in 7 of the 11 premium tax audits identified during our audit. MIA's review of the remaining 4 premium tax audits was completed during our follow-up review. However, for 6 of the 11 audits, MIA did not take appropriate corrective action because its review of the audits resulted in inaccurate conclusions. For example, quarterly payments received were not properly credited to the companies' accounts which could have resulted in improper penalties and interest being assessed.

Prior Finding 6

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

Prior Report Recommendation 6

We recommended 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.

Auditor's Assessment of Status – In Progress

While MIA has established procedures to record the postmark dates in the manual tax records, these procedures did not ensure the accuracy of the dates posted. Currently, a master payment spreadsheet is maintained by MIA to record the postmark dates and amounts of all tax payments remitted by insurance companies throughout the year. However, MIA did not verify the accuracy of dates posted to the master payment spreadsheet by having an independent employee trace the dates recorded back to the postmark dates. Because this spreadsheet is used by

the premium tax auditors to determine the timeliness of payments for the related company audits, inaccurate refunds or penalties could result.

In our test of 12 premium tax audits, for which 14 payments had been recorded in the master payment spreadsheet, we noted that one postmark date was not recorded accurately. In this instance, because the payment was not late, penalties and interest were not applicable. We were unable to verify the accuracy of two other postmark dates because MIA could not provide the related payment envelopes as supporting documentation.

Prior Finding 8

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

Prior Report Recommendation 8

We recommended that MIA

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

Auditor's Assessment of Status – In Progress

Although MIA developed procedures for conducting monthly reconciliations of its master payment spreadsheet with the corresponding State records, the related instructions did not provide for a proper reconciliation. Specifically, these procedures instructed the responsible employee to reconcile the current monthly activity between the records, but did not require a reconciliation of the two cumulative year-to-date premium tax record balances. Accordingly, uncorrected errors or unauthorized changes to a prior month's activity would not be detected.

For example, MIA successfully reconciled its March 2015 tax activity with the State's records in May 2015. However, when we tested this reconciliation in September 2015, we discovered that a quarterly payment of \$2,307, with a deposit date of March 9, 2015, was recorded twice in the master payment spreadsheet. This payment was only reflected once in MIA's reconciliation document. When we brought this error to its attention, MIA could not provide an explanation. Furthermore, this error had not been detected by MIA during any subsequent reconciliations which only considered premium tax activity that was recorded during the month being reconciled. It is critical that MIA ensure the accuracy of the master payment spreadsheet because MIA auditors rely on it to perform premium tax audits of insurance companies.

In addition, these reconciliations were not always performed by an independent employee. Specifically, the employee who reconciled the premium tax records during the period between October 2014 and May 2015 also had the ability to post payments to the master payment spreadsheet.

Finally, based on our testing, we noted that MIA adequately investigated and took sufficient corrective action to address the differences cited in the audit report between the State's accounting records and the premium tax records maintained by MIA.

Scope, Objectives, and Methodology

We conducted a follow-up review of the actions taken by the Maryland Insurance Administration (MIA) to address the findings in our November 20, 2014 audit report. In that report, we concluded that MIA's fiscal accountability and compliance rating was unsatisfactory.

The purpose of our review was to determine the status of MIA's corrective actions to address certain of our audit findings. This review was conducted under the authority of Section 2-1220(a)(4) of the State Government Article and was based on our long-standing practice of performing a follow-up review whenever an agency receives an unsatisfactory rating in its fiscal compliance audit report. The rating system was established, in accordance with State Government Article, Section 2-1221 of the Annotated Code of Maryland, for the purpose of determining an overall evaluation of an agency's fiscal accountability and compliance with State laws and regulations.

Our review consisted of obtaining a status report from MIA, as of May 20, 2015, which described the level of implementation of each prior audit report finding, as well as obtaining additional clarification from MIA of the actions taken to resolve the findings. Our review also consisted of performing tests and analyses of selected information and holding discussions with MIA personnel as we deemed necessary to determine the status of MIA's corrective actions to address selected findings from our November 20, 2014 audit report.

This review did not constitute an audit conducted in accordance with generally accepted government auditing standards. Had we conducted an audit in accordance with generally accepted government auditing standards, other matters may have come to our attention that would have been reported.

Our review was conducted primarily during the period from July through October 2015, and in certain cases, our assessment of the status of MIA's corrective actions was performed at the time of our review.

MIA's response to our follow-up review 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

LARRY HOGAN
Governor

BOYD K. RUTHERFORD
Lt. Governor



AL REDMER, JR.
Commissioner

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Deputy Commissioner

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February 5, 2016

*Delivered Electronically and via
Regular Mail*

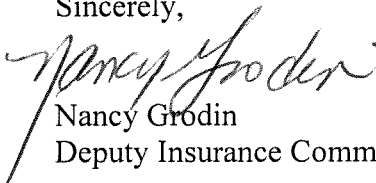
Mr. Thomas J. Barnickel III, CPA
Legislative Auditor
Department of Legislative Services
301 W. Preston Street, Room 1202
Baltimore, Maryland 21201

Re: Response to Follow-Up Review Dated January, 2016

Dear Mr. Barnickel,

On behalf of the Maryland Insurance Administration (MIA), I am filing this response to the Follow-Up Review dated January, 2016 issued by the Office of Legislative Audits. Should you have any questions, please contact me at 410-404-2009 or nancy.grodin@maryland.gov.

Sincerely,


Nancy Grodin
Deputy Insurance Commissioner

Attachment

Cc: Al Redmer, Jr. Insurance Commissioner

Maryland Insurance Administration
Audit Follow-Up Review Dated January, 2016
Response Dated February 5, 2016

The Maryland Insurance Administration (MIA) agrees with findings 1-3, 5-9, and 14¹ set forth in the Follow-Up Review dated January, 2016 (Review). The MIA respectfully provides additional information regarding Findings 5, 6, and 8.

The MIA also respectfully submits that the Examination and Audit Unit has been tasked with conducting a quarterly audit to ensure the integrity of the MIA's documentation of the receipt of premium tax payments, the cash receipts process, and the reconciliation of premium tax records with corresponding State records.

1. Review Finding #5:

The Commissioner or his designee now executes a document describing the rationale for not imposing penalties or interest.² Further, a written document describing the MIA's current policy for limiting a late penalty to the largest of two or more penalties per company per year is pending review by the Office of the Attorney General and will be finalized by March 1, 2016. The MIA agrees that the quarterly payments referred to in the Review were not properly credited to company accounts, but respectfully submits that in several cases companies submitted incorrect information leading to the auditor's error which was ultimately identified and corrected during the supervisory sign-off. Other cases were determined to have been accepted by the MIA as timely filed or within accepted filing parameters. None of the companies was assessed an improper penalty or interest.

2. Review Finding #6:

The MIA has incorporated the auditor's recommendation into its procedure. On a daily basis the Director of Fiscal Services or his designee performs this comparison and acknowledges in writing that it has been completed.

3. Review Finding #8:

The MIA has incorporated the auditor's recommendation into its procedure. A monthly cumulative-to-date reconciliation is performed as a separate transaction. The MIA also acknowledges that due to a shortage of available staff, the employee who performed the monthly premium tax reconciliation from October, 2014 until May, 2015, had the ability to post payments to the Excel master payment spreadsheet. This deficiency was corrected in May, 2015.

¹ Findings 4 and 10-13 were not a part of the Review.

² Insurance law provides discretion for the Commissioner to determine if penalties and interest should be assessed.

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