

INDEPENDENT EXTERNAL AUDIT

2018 AUDIT FINDINGS REPORT
COMMONWEALTH OF KENTUCKY
HEALTH BENEFIT EXCHANGE



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2018 FINDINGS REPORT

To: Kentucky Health Benefit Exchange
From: Kentucky Auditor of Public Accounts
Date: April 16, 2019

Subject: Audit Findings Report for Kentucky

I. EXECUTIVE SUMMARY

PURPOSE

The purpose of this independent external audit is to ensure that the Commonwealth of Kentucky is in compliance with the financial and programmatic requirements set forth by the Centers for Medicare and Medicaid Services (CMS). Kentucky Health Benefit Exchange (KHBE), is administered by the Kentucky Cabinet for Health and Family Services, which requested an external audit from the Kentucky Auditor of Public Accounts (APA) to comply with the audit requirements for State-based Marketplaces contained in the Program Integrity Rule Part II, 45 C.F.R. 155.

The APA is responsible for expressing an opinion about whether the financial statements of KHBE are fairly presented in all material respects, in conformity with U.S. generally accepted accounting principles (GAAP) and with generally accepted government auditing standards (GAGAS) as required by 45 C.F.R. 155.1200(c). Additionally, to meet the programmatic requirements established by CMS, the audit follows requirements set forth for State-based Marketplaces in 45 C.F.R. Part 155.

SCOPE

The scope of the engagement is to audit KHBE financial and programmatic compliance activity as of and for the year ended June 30, 2018. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. Therefore, our audit involved judgment about the number of transactions to be examined and the areas to be tested. Also, we planned and performed the audit to obtain reasonable rather than absolute assurance about whether the financial statements are free of material misstatement, whether from errors, fraudulent



financial reporting, misappropriation of assets, or violations of laws or governmental regulations that are attributable to the entity or to acts by management or employees acting on behalf of the entity. Draft financial statements, including Statement of Net Position; Statement of Revenues, Expenses and Changes in Net Position; Statement of Cash Flows; and related note disclosures, were compiled by KHBE with the assistance of the Kentucky Finance and Administration Cabinet based on activity recorded in the Commonwealth's financial accounting system, eMARS. To arrive at an opinion on KHBE's financial statements, the audit consisted of testing financial records to support amounts reported in KHBE's draft financial statements.

These records included tests of receipts, expenses, including payroll expenses, and assets and liabilities and related accrual information, which included the following types of information:

- Grant drawdown requests and requests for payment
- Internal worksheets for tracking drawdown requests
- eMARS documentation to record receipt/expense transactions and the underlying supporting information
- Summary reporting documentation
- Vendor invoices
- Reviews of contractual arrangements
- Timesheets and related documents

Compliance testing focused on requirements outlined 45 C.F.R. 155.

In prior years, compliance requirements were also tested in the areas of Eligibility Determinations for Exchange Participation, Subpart D, Enrollment in Qualified Health Plans, Subpart E, and Certification of Qualified Health Plans, Subpart K. However, as of January 1, 2017 KHBE no longer enrolls participants, determines eligibility, or certifies Qualified Health Plans and therefore these areas were not applicable.

Additionally, we obtained an understanding of the entity and its environment, as well as obtained an understanding of the internal control and the design of those controls. Our procedures included a review of policies and procedures for the accurate accounting of receipts, expenditures, including payroll expenditures, grants and contracts to ensure compliance with applicable compliance requirements. These tests also included KHBE's oversight and monitoring policies and procedures.

The results of our audit include an unmodified opinion on the financial statements.

We have included our findings related to weaknesses noted in internal control. Those findings are included both in the audit report and as part of this report. In addition, KHBE has provided its corrective action plan to address the noted weaknesses in internal control.

Finally, our consideration of KHBE's internal control over financial reporting disclosed a material weakness and two significant deficiencies. In addition, our consideration of KHBE's internal control over compliance disclosed no significant deficiencies or control deficiencies. These findings and the agency's corrective action plan are fully described in the audit report of the Kentucky Health Benefit Exchange.

METHODOLOGY

Background of Kentucky Auditor of Public Accounts

The Auditor of Public Accounts (APA) was established by the Kentucky Legislature on June 22, 1792 and became an elected office on June 11, 1850. The Kentucky Auditor of Public Accounts is an independent and impartially elected-office charged with auditing the accounts and financial transactions of all state and local public accounts within the Commonwealth of Kentucky. The APA conducts and oversees more than 600 external financial audits, single audits, and special examinations annually, including the:

- Commonwealth's Comprehensive Annual Financial Report (CAFR);
- Commonwealth's Statewide Single Audit (SSWAK);
- Annual financial statement audits and single audits of local government offices, including the audits of fiscal courts, sheriffs, county clerks, and others.

The APA participates in the peer review program of the National State Auditor's Association (NSAA). In its most recent peer review conducted in 2016, the APA received a "pass" rating.

Standards Followed During the External Audit

The audit of KHBE was conducted in accordance with auditing standards generally accepted in the United States of America and the standards applicable to the financial audits contained in *Government Auditing Standards* (GAGAS), issued by the Comptroller General of the United States. The APA complies with these auditing standards, as identified in the independent auditor's letter included in KHBE's audit report.

Additionally, as noted in the independent auditor's letter in KHBE's audit report, KHBE's financial statements were presented in accordance with generally accepted accounting principles (GAAP). The APA believes the audit evidence obtained is sufficient and appropriate to provide a basis for an audit opinion in accordance with GAAP.

Interviews with Key Employees

As part of our audit of KHBE, the APA interviewed key employees within the KHBE program and the Cabinet for Health and Family Services, who assisted in the preparation of the financial statements. Those officials included:

- Melea Rivera –Assistant Director KHBE, CHFS
- Kim Minter – Staff Assistant-Office of Health Data and Analytics, CHFS
- Dave Sumner, System Consultant, Division of General Accounting (DGA), CHFS

Procedures for this audit included additional interviews with KHBE and CHFS staff to gain an understanding of the internal controls in place for receipts, payroll, and expenditures. In addition, the APA documented compliance with State-based Marketplace requirements contained in 45 C.F.R.

155. Further, we requested and examined various records and information that included, but was not limited to, organizational charts, certain expense reimbursements, vendor payments, contracts, policies, procedures, data system configuration settings, and other information.

Sampling Methodology

Audit testing generally includes both tests of internal controls and substantive tests of details, including tests of compliance. Audit sampling is the application of an audit procedure to less than 100 percent of the items within an account balance or class of transactions for the purpose of evaluating some characteristic of the balance or class. The APA used sampling techniques during internal control and substantive testing.

The APA sampling is a nonstatistical sampling methodology that utilizes certain statistical features to assess the sufficiency of sample sizes in the population. This sampling methodology meets documentation requirements in auditing standards, including *Codification of Statements on Auditing Standards* Section AU-C 530. Included in this methodology are:

- Considerations of the relationship of the sample to the relevant audit objective,
- Preliminary estimates of materiality levels,
- Determination of the auditor's allowable risk,
- Consideration of the characteristics of the population,
- Evaluation of the sample results, and
- Projection of the results into the population, when applicable.

The results of tests confirmed that KHBE had controls in place and operating effectively and in compliance with requirements over Small Business Health Options Program guidelines set forth in 45 C.F.R part 155.

II. AUDIT FINDINGS

KEY FINDINGS

2018-KHBE-01: The Kentucky Health Benefit Exchange Incorrectly Reversed A Prior Year Accrual Relating To Federal Grant Revenues Which Led To A Material Misstatement In The Prior Year

During the fiscal year (FY) 2018 audit of the Kentucky Health Benefit Exchange (KHBE), a material misstatement of \$168,176 was identified related to federal grant revenues. The error was determined to be a result of a prior year misstatement caused by an inaccurate reversal of a prior year accounting accrual. KHBE accepted an audit adjustment to correct the FY 2018 financial statements, resulting in a correction to increase federal grant revenues and a prior period restatement to reduce beginning total net position by \$168,176

KHBE double accounted for the reversal of prior year federal accounts receivable accrual, resulting in an understatement of federal grant revenues. Failure by KHBE to properly account for prior year reversal entries led to the error being carried forward into the FY 18 balances. This error resulted in a

2018-KHBE-01: The Kentucky Health Benefit Exchange Incorrectly Reversed A Prior Year Accrual Relating To Federal Grant Revenues Which Led To A Material Misstatement In The Prior Year (Continued)

material understatement of KHBE's federal grant revenues and a material understatement of beginning total net position. As noted above, the agency accepted an audit adjustment to correct this error in the FY 2018 financial statements.

Proper internal controls require management to have sufficient procedures to ensure accurate accounting and financial reporting. Implementation of control activities should focus on the prevention, detection, and correction of errors and/or misstatements.

KHBE financial statements are presented on an accrual basis of accounting, which requires that revenues be recognized in the period in which they are earned. In the case of federal grants, revenues are considered earned when all applicable eligibility requirements have been met (GASB Cod Sec N50.118). Had it not been detected during the audit and corrected, the accounting error identified would have departed from this requirement under Generally Accepted Accounting Principles.

Recommendation

We recommend KHBE strengthen procedures of relevant accounting and financial reporting functions. In addition, improved monitoring controls over the accounting and reporting functions should be implemented to verify the completeness and accuracy of financial reports, as well as to improve the detection of errors.

Management's Response and Corrective Action Plan

The total amount of understatement of revenues of \$168,176 is less than one percent (0.8817%) of total fund balance and less than one percent (0.9831%) of total revenues for the year in question (FY2017). The error was of a non-cash nature; its effect upon the financial statements was one of revenue recognition, and the only question was whether the revenue was to be recognized in FY2017 or FY2018.

Despite the immaterial amount, upon suggestion of the Auditors of Public Accounts (APA), we have revised the ending Accounts Receivable and Net Fund balances for fiscal year-end 2017, a year previously reviewed by APA, rather than allow the adjustment to be made to the current year FY2018, where it originally was reflected.

In order to mitigate this type of error from reoccurring, Division of General Accounting has established a set of procedures for creating and reviewing the HBE financials. These procedures are available upon request.

Auditor's Reply

The amount of the error did exceed tolerable misstatement for the FY 2018 KHBE audit. If this error was not corrected, it would have caused a material misstatement in the FY 2018 KHBE financial statements and would have resulted in a modified audit opinion.

2018-KHBE-02: The Kentucky Health Benefit Exchange Did Not Pay Invoices Timely

This is a repeat finding. The previous year's finding, 2017-001, was included in the fiscal year 2017 report.

FY 18 testing indicated KHBE failed to meet the guidelines set forth in KRS 45.453 pertaining to timely payment of invoices from vendors. During the period of audit, evidence provided for the sample items tested indicates that eight invoices were paid more than 30 business days after the date of invoice.

Delayed payment of vendor invoices may increase the risk of a misstatement of expenditures in the financial statements, as well as increase costs for the agency if the vendor enforces the 1% penalty for invoices paid past 30 business days.

KHBE failed to ensure that all invoices received were paid timely in accordance with KRS 45.453, which allows 30 working days from the date of the vendor's invoice to pay.

According to KRS 45.453, "All bills shall be paid within (30) working days of receipt of goods and services or a vendor's invoice except when the purchasing agency has transmitted a rejection notice to the vendor." Additionally, KRS 45.454 states, "An interest penalty of one percent (1%) of any amount approved and unpaid shall be added to the amount approved for each month or fraction thereof after the thirty (30) working days which followed receipt of the goods or services or vendor's invoice by a purchasing agency."

Recommendation

We recommend payments be made timely in accordance with legal requirements. Internal controls should be developed and implemented to ensure timely processing and payment of invoices in compliance with legal requirements. Implementing adequate procedures for personnel involved in processing and approving payments to avoid late penalties assessed by vendors should be considered.

Management's Response and Corrective Action Plan

The Cabinet for Health and Family Services (CHFS) agrees with the finding. The Division of General Accounting (DGA) has posted all payment policies and procedures on the CHFS intranet. DGA will send notifications to all departments that these policies are available and will make all departments aware of the time frame in which payments have to be made. In addition, DGA is now using the Kentucky Invoice Tracking System (KITS) to track all invoices. KITS automatically records the date an invoice is entered into the system. DGA monitors the time lapse between when an invoice is initially received and when it is uploaded. DGA management will flag invoices that have a large time gap and email the uploader to ensure this does not happen in the future. In addition, DGA runs a report every morning that flags invoices approaching the 30-day mark, which is then sent to all DGA management. This system along with intranet payment policies should help prevent late payments.

2018-KHBE-03: The Kentucky Health Benefit Exchange Processed Duplicate Payments In The Amount of \$133,369 To The Wrong Vendor

During the fiscal year 2018 audit of the Kentucky Health Benefit Exchange (KHBE), internal controls were tested to verify and ensure the accuracy, timeliness and completeness of invoice processing and payments to vendors. Review of supporting documents indicated that the agency erroneously made duplicate payments for four different invoices which resulted in duplicate payments of \$133,369. Supporting documentation indicates that the error in each case was found by the vendor.

Additionally, another payment was made to the incorrect vendor in the amount of \$31,307. The vendor that was paid in error realized the mistake and returned the uncashed check 30 days later. The agency issued a payment of \$31,307 to the correct vendor more than 30 days after the invoice date.

The agency did not have a procedure in place to individually identify invoices from vendors. Since the discovery of the \$133,369 in duplicate payments, the Division of General Accounting (DGA) payables department has issued a standard procedure called "Smart Codes".

Vendor numbers are not hard coded into contracts. When a contract is referenced during the creation of the payment the vendor number is manually entered by staff, in this case the vendor number was not entered correctly resulting in \$31,307 paid to an incorrect vendor. Reviews are conducted by one of three different DGA payables staff. The DGA payables staff has access to the supporting documentation in eMARS and are supposed to verify the supporting documentation before approving the payment. If all details of the payment are not approved accordingly a payment could be made erroneously. In this particular situation, after the erroneous payment was detected by the vendor the corrected payment was made after the 30 day time limit.

Sound accounting procedures dictate that internal controls be established in order to prevent errors, fraud, waste, and abuse. Implemented internal controls should be documented, well designed, and approved by management. Management should fully support its control environment, as a control structure that is easily circumvented is inadequate and ineffective.

Recommendation

We recommend the agency improve its internal control procedures and require all staff to follow the established procedures. Required processes should be communicated in policy and procedure manuals, such as the agency's enforced "smart codes", to ensure expectations are clearly defined.

Management's Response and Planned Corrective Action

The Cabinet for Health and Family Services (CHFS) agrees with the finding. This payment was made in eMARS 3.10. The documents in question had the wrong vendor code listed on them, which caused the wrong vendor to be paid. CHFS is now using eMARS 3.11 and has changed the process for ensuring the correct vendor code is used by looking at the address. The Division of General Accounting (DGA) will not use a vendor code that does not have a matching address to the invoice unless it has been verified. If a matching address is not found, DGA will ask the department to modify the vendor, so that

2018-KHBE-03: The Kentucky Health Benefit Exchange Processed Duplicate Payments In The Amount of \$133,369 To The Wrong Vendor (Continued)

Management's Response and Planned Corrective Action (Continued)

a matching address will be available for the future. This internal control will prevent this issue from happening again.

In order to prevent duplicate payments, CHFS Division of General Accounting (DGA) is now using a new system to track invoices called the Kentucky Invoice Tracking System (KITS). Using this system along with smart coding all documents should prevent duplicate payments.

AUDITOR'S OPINION

Based on the Key Findings above, it is the Auditor of Public Accounts' opinion that the accounting practices and financial statements reviewed during the 2018 independent external audit are:

MODIFIED UNMODIFIED ADVERSE DISCLAIMER

III. RECOMMENDATIONS

Recommendations made by the APA are included with the Key Audit Findings in Section II above.

KHBE's management responses to audit findings identify its corrective action plan are also included with the Key Audit Findings in Section II above.

IV. CONCLUSION

We confirm to the best of our knowledge that the information included in this Audit Findings Report is accurate and based on a thorough review of the documentation required for this report.

Signature of Audit Firm:



Completion Date of Audit Findings Report: April 16, 2019