

Audit Report

Maryland Insurance Administration

December 2008



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

Bruce A. Myers, CPA
Legislative Auditor

December 8, 2008

Senator Verna L. Jones, Co-Chair, Joint Audit Committee
Delegate Steven J. DeBoy, Sr., Co-Chair, Joint Audit Committee
Members of Joint Audit Committee
Annapolis, Maryland

Ladies and Gentlemen:

We have audited the Maryland Insurance Administration (MIA) for the period beginning December 21, 2004 and ending December 31, 2007. MIA is responsible for licensing and regulating insurers and insurance agents and brokers who conduct business in the State, and for monitoring the financial solvency of licensed insurers.

Our audit disclosed that the Maryland Health Insurance Plan (MHIP) did not achieve cost savings, estimated to total approximately \$300,000 during fiscal year 2007, because MHIP's third party administrator did not implement a pharmacy benefits exclusion imposed by MHIP. This exclusion would have denied pharmacy benefits relating to pre-existing conditions of new MHIP participants for a specified period of time. Furthermore, MHIP did not verify that the administrator met certain contract performance standards, such as time limits for determining applicant eligibility and for paying claims. In addition, we noted that MHIP submitted a claim for approximately \$1.4 million to MHIP's former third party administrator for overpayment of benefit claims. However, the former administrator is disputing the basis of MHIP's claim. Effective October 1, 2008, MHIP became an independent unit of State government.

Our audit also disclosed certain control deficiencies related to the processing of insurance producer licenses, thus reducing assurance that all such licenses were properly issued. In addition, we found that the vendor responsible for the administration of insurance agent and broker testing had underpaid MIA testing fees totaling approximately \$71,000. Also, MIA had erroneously issued accounts receivable credits to an insurance company totaling approximately \$154,000. After our inquiries, MIA was able to collect both of these amounts from the applicable parties.

Finally, we noted numerous security and control deficiencies with respect to MIA's information systems and certain other record keeping and control deficiencies regarding premium taxes, cash receipts, and equipment.

Since 6 findings in this report have been repeated from our preceding report, MIA is required by State law to submit quarterly corrective action status reports to the Office of Legislative Audits until satisfactory progress is made to address the 15 findings in this report.

An Executive Summary of our findings can be found on page 5. 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,

Bruce A. Myers, CPA
Legislative Auditor

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Executive Summary

Legislative Audit Report on Maryland Insurance Administration (MIA) December 2008

- **The Maryland Health Insurance Plan's (MHIP) third party administrator, which is responsible for the operational functions of the plan including claim payments, did not implement a pharmacy benefits exclusion when imposed by MHIP. As a result of the administrator's failure to immediately implement the exclusion, MHIP did not achieve cost savings which it estimated could have totaled as much as \$300,000.**

MIA, in conjunction with MHIP, should take steps to determine the actual amount of lost cost savings and to recover such amounts from the administrator.

- **Certain performance standards included in its contract with the third party administrator were not being verified by MHIP. These standards included, for example, specific time limits for making eligibility determinations for MHIP applicants, and for paying claims.**

MIA, in conjunction with MHIP, should verify that all contract performance standards are being met.

- **A claim totaling approximately \$1.4 million made by MHIP against its former third party administrator for benefit overpayments is in dispute. The claim is based on an audit performed by a consulting firm hired by MHIP to examine benefit claims processed by the former administrator.**

MIA, in conjunction with MHIP and in consultation with legal counsel, should take appropriate action to resolve this dispute and collect any amounts due.

- **Controls over MIA's insurance producer licensing were not sufficient. For example, certain employees had system access which allowed them to process and approve licensing applications without independent review and approval.**

MIA should take the recommended actions to improve controls over the insurance producer licensing process.

- **MIA did not adequately verify certain critical provisions of its contract for the administration of insurance agent and broker testing, such as the remission of test fees to MIA. Based on our testing and inquiries, it was determined that the vendor hired to administer these tests underpaid fees remitted to MIA by approximately \$71,000 in fiscal year 2008. MIA subsequently collected this amount from the vendor.**

MIA should adequately monitor and enforce all critical contract provisions.

- **Controls over the processing of non-cash credit adjustments to MIA's accounts receivable records were not sufficient. For example, output reports of processed credits were not generated and verified to supporting documentation. Our testing of selected credits disclosed two credits totaling approximately \$154,000 which had been issued in error. After our inquiries, MHIP subsequently recovered this amount from the applicable insurance company.**

MIA should implement the recommended procedures to improve controls over the processing of non-cash credits.

- **Interest and penalties on unpaid premium taxes were not accurately calculated by its automated system, and MIA's record of premium tax revenues was not reconciled with the State's accounting records in a timely or comprehensive manner. Premium taxes totaled approximately \$282 million in fiscal year 2007.**

MIA should ensure that the premium tax system correctly calculates interest and penalties and that its record of premium tax revenue is reconciled with the corresponding State's records in a timely and comprehensive manner.

- **Numerous security and control deficiencies were noted with regard to MIA's information systems. For example, critical network devices were not protected from external and internal threats.**

MIA should take the recommended actions to improve controls and security.

Background Information

Agency Responsibilities

The Maryland Insurance Administration (MIA) operates under the authority of Title 2 of the Insurance Article of the Annotated Code of Maryland. MIA is responsible for licensing and regulating insurers and insurance agents and brokers who conduct business in the State, and for monitoring the financial solvency of licensed insurers. We were advised that, as of December 31, 2007, there were 73 domestic (based in Maryland) and 1,449 foreign (based in other states) insurers authorized to conduct business in the State. MIA's records also indicated that direct premiums written by domestic and foreign companies operating in Maryland in 2007 totaled \$25.8 billion.

The Maryland Health Insurance Plan (MHIP) also operated within MIA until it became an independent unit of State government effective October 1, 2008. MHIP was established by the law to provide subsidized health insurance benefits to medically uninsurable State residents. As noted, Chapter 259, Laws of Maryland, 2008 removed MHIP from MIA and established it as an independent unit.

The Insurance Article, Section 19-802 of the Annotated Code of Maryland established the Maryland Health Care Provider Rate Stabilization Fund effective April 1, 2005 to serve several purposes, including retention of certain health care providers in the State by subsidizing their malpractice insurance premiums for a specified number of years. The Fund is administered by the Commissioner of MIA and, by law, we audit the receipts and disbursements of the Fund on an annual basis. The results of those audits are reported separately from our audits of MIA.

According to the State's records, total MIA expenditures were approximately \$150.2 million during fiscal year 2007, and revenues (excluding those from the Rate Stabilization Fund and MHIP) totaled approximately \$312.3 million; the majority of these revenues related to premium tax collections.

Status of Findings From Preceding Audit Report

Our audit included a review to determine the status of the 16 findings contained in our preceding audit report dated October 17, 2005. We determined that MIA had satisfactorily resolved 10 findings. The remaining 6 findings are repeated in this report.

Findings and Recommendations

Maryland Health Insurance Plan

Background

Chapter 153, Laws of Maryland, 2002 established the Maryland Health Insurance Plan (MHIP) as an independent unit which, until October 1, 2008, operated within the Maryland Insurance Administration (MIA) and was included in MIA's budget. Chapter 259, Laws of Maryland, 2008 removed MHIP from MIA and established it as an independent unit of State government effective October 1, 2008. Since MHIP was a unit within MIA during the audit period, it was included within the scope of our current audit of MIA, and the results of our review of MHIP are included in this report.

MHIP is governed by a Board of Directors, and primarily provides subsidized health insurance benefits to medically uninsurable residents of the State. By law, the health insurance component of MHIP is funded by annual assessments on the gross revenue of hospitals in the State and by insurance premiums paid by MHIP members. According to MHIP's fiscal year 2007 audited financial statements, these assessments and premiums totaled approximately \$112 million, and plan benefits paid (and incurred but not yet paid) as of June 30, 2007 totaled approximately \$84.1 million. As of June 30, 2007, MHIP had a fund balance of approximately \$139.3 million.

MHIP is administered by a third party administrator who is responsible for all operational functions of MHIP, including enrollment, premium billing and collection, and payment of provider claims. Claims are initially paid from premiums collected, but if claims exceed premiums collected, the administrator is reimbursed by MHIP. The administrator is paid certain monthly fees, including an administrative fee for each MHIP member. According to MIA's records, fees paid to the administrator totaled approximately \$5 million in fiscal year 2007 and MHIP enrollment totaled approximately 11,000 for the year. As of July 1, 2007, MHIP hired a new vendor to serve as its third party administrator. The previous vendor had been in place since MHIP's inception.

Finding 1

The third party administrator did not implement a pharmacy benefits exclusion as dictated by MHIP. Consequently, MHIP did not achieve cost savings which it estimated could have totaled as much as \$300,000.

Analysis

The third party administrator did not implement a pharmacy benefits exclusion as dictated by MHIP beginning July 1, 2007. Although a final determination had not been made at the time of our review, MHIP estimated that cost savings achieved from the exclusion could have totaled as much as \$300,000. Under the exclusion, new MHIP participants would, for a specified period of time, be denied pharmacy benefits relating to pre-existing conditions.

Despite the fact that MHIP's contract permits MHIP to dictate, as it did, an exclusion of benefits for the treatment of a pre-existing condition for the first six months of a member's coverage to the extent permitted by law, the administrator contended that it was unable to implement the exclusion because of certain administrative restrictions regarding the identification of pre-existing conditions.

We were advised by MHIP that an agreement was subsequently reached under which the administrator implemented the exclusion effective July 1, 2008. However, we were also advised that there has been no resolution regarding lost cost savings resulting from the administrator's failure to initially implement the exclusion. Although MHIP determined that \$300,000 could be the maximum potential recovery, additional steps are necessary to determine and recover the actual amount due.

Recommendation 1

We recommend that MIA, in conjunction with MHIP, perform an analysis of pharmacy benefits paid under MHIP to determine the actual amount of lost cost savings resulting from the administrator's failure to implement the pharmacy benefits exclusion timely. We further recommend that steps be taken to recover such amounts from the administrator.

Finding 2

MHIP did not verify that certain performance standards required by its contract with the third party administrator were met.

Analysis

MHIP did not verify that certain monthly performance standards required by its contract with the third party administrator were met. The standards relate

primarily to the timing of eligibility determinations, claim payments, and certain other services provided to MHIP members. For example, the standards require that the administrator make eligibility determinations for an applicant within 3 calendar days, that 98 percent of complete and accurate claims received be paid within 30 calendar days of receipt, and that 85 percent of all calls received by the administrator be answered within 30 seconds. However, as of June 2008, MIA had not received any of the required information from the contractor in order to verify that these performance requirements had been met even though the contract had been in effect since July 2007. The contract provides that certain liquidated damages may be imposed for the failure to meet these requirements, such as a one percent reduction in the monthly fee due to the administrator for each standard not met.

Recommendation 2

We recommend that MIA, in conjunction with MHIP, verify that all contract performance standards are being met, and that documentation of this verification be maintained. We further recommend that liquidated damages be imposed as warranted.

Finding 3

A claim totaling approximately \$1.4 million made by MHIP against its former third party administrator is in dispute.

Analysis

In June 2008, MHIP requested payment totaling approximately \$1.4 million from its former third party administrator for claim overpayments made during the last two years of its contract ending June 30, 2007. However, the former administrator is disputing this request, which was based on the results of a claim audit conducted in November 2007 by a consulting firm hired by MHIP. The audit included the examination of selected claims processed for various attributes, such as claimant eligibility, accuracy, authorization, and whether the claim was adequately supported and properly recorded. The firm's April 2008 report noted numerous errors resulting in claim overpayments including, for example, a lack of required authorization and the ineligibility of the participant at the time of service.

A response to the report findings was provided by the subcontractor used by the former administrator to conduct the day-to-day operations of MHIP, including claims processing. In its response, the subcontractor disagreed with the findings by noting, for example, fundamental differences in error definitions and disagreements with how errors were tabulated. Furthermore, in a letter to MHIP dated August 12, 2008, the administrator stated that there were errors and

inaccuracies in the final report and reiterated that the findings were in dispute. In addition, a subsequent letter to MHIP from the administrator's legal counsel stated that MHIP's request for payment was flawed due, in part, to the fact that it was not based on actual overpayments, but relied on extrapolation of sample results to a larger claims population. In a September 2008 letter, MIA's legal counsel responded to the administrator's counsel by noting certain counter-arguments, and essentially stating that MHIP's Board of Directors is obligated to protect the interests of MHIP and, therefore, has no option but to seek recovery of any overpayment of MHIP benefits.

Recommendation 3

We recommend that MIA, in conjunction with MHIP and in consultation with legal counsel, continue its efforts to resolve this dispute and collect amounts due.

Producer Licensing

Finding 4

Controls over insurance producer licensing were not sufficient.

Analysis

Controls over the issuance of producer licenses were not sufficient. Specifically, we noted the following conditions:

- There was no procedure in place to verify, at least on a test basis, licenses issued from the system to authorized supporting documentation to help ensure that only valid licenses were issued. In addition, although required by their job duties, six employees had system access which allowed them to process and approve licensing applications without independent review and approval. According to MIA's records, during fiscal year 2007, approximately 64,000 applications for producer licenses (including renewal applications) were approved.
- Two employees had responsibility for assigning system access permissions to MIA employees based on authorization received from designated supervisory personnel. However, there was no independent verification of system output reports of critical access assignments or modifications processed to appropriate supporting documentation. Consequently, there was a lack of assurance that all such transactions were proper.

- As of June 2008, there were seven individuals who had access to the system, but either no longer worked at MIA or had transferred from the producer licensing department to another unit and did not require the access. These individuals resigned or were transferred between March 2007 and April 2008.

An insurance producer is an individual who, for compensation, sells, solicits, or negotiates insurance contracts, or the renewal of insurance contracts for persons issuing such contracts. MIA is responsible for licensing producers based on certain established criteria, such as education or experience requirements. In our preceding audit report, we commented that, in September 2005, two former MIA employees pled guilty to certain criminal charges relating to unauthorized use of the licensing system. It is incumbent upon MIA to continually ensure that all system access is adequately controlled and that critical system output is properly verified.

Recommendation 4

We recommend that independent supervisory personnel verify, at least on a test basis, producer licenses issued to authorized supporting documentation. Similarly, we recommend that output reports of critical additions and modifications to producer licensing system access be independently verified to appropriate supervisory authorizations. Furthermore, we recommend that all system access be terminated on a timely basis for employees who leave MIA or no longer require such access to perform their job functions, including the seven individuals noted above. We advised MIA on accomplishing the necessary separation of duties using existing personnel.

Contractual Services

Finding 5

MIA did not adequately monitor certain critical provisions of its contract for the administration of insurance agent and broker testing.

Analysis

MIA did not adequately monitor certain critical provisions of its contract for the testing of insurance agent and broker candidates. Specifically, the accuracy of the vendor's remission of test fees to MIA was not adequately verified. In this regard, MIA was underpaid approximately \$71,000 in test fees, primarily during fiscal year 2008. In addition, MIA did not obtain documentation that the vendor had obtained \$1 million in general liability insurance as required by the contract.

MIA hired a vendor to administer the testing of insurance agent and broker licensing candidates, including the collection of testing fees. The vendor retained a portion of the fee collected for each test administered, and the remainder was to be remitted to MIA. Approximately \$256,000 in testing fees was remitted in fiscal year 2008. Although the vendor provided MIA with summary reports of the fees it remitted, MIA did not verify the fees to other supporting documentation, such as test results, to ensure that it had received all the money to which it was entitled.

After we brought certain apparent underpayments to MIA's attention, MIA performed an analysis of fees remitted for the period June 8, 2007 through June 6, 2008. The analysis revealed that the vendor had underpaid MIA by \$70,675, which the vendor remitted to MIA on June 20, 2008. The period of analysis covered the majority of time to date for which the current vendor had been under contract for this service.

Furthermore, although the contract required the vendor to obtain general liability insurance of \$1 million, MIA did not obtain documentation supporting the vendor's compliance with this provision. After our inquiry, MIA determined that the required insurance had been obtained. Similar conditions were commented upon in our preceding audit report.

Recommendation 5

We again recommend that MIA adequately monitor all critical contract provisions. Specifically, we recommend that MIA independently verify, through examination of supporting records, that it receives all fees due. We also again recommend that MIA obtain documentation to verify insurance requirements have been met.

Accounts Receivable

Finding 6

Controls over the processing of non-cash credit adjustments to accounts receivable were not sufficient, and our testing disclosed credits totaling approximately \$154,000 that were processed in error.

Analysis

Controls over the processing of non-cash credit adjustments to accounts receivable (such as insurance company assessments) were not sufficient. According to MIA's records, these credits totaled approximately \$625,000 for the

first eight months of fiscal year 2008. Specifically, we noted the following conditions:

- Two employees with the ability to record non-cash credit adjustments on the automated accounts receivable records also had the capability to modify remittance addresses on the automated billing notices. Consequently, these employees could direct payers to remit payments to an unauthorized location and conceal the misappropriation by preparing a non-cash credit adjustment. The Department of Budget and Management's manual on *Internal Control and Security Policy and Procedures* specifies that employees who can alter remittance addresses should not have the capability to process non-cash credits.
- Output reports of non-cash credits recorded on the accounts receivable records were not generated and verified to supporting documentation to ensure that only valid and authorized credits were recorded. Our review of 12 credits recorded during fiscal years 2006 through 2008 totaling approximately \$2.1 million disclosed 2 credits totaling \$154,449 issued in March 2007 for which MIA was unable to provide adequate supporting documentation. Based on our inquiries, MIA determined that the credits had been issued in error and that an assessment was needed to recover the amount of the credits from the applicable insurance company. In June 2008, the company paid MIA \$154,449 for the amount due.

Similar conditions regarding employee access capabilities and the lack of a verification of recorded adjustments to output reports were commented upon in our preceding audit report.

Recommendation 6

We again recommend that employees who have the capability to process non-cash credits not be given the capability to modify billing notices. In addition, we again recommend that output reports of non-cash credits recorded on the accounts receivable records be generated and verified, at least on a test basis, to supporting documentation by independent supervisory personnel.

Furthermore, based on our findings of two significant unsupported credits, we recommend that the propriety of prior non-cash credit adjustments be verified on a test basis.

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. According to MIA's records, premium taxes collected and deposited to the State's General Fund during fiscal year 2007 totaled approximately \$282 million. Insurance companies are required to make estimated tax payments at specified intervals throughout the calendar year. By March 15th of the following year, the companies are required to file a final tax declaration of premiums written during the preceding calendar year and to remit any related premium tax due to the State. Insurance companies that do not submit premium taxes when due are subject to interest charges and penalties in accordance with the Insurance Article. Both the premium taxes and related interest or penalties are subject to subsequent audit by MIA.

Finding 7

Interest and penalties on unpaid premium taxes were not correctly calculated by MIA's automated tax system.

Analysis

Interest and penalties on unpaid premium taxes were not correctly calculated. These amounts were automatically calculated by MIA's automated premium tax system as part of MIA's tax audit process. However, our test of 12 premium tax audits in which penalties and/or interest totaling approximately \$1.1 million were calculated, disclosed that, in each instance, the amount calculated by the system was not correct. The miscalculations totaled approximately \$22,000. Since the ultimate assessment of premium taxes, including penalties and interest, could change pending resolution of the audit results, the actual impact of the miscalculation for the aforementioned tax cases could also change. While MIA was subsequently able to determine the cause of some of the miscalculations, it was uncertain as to exactly why others occurred.

Recommendation 7

We recommend that, in the future, MIA ensure that the premium tax system correctly calculates interest and penalties for unpaid premium taxes. We also recommend that MIA determine if any amounts are due from or to insurance companies as a result of previous miscalculations, and take appropriate actions, such as recovering amounts due or refunding amounts overpaid.

Finding 8

MIA's records of premium tax revenues were not reconciled with the State's accounting records in a timely or comprehensive manner.

Analysis

MIA did not reconcile its record of premium tax revenues with the corresponding State records in a timely manner. As of May 2008, the most recently completed reconciliation of the two records was for the month of October 2007.

Furthermore, differences identified during the reconciliation of the records were not documented as resolved. For example, the October 2007 reconciliation disclosed two tax payments totaling approximately \$68,000 that were received and recorded in the State's records in October, but as of May 2008 had not been recorded in MIA's records. Consequently, there was a lack of assurance that all premium tax transactions were properly accounted for.

The lack of timely reconciliations has been commented upon in our four prior audit reports dating back to November 1996.

Recommendation 8

We again recommend that MIA reconcile its premium tax records with the corresponding State records in a timely manner. In addition, we recommend that MIA document the investigation and resolution of significant reconciling items.

Cash Receipts**Finding 9**

Controls over cash receipts received in the mail were not sufficient.

Analysis

Controls over cash receipts received by mail were not sufficient. These collections, which according to MIA's records totaled approximately \$87 million in fiscal year 2007, were recorded on a cash register when received, and included primarily premium taxes and assessments, and licensing fees. However, the employee responsible for verifying that all recorded collections were deposited also had access to the receipts prior to deposit since the employee prepared the deposits. As a result, errors or other discrepancies could occur without detection. The employee who ensures that all recorded collections are subsequently deposited should not have access to the collections. A similar condition was commented upon in our preceding audit report.

Recommendation 9

We again recommend that an employee independent of the cash receipts function verify that all recorded collections are deposited. We advised MIA on accomplishing the necessary separation of duties using existing personnel.

Information Systems Security and Control

Background

MIA's Management Information Systems Division manages the development, maintenance, and support of the MIA information technology infrastructure including all related networking, telecommunications, and business information systems. The Division maintains a network which includes email, application, and database servers and connectivity to the Internet. Furthermore, the Division operates web enabled systems, including a licensing application which allows for online payment of associated licensing costs by insurance companies and producers.

Finding 10

MIA's computer network was not adequately secured.

Analysis

Adequate security measures had not been established to protect MIA's critical network devices and administrative systems from external and internal threats. Specifically, we noted the following conditions:

- Several publicly accessible servers were located on the internal network rather than in a separate network zone to minimize security risks. These publicly accessible servers, which could potentially be compromised, exposed the internal network to attack from external sources. The Department of Information Technology's *Network Security Standard* requires that all publicly accessible servers be placed in a neutral network zone.
- A critical firewall's logs were stored on the device itself and not recorded on a separate logging server and, as a result, the logs were not adequately safeguarded from alteration or deletion. Furthermore, log files stored on the firewall were overwritten when filled, resulting in lost logging information. Separately, neither of MIA's two firewalls sent alerts to network administrators advising them of configuration changes detected by the devices. Additionally, although MIA personnel advised us that the firewalls' log files were regularly reviewed, these reviews were not documented.

- Administrative connections to the MIA firewalls were allowed from all individuals on the internal network rather than from only the firewall administrators. Access rules for critical network devices should use a “least privilege” security strategy which gives individuals only those privileges needed to perform assigned tasks.

Recommendation 10

We recommend that MIA place all publicly accessible servers in a separate network zone to minimize security risks. We also recommend that logging for MIA’s firewalls be recorded on a separate logging server and that alerts be sent to network administrators for serious concerns detected by the devices. Furthermore, we recommend that logs for all critical network devices be reviewed on a daily basis and that these reviews be documented and retained for future reference. Finally, we recommend that MIA limit administrative connections to its firewalls to only those individuals requiring such access.

Finding 11

Security controls over the company and producer licensing applications’ payment component were inadequate.

Analysis

Security controls over the company and producer licensing applications’ payment component were inadequate. We were advised that payments through this system totaled approximately \$3.8 million during fiscal year 2007. Specifically, we noted the following conditions:

- Controls over the credit card service provider accounts used to process credit card payments for license renewals were inadequate. We noted that a single credit card service provider account was used to both manage credit card verification and payment settings and to process credit card payments for company license renewals. A similar account was used for producer license renewals. Separate accounts should be established for credit card service management and for payment transaction processing to limit security risks, such as the improper alteration of credit card payment settings and the processing of refunds. Also, both account names and their related passwords were stored in plain text files within the licensing application. Accordingly, MIA’s credit card verification and payment settings were at risk of improper alteration from anyone capable of reading the plain text userids and passwords.

- The credit card service provider allows merchants (including MIA) to limit access to their service management accounts from only specific Internet addresses, thereby enhancing security over who could attempt to use these accounts. However, MIA did not exercise this option to limit such access. Improper access to the service management account could allow a hacker to change control settings related to the types and amounts of transactions that can be processed through the website.
- The credit card service provider allows merchants to control the processing of refunds. However, MIA's settings for the company license application allowed credits (of any amount) to be issued without association to a previous sales transaction. In the event that the website application was compromised, an attacker could potentially make unauthorized changes to the application to generate credit transactions that would otherwise not be possible based upon the application's original design.

Recommendation 11

We recommend that separate accounts be established for credit card payment transaction processing and service management to limit security risks. Additionally, we recommend that the service management and application processing accounts and passwords not be stored in plain text. We also recommend that the use of the service management accounts be restricted to defined Internet addresses. Finally, we recommend that MIA amend its refund settings and not allow a credit to exceed an original transaction amount and not to be issued without association with a previous sales transaction.

Finding 12

Administrative rights, account controls and password controls on several critical servers were not properly established.

Analysis

Administrative rights, account controls and password controls on several critical servers were not properly established. Specifically, we noted the following conditions:

- Seven programmers were improperly granted full administrator capabilities on two critical servers. As a result, these programmers could modify production data and program files without management's knowledge.

- Three critical servers had a vendor installed system account (an administrative account) that had not been renamed.
- Passwords for four accounts, including two administrator accounts, were set to never expire. In addition, the minimum password length, for all domain accounts, was set at six characters and password complexity requirements were not enabled. These password settings were not in compliance with the requirements of the Department of Information Technology's *Access Control Standard*.

Similar conditions were commented upon in our preceding audit report.

Recommendation 12

We again recommend that MIA review access rights on its critical servers and limit administrative access to only those individuals requiring such access. We also again recommend that MIA rename the vendor installed system account so that it cannot be readily identified. Finally, we again recommend that password controls be established in accordance with the requirements of the Department of Information Technology's *Access Control Standard*.

Finding 13

Password, account, and monitoring controls over a critical database were inadequate.

Analysis

Password, account, and monitoring controls over a critical database were inadequate. Specifically, we noted the following conditions:

- Passwords were set to never expire, the minimum password length was set at six characters and password complexity requirements were not enabled. In addition, account lockout after a set number of invalid logon attempts was not enabled. These password and account settings were not in compliance with the requirements of the Department of Information Technology's *Access Control Standard*.
- The database auditing feature was not installed and the database was not configured to log failed logon attempts. As a result, security-related activity was not logged for subsequent review. These conditions could result in unauthorized or inappropriate activities (affecting the integrity of the production database information) which could go undetected by management.

Recommendation 13

We recommend that password and account controls be established in accordance with the requirements of the Department of Information Technology's *Access Control Standard*. We also recommend that the database auditing feature be enabled to log significant security events and that failed logon attempts be logged. We further recommend that security reports of the logged activity be produced and regularly reviewed and that questionable items be investigated. Finally, we recommend that these reviews be documented and retained for future reference.

Finding 14

MIA did not have an adequate disaster recovery plan.

Analysis

MIA did not have an adequate disaster recovery plan. Specifically, we noted that MIA did not have a complete information technology disaster recovery plan (DRP) for recovering from disaster scenarios (for example, a fire). The Department of Budget and Management's *IT Disaster Recovery Guidelines*, dated July 2006, specify the minimum elements needed for a complete information systems' DRP. However, MIA's plan did not address many of these minimum elements. For example, the DRP did not address alternate site processing arrangements, network connectivity, and contact information for certain critical personnel. Without a complete 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 14

We recommend that, in accordance with the aforementioned *IT Disaster Recovery Guidelines*, MIA develop a disaster recovery plan that addresses the minimum elements needed for a comprehensive disaster recovery plan.

Equipment

Finding 15

MIA was not in compliance with several requirements established by the Department of General Services relating to accountability and control over equipment.

Analysis

MIA's procedures and controls for equipment were not in compliance with several requirements of the Department of General Services' (DGS) *Inventory Control Manual*. For example, a physical inventory of both sensitive and non-sensitive equipment had not been completed since May 2004. Although MIA initiated an inventory in May 2007 by scanning all equipment barcode tags, the inventory was never completed because of problems encountered when processing the scanned data. According to MIA's records, equipment totaled approximately \$2.8 million as of March 28, 2008.

Similar instances of noncompliance with the DGS *Inventory Control Manual* were commented upon in our preceding audit report. In addition, that report noted that MIA had not located or otherwise determined the disposition of 185 equipment items with a recorded cost of approximately \$231,000 that were noted as missing during the May 2004 physical inventory. Our current audit disclosed that the location or disposition of 98 of those items with a recorded cost of approximately \$110,000 had still not been determined.

The DGS *Inventory Control Manual* requires that adequate procedures and controls be maintained for equipment. For example, the *Manual* requires that a physical inventory of non-sensitive equipment be taken once every three years and once every year for sensitive equipment and provides specific procedures and requirements regarding the investigation, reporting to DGS, and removal of missing items from the supporting records.

Recommendation 15

We again recommend that MIA comply with the requirements of the DGS *Inventory Control Manual*.

Audit Scope, Objectives, and Methodology

We have audited the Maryland Insurance Administration (MIA) for the period beginning December 21, 2004 and ending December 31, 2007. 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. We also determined the status of the findings contained in our preceding audit report.

In planning and conducting our audit, we focused on the major financial-related areas of operations based on assessments of materiality and risk. Our audit procedures included inquiries of appropriate personnel, inspections of documents and records, and observations of MIA'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 scope was limited with respect to MIA's cash transactions because the Office of the State Treasurer was unable to reconcile the State's main bank accounts during a portion of the audit period. Due to this condition, we were unable to determine, with reasonable assurance, that all MIA cash transactions prior to July 1, 2005 were accounted for and properly recorded on the related State accounting records as well as the bank's records. Additionally, the Maryland Health Care Provider Rate Stabilization Fund was also not included within the scope of this audit since, as required by law, we audit this Fund annually and separately report the results.

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.

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

APPENDIX

MARTIN O'MALLEY
Governor

ANTHONY G. BROWN
Lt. Governor



RALPH S. TYLER
Commissioner

BETH SAMMIS
Deputy Commissioner

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December 4, 2008

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

Dear Mr. Myers:

Enclosed is the Maryland Insurance Administration's ("MIA") response to the draft audit report for the period beginning December 21, 2004 and ending December 31, 2007.

Findings 1-3 involve the Maryland Health Insurance Plan ("MHIP"). MHIP agrees with Findings 1-3 and has taken appropriate corrective actions with respect to each of these Findings. During the audit period, MHIP was a unit of the MIA; effective October 1, 2008, MHIP was separated from MIA and operates as an independent agency.

Findings 4-15 involve the MIA. The MIA agrees with all of these Findings. The MIA has taken or will take appropriate corrective actions so that there is no recurrence of any of these Findings. Additional details are provided in the attached responses to the Findings.

Please let me know if you have any questions, or need any additional information.

Very truly yours,

Ralph S. Tyler
Insurance Commissioner

Enclosure

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Summary of Responses to Audit Findings

Findings 1-3 involve the Maryland Health Insurance Plan (“MHIP”). MHIP agrees with Findings 1-3 and has taken appropriate corrective actions with respect to each of these Findings. During the audit period, MHIP was a unit of the Maryland Insurance Administration (“MIA”); effective October 1, 2008, MHIP was separated from MIA and operates as an independent agency.

Findings 4-15 involve the MIA. The MIA agrees with all of these Findings. The MIA has taken or will take appropriate corrective actions so that there is no recurrence of any of these Findings.

Maryland Health Insurance Plan

Finding 1

The third party administrator did not implement a pharmacy benefits exclusion as dictated by MHIP. Consequently, MHIP did not achieve cost savings which it estimated could have totaled as much as \$300,000.

Recommendation 1

We recommend that MIA, in conjunction with MHIP, perform an analysis of pharmacy benefits paid under MHIP to determine the amount of lost cost savings resulting from the administrator’s failure to implement the pharmacy benefits exclusion timely. We further recommend that steps be taken to recover such amounts from the administrator.

MIA Response:

While MHIP is an independent unit of the Administration, MHIP is, by statute, operated by an Executive Director under the direction of a nine-member Board. By statute, the operation of the Plan, and the oversight of the Fund and the activities of the Third Party Administrator are vested in the Board and not in the Administration. The recommendations, therefore, are properly directed to the Plan, and not to the Administration.

MHIP agrees with the recommendation.

MHIP has asserted to the Administrator since July 2007 that the pre-existing condition applied to pharmacy benefits. The Administrator recently signed the Agreement and acknowledges that the pre-existing condition exclusion applies to all plan benefits and is effective beginning with the Plan Year commencing July 1, 2007. In February of 2008 the Administrator agreed in principle to a proposed

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methodology for accomplishing this purpose, but a final settlement has not been agreed upon. Once a settlement is reached, MHIP will seek an adjustment for the lost value to the Plan for the period from July 1, 2007 through June 30, 2008. Based on an initial review by MHIP staff, \$308,835 in drug costs were associated with members subject to the pre-existing condition exclusion during July 2007 through June 2008. Not all of the \$308,835 in drug costs were associated with excluded pre-existing health conditions, so the final recovered amount will be a lower figure. This information was shared with the Legislative Auditor.

Finding 2

MIA did not verify that certain performance standards required by its contract with the third party administrator were met.

Recommendation 2

We recommend that the MIA, in conjunction with MHIP, verify that all contract performance standards are being met, and that documentation of this verification be maintained. We further recommend that liquidated damages be imposed as warranted.

MIA Response:

While MHIP is an independent unit of the Administration, MHIP is, by statute, operated by an Executive Director under the direction of a nine-member Board. By statute, the operation of the Plan, and the oversight of the Fund and the activities of the Third Party Administrator are vested in the Board and not in the Administration. The recommendations, therefore, are properly directed to the Plan, and not to the Administration.

MHIP agrees with the recommendation.

Recently, MHIP and the Third Party Administrator resolved a potential system-based obstacle to evaluating the performance standards appropriately. MHIP staff issued the final results of an audit of CareFirst's eligibility determinations on July 18, 2008, a preliminary draft of which was shared with the Office of Legislative Audits on July 2, 2008. MHIP is currently in discussions with the Administrator regarding \$93,160 in performance guarantee penalties for FY08. MHIP intends to assess compliance with all performance standards and to impose liquidated damages if warranted.

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Finding 3

A claim totaling approximately \$1.4 million made by MHIP against its former third party administrator is in dispute.

Recommendation 3

We recommend that MIA, in conjunction with MHIP and in consultation with legal counsel, continue its efforts to resolve this dispute and collect amounts due.

MIA Response:

While MHIP is an independent unit of the Administration, MHIP is, by statute, operated by an Executive Director under the direction of a nine-member Board. By statute, the operation of the Plan, and the oversight of the Fund and the activities of the Third Party Administrator are vested in the Board and not in the Administration. The recommendations, therefore, are properly directed to the Plan, and not to the Administration.

MHIP agrees with the recommendation and will continue to pursue recovery of incorrect payments by the prior Plan Administrator.

Producer Licensing

Finding 4

Controls over insurance producer licensing were not sufficient.

Recommendation 4

We recommend that independent supervisory personnel verify, at least on a test basis, producer licenses issued to authorized supporting documentation. Similarly, we recommend that output reports of critical additions and modifications to producer licensing system access be independently verified to appropriate supervisory authorizations. Furthermore, we recommend that all system access be terminated on a timely basis for employees who leave MIA or no longer require such access to perform their job functions, including the seven individuals noted above. We have advised MIA on accomplishing the necessary separation of duties using existing personnel.

MIA Response:

The Administration agrees with the recommendation. Independent supervisory personnel verify on a test basis, that producer licenses issued match authorized supporting documentation. The Director of Producer Licensing randomly generates a report each month of all initial and renewal license applications that

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were placed in a pending status and subsequently resolved manually. Each application is verified against the supporting documentation used to approve the license application. A spreadsheet is maintained to document that this verification took place.

The Administration also agrees with the recommendation that output reports of critical additions and modifications to the producer licensing system be independently verified to appropriate supervisory authorizations. A monthly report of system permissions is now being verified against the appropriate supervisory permissions. The employee verifying permissions is not the same person who has the responsibility for assigning permissions to access the system.

The Administration agrees and has implemented the recommendation that all system access be terminated on a timely basis for employees who leave the MIA or no longer require such access to perform their job duties.

With reference to the two former employees who had unauthorized access to the system, MIA took corrective action immediately and the matter has been closed since September 8, 2005.

Contractual Services

Finding 5

MIA did not adequately monitor certain critical provisions of its contract for the administration of insurance agent and broker testing.

Recommendation 5

We again recommend that MIA adequately monitor all critical contract provisions. Specifically, we recommend that MIA independently verify, through examination of supporting records, that it receives all fees due. We also again recommend that MIA obtain documentation to verify insurance requirements have been met.

MIA Response:

The Administration agrees with the recommendation. The MIA is verifying the exam fees collected and remitted to the MIA against the supporting records to ensure it has received all fees due. The MIA notes that as soon as the underpayment of the MIA's portion of the exam fees was discovered, the vendor immediately remitted the balance due.

With reference to the issue of insurance, the contract required and the vendor maintains, and continues to maintain, general liability insurance. The vendor has provided us with a Certificate of Insurance.

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Accounts Receivable

Finding 6

Controls over the processing of non-cash credit adjustments to accounts receivable were not sufficient, and our testing disclosed credits totaling approximately \$154,000 that were processed in error.

Recommendation 6

We again recommend that employees who have the capability to process non-cash credits not be given the capability to modify billing notices. In addition, we again recommend that output reports of non-cash credits recorded on the accounts receivable records be generated and verified, at least on a test basis, to supporting documentation by independent supervisory personnel. Furthermore, based on our findings of two significant unsupported credits, we recommend that the propriety of prior non-cash credit adjustments be verified on a test basis.

MIA Response:

The Administration has implemented the auditor's recommendations. In addition, the MIA has received and reviewed the non-cash credit transactions report for Fiscal Year 2007 and Fiscal Year 2008 and the adjustments are appropriate. There has been no loss of revenue.

Premium Taxes

Finding 7

Interest and penalties on unpaid premium taxes were not correctly calculated by MIA's automated tax system.

Recommendation 7

We recommend that, in the future, MIA ensure that the premium tax system correctly calculates interest and penalties for unpaid premium taxes. We also recommend that MIA determine if any amounts are due from or to insurance companies as a result of previous miscalculations, and take appropriate actions, such as recovering amounts due or refunding amounts overpaid.

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MIA Response:

The Administration agrees and will comply with the auditor's recommendation. The system is now calculating penalty and interest correctly.

Finding 8

MIA's records of premium tax revenues were not reconciled with the State's accounting records in a timely or comprehensive manner.

Recommendation 8

We again recommend that MIA reconcile its premium tax records with the corresponding State records in a timely manner. In addition, we recommend that MIA document the investigation and resolution of significant reconciling items.

MIA Response:

The Administration agrees and has instituted the auditor's recommendation. As of month-end November 2008, the most recently completed reconciliations are complete through September 2008. Differences identified during the reconciliations are documented and resolved.

Cash Receipts

Finding 9

Controls over cash receipts received in the mail were not sufficient.

Recommendation 9

We again recommend that an employee independent of the cash receipts functions verify that all recorded collections are deposited. We advised MIA on accomplishing the necessary separation of duties using existing personnel.

MIA Response:

The Administration has implemented the auditor's recommendation. All receipts are verified independently and deposited correctly. There has been no loss of revenue.

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Information Systems Security and Control

Finding 10

MIA's computer network was not adequately secured.

Recommendation 10

We recommend that MIA place all publicly accessible servers in a separate network zone to minimize security risks. We also recommend that logging for MIA's firewalls be recorded on a separate logging server and that alerts be sent to network administrators for serious concerns detected by the devices. Furthermore, we recommend that logs for all critical network devices be reviewed on a daily basis and that these reviews be documented and retained for future reference. Finally we recommend that MIA limit administrative connections to its firewalls to only those individuals requiring such access.

MIA Response:

The Administration agrees with the recommendations. All firewall corrective actions will be completed by December 31, 2008. The migration of publicly accessible servers will be completed by April 30, 2009.

Finding #11

Security controls over the company and producer licensing applications' payment component were inadequate.

Recommendation 11

We recommend that separate accounts be established for credit card payment transaction processing and service management to limit security risks. Additionally, we recommend that the service management and application processing accounts and passwords not be stored in plain text. We also recommend that the use of service management accounts be restricted to defined Internet addresses. Finally, we recommend that the MIA amend its refund settings and not allow a credit to exceed an original transaction amount and not to be issued without association with a previous sales transaction.

MIA Response:

The Administration agrees and will comply with the recommendations by December 31, 2008.

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Finding 12

Administrative rights, account controls and password controls on several critical servers were not properly established.

Recommendation 12

We again recommend that MIA review access rights on its critical servers and limit administrative access to only those individuals requiring such access. We also again recommend that MIA rename the vendor installed system account so that it cannot be readily identified. Finally we again recommend that password controls be established in accordance with the requirements of the Department of Information Technology's *Access Control Standard*.

MIA Response:

The Administration agrees and will comply with the recommendations by December 31, 2008.

Finding 13

Password, account, and monitoring controls over a critical database were inadequate.

Recommendation 13

We recommend that password and account controls be established in accordance with the requirements of the Department of Information Technology's *Access Control Standard*. We also recommend that the database auditing feature be enabled to log significant security events and that failed logon attempts be logged. We further recommend that security reports of the logged activity be produced and regularly reviewed and that questionable items be investigated. Finally, we recommend that these reviews be documented and retained for future reference.

MIA Response:

The Administration agrees and will comply with the recommendations by June 30, 2009.

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Finding 14

MIA did not have an adequate disaster recovery plan.

Recommendation 14

We recommend that, in accordance with the aforementioned *IT Disaster Recovery Guidelines*, MIA develop a disaster recovery plan that addresses the minimum elements needed for a comprehensive disaster recovery plan.

MIA Response:

The Administration agrees and will comply with the recommendations by June 30, 2009.

Equipment

Finding 15

MIA was not in compliance with several requirements established by the Department of General Services relating to accountability and control over equipment.

Recommendation 15

We again recommend that the Administration comply with the requirements of the *DGS Inventory Control Manual*.

MIA Response:

The Administration agrees with the auditor's recommendation. An inventory was completed in June 2008 of all items. The report for FY2008 was filed by the Sept 15 deadline as required. The un-reconciled difference between the detail and control records is now approximately \$26,000 which is 0.9% of total inventory.

Remaining tasks are the final reconciliation of missing, stolen and damaged equipment, and requesting permission to write-off any un-reconciled difference between the control and detailed accounts. These tasks will be completed by June 30, 2009.

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