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MEMORANDUM

To: The Honorable Nikki Haley
The Honorable Hugh K. Leatherman, Sr.
The Honorable W. Brian White

From: Marcia Adams, Executive Director

Marcia Adams

RE: Recovery Audit Report

Date: January 17, 2013

Pursuant to Proviso 89.104 of the 2012-2013 Appropriation Act, I am transmitting the Best Practices Recommendations and 2012 Recovery Audit Management Report that was prepared by Recovery Audit Specialists.

If you have questions regarding this report, please feel free to contact me.

Cc: Mr. Rich Gilbert, Interim Director
State Auditor's Office

**Best Practices
Recommendations &
2012 Recovery Audit
Management Report**

*Prepared by
Recovery Audit Specialists
December 31, 2012*

Recovery Audit Specialists

Accountability ▪ Transparency ▪ Recovered Funds

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Brenda Russell
*President/CEO, Recovery
Audit Specialists, LLC*

December 31, 2012

Ron Conner
State of South Carolina Budget and Control Board
Information Technology Management Office
1200 Senate Street
Columbia, SC 29201

Dear Mr. Conner:

Recovery Audit Specialists (RAS) greatly appreciates the professionalism and dedication you and other officials from the Budget and Control Board (B&CB), Comptroller's Office and the South Carolina Enterprise Information System (SCEIS) have exhibited in implementing this comprehensive recovery audit.

RAS is pleased to provide you with the current status of audit progress and our recommendations to streamline and improve the process for the benefit of the State. This 2012 report covers the early stages of the recovery audit activity for the State of South Carolina from January 1, 2012 through December 31, 2012.

It is important to note that the numbers in this report will change daily since RAS is in the early stages of the data examination and documentation phase for claims with suspected overpayments. Our robust recovery audit technology has analyzed more than 1.5 million financial transactions amounting to \$8 billion in State expenditures.

Recovery auditing is a process of elimination, whereby we examine each financial transaction for any potential anomaly until we eliminate the error free claims. Then, we focus our work on validating and documenting transactions that resulted in a suspected overpayment by the State. Once documented, RAS works to recover the State funds.

RAS thanks you again for the opportunity to perform our services for the State of South Carolina. We appreciate the confidence and trust you have placed in us to conduct this recovery audit, and look forward to our continued work on behalf of South Carolina.

Sincerely,



Brenda Russell
President/CEO

Table of Contents

Executive Summary.....	2
Background	5
Recovery Audit Scope	5
Agency Meetings.....	5
Initial Audits	5
Data Acquisition and Analysis.....	5
State Agencies.....	7
Status Report	7
Amount of Claim by Status	9
Number of Claims by Status.....	9
Amount of Claim by Root Cause	10
Number of Claims by Root Cause	10
Statement Audit.....	11
Commercial Leases	11
Public Technical Colleges	11
South Carolina Public Senior Institutions	11
Public Employee Health Care Benefits.....	12
Best Practices Recommendations.....	13
Streamline the Audit Process.....	13
Prohibit Audit Restrictions	13
Conclusion.....	14

South Carolina Recovery Audit Report

Executive Summary

Recovery Audit Specialists (RAS) was selected through a competitive Request for Proposal process in December 2011, to conduct comprehensive recovery audits for all South Carolina Executive Agencies, including the public higher education system. South Carolina is to be commended as it is one of the early states to adopt the comprehensive recovery audit model.

RAS recently received the state agency data housed in the SCEIS system for 1.5 million transactions totaling \$8 billion in State expenditures. Our sophisticated software and data analysts are actively analyzing the data for potential overpayments.

Recovery auditing is a process of elimination, whereby our algorithms and multiple sorts examine each financial transaction for any potential anomaly until we eliminate the error free claims. Then, we focus our work on validating and documenting transactions that resulted in a suspected overpayment by the State. Once documented, RAS works to recover the State funds.

The results reported here will change daily as RAS is in the early stages of our analysis and validation process.

We have identified 11,976 invoices from state agencies that contain a potential anomaly and have imported those for further analysis. Thus far, we have analyzed 5,856 of those invoices and identified 769 possible claims; the remaining 6,120 invoices are in process. These 769 possible claims need to be examined further by our expert auditors to verify their validity. The auditors do so by locating additional information to document the accuracy of the claim.

Industry standards for non-medical recoveries are typically 1/10 to 3/10 of a percent of expenditures; healthcare findings may range from 3 percent to 8 percent of expenditures, however. At this early point, auditors have validated and confirmed five overpayments with a total cash value of \$5,076.43. We are currently processing the remaining 6,120 invoices, and at the same time we have auditors working to validate the remaining 769 possible claims already identified.

Once RAS receives the data, it typically it takes approximately six to nine months to conduct a statewide recovery audit, depending on the size, complexity, and the amount and quality of the data provided. RAS started receiving State data in late fall of 2012.

Usually in a comprehensive statewide audit, the auditing firm works with one central authority, such as the Budget and Control Board, to acquire the data and approve RAS' documentation for the claims and recovery. This centralized type of structure facilitates an efficient, coordinated and timely process from inception to completion of the comprehensive audit.

South Carolina's audit process required each state agency and institution of higher education to individually request to be audited. This process required significant effort on the part of the Budget and Control Board (B&CB) staff to inform and educate the agencies regarding the recovery audit requirements and the need for them to request an audit. Then, after South Carolina Enterprise Information System (SCEIS) staff prepared the data for submission, each agency had to approve the data before it was released to RAS

No changes were made to the data during this approval process since the data is factual information on financial transactions. This process however, required individual contacts and coordination with eighty-six (86) state agencies on the part of B&CB, SCEIS and RAS staff. A decentralized structure creates additional work for state employees and the auditing firm—without adding any value to the State—and it dramatically slows down the audit process and recovery of funds.

The ten public universities and sixteen colleges/technical schools also needed to be handled individually; however, this is typical as each tends to operate its own system.

South Carolina began migrating its financial systems over the prior three-year period from the STARS legacy system to the updated SCEIS system. RAS will be obtaining the remaining STARS data from each agency for inclusion in the recovery audit. Our technical software is capable of threading the disparate data sets into one, so we will be able to provide the State with a complete analysis on all three years of historical agency data and our findings.

An agency with the potential for the most significant recoveries, the Public Employee Benefit Authority, has not participated in the recovery audit. RAS met with officials of the Employee Insurance Program (EIP) in April 2012, after they informed RAS they were ready to proceed. Then, the audit was put on hold pending the new Public Employee Benefit Authority (PEBA) establishment. RAS met with officials of PEBA on November 29, 2012 who did not appear to be ready to participate in the recovery audit.

Recovery audit industry standards typically recover from three to eight percent in self-funded healthcare and pharmacy benefit programs, while non-medical expenditures typically recover from one-tenth to three-tenths of a percent of expenditures.

In our *Best Practices Recommendations* section beginning on page 13 of this report, RAS provides recommendations on how South Carolina can streamline its process, lessen the workload on its employees, recover its overpayments in a timely manner, including , recover significant funds from its employee healthcare benefits programs.

Background

The South Carolina Budget and Control Board (B&CB) is the agency charged with administering the recovery audit. Recovery Audit Specialists (RAS) works closely with the B&CB and the Comptroller's Office and key South Carolina Enterprise Information System (SCEIS) staff. RAS was selected through a competitive Request for Proposal process in December 2011 to conduct comprehensive recovery audits for all South Carolina Executive Agencies, including the public higher education system.

Recovery Audit Scope

The primary focus of the South Carolina audit is to validate that vendors under contract with the State are charging the correct prices agreed to under the terms and conditions of the contract. The objective of the review is to verify that the vendor complied with the pricing terms of the contract, to negotiate refunds with suppliers on behalf of South Carolina agencies and institutions, and to identify on-going savings opportunities which can be implemented by the State. The service will include at a minimum: review of payable transactions, general ledger data, taxes, contract award statements, purchase orders, invoices, and other statements to ensure compliance with state contracts, as well as agency contracts.

Agency Meetings

Shortly after receiving the contract award, RAS made an overview presentation to the heads of state agencies and the higher education institutions to introduce the company, explain the recovery audit process and respond to questions. As we were working with SCEIS to acquire the state agency data, numerous questions arose and RAS again met with agency heads. The B&CB arranged the meeting and both the Comptroller's office and key SCEIS staff participated in the discussion session.

Initial Audits

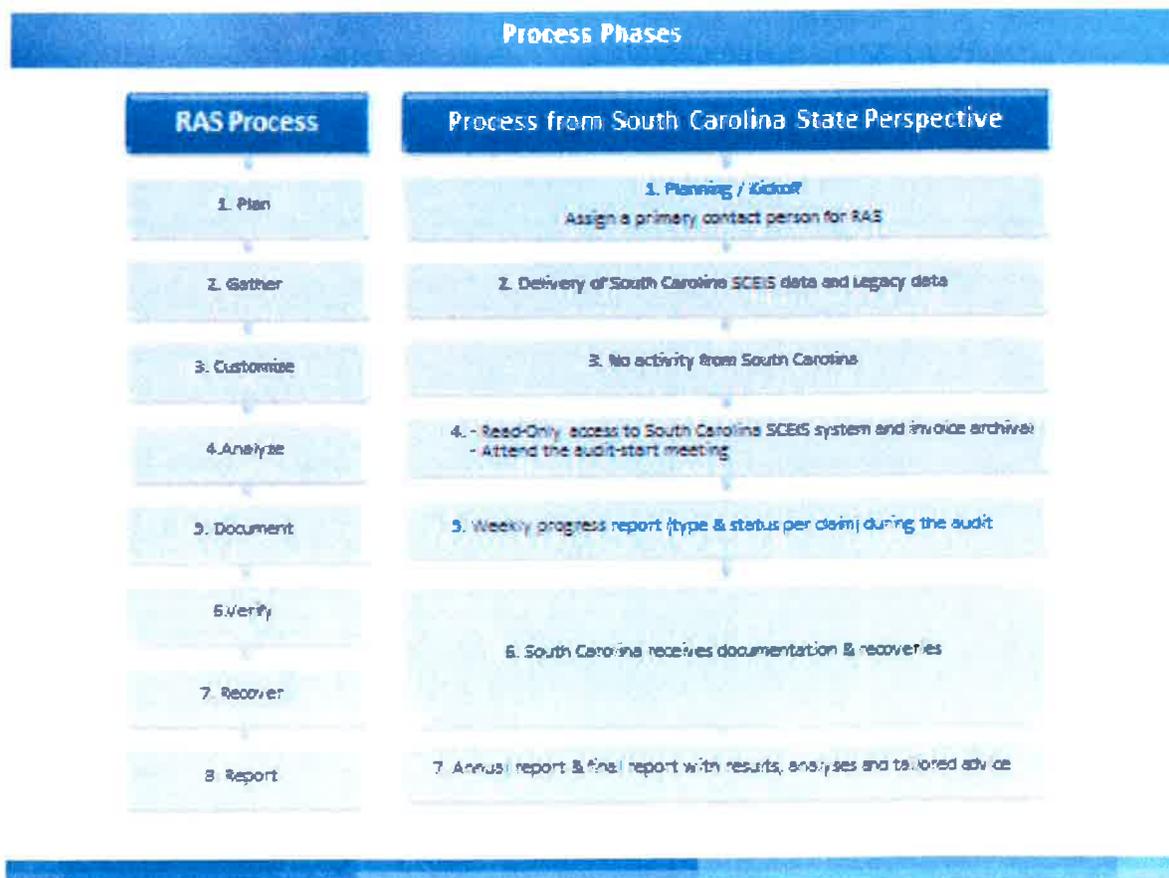
RAS initiated recovery audits with the public university system first, as each institution is different and must be dealt with individually. RAS has completed several audits and is actively engaged with several more public universities.

Data Acquisition and Analysis

RAS recently received the data housed in the SCEIS system for 1.5 million transactions totaling \$8 billion in State expenditures. Our sophisticated software and data analysts are actively analyzing the data for potential overpayments.

Recovery auditing is a process of elimination, whereby we examine each financial transaction for any potential anomaly until we eliminate the error free claims. Then, we focus our work on validating and documenting transactions that resulted in a suspected overpayment by the State. Once documented, RAS works to recover the State funds.

South Carolina is migrating its financial systems over a three-year period from the STARS legacy system to the updated SCEIS system. RAS will be obtaining the remaining STARS data from each agency for inclusion in the recovery audit. Our technical software is capable of threading the disparate data sets into one, so we will be able to provide the State with a complete analysis on all three years of historical agency data and our findings.



This report will provide the status of the audit at this point in time. The results reported here will change daily as RAS is in the early stages of our analysis and validation process.

State Agencies

Status Report

Recovery auditing is a process of on-going elimination of potential errors initially flagged by algorithms. As additional algorithms and edits are applied during the data analysis the list is reduced to those transactions that require hands-on examination of supporting documentation.

Of the 1.5 million invoices RAS has received, it is currently conducting further analysis on 11,976 transactions. This latter number is more indicative of the amount of work we do on the data than the number of actual erroneous payments we anticipate will be documented during the audit. The number of potential overpayments declines daily as our work progresses.

When our technological analysis is complete we anticipate 100-200 transactions will require more in-depth examination by our auditors. Obviously, the exact number cannot be known until our discovery work is finalized.

We have identified 11,976 invoices that contain a potential anomaly and have imported those for further analysis. Thus far, we have analyzed 5,856 of those invoices and identified 769 possible claims; with the remaining 6,120 invoices in process. In this fourth stage of the filtering process, our expert auditors examine the possible claim and decide if it is appropriate to pursue it further.

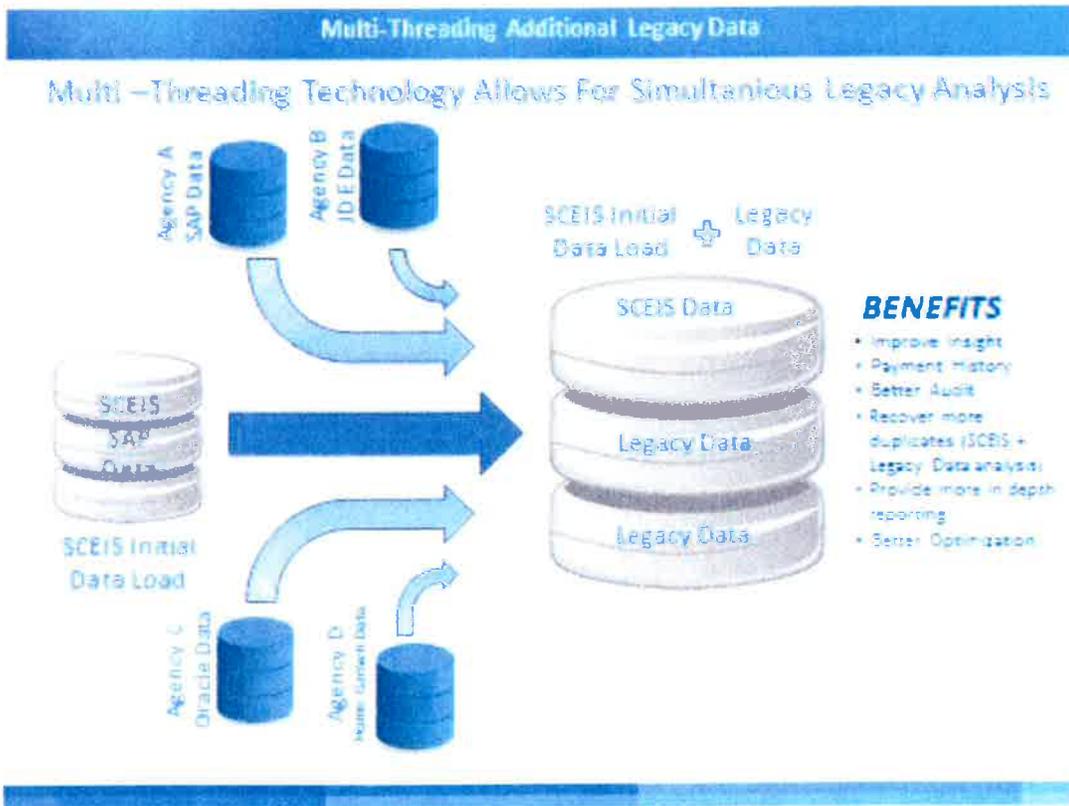
We are currently processing the remaining 6,120 invoices, and at the same time we have auditors working to validate the rest of the 769 possible claims already identified. There currently are 23 claims where we are working to obtain information. Stage four and five of the process where we contact the supplier as necessary.

Auditors confirm claim validity by locating additional information to document the accuracy of the claim. Thus far, auditors have validated and confirmed five overpayments with a total cash value of \$5,076.43. During stage five and six the claim is validated; the supplier has been contacted and is ready to submit the refund as we move into stage seven, recovery. Once an overpayment is verified, RAS, working with each agency begins recovery of that amount on the State's behalf.

Our system is capable of incorporating data from almost any system. The state does not have to deal with data conversion issues since RAS will do that for SC. Not all of the data subject to the recovery audit is contained in the SCEIS system and RAS is currently obtaining legacy systems data from the individual agencies.

Our sophisticated technology can pull together the data from disparate systems by threading it together into one data set. This will enable South Carolina to have a comprehensive overview of its data for the full three-year audit period—regardless of whether the agency was in the SCEIS system for one, two or three years. Without our data threading capability, South Carolina would see two different reports on the same agency data; one based on SCEIS and one from the agency’s legacy system.

Ras provides considerable consulting services, including Best Practice Recommendations as part of our recovery audit. Our data threading capability enables RAS to inform the state on the difference between the older systems and the newer SCEIS system’s capability to detect and deter overpayments.

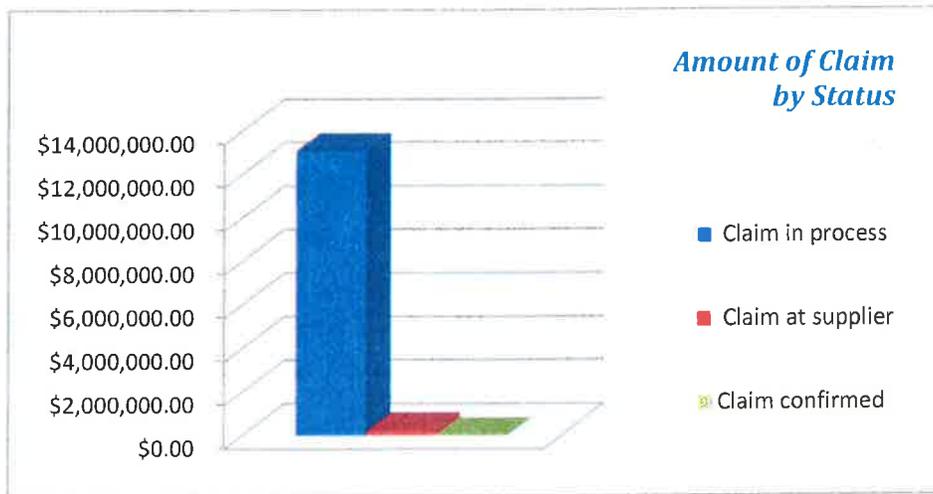


The following charts detail the status of our analysis and a profile of potential overpayments claims we are reviewing. The charts are based on the SCEIS data RAS has obtained.

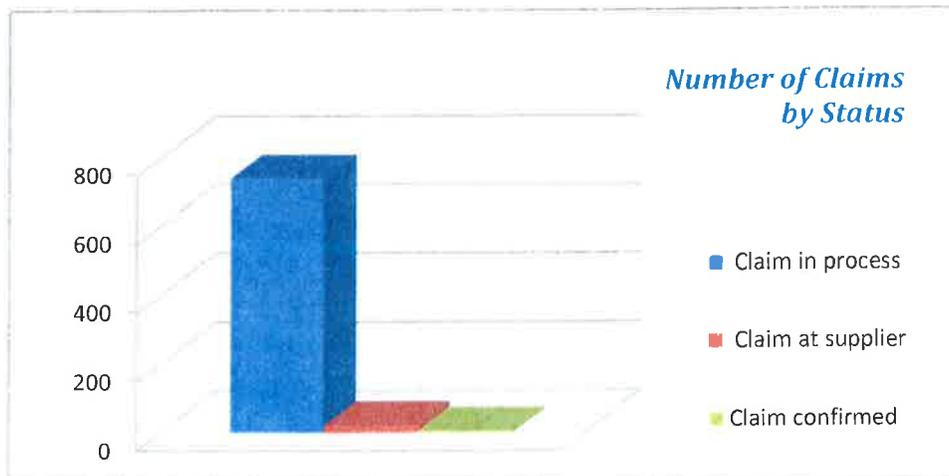
Overview Key

Status	Number of claims	Amount
Claim in process	741	\$13,070,022.89
Claim at supplier	23	\$220,716.95
Claim confirmed	5	\$5,076.43
Total	769	\$13,295,816.27

Amount of Claim by Status



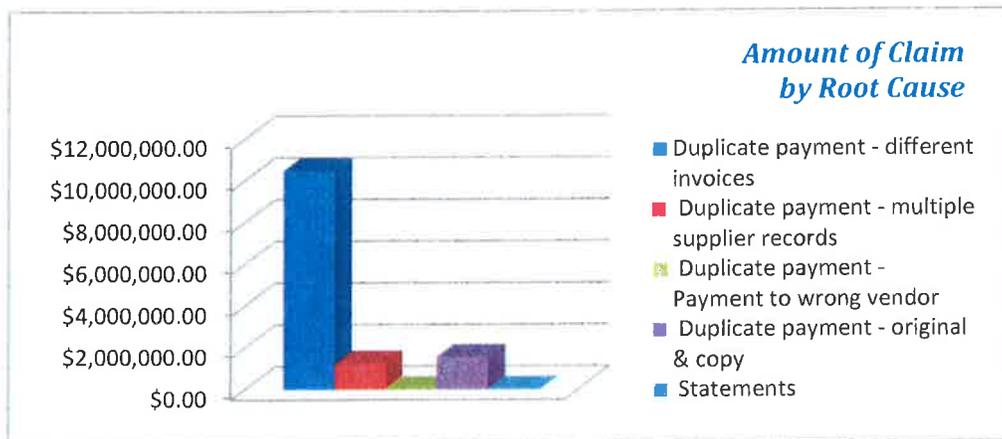
Number of Claims by Status



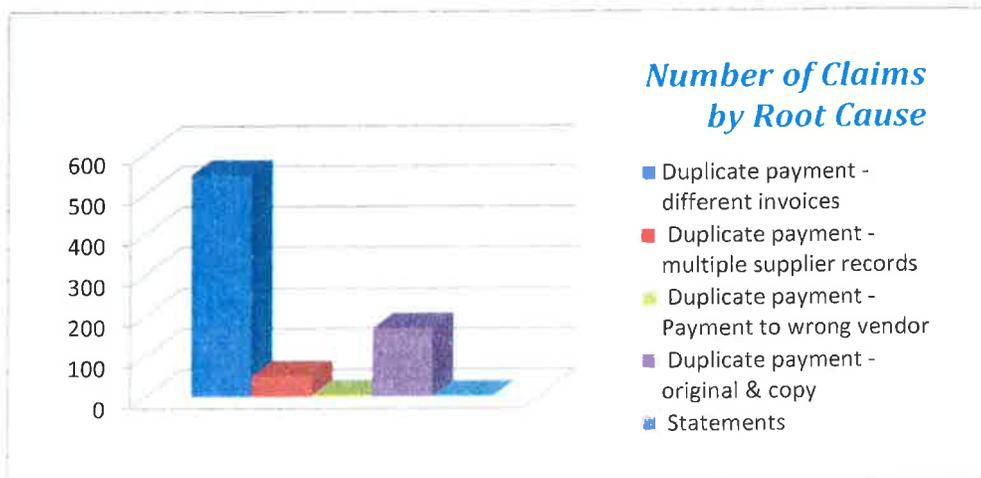
Overview Key

<i>Root Cause</i>	<i>#of claims</i>	<i>Amount</i>
Duplicate payment - different invoices	545	\$10,477,581.35
Duplicate payment - multiple supplier records	51	\$ 1,232,930.86
Duplicate payment - Payment to wrong vendor	4	\$ 22,016.31
Duplicate payment - original & copy	168	\$ 1,562,465.75
Statements	1	\$ 822.00
Total	769	\$13,295,816.27

Amount of Claim by Root Cause



Number of Claims by Root Cause



Statement Audit

RAS compiled a list of 2,985 vendors and mailed each vendor a statement request letter on December 18, requesting a response within ten days. Prior to the mailing we cleansed the list of duplicate suppliers, verified addresses and appropriate contact person. These statements provide significant opportunity to locate unknown credits and/or other unresolved issues. RAS has mailed the statement request letters and we anticipate receiving a large response in the coming days.

As each response is received our team analyzes the statement and marks any suspicious items. The suspicious items are then given to the auditors to examine and validate. Upon confirmation of overpayments, RAS moves to recover the funds for South Carolina. Suppliers that do not respond to the statement letter receive a follow up call for the request.

Commercial Leases

A RAS auditor is currently in Columbia reviewing more than fifty commercial leases at the request of the B&CB.

Public Technical Colleges

RAS is waiting on a data file from all sixteen schools, which is being coordinated by the schools.

South Carolina Public Senior Institutions

RAS has completed the audit of three universities with minor discoveries: The Citadel with \$180 million in expenditures, the College of Charleston with \$220 million in expenditures and Winthrop University with \$194 million in expenditures. Auditors' observations were that those institutions had sound practices and multiple layers of staff that reviewed the financial transactions.

Data on \$500 million in expenditures is currently being reviewed for Clemson University and expenditures of \$168 million for Coastal Carolina University. Once data analysis is complete auditors will be on-site to validate potential overpayments, most likely in mid-January 2013.

RAS is waiting to receive data from the University of South Carolina with expenditures of \$1 billion and Lander University with expenditures of \$43 million.

Francis Marion University, Medical University of SC and South Carolina State University have been unresponsive to requests for data from RAS; we have informed the B&CB.

Public Employee Health Care Benefits

An agency with the potential for the most significant recoveries, the Public Employee Benefit Authority, has not participated in the recovery audit. RAS met with officials of the Employee Insurance Program (EIP) in April 2012, after they informed RAS they were ready to proceed with the recovery audit. RAS held an extensive meeting with key officials of EIP to start the audit process. Shortly after our April meeting, the audit was put on hold pending establishment of the new Public Employee Benefit Authority (PEBA). RAS met with officials of PEBA on November 29, 2012 who did not indicate that PRBA was ready to participate in the recovery audit.

Recovery audit industry standards typically recover from three to eight percent in self-funded healthcare and pharmacy benefit programs, while non-medical expenditures typically recover from one-tenth to three-tenths of a percent of expenditures.

In addition to our cutting-edge technology and data analysts, RAS' medical audit teams consist of doctors, clinical nurses and certified coders that analyze the claims for accuracy and appropriateness.

South Carolina's best opportunity for significant recovery of funds is in its self-funded healthcare and pharmacy benefits programs. Early in 2012, RAS requested copies of the State contracts with its vendors for healthcare services from the Employee Insurance Program so we could begin the contract compliance review, which is the first step in the process. RAS, however, has not received the contracts to review. RAS has found that almost all Third Party Administrators (TPAs), such as Blue Cross and Cigna (and sometimes even Pharmacy Benefit Managers (PBMs)), put very restrictive audit language in their contracts, which prevents the State from verifying that the TPA and PBM is spending the State's funds accurately. RAS does not know whether South Carolina healthcare vendors included such audit restrictions since we have been unable to review the contracts.

As a matter of good public policy, however, no private company that is retained by government to administer public healthcare expenditures should be able to deny the government the ability to fully audit 100 percent of its public expenditures. Such arbitrary audit restrictions can even inadvertently aid unscrupulous providers that might be working to defraud the government.

Best Practices Recommendations

Recommendation One: Streamline the Audit Process

RAS recommends that South Carolina streamline the process to make it more efficient, timely and productive for the State. Our recommendations include making the following changes.

- Place the B&CB fully in charge of the recovery audit and *require* all agencies to participate in the recovery audit, unless B&CB determines an agency's participation likely would not be productive (e.g., payables are too small).
- RAS auditors will need to contact an agency only when there are questions about documentation for a claim by RAS or the B&CB.
- RAS auditors will work with agencies on selected claims needing verification when the backup documentation is not contained in the SCEIS system.
- Require checks for recoveries to be sent to one central repository under the B&CB, thereby increasing accountability and reducing errors in documenting the recoveries. Doing so relieves State workers of unnecessary and /or redundant activities. Currently when an agency receives a check for a recovery, it records it and sends a check to the B&CB for deposit into the Special State Fund. Sending the check straight to the B&CB will increase accuracy and timeliness of the State recoveries.

Background

Since RAS identifies all claims and recoveries by agency, vendor and root cause, the State will have full accountability on overcharges, errors and the reason it occurred by agency. South Carolina will not lose any information or documentation under the streamlined process. Should the B&CB have a question on the documentation for any claim; it can contact the agency on an as needed basis. RAS would be pleased to work with the B&CB or State Legislature on ways to streamline the process based on our experience with systems used in other states' comprehensive recovery audits.

Recommendation Two: Prohibit Audit Restrictions

If there are audit restrictions in State contracts they should be nullified and prohibited in future renewals or awards. Audit restrictions are rarely included in non-medical contracts. They are, however, overwhelmingly prevalent in healthcare contracts written by TPAs and sometimes by PBMs.

The claims data is the government's property based on its taxpayer funded expenditures and this should be clearly addressed in all contracts, especially all healthcare-related contracts. The

government has a right—and a responsibility—to manage its taxpayer’s resources wisely; auditing public expenditures and recovering overcharges are sound management tools, especially in today’s tight economic climate.

A private vendor should not be allowed to obstruct public accountability and transparency in the financial transactions it performs for government. Taxpayers simply would not understand or condone such actions.

RAS will be pleased to work with South Carolina on ways to eliminate such audit restrictions without disrupting its current healthcare contracts.

Conclusion

This report covers the early phase of the recovery audit contract. As we have now entered a fast paced time in the recovery, the findings will change daily. RAS will meet with the B&CB regularly to keep staff apprised of the status of the audit and its recoveries. Additionally, B&CB staff has been provided a technology key that enables them to log on to our secure website and view the status of the South Carolina non-healthcare audit at any time.

Due to strict federal HIPAA privacy requirements for protected healthcare data, RAS does not maintain web based access to its health care audits.

RAS looks forward to reporting its recoveries on behalf of the State of South Carolina. We applaud the professionalism and dedication of the officials we have the pleasure of working with from the B&CB, Comptroller’s Office and SCEIS system.

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