

Audit Report

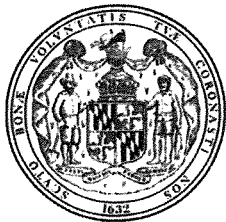
Maryland Automobile Insurance Fund

September 2012



OFFICE OF LEGISLATIVE AUDITS
DEPARTMENT OF LEGISLATIVE SERVICES
MARYLAND GENERAL ASSEMBLY

-
- This report and any related follow-up correspondence are available to the public through the Office of Legislative Audits at 301 West Preston Street, Room 1202, Baltimore, Maryland 21201. The Office may be contacted by telephone at 410-946-5900, 301-970-5900, or 1-877-486-9964.
 - Electronic copies of our audit reports can be viewed or downloaded from our website at <http://www.ola.state.md.us>.
 - Alternate formats may be requested through the Maryland Relay Service at 1-800-735-2258.
 - The Department of Legislative Services – Office of the Executive Director, 90 State Circle, Annapolis, Maryland 21401 can also assist you in obtaining copies of our reports and related correspondence. The Department may be contacted by telephone at 410-946-5400 or 301-970-5400.
-



Karl S. Aro
Executive Director

DEPARTMENT OF LEGISLATIVE SERVICES
OFFICE OF LEGISLATIVE AUDITS
MARYLAND GENERAL ASSEMBLY

Bruce A. Myers, CPA
Legislative Auditor

September 24, 2012

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

Ladies and Gentlemen:

We have audited the Maryland Automobile Insurance Fund (MAIF) for the period beginning March 4, 2009 and ending February 29, 2012. MAIF's primary responsibilities are to provide automobile insurance policies for those residents of Maryland whose applications have been declined by private insurers and to administer and pay claims to residents of Maryland who are involved in accidents in Maryland with motorists who are uninsured.

Our audit disclosed that invoice billing rates for certain contractual information system services did not agree to contract terms. We also noted that there was no documented verification that recorded collections were subsequently deposited.

MAIF'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 MAIF.

Respectfully submitted,

A handwritten signature in black ink, reading "Thomas J. Barnickel III".

Thomas J. Barnickel III, CPA
Acting Legislative Auditor

Background Information

Agency Responsibilities

The Maryland Automobile Insurance Fund (MAIF), which consists of an Insured and an Uninsured Division, operates under the provisions of Title 20 of the Insurance Article of the Annotated Code of Maryland. The Insured Division's purpose is to provide automobile liability and property damage insurance coverage on personal vehicles and, to a lesser extent, commercial vehicles to Maryland residents who are unable to obtain coverage from private insurance carriers. The Uninsured Division is responsible for paying claims to eligible victims of traffic accidents caused by operators of uninsured or unidentified vehicles in instances in which the victim does not have recourse through an insurance policy which would cover the related loss. According to its records, during calendar year 2011, MAIF processed and issued claim payments that totaled approximately \$80.2 million. In addition, total MAIF operating expenditures were approximately \$43.8 million during that period.

Financial Statement Audits

MAIF engaged an independent accounting firm to audit the statutory-basis financial statements of the Insured Division. In the related audit reports for calendar years 2009, 2010, and 2011, the firm stated that the financial statements presented fairly, in all material respects, the financial position of the Insured Division, and the results of its operations and its cash flows for the years then ended in conformity with accounting practices prescribed or permitted by the Maryland Insurance Administration.

In addition, MAIF engaged the same accounting firm to audit the financial statements of the Uninsured Division for the calendar years 2009, 2010, and 2011. In the related audit reports, the firm stated that the financial statements presented fairly, in all material respects, the financial position, results of operations and cash flows of the Uninsured Division for the years then ended in conformity with accounting principles generally accepted in the United States of America.

The audit report on the Uninsured Division for calendar year 2011 included a note to the financial statements that indicated that certain factors raised substantial doubt about the Uninsured Division's ability to continue as a going concern. The note indicated that a \$4 million liability to the State of Maryland, as of December 31, 2011—a transfer required by the Maryland Budget Reconciliation and Financing Act of 2011—resulted in the Division's total liabilities exceeding its total assets by \$915,551. However, the note further indicated that management

would provide sufficient cash flow support from the Insured Division to the Uninsured Division to ensure that the Uninsured Division continues to meet all of its obligations until such time as the Uninsured Division's equity has recovered. The note also stated that, if necessary, MAIF's Board of Trustees would authorize a transfer of funds between the Insured and Uninsured Divisions.

Status of Findings From Preceding Audit Report

Our audit included a review to determine the status of the five findings contained in our preceding audit report dated November 4, 2009. We determined that MAIF satisfactorily addressed these findings.

Findings and Recommendations

Contract Payments

Finding 1

MAIF did not verify that invoice billing rates for certain contractual services agreed to contract terms.

Analysis

MAIF did not verify billing rates from information system contractual services invoices to related contract terms. Specifically, our review of five contracts, totaling approximately \$3 million, disclosed that billings related to one \$1.5 million contract for information retrieval services (covering the period from July 2010 through December 2011) were not verified to payment rates included in the related contract. Consequently, there was a lack of assurance that invoiced amounts were valid.

We reviewed approved billings totaling approximately \$890,000. Based on our calculations, MAIF made various overpayments and underpayments for these services, collectively totaling approximately \$133,000, because incorrect billing rates were used and not detected. Although the net difference was a small underpayment for the period, it is incumbent upon MAIF to ensure that such billings reflect agreed-upon rates specified in the contract terms.

Recommendation 1

We recommend that MAIF

- a. verify all billing rates to contract terms, and**
- b. review all past invoices from the aforementioned vendor and take appropriate action for any payment discrepancies noted.**

Cash Receipts

Finding 2

There was no documented verification that all recorded collections were subsequently deposited.

Analysis

MAIF did not have a documented deposit verification process. Specifically, although MAIF advised us that collections received in the form of checks at its office were independently verified by reconciling with subsequent deposit documents, this verification was not documented. Our limited testing did not disclose any instances of a failure to deposit collections; however, this condition results in a lack of assurance that this critical control was being performed and that all collections were deposited. MAIF's check collections totaled approximately \$24.1 million in calendar year 2011.

The Comptroller of Maryland's *Accounting Procedures Manual* states that the reconciliation of cash receipts to deposit be performed by an employee independent of the cash receipts function. The Manual also states that critical control procedures should be documented.

Recommendation 2

We recommend that MAIF document the independent verification of collections received to deposit.

Audit Scope, Objectives, and Methodology

We have audited the Maryland Automobile Insurance Fund (MAIF) for the period beginning March 4, 2009 and ending February 29, 2012. 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 MAIF'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. The areas addressed by the audit included cash receipts, procurements and disbursements, accounts receivable, and payroll. Our audit procedures included inquiries of appropriate personnel, inspections of documents and records, and observations of MAIF'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.

MAIF engaged an independent accounting firm to audit the statutory-basis financial statements of the Insured Division. In the related audit reports for calendar years 2009, 2010, and 2011, the firm stated that the financial statements presented fairly, in all material respects, the financial position of the Insured Division, and the results of its operations and its cash flows for the years then ended in conformity with accounting practices prescribed or permitted by the Maryland Insurance Administration. MAIF engaged the same accounting firm to audit the financial statements of the Uninsured Division for the calendar years 2009, 2010, and 2011. In the related audit reports, the firm stated that the financial statements presented fairly, in all material respects, the financial position, results of operations and cash flows of the Uninsured Division for the years then ended in conformity with accounting principles generally accepted in the United States of America. We have relied on the work of the independent accounting firm to provide audit coverage of certain aspects of MAIF's operations (that is, internal controls and testing for claims and investments). Our audit procedures in these areas were generally limited, therefore, to obtaining a sufficient basis for that reliance.

MAIF'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 MAIF's ability to maintain reliable financial records, operate effectively and efficiently, and/or comply with applicable laws, rules, and regulations. Our audit also disclosed a significant instance of noncompliance with applicable laws, rules, or regulations. Other less significant findings were communicated to MAIF that did not warrant inclusion in this report.

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

APPENDIX



M. Kent Krabbe, Executive Director

Maryland Automobile Insurance Fund

September 13, 2012

Thomas J. Barnickel III, CPA
Acting Legislative Auditor
State of Maryland
Office of Legislative Audits
State Office Building, Room 1202
301 West Preston Street
Baltimore, Maryland 21201

Re: MAIF's Response to the Office of Legislative Audits ("OLA")
September 2012 Report

Dear Mr. Barnickel:

We commend your office for the high level of professionalism with which it conducted its most recent audit of the Maryland Automobile Insurance Fund ("MAIF"). We welcome the report and recommendations, and were gratified by two points. First, no comments were repeated from the 2009 audit, indicating that MAIF has assertively addressed those points. Second, it is heartening to know that regarding our handling of \$43.8 million in operating expenditures and over \$80 million in claims payments in calendar year 2011 alone, your audit found no material instances of fraud or misfeasance.

With respect to Finding 1, MAIF is now ensuring that it reconciles invoices to the correct contract prices and terms. As to the aggregate underpayment, the vendor has determined after discussion with MAIF that no additional payment is due.

With respect to Finding 2, after consultation with the OLA audit team, MAIF will enhance its procedures to document the independent verification of recorded collections to deposit by having the daily work papers initialed by the appropriate employee.

Thank you again for the report.

A handwritten signature in black ink, appearing to read "Kent Krabbe", is written over a horizontal line.

M. Kent Krabbe
Executive Director

A handwritten signature in black ink, appearing to read "Gregory L. Macauley", is written over a horizontal line.

Gregory L. Macauley
Chair, Board of Trustees

AUDIT TEAM

Paul R. Denz, CPA

Audit Manager

W. Thomas Sides

Senior Auditor

Roger E. Jaynes, CFE

Nathan H. Suffin

Staff Auditors