



# **STATE OF NORTH CAROLINA**

## **NORTH CAROLINA TEACHERS' AND STATE EMPLOYEES' COMPREHENSIVE MAJOR MEDICAL PLAN**

### **STATEWIDE FINANCIAL AUDIT PROCEDURES**

**FOR THE YEAR ENDED JUNE 30, 2007**

**OFFICE OF THE STATE AUDITOR**

**LESLIE W. MERRITT, JR., CPA, CFP**

**STATE AUDITOR**



STATE OF NORTH CAROLINA  
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January 17, 2008

The Honorable Michael F. Easley, Governor  
Members of the North Carolina General Assembly  
Mr. George Stokes, Executive Administrator  
North Carolina Teachers' and State Employees' Comprehensive Major Medical Plan

We have completed certain audit procedures at the North Carolina Teachers' and State Employees' Comprehensive Major Medical Plan related to the State of North Carolina reporting entity as presented in the *Comprehensive Annual Financial Report (CAFR)* and *Single Audit Report* for the year ended June 30, 2007. Our audit was performed by authority of Article 5A of Chapter 147 of the *North Carolina General Statutes*.

In the *CAFR*, the State Auditor expresses an opinion on the State's financial statements. In the *Single Audit Report*, the State Auditor presents the results of tests of internal control and compliance with laws, regulations, contracts and grants applicable to the State's financial statements and to its federal financial assistance programs. Our audit procedures were conducted in accordance with auditing standards generally accepted in the United States of America, *Government Auditing Standards*, issued by the Comptroller General of the United States and the Single Audit Act as applicable. Our audit scope at the North Carolina Teachers' and State Employees' Comprehensive Major Medical Plan included the following:

State of North Carolina's Financial Statements

Pension and Other Employee Benefit Trust Fund: State Health Plan

State of North Carolina's Administration of Federal Financial Assistance Programs

State Children's Insurance Program

Our audit procedures at the North Carolina Teachers' and State Employees' Comprehensive Major Medical Plan were less in scope than would be necessary to report on the financial statements that relate solely to the Plan or its administration of federal programs. Therefore, we do not express such conclusions.

The results of our audit procedures yielded audit findings for the Plan related to the State's financial statements and federal financial assistance programs that may require disclosure in the aforementioned reports. These findings are included in the Audit Findings and Responses section of this report.

The North Carolina Teachers' and State Employees' Comprehensive Major Medical Plan's responses to the findings identified in our audit are included in the Audit Findings and Responses section of this report. We did not audit the responses, and accordingly, we express no opinion on them.

*North Carolina General Statutes* require the State Auditor to make audit reports available to the public. Copies of audit reports issued by the Office of the State Auditor may be obtained through one of the options listed in the back of this report.

A handwritten signature in black ink that reads "Leslie W. Merritt, Jr." in a cursive script.

Leslie W. Merritt, Jr., CPA, CFP  
State Auditor

## **AUDIT FINDINGS AND RESPONSES**

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### **Matters Related to Financial Reporting or Federal Compliance Objectives**

The following findings were identified during the current audit and discuss conditions that represent significant deficiencies in internal control and/or noncompliance with laws, regulations, contracts or grants.

#### **1. CLAIM PAYMENTS MADE IN ERROR**

During the 2007 State fiscal year, twelve HealthChoice medical claims were found to be paid incorrectly by the claims processing contractor from a sample of 504 medical claims tested. Our review included federal grant awards 05-0605NC5021 and 05-0705NC5021 for the federal fiscal years ending September 30, 2006 and 2007, respectively. The details of the twelve errors are discussed below.

- a. Six errors resulted in overpayments totaling \$26,025. The federal share of \$19,510 is questioned costs.
  - One error was due to the use of an incorrect usual and customary rate resulting in an overpayment of \$2,500.
  - One error was due to the use of an incorrect discount of the billed charges rather than diagnostic related grouping rate resulting in an overpayment of \$4,487.
  - One error was due to incorrect pricing resulting in an overpayment of \$1,953.
  - One error was due to incorrectly applying the private duty nursing daily rate resulting in an overpayment of \$48.
  - Two duplicate payment errors totaling \$17,037 were due to claims being released for payment using an inappropriate transaction type which bypassed diagnostic related grouping pricing logic.
- b. Six errors resulted in underpayments totaling \$50,586. The federal share of underpayments is \$37,656.
  - Four errors totaling \$50,580 were due to using the incorrect diagnostic related grouping amount to determine appropriate costs.
  - Two instances of incorrect pricing resulted in an error of \$6.

The claim processing contractor's twelve errors resulted in a claim payment error rate of 2.42% based on the absolute dollar amount of errors noted in the claims tested (\$76,611) divided by the total dollar amount of claims in the sample (\$3,169,359). The projected payment error amount of \$3,613,386 is considered to be immaterial to the Plan's Statement of Medical Claims Paid for the year ended June 30, 2007.

## AUDIT FINDINGS AND RESPONSES (CONCLUDED)

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All medical claims should be processed accurately in accordance with the *North Carolina General Statutes*. Office of Management and Budget (OMB) Circular A-87 requires allowable costs to be adequately documented and program costs to be necessary and reasonable for proper and efficient administration of the grant program.

*Recommendation:* Plan management should continue its efforts to ensure that the claims processing contractor accurately processes all medical claims. Additionally, the Plan should ensure the appropriate actions are taken to correct the claim payment errors identified above.

*Response:* The Plan's CPC has identified the cause for the claim payments made in error and has implemented corrective actions with its claim processors. The errors were not system errors but errors in the manual processing of claims that required manual input from the claim processors.

### 2. DEFICIENCIES IN FINANCIAL REPORTING

During our audit of the State Health Plan, we identified errors in determining and recording year-end journal entries that resulted in misstatements in the financial statements. Misstatements noted in our audit included:

- Two year-end journal entries to reallocate revenues between employer and member contributions were prepared incorrectly, resulting in revenues and receivables being understated by \$5 million.
- A 2006 journal entry was incorrectly entered into the accounting system as an accrual entry to be automatically reversed in 2007, which resulted in 2007 revenues and expenditures each being understated by \$11 million.
- Medical Claims Payable was overstated by \$9 million because the Claims Processing Contractor provided incomplete data to the actuary for use in estimating the amount.

*Recommendation:* The State Health Plan should enhance internal control over year-end journal entries to ensure that the financial statements are complete and accurate.

*Response:* Additional year end procedures will be implemented to ensure accrual amounts are recorded correctly in the modified accrual financial statements for the State Health Plan. The journal entries for the first finding were incorrectly prepared because the new accounting staff used prior year's journal entries as a guide without having a complete knowledge of the accounting transactions. The second accrual journal entry was prepared correctly for the 2006 fiscal year; however, the system automatically reversed the journal entry for the 2007 fiscal year which resulted in an understatement of revenues by \$10.6 million. This reversal occurred due to the journal entry type or description used when recording the entry. The above findings were immaterial to the financial statements as a whole.

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