

Audit Report

---

**Maryland Insurance Administration**

May 2018

---



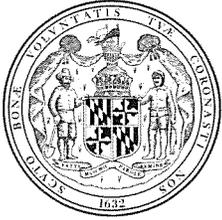
**OFFICE OF LEGISLATIVE AUDITS**  
DEPARTMENT OF LEGISLATIVE SERVICES  
MARYLAND GENERAL ASSEMBLY

**For further information concerning this report contact:**

**Department of Legislative Services**  
**Office of Legislative Audits**  
301 West Preston Street, Room 1202  
Baltimore, Maryland 21201  
Phone: 410-946-5900 · 301-970-5900  
Toll Free in Maryland: 1-877-486-9964  
Maryland Relay: 711  
TTY: 410-946-5401 · 301-970-5401  
E-mail: [OLAWebmaster@ola.state.md.us](mailto:OLAWebmaster@ola.state.md.us)  
Website: [www.ola.state.md.us](http://www.ola.state.md.us)

**The Office of Legislative Audits operates a Fraud Hotline to report fraud, waste, or abuse involving State of Maryland government resources. Reports of fraud, waste, or abuse may be communicated anonymously by a toll-free call to 1-877-FRAUD-11, by mail to the Fraud Hotline, c/o Office of Legislative Audits, or through the Office's website.**

*The Department of Legislative Services does not discriminate on the basis of age, ancestry, color, creed, marital status, national origin, race, religion, gender, gender identity, sexual orientation, or disability in the admission or access to its programs, services, or activities. The Department's Information Officer has been designated to coordinate compliance with the nondiscrimination requirements contained in Section 35.107 of the Department of Justice Regulations. Requests for assistance should be directed to the Information Officer at 410-946-5400 or 410-970-5400.*



DEPARTMENT OF LEGISLATIVE SERVICES  
OFFICE OF LEGISLATIVE AUDITS  
MARYLAND GENERAL ASSEMBLY

Victoria L. Gruber  
Executive Director

Thomas J. Barnickel III, CPA  
Legislative Auditor

May 15, 2018

Senator Craig J. Zucker, Co-Chair, Joint Audit Committee  
Delegate C. William Frick, 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 August 5, 2013 and ending January 30, 2017. 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 doing business within the State.

Our audit disclosed that MIA's use of an electronic system to record and compile premium tax data did not provide sufficient controls to ensure the propriety of recorded data and the results of premium tax audits. MIA collected \$455 million in premium tax revenue during fiscal year 2016. We also noted inadequate controls over the processing of premium tax refunds due to insurance companies and the processing of applications received for insurance producer licenses. Furthermore, adequate processes were not in place to ensure that all collections, which consisted primarily of premium tax payments, were deposited, and that all non-cash credits recorded in its accounts receivable records were valid.

Certain business partners had excessive access into the MIA computer network, and MIA did not have a complete information technology disaster recovery plan for recovering from disaster scenarios. Finally, MIA lacked assurance that the producer licensing and disaster recovery service providers were sufficiently protected against operational and security risks.

In our preceding audit report, dated November 20, 2014, we reported that MIA's accountability and compliance level was unsatisfactory in accordance with the rating system we established in conformity with State law. Based on the results

of our current audit, we have concluded that MIA has made improvements in its fiscal and compliance operations and, accordingly, MIA's accountability and compliance level is no longer unsatisfactory.

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 "TJ Barnickel III". The signature is written in a cursive style with a large initial "TJ" and a stylized "Barnickel III".

Thomas J. Barnickel III, CPA  
Legislative Auditor

## Table of Contents

<b>Background Information</b>	5
Agency Responsibilities	5
Status of Findings From Preceding Audit Report	5
<b>Findings and Recommendations</b>	6
<b>Premium Taxes</b>	
Finding 1 – The Maryland Insurance Administration (MIA) used a premium tax spreadsheet system that lacked adequate controls to ensure the propriety of data recorded and the results of premium tax audits performed.	7
Finding 2 – MIA did not establish adequate controls over the processing of premium tax refunds paid to insurance companies.	8
<b>Producer Licensing</b>	
Finding 3 – Employees who processed certain producer license applications also had the capability to approve the licenses.	9
<b>Cash Receipts and Accounts Receivable</b>	
Finding 4 – Controls over cash receipts and non-cash credit adjustments were not sufficient.	10
<b>Information Systems Security and Control</b>	
Finding 5 – Business partners had excessive access into the MIA computer network.	12
Finding 6 – MIA did not have a complete information technology disaster recovery plan for recovering computer operations.	13
* Finding 7 – MIA lacked assurance that the insurance producer pre-licensing, licensing, and disaster recovery services systems, each managed by separate service providers, were sufficiently protected against operational and security risks.	13
* <b>Denotes item repeated in full or part from preceding audit report</b>	

**Audit Scope, Objectives, and Methodology**

16

**Agency Response**

Appendix

## **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 February 7, 2017, there were 1,770 insurers authorized to conduct business in the State. MIA's records also indicated that direct premiums written by domestic (based in Maryland) and foreign (based in other states) companies operating in Maryland during calendar year 2016 totaled \$37.8 billion.

According to the State's records, during fiscal year 2016, MIA's revenues totaled \$508 million, including \$455 million in premium tax revenue, and its expenditures totaled \$30 million. As required by State law, MIA transferred \$322 million in revenue to the State's General Fund, \$154 million to the Maryland Health Care Rate Stabilization Fund, and \$32 million to the State's Insurance Regulation Fund in fiscal year 2016.

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

Our audit included a review to determine the status of the 14 findings contained in our preceding audit report dated November 20, 2014. We determined that MIA satisfactorily addressed 13 of these findings. The remaining finding is repeated in this report.

In our preceding audit report, we reported that MIA's accountability and compliance level was unsatisfactory in accordance with the rating system we established in conformity with State law. Based on the results of our current audit, we have concluded that MIA has improved its fiscal and compliance operations and its accountability and compliance level is no longer unsatisfactory.

# Findings and Recommendations

## Premium Taxes

### 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. Insurance companies are required to make estimated tax payments on a quarterly basis 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 the Maryland Insurance Administration (MIA). Specifically, premium tax audits are performed annually to determine whether any additional taxes are owed, or whether the insurance company is due a refund. According to the State's records, during fiscal year 2016, MIA collected \$455 million in premium tax revenue.

For many years, MIA used a legacy premium tax system to record and audit premium taxes reported by insurance companies on quarterly tax declaration forms and final returns that were mailed to MIA, along with their payments. In February 2012, MIA implemented a new automated system created by a contractor under an agreement with MIA. However, because of certain system deficiencies, including insufficient system security and inadequate system functionality as noted in our preceding audit report, MIA discontinued its use of the system in November 2014.

During the audit period, MIA used an electronic spreadsheet system to track the receipt of quarterly estimated and annual tax payments, document the performance of the annual premium tax audits, and calculate any penalties and interest. This electronic spreadsheet system was intended to be used only on a temporary basis; however, MIA's efforts to procure a new system were not successful for various reasons.

MIA's efforts to procure a new automated system began when the former system was discontinued in November 2014; however, this process was delayed for several years because of budgetary constraints and an unsuccessful procurement. In November 2017, we were advised by MIA management that it was seeking to obtain a licensing agreement, at no cost, for access to an automated premium tax system provided through the National Association of Insurance Commissioners

(NAIC). According to the NAIC website, as of March 2018, the system was being used by 16 other states.

**Finding 1**

**MIA used a premium tax spreadsheet system that lacked adequate controls to ensure the propriety of data recorded and the results of premium tax audits performed.**

**Analysis**

Absent a new automated premium tax system, MIA used an electronic spreadsheet system for recording and compiling premium tax data and documenting the annual premium tax audits; however, MIA's use of the spreadsheet system did not provide for adequate controls to ensure the propriety of recorded data and the results of premium tax audits. According to MIA's records, as of January 2017, approximately \$1.1 billion in insurance premium taxes had been collected since MIA began using the electronic spreadsheet system in November 2014. MIA completes more than 1,600 audits annually.

Specifically, data recorded on system spreadsheets, as well as formulas and templates recorded by MIA in the system to automatically compile data and perform needed calculations, could be modified without independent supervisory review and approval. While certain system controls were available in the spreadsheet system to restrict access to recorded data and formulas, these controls were not always used and MIA had not implemented adequate manual controls to compensate. Specifically, the employee responsible for ensuring that tax payments were accurately recorded had the capability to modify the tax payment record. In addition, the employee responsible for reviewing and approving the audit results had the capability to modify the audit record and supporting documents. In some cases, MIA was unaware of available controls in the spreadsheet system.

Furthermore, the spreadsheet system did not provide a means for changes in data or formulas to be recorded for subsequent review, and the identity of the individuals performing such changes could not be ascertained.

Since data recorded in the system is used extensively in the performance of premium tax audits, there was a lack of assurance that audit results, including taxes due from or refunds due to insurance companies, were proper. While no significant errors or discrepancies were noted in our tests of premium tax audits, the lack of controls over the data and the lack of accountability over system changes made recorded premium tax data vulnerable to such discrepancies.

### **Recommendation 1**

**We recommend that MIA take appropriate action to control the propriety of premium tax data and audit activity. Specifically, we recommend that MIA procure and implement a new automated premium tax system with sufficient control capabilities or establish adequate controls within its existing system.**

### **Finding 2**

**MIA did not establish adequate controls over the processing of premium tax refunds paid to insurance companies.**

### **Analysis**

MIA lacked adequate controls over premium tax refunds paid to insurance companies, as determined by premium tax auditors based on their examination of tax documents submitted by the insurance companies. According to State records, MIA processed \$19.2 million in premium tax refunds during fiscal year 2016.

Specifically, after review and approval by supervisory personnel, but before being submitted for payment, refund requests were returned to the premium tax auditors who initially prepared them. The approved requests were then forwarded by the auditors to MIA's Fiscal Services unit for processing the payments. According to MIA, the approved refund requests were returned to the auditors so that the approved requests could be scanned into the insurance company's audit records; however, this process provided the opportunity for critical information on the requests, such as the payee information and amount, to be modified without further supervisory review.

In addition, MIA's Fiscal Services unit processed these payments in the State's accounting system using a payment method that was designed for one-time payments. Specifically, payee information (that is, insurance company name and address) was manually entered by Fiscal Services personnel for each individual refund based on the refund request form; as a result, payee information was susceptible to error or manipulation. We were advised by MIA management personnel that consideration has never been given to using a payment method that requires the use of pre-established vendor tables in the State's accounting system. Since the vendor table is controlled by the Comptroller of Maryland, the use of vendor tables would enhance controls over the payment of premium tax refund payments.

## **Recommendation 2**

**We recommend that MIA**

- a. ensure that approved premium tax refund requests are not returned to the premium tax auditor prior to the processing of the refund payment by the Fiscal Services unit; and**
- b. pursue, with the Comptroller of Maryland, the use of a payment method in the State's accounting system for refunds issued that enforces the use of the State's vendor table.**

## **Producer Licensing**

### **Finding 3**

**Employees who processed certain producer license applications also had the capability to approve the licenses.**

### **Analysis**

Eight employees had the capability to both process and approve insurance producer licenses that were received in the mail or flagged during the online application process. As a result, improper licenses could be issued and recorded in the producer licensing system without detection, and a subsequent review process did not provide sufficient compensating controls. According to MIA records, during fiscal year 2016, MIA issued or renewed 88,288 producer licenses, with related collections totaling approximately \$5.8 million. MIA received 2,033 license applications through the mail. The number of on-line applications flagged for manual review could not be determined because of system limitations.

Online applications were approved automatically by the producer licensing system if specific pre-determined criteria were met, but were flagged for manual review under certain circumstances, such as when there were questions regarding eligibility. Applications that were received in the mail or flagged were manually processed and recorded in the system by one of these eight employees. Although MIA procedures provided that each manually processed application was to be reviewed and approved by an employee independent of the employee who processed it, system capabilities did not exist to enforce this requirement.

A similar condition was noted in our preceding audit report and, in response, MIA enhanced its subsequent independent review procedures. Specifically, MIA implemented a procedure to review approximately 10 percent of all licenses processed on a monthly basis; previously, fewer than one percent of licenses were subject to this review process. During fiscal year 2017, MIA reviewed 8,111

licenses, of which 340 licenses had been processed by these eight employees. MIA believes this review provides sufficient mitigating controls over manually processed applications but because of system limitations, could not determine the extent to which licenses manually processed by these eight employees were subject to this review process. Nevertheless, MIA is in discussions with the system vendor to modify the system to separate the capabilities to process and approve licenses.

MIA's 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. Most licenses are issued for a two-year period.

### **Recommendation 3**

**We recommend that MIA work with the system vendor to enhance system capabilities to ensure manually processed producer licenses are subject to independent online approval requirements.**

## **Cash Receipts and Accounts Receivable**

### **Finding 4**

**Controls over cash receipts and non-cash credits were not sufficient.**

### **Analysis**

MIA had not established adequate controls over mail-in collections and non-cash credits posted to its automated accounts receivable records. Collections were first recorded on a check log, then processed using a remote deposit system. Remote deposit is a process whereby checks are scanned and the images of the checks are sent electronically to the bank for deposit. According to the State's records, MIA's collections totaled approximately \$377 million during fiscal year 2016, with the majority of the collections consisting of premium taxes and insurance company assessments. Non-cash credits posted to accounts receivable during the audit period totaled approximately \$8.1 million.

- An independent verification of recorded collections to validated deposits was not performed. The two employees responsible for performing the verification of collections initially recorded on the check log to subsequent deposit were not independent of the cash receipts process since both acted in a back-up capacity for employees who regularly handled cash receipts.

Furthermore, one of these employees had access to the safe where collections were kept prior to deposit.

- Checks to be destroyed after being deposited through the remote deposit system were not first reconciled to the log of checks received, as required, to ensure that all checks received were in fact destroyed. Furthermore, as of April 6, 2017, MIA had not destroyed more than 1,500 checks totaling approximately \$8.6 million that were remotely deposited between 30 and 73 days earlier.
- Non-cash credits recorded in the accounts receivable records were not subject to independent supervisory review and approval. Two employees who were responsible for reviewing, for propriety, automated output reports of non-cash credits processed, also had the capability to initiate non-cash credits.

The Comptroller of Maryland's *Accounting Procedures Manual* requires the establishment of sufficient internal controls over collections, including an independent verification of collections to deposit. The *Manual* also requires supervisory review and approval of non-cash credits to accounts receivable records. The Office of the State Treasurer's *Policy on the Use of Remote Deposit Services by Maryland State Agencies* requires that State agencies independently reconcile destroyed checks to the record of incoming checks. The *Policy* also requires scanned and transmitted (deposited) checks to be stored in a secure location no longer than 30 days before they are destroyed.

#### **Recommendation 4**

**We recommend that MIA ensure**

- a. that an employee who does not have access to collections performs and documents the deposit verification,**
- b. that the initial record of checks received is reconciled with the record of checks destroyed in compliance with the aforementioned State Treasurer's *Policy*,**
- c. that deposited checks are destroyed within the time frame required by the State Treasurer's *Policy*, and**
- d. that non-cash credits to accounts receivable are subject to independent supervisory review and approval.**

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

## Information Systems Security and Control

### Background

MIA's Management Information Systems (MIS) Department is responsible for the development, maintenance, and support of MIA's information systems, including operation of an internal network at MIA. The network is connected to networkMaryland for Internet and Statewide Government Intranet connectivity. MIA's main critical application is the enterprise system which supports insurance company licensing, complaints, and case tracking. The MIS Department also coordinates and supports MIA's use of multiple Internet-based cloud service provider systems for support of its internal operations.

MIA contracts with vendors to provide various computer systems and services. Specifically, MIA contracts with

- a pre-licensing services vendor to provide a standardized producer electronic examination system to include application processing, online examinations, examination grading, and reporting;
- the NAIC to use its producer licensing system for all producer information, demographics, contacts, and license status; and
- a cloud service provider for disaster recovery services.

As of July 2017, MIA was replicating data from 16 internal MIA servers to the cloud provider, including a server containing MIA's enterprise complaint tracking system, which recorded sensitive personally identifiable information (PII), such as names and social security numbers.

### **Finding 5**

**Business partners had excessive access into the MIA computer network.**

### Analysis

Business partners had excessive access into the MIA computer network because their access was not limited to only accessing those network resources related to their contractual responsibilities. For example, an individual system development contractor and an external disaster recovery service provider had required access into the MIA internal network via a remote virtual private network (VPN) connection service. The development contractor was provided access to the entire MIA network even though the contractor only required access to one application and the service provider was granted access to 69 servers even though the provider only required access to 16 servers for disaster recovery replication. The State of Maryland *Information Security Policy*, requires that agency systems shall be configured to monitor and control communications at external boundaries.

### **Recommendation 5**

**We recommend that MIA secure its internal network by limiting its business partners' remote VPN connections access to only those destination addresses required per contractual responsibilities.**

### **Finding 6**

**MIA did not have a complete information technology disaster recovery plan (DRP) for recovering computer operations.**

### **Analysis**

MIA did not have a complete information technology DRP for recovering computer operations from disaster scenarios (for example a fire). The State of Maryland *Information Technology Disaster Recovery Guidelines* provide best practices on the minimum required elements needed for a DRP. MIA's DRP did not address certain of these minimum requirements. For example, the DRP did not contain required listings of hardware and software and adequate details for restoration of network connectivity. Additionally, the DRP had not been tested during the two prior years. Without a complete and tested DRP, a disaster could cause significant delays (for an undetermined period of time) in restoring information systems operations above and beyond the expected delays that would exist in a planned recovery scenario.

### **Recommendation 6**

**We recommend that MIA**

- a. develop and implement a comprehensive DRP that is in accordance with the aforementioned *Information Technology Disaster Recovery Guidelines*; and**
- b. periodically test the DRP, document the testing, and retain the documentation for future reference.**

### **Finding 7**

**MIA lacked assurance that the insurance producer pre-licensing, licensing, and disaster recovery services systems, each managed by separate service providers, were each sufficiently protected against operational and security risks.**

### **Analysis**

MIA lacked assurance that the producer pre-licensing, licensing, and disaster recovery services systems, each managed by separate service providers, were each sufficiently protected against operational and security risks. Specifically, our

review of MIA's actions for obtaining necessary independent security assurances for these systems' primary service providers and all subcontractors performing material services disclosed the following:

- For the pre-licensing services system, MIA had not obtained a System and Organization Controls (SOC) report or any other similar independent security assurances report.
- For the NAIC licensing system, MIA had obtained and reviewed the most recently issued SOC report dated March 13, 2017, applicable to the service provider, covering the period from January 1, 2016 to December 31, 2016. However, MIA did not contractually require or obtain a SOC report or any other form of independent security assurances for a subcontractor, which performed significant co-location backup and recovery hosting services for the NAIC. As of January 2018, the original and backup NAIC licensing system databases contained records for approximately 400,000 MIA licensed State of Maryland producers, having either an active or inactive status, including PII comprised of names and social security numbers.
- For its disaster recovery (DR) service provider, MIA had obtained a SOC2 Type 2 report, dated March 10, 2017, applicable to the service provider, covering a period from January 1, 2016 to December 31, 2016. However, as of August 8, 2017, MIA had not yet reviewed the report to ascertain the status of security and operational controls. We reviewed the report and found that the review addressed these controls, and no control weaknesses were cited. As of August 2017, MIA information stored with the disaster recovery service provider included approximately 191,000 of the above described NAIC PII records because MIA periodically downloaded NAIC active status producer licensing records to an internal MIA server, whose contents were also being replicated to the DR service provider.

As a result of these conditions, significant operational and security risks could exist and remain undetected, resulting in increased vulnerability of systems and data to compromise or loss.

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 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 MIA information contained in the pre-licensing, producer licensing, and disaster recovery service provider systems, we believe a SOC 2 Type 2 report is required for these service providers and any related subcontractor performing material services. A similar situation regarding MIA's failure to monitor for security and operational risks of certain service providers was commented upon in our two preceding audit reports.

#### **Recommendation 7**

**We recommend that MIA**

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

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

We have conducted a fiscal compliance audit of the Maryland Insurance Administration (MIA) for the period beginning August 5, 2013 and ending January 30, 2017. 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, payroll, information systems security and control, accounts receivable, premium tax audits, and producer licensing. We also determined the status of the findings contained 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. Generally, transactions were selected for testing based on auditor judgment, which primarily considers risk. Unless otherwise specifically indicated, neither statistical nor non-statistical audit sampling was used to select the transactions tested. Therefore, the results of the tests cannot be used to project those results to the entire population from which the test items were selected.

We also performed various data extracts of pertinent information from the State's Financial Management Information System (such as revenue and expenditure data) and the State's Central Payroll Bureau (payroll 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 sources were sufficiently reliable for the purposes the data were used during this audit. We also extracted data from MIA's producer licensing system for the purpose of testing the issuance of licenses. We performed various tests of the relevant data and determined that the data were sufficiently reliable for the purposes the data were used during the

audit. Finally, we performed other auditing procedures that we considered necessary to achieve our audit objectives. The reliability of data used 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.

In our preceding audit report, we reported that MIA's accountability and compliance level was unsatisfactory in accordance with the rating system we established in conformity with State law. Our current audit disclosed that MIA has improved its fiscal and compliance operations and, accordingly, MIA's accountability and compliance level is no longer unsatisfactory. Our rating conclusion has been made solely pursuant to the aforementioned 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**

LARRY HOGAN  
Governor

BOYD K. RUTHERFORD  
Lt. Governor



AL REDMER, JR.  
Commissioner

NANCY GRODIN  
Deputy Commissioner

200 St. Paul Place, Suite 2700 Baltimore, Maryland 21202  
Direct Dial: 410-468-2009 Fax: 410-468-2020  
Email: [nancy.grodin@maryland.gov](mailto:nancy.grodin@maryland.gov)  
1-800-492-6116 TTY: 1-800-735-2258  
[www.insurance.maryland.gov](http://www.insurance.maryland.gov)

May 7, 2018

*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: April 2018 Draft Audit Report; Maryland Insurance  
Administration Response.

Dear Mr. Barnickel:

On behalf of the Maryland Insurance Administration, attached please find the MIA's response to the April 2018 Draft Audit Report. If you have any questions or concerns please contact me at 410.468.2009 or [nancy.grodin@maryland.gov](mailto:nancy.grodin@maryland.gov). Thank you.

Sincerely,

A handwritten signature in cursive script that reads "Nancy Grodin".

Nancy Grodin  
Deputy Insurance Commissioner

Cc: Al Redmer Jr., Insurance Commissioner  
Godwin Ehirim, Director, Fiscal Services  
Paula Keen, Chief Information Officer  
J. Van Lear Dorsey, Principle Counsel

Maryland Insurance Administration  
Response to Draft Audit Report April 2018  
May 7, 2018

**Finding 1**

MIA used a premium tax spreadsheet system that lacked adequate controls to ensure the propriety of data recorded and the results of premium tax audits performed.

Recommendation

We recommend that MIA take appropriate action to control the propriety of premium tax data and audit activity. Specifically, we recommend that MIA procure and implement a new automated premium tax system with sufficient control capabilities or establish adequate controls within its existing system.

Response

The MIA agrees with Finding 1 and has taken appropriate actions to meet the recommendation.

A proprietary premium tax system was licensed by the MIA from the National Association of Insurance Commissioners in February 2018. The *OPTins* system permits an insurance company to file its quarterly estimated and annual payments online. Batch deposits are transmitted to the State of Maryland account. The *OPTins* program provides report functions and other data collection abilities. *OPTins* was available for payments beginning with the 1<sup>st</sup> quarter estimate that was due on April 15, 2018. *OPTins* will be available for annual premium tax statement online filings when the 2018 statements are due in early 2019.

The current system will be maintained with the following change. The Audit Workbook data base Worksheets have been password protected with the password retained by the Premium Tax Supervisor. Premium Tax Auditors will not be permitted to amend source data contained in the Audit Workbook. Saved PDF copies of the analysis sheets and notes of the Audit Workbook will continue to be required.

**Finding 2**

MIA did not establish adequate controls over the processing of premium tax refunds paid to insurance companies.

Recommendation

We recommend that MIA

- a. ensure that approved premium tax refund requests are not returned to the premium tax auditor prior to the processing of the refund payment by the Fiscal Services unit; and
- b. pursue, with the Comptroller of Maryland, the use of a payment method in the State's accounting system for refunds issued that enforces the use of the State's vendor table.

## Response

The MIA agrees with Finding 2, but respectfully submits that the below-described alternate methodology addresses the potential gap in control addressed by Recommendation (a).

Steps 4, 7, and 8 have been added to the current procedure.

1. The Refund Request is reviewed by the Premium Tax Supervisor along with conducting the Supervisory Review of the audit and, if approved, the status is enrolled in the Master Completion Schedule.
2. If approved by the Premium Tax Supervisor, the Refund Request is delivered to the Associate Commissioner for review and approval.
3. Upon the Associate Commissioner's approval, the Refund Request is returned to the Premium Tax Supervisor who enrolls the approval on the Master Completion Schedule.
4. *The Premium Tax Supervisor creates an Approved Refund and Invoice Schedule and electronically transmits the schedule in .pdf format directly to the Fiscal Director.*
5. The Premium Tax Supervisor then delivers the Refund Request to the Premium Tax Auditor in order for the approval documents to be scanned to update the file and appropriate communication made to the company as necessary.
6. After documentation of the file, the Premium Tax Auditor delivers the Refund Request to the Fiscal Unit.
7. *The Fiscal Unit will confirm the Refund Request against the Approved Refund and Invoice Schedule provided directly from the Premium Tax Supervisor and contact the Premium Tax Supervisor directly with questions.*
8. *The Fiscal Unit will verify the insurance company address prior to processing the refund payment.*

These changes address the concerns indicated by Finding 2, Recommendation 2(a), as the approved refund amount is confirmed directly between the Premium Tax Supervisor and the Fiscal Director. No refund may be issued that is not on the *Approved Refund and Invoice Schedule*. Further, an unauthorized change to the Refund Request will be obvious when compared to the *Approved Refund and Invoice Schedule*. This change will eliminate the need for hiring an additional staff member to complete the scanning before redirecting a Refund Request back to the Premium Tax Auditor. Finally, the MIA will investigate the potential use of the State's accounting system for premium tax refunds.

## **Finding 3**

Employees who processed certain producer license applications also had the capability to approve the licenses.

## Recommendation

We recommend that MIA work with the system vendor to enhance system capabilities to ensure manually processed producer licenses are subject to independent online approval requirements.

## Response

The MIA agrees with Finding 3. At the time of the audit, online applications were automatically approved by the vendor's system if specific pre-determined criteria were met. At the same time, however, the vendor's system was unable to separate the role and permission for entering data from an application into the system from the role and permission for approving the application in the system. As a result, the MIA had previously implemented an internal policy and procedure requiring each staff member to expressly acknowledge in writing that they understood that a staff member who entered data from an application into the system could not also approve the application and a person who had permission to approve an application could not also enter data from the application into the system. The Examination and Audit Unit at the MIA was responsible for reviewing 10% of these applications for compliance.

Since the audit, the vendor has successfully revised the system so that a person who has permission to enter data from an application into the system cannot also approve the application. The MIA and vendor are now working on a revision to the system to ensure that a person who has permission to approve an application cannot also enter data from the application into the system. While the vendor continues to work on this revision, the MIA continues to use its previously developed internal policy and procedure. In addition, the MIA has initiated a process whereby as part of its review of 10% of the applications not automatically approved, the Examinations and Audit Unit reviews 100% of paper applications received.

## **Finding 4**

Controls over cash receipts and non-cash receipts were not sufficient.

### Recommendation

We recommend that MIA ensure

- a. that an employee who does not have access to collections performs and documents the deposit verification,
- b. that the initial record of checks received is reconciled with the record of checks destroyed in compliance with the aforementioned State Treasurer's *Policy*,
- c. that deposited checks are destroyed within the time frame required by the State Treasurer's *Policy*, and
- d. that non-cash credits to accounts receivable are subject to independent supervisory review and approval.

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

## Response

The MIA agrees with Finding 4 and with Recommendations 1(a) through 1(d). Corrective action plans have been implemented to ensure that an employee who is responsible for performing the verification of collections initially recorded on the check log to the subsequent deposit does not act in a back-up capacity for an employee who handles cash receipts. Further that such employee

does not have access to the safe where collections are kept prior to deposit. In addition, prior to destroying deposited checks in accordance with the time frame and other requirements found in the Comptroller of Maryland's *Accounting Procedures Manual*, checks are first reconciled with the record of checks received and recorded. Finally, all non-cash credits to accounts receivable are independently reviewed, verified, and approved by a supervisor.

#### **Finding 5**

Business partners had excessive access into the MIA computer network.

#### Recommendation

We recommend that MIA secure its internal network by limiting its business partners' remote VPN connections access to only those destination addresses required per contractual responsibilities.

#### Response

The MIA agrees with Finding 5. The MIA also agrees with the "least privilege" security defense principal and uses filters to limit business partner access to designated servers. Due to an administrative oversight when setting up a particular development contractor's VPN account, the appropriate filter was not selected. The appropriate filter has since been added to this contractor's account. Going forward, the MIA will ensure that such filters are appropriately added.

#### **Finding 6**

MIA did not have a complete information technology disaster recovery plan (DRP) for recovering computer operations.

#### Recommendation

We recommend that MIA

- a. develop and implement a comprehensive DRP that is in accordance with the aforementioned *Information Technology Disaster Recovery Guidelines*; and
- b. periodically test the DRP, documenting the testing and retain the documentation for future reference.

#### Response

The MIA agrees with Finding 6 and that the Agency Disaster Recovery Plan needs improvement and should be tested on a periodic basis. The MIA's current Disaster Recovery Plan was updated in August 2017 to incorporate changes to the MIA's Business Critical Systems and improvements to the MIA's Back-up Procedures. As stated in the Disaster Recovery plan, the

MIA does not currently have an off-site system recovery site defined or under contract. In the event of a disaster causing the MIA data center at St. Paul Place to become inoperable, an alternate data center location will need to be identified and leased by the MIA COOP team before any system restoration activities may begin. The MIA agrees that periodic testing of the DRP is needed along with documenting the testing and retaining the documentation for future reference.

### **Finding 7**

MIA lacked assurance that the insurance producer pre-licensing, licensing, and disaster recovery services systems, each managed by separate service providers, were each sufficiently protected against operational and security risks.

### **Recommendation**

We recommend that MIA:

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

### **Response**

The MIA agrees with Recommendation 7(a) and will ensure that, upon renewal, its pre-licensing vendor contract includes a requirement to provide a SOC 2 Type 2 Report. The MIA wishes to point out, however, that while the pre-licensing vendor contract does not now contain a requirement to provide a SOC 2 Type 2 Report, the MIA did request, receive and review a 2016 SOC 1 Type 2 Report for this vendor. With respect to Recommendation 7(b), the MIA agrees that it did not contractually require and did not review a SOC 2 Type 2 Report for a subcontractor of its insurance producer licensing vendor and failed to review the SOC 2 Type 2 Report for its disaster recovery services vendor in a timely manner.

AUDIT TEAM

**Heather A. Warriner, CPA**  
Audit Manager

**Stephen P. Jersey, CPA, CISA**  
Information Systems Audit Manager

**Nelson W. Hopkins, CPA**  
Senior Auditor

**R. Brendan Coffey, CPA, CISA**  
Information Systems Senior Auditor

**Timothy S. Rice**  
**Winnie J. Tenekam**  
Staff Auditors

**Roman J. Gouin**  
**Justin P. Vlahacos**  
Information Systems Staff Auditors