

**DEPARTMENT OF FINANCIAL SERVICES**

**DIVISION OF RISK MANAGEMENT  
MONITORING OF THIRD-PARTY  
ADMINISTRATORS**

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**Operational Audit**



## CHIEF FINANCIAL OFFICER

Pursuant to Article IV, Sections 4(c) and 5(a) of the State Constitution, the Chief Financial Officer is an elected member of the Cabinet and serves as the chief fiscal officer of the State. Pursuant to Section 20.121(1), Florida Statutes, the Chief Financial Officer is the head of the Department of Financial Services. During the period of our audit the following individuals served as Chief Financial Officer:

Honorable Jeff Atwater	From January 4, 2011
Honorable Alex Sink	Through January 3, 2011

The audit team leader was Jacqueline Joyner, CPA, and the audit was coordinated by Frank Belt, CPA. Please address inquiries regarding this report to Lisa Norman, CPA, Audit Manager, by e-mail at [lisanorman@aud.state.fl.us](mailto:lisanorman@aud.state.fl.us) or by telephone at (850) 487-9143.

This report and other reports prepared by the Auditor General can be obtained on our Web site at [www.myflorida.com/audgen](http://www.myflorida.com/audgen); by telephone at (850) 487-9175; or by mail at G74 Claude Pepper Building, 111 West Madison Street, Tallahassee, Florida 32399-1450.

**DEPARTMENT OF FINANCIAL SERVICES**

Division of Risk Management

Monitoring of Third-Party Administrators

**SUMMARY**

This operational audit of the Department of Financial Services (Department) focused on the Division of Risk Management (Division) claims management process. Our audit disclosed the following:

**Finding No. 1:** The Division did not adequately monitor third-party administrators engaged to provide workers' compensation case management administrative services and pharmacy benefits management.

**BACKGROUND**

The Division of Risk Management (Division) within the Department of Financial Services (Department) acts as State government's insurance company by administering a self-insurance program for, among other coverages, workers' compensation.<sup>1</sup> As illustrated in Table 1 below, the Division entered into agreements with various third-party administrators (TPAs) to provide workers' compensation case management administrative services and a pharmacy benefits management program. The case management administrative services include the establishment of a network of health care providers, intake services, clinical case management, payment of claims, medical bill review, utilization review, and quality assurance. The pharmacy benefits management program is to include the establishment of a Statewide network of retail pharmacies, a mail-order prescription program, educational materials, claims processing, and concurrent and retrospective drug utilization reviews.

Each TPA uses its own information technology system to pay and administer claims, and subsequently uploads selected information on claims paid into STARS, a claims administration system that is to be used by the Department to account for basic claim information, such as claimant, amount paid, provider name, and date of service, and to calculate payments due to each of the Division's third-party administrators. Additionally, information from STARS serves as the basis for amounts recorded in the State's general ledger accounting records.

**Table 1**  
**Third-Party Administrators**  
**Summary of Workers' Compensation Claims**  
**For the Period July 1, 2009, Through February 28, 2011**

Vendor	Services Provided	Contract Term	Paid Claim Amounts
OptaComp	Workers' compensation case management administrative services for employee claims reported on or after January 1, 2009.	January 1, 2009, to December 31, 2013	\$51,989,661
CorVel Healthcare Corporations	Workers' compensation case management administrative services for employee claims reported to CorVel before December 31, 2008.	January 1, 2009, to December 31, 2012	\$19,627,969
Cypress Care Inc. (Cypress)	Pharmacy benefits management program for workers' compensation claimants.	January 1, 2009, to December 31, 2011	\$21,545,274
<b>Total Claims Paid</b>			<b>\$93,162,904</b>

<sup>1</sup> Chapter 284, Florida Statutes.

Our review of the Division's processes for administering the State's self-insurance programs disclosed that the Division did not follow existing procedures and, in some cases, did not have appropriate procedures in place to ensure that workers' compensation claims were paid appropriately or to prevent or detect the payment of fraudulent claims, as described below.

## FINDINGS AND RECOMMENDATIONS

### Finding No. 1: Contract Monitoring

Effective contract management requires the monitoring of contractor performance to determine compliance with contractual provisions and provides a means for early detection of potential performance problems. Monitoring procedures, plans, and activities should be documented in Department records and should include evaluations of TPA-submitted data and periodic on-site monitoring visits.

Our tests of the Division's monitoring of the TPA contracts associated with the workers' compensation program disclosed that, based on available documentation, the level of contractor monitoring was not sufficient. Specifically:

- Division Policy and Procedure<sup>2</sup> required the performance of quarterly workers' compensation payment audits. The Division's audit procedures required that a statistically valid selection of TPA claim payments to medical service providers be tested by sending negative confirmation letters to the selected providers to confirm that the selected payments shown by Division records were properly received by the provider. Our review disclosed that the Division had not performed the prescribed workers' compensation payment audits during the period July 1, 2009, through June 30, 2011.
- Division Policy and Procedure<sup>3</sup> required the performance of monthly workers' compensation medical reimbursement audits that required, among other steps, a review of the ten largest dollar claims paid during the previous month. Our audit disclosed that the Division had not performed monthly workers' compensation medical reimbursement audits during the period July 1, 2009, through June 30, 2011. According to Division records, the most recent audit was performed for claims processed in August 2008 by Humana (medical care claims submitted prior to December 31, 2002), CorVel (medical care claims submitted after January 1, 2003), and Cypress, and was dated October 27, 2008.
- Division Policy and Procedure<sup>4</sup> required the Division, on a quarterly basis, to perform audit tests of TPA medical reimbursements to determine whether the amounts reported by the TPAs for reimbursement were consistent with amounts paid by the TPA to service providers, correct as to claim service dates, and properly coded as to the type of service. The Policy and Procedure also required that the sample sizes of claim payments be statistically large enough to allow for a 90 percent confidence level. Although the TPAs submitted to the Division listings of payments made to service providers, the Division had not, during the period July 1, 2009, through June 30, 2011, performed tests to determine that the amounts reimbursed were consistent with the listing of payments to the service providers.
- The agreement between the Division and Cypress provided that the Division's reimbursements to Cypress for pharmaceuticals be based on the drug's average wholesale price (AWP)<sup>5</sup> less 2 percent plus a \$3 dispensing fee for brand name drugs and the AWP less 6 percent plus a \$3 dispensing fee for generic drugs. The Division had not established a policy or procedures to evaluate amounts paid to Cypress, nor had the

<sup>2</sup> Division Policy and Procedure Number 1.02, Section VII(B), Workers' Compensation Claims File Audit, Payment Audit, and Medical Reimbursement Audit, dated July 1, 2007.

<sup>3</sup> Division Policy and Procedure Number 1.02, Section VII(C), Workers' Compensation Claims File Audit, Payment Audit, and Medical Reimbursement Audit, dated July 1, 2007.

<sup>4</sup> Division Policy and Procedure Number 1.07, Section VI(G), Managed Care Contract Compliance and Oversight, effective date of September 19, 2006.

<sup>5</sup> AWP is calculated by an independent commercial publisher using drug pricing information obtained from manufacturers, distributors, and other drug suppliers.

Division performed procedures to evaluate the price paid for pharmaceuticals. Such procedures may include, for example, obtaining an understanding of the methodologies used by the TPA to maintain and apply AWP along with specific procedures to verify that the drug prices paid by the State were calculated in accordance with contract terms.

Additionally, the agreement provided that if savings were identified using a stipulated alternative calculation, the Division would be entitled to a refund. However, the Division was unable to provide documentation evidencing that the alternative calculation had been performed either internally or by the contractor, and a determination as to whether a refund was due had not been made. Subsequent to audit inquiry, the Division requested and received an analysis from Cypress showing the Division was not owed a refund.

- The Division did not have policies and procedures in place regarding on-site monitoring of TPAs. Such policies and procedures should address the frequency of monitoring visits, activities and functions to be examined, and procedures for following-up on any noted deficiencies. Division staff performed no monitoring of two of three TPAs. However, the Division did contract with an accounting firm to conduct an evaluation of OptaComp's compliance with contract terms and received a report in August 2010 which noted significant noncompliance and instances in which compliance was not testable due to lack of data. An additional evaluation performed by the accounting firm on OptaComp's performance metrics for the period June 1, 2010, through May 31, 2011, also indicated that OptaComp data may not be reliable as certain record counts that should have equaled did not, and could not be reconciled. The review indicated that OptaComp did not meet 12 of 13 performance metrics evaluated.<sup>6</sup>
- The Division did not include in the TPA contracts a clause requiring the provision of an independent service auditor's report to describe and provide an assessment of the effectiveness of relevant TPA internal controls, nor had the Division requested or received such a report from any of its TPAs. While the Division had contracted for and obtained a report describing the controls placed in operation at OptaComp and the suitability of control design, as of September 2010, the examination did not extend to an evaluation of the effectiveness of the operation of those controls.
- The Division's STARS system did not contain detailed information on claims paid, nor did the Division have access to TPA systems containing detailed information. Access to additional information, such as, for example, service delivery location and specific information on the types of services and pharmaceuticals provided, would enhance the Division's ability to monitor the appropriateness of amounts paid and allow the Division to perform procedures to detect potentially fraudulent claims. Such procedures may include data mining to, for example, identify workers' compensation cases where claims paid for claimants may not be consistent with the nature of the documented injury.

Without a more effective monitoring program, Division management cannot be reasonably assured that relevant internal controls are in place and functioning effectively as intended or that contractors are operating in compliance with contract terms. Additionally, Division management cannot ensure that errors or fraud are prevented or timely corrected, should they occur.

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<sup>6</sup> On July 25, 2011, the Division Director informed OptaComp that the Department had found OptaComp to be in default of its contractual obligations. The letter also listed the performance metrics that had caused the default and required that corrective actions be taken by August 24, 2011.

**Recommendation: We recommend the Division:**

- Comply with its policies and procedures related to performing required payment audits, medical reimbursement audits, and audit tests of TPA reimbursements.
- Develop specific policies and procedures to require periodic audits of pharmaceutical claims paid by the Division's pharmaceutical benefit service provider.
- Perform on-site monitoring of all TPAs.
- Amend TPA contracts to require service auditor reports.
- Establish a database or obtain access to TPA data containing detailed information on claims paid.

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### OBJECTIVES, SCOPE, AND METHODOLOGY

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The Auditor General conducts operational audits of governmental entities to provide the Legislature, Florida's citizens, public entity management, and other stakeholders unbiased, timely, and relevant information for use in promoting government accountability and stewardship and improving government operations.

We conducted this operational audit 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. This operational audit focused on Division of Risk Management's administration of the self-insurance programs, including the Division's monitoring of TPA operations. The overall objectives of the audit were:

- To evaluate the effectiveness of established internal controls in achieving management's control objectives in the categories of compliance with controlling laws, administrative rules, and other guidelines; the economic, efficient, and effective operation of State government; the relevance and reliability of records and reports; and the safeguarding of assets.
- To evaluate management's performance in achieving compliance with controlling laws, administrative rules, and other guidelines; the economic, efficient, and effective operation of State government; the relevance and reliability of records and reports; and the safeguarding of assets.
- To identify statutory and fiscal changes that may be recommended to the Legislature pursuant to Section 11.45(7)(h), Florida Statutes.

In conducting our audit we:

- Obtained an understanding of IT controls, evaluated whether selected general and application IT controls were in place, and tested the effectiveness of the controls.
- Evaluated the effectiveness of Division procedures for monitoring third-party administrators.
- Examined documentation relating to 60 expenditures totaling \$4,239,339 to determine whether claim reimbursement payments agreed with the amount invoiced by the TPA and whether the payments were properly recorded in the Department's accounting system.
- Performed an analysis to determine whether the self-insurance levels utilized by the Division were consistent with Division procedures or Legislative requirements.
- Examined documentation relating to 50 insurance premiums paid by insured agencies totaling \$27,826,882 to determine whether the charges were calculated in accordance with Division procedures and in compliance with applicable laws.

- Reviewed the procurement process utilized in the purchase of reinsurance products to determine compliance with applicable Florida laws.
- Obtained an understanding of the Division's Anti-Fraud Plan.
- Performed analytical procedures to determine the possible existence of duplicate payments to workers' compensation claimants or the possible existence of payments made to deceased workers' compensation claimants.
- Examined documentation relating to Division-prepared reconciliations between claims activity maintained in STARS, corresponding bank accounts, and the State's accounting records.
- Performed various other auditing procedures, including analytical procedures, as necessary, to accomplish the objectives of the audit.
- Prepared and submitted for management response the findings and recommendations that are included in this report and which describe those matters requiring corrective actions.

#### AUTHORITY

Section 11.45, Florida Statutes, requires that the Auditor General conduct an operational audit of each State agency on a periodic basis. Pursuant to the provisions of Section 11.45, Florida Statutes, I have directed that this report be prepared to present the results of our operational audit.



David W. Martin, CPA  
Auditor General

#### MANAGEMENT'S RESPONSE

In a response letter dated December 29, 2011, the Chief Financial Officer concurred with our audit findings and recommendations. The Chief Financial Officer's response is included as **EXHIBIT A**.

**EXHIBIT A  
MANAGEMENT'S RESPONSE**



CHIEF FINANCIAL OFFICER  
**JEFF ATWATER**  
STATE OF FLORIDA

December 29, 2011

Mr. David W. Martin  
Auditor General  
111 West Madison Street  
Tallahassee, Florida 32399-1450

Dear Mr. Martin:

Pursuant to Section 11.45(4)(d), Florida Statutes, the enclosed response is provided for the preliminary and tentative audit findings included in the Auditor General's operational audit of the *Department of Financial Services, Division of Risk Management Monitoring of Third-Party Administrators*.

If you have any questions concerning this response, please contact Ned Luczynski, Inspector General, at (850) 413-4960.

Sincerely,

A handwritten signature in blue ink, appearing to read "Jeff Atwater".

Jeff Atwater

JA:sll

Enclosure

**EXHIBIT A**  
**MANAGEMENT'S RESPONSE (CONTINUED)**

**DEPARTMENT OF FINANCIAL SERVICES**  
**DIVISION OF RISK MANAGEMENT**  
**MONITORING OF THIRD-PARTY ADMINISTRATORS**

**Finding No. 1: Contract Monitoring**

The Division did not adequately monitor third-party administrators engaged to provide workers' compensation case management administrative services and pharmacy benefits management.

**Recommendation:**

We recommend the Division:

- Comply with its policies and procedures related to performing required payment audits, medical reimbursement audits, and audit tests of TPA reimbursements.
- Develop specific policies and procedures to require periodic audits of pharmaceutical claims paid by the Division's pharmaceutical benefit service provider.
- Perform on-site monitoring of all TPAs.
- Amend TPA contracts to require service auditor reports.
- Establish a database or obtain access to TPA data containing detailed information on claims paid.

**Response:**

We agree the Division needs to strengthen its monitoring of third-party administrators (TPAs) and anticipate that a coordinated, long-term strategy will be required to accomplish this objective.

We plan to update and revise as appropriate the Division's policies and procedures regarding payment audits, medical reimbursement audits and audit tests of TPA reimbursements. We will also establish policies and procedures for periodic audits of pharmaceutical claims paid by the Division's service provider. The Division currently does not have the staff resources to conduct the reviews contemplated in the Division's policies and procedures. We will therefore evaluate our business processes and will realign staff duties and responsibilities to accommodate these reviews. Such realignment will be undertaken to the extent possible given on-going operational needs. If necessary, we will request additional staff resources or funding to contract for review services in the Department's next Legislative Budget Request.

Regarding on-site monitoring of the Division's TPAs we concluded that such monitoring could be conducted in conjunction with data mining activities. Obtaining access to detailed information on claims paid by the TPAs would permit the Division to conduct on-going monitoring of TPA activity without the expense of sending staff to remote locations for a period of time or contracting with outside parties for on-site monitoring services. We will therefore require TPA's to provide, or make such detailed data available in future contracts. The Division will also evaluate whether the current Risk Management Information System (RMIS) can be reconfigured to capture such data. We will incorporate requirements for such system

**EXHIBIT A**  
**MANAGEMENT'S RESPONSE (CONTINUED)**

capabilities in future contracts for RMIS services. We also noted that establishing a requirement for service auditor reports, such as Statement on Standards for Attestation Engagements (SSAE) 16 Reporting on Controls of a Service Organization Type II audits are generally viewed as a replacement for conducting on-site testing. To this end, future TPA contracts will include a requirement for the TPA to conduct an SSAE 16 Type II audit annually during the life of the contract.