

Audit Report

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**Subsequent Injury Fund**

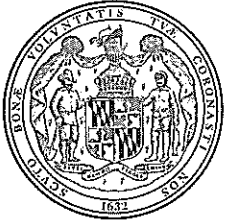
September 2011

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**OFFICE OF LEGISLATIVE AUDITS**  
DEPARTMENT OF LEGISLATIVE SERVICES  
MARYLAND GENERAL ASSEMBLY

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DEPARTMENT OF LEGISLATIVE SERVICES  
OFFICE OF LEGISLATIVE AUDITS  
MARYLAND GENERAL ASSEMBLY

September 21, 2011

Karl S. Aro  
Executive Director

Bruce A. Myers, CPA  
Legislative Auditor

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

Ladies and Gentlemen:

We have audited the Subsequent Injury Fund (SIF) for the period beginning January 23, 2008 and ending January 4, 2011. SIF pays workers' compensation awards in connection with claims for employees' subsequent occupational injuries or deaths, and collects assessments from certain employers and insurance companies to fund these awards.

Our audit disclosed that procedures for ensuring SIF funds were only disbursed to eligible beneficiaries were not sufficiently comprehensive. Specifically, SIF did not have sufficient procedures for ensuring funds were not disbursed to deceased beneficiaries resulting in at least \$129,000 that was disbursed, or was scheduled to be disbursed in the future, to deceased individuals. In addition, SIF did not conduct independent reviews of certain recurring payments to SIF beneficiaries. Furthermore, SIF also did not conduct independent reviews of certain critical accounts receivable transactions.

Finally, regarding its information systems, SIF did not have a disaster recovery plan and security event monitoring was not adequate.

SIF's response to our findings and recommendations is included as an appendix to this report. We wish to acknowledge the cooperation extended to us by SIF during the course of this audit.

Respectfully submitted,

Bruce A. Myers, CPA  
Legislative Auditor



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\* Denotes item repeated in full or part from preceding audit report



## **Background Information**

### **Agency Responsibilities and Financial Activity**

The purpose of the Subsequent Injury Fund (SIF) is to encourage the employment of handicapped individuals by limiting an employer's liability should a subsequent occupational injury render an individual permanently disabled or result in the individual's death. The employer's liability is limited to compensation for damages from the current injury, and SIF incurs the liability associated with the combined effects of all injuries.

The principal source of funding for benefit payments and SIF's operating expenses is assessments collected from employers and insurance companies based on all awards and settlement agreements approved by the Workers' Compensation Commission involving permanent disability and death. SIF calculates these assessments, which are currently 8.5 percent of the aforementioned award amounts, with 6.5 percent allocated to SIF and 2 percent allocated to the Uninsured Employers' Fund (UEF). UEF pays workers' compensation awards to claimants who failed to receive payments from uninsured employers. During the audit period, SIF also provided certain support services (such as processing of invoices, processing collections for deposit, maintenance of accounting records, and data processing services) to UEF.

According to SIF's records, as of June 30, 2010, SIF's fund balance totaled approximately \$71 million. The fund balance does not reflect liabilities for future payments to beneficiaries. In this regard, SIF's most recent actuarial study performed in November 2003<sup>1</sup> indicated that, at that time, SIF had an unfunded liability for permanent injury and death claims of approximately \$201 million (discounted at 5 percent). This amount represents a 16 percent increase from the previous actuarial study performed in August 1996. Claim benefit obligations are funded on a pay-as-you-go basis so when obligations become due in future periods, the obligations will have to be paid from future assessments collected from employers and insurance companies. In this regard, a September 8, 1992 advice of the Attorney General concluded that should fund awards ever exceed the amount of monies in the SIF, the State would not be liable to appropriate its own funds to pay claims.

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<sup>1</sup> In December 2010, SIF contracted for a new actuarial study which was expected to be completed in July 2011.

## **Ongoing Litigation**

During the course of our audit, there was ongoing litigation with the Injured Workers Insurance Fund (IWIF) over IWIF's failure to pay certain assessments to SIF. The litigation involves the statutory assessment imposed on insurance companies and employers used to fund SIF. The assessment is a percentage of the Workers' Compensation Commission (WCC) awards (currently 6.5 percent for SIF). SIF historically calculated the assessment based on the total WCC award. In April 2007, SIF management noted that IWIF was withholding a portion of its assessments. Subsequent discussions with IWIF management disclosed that the payments were withheld because IWIF management believed that the assessment calculation should not consider medical costs. Based on its review, as of January 31, 2011, SIF calculated that IWIF owed SIF approximately \$2.6 million.

SIF presented the IWIF issue to WCC in October 2009, and WCC ruled that the assessment should be based on the entire award including the medical costs<sup>2</sup>. IWIF appealed the ruling to the Circuit Court of Maryland and on March 23, 2011, the Circuit Court confirmed the WCC ruling. In June 2011, IWIF appealed the verdict to the Court of Special Appeals, and the appeal is currently pending.

## **Status of Findings From Preceding Audit Report**

Our audit included a review to determine the status of the nine findings contained in our preceding audit report dated April 9, 2009. We determined that SIF satisfactorily addressed seven of the findings. The remaining two findings are repeated in this report.

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<sup>2</sup> A similar ruling was issued for a different insurance company who had previously presented the same issue to the WCC.

## Findings and Recommendations

### Claims

#### **Finding 1**

**Subsequent Injury Fund (SIF) procedures for ensuring funds are not disbursed to deceased beneficiaries were not sufficiently comprehensive, resulting in at least \$12,000 being disbursed, and another \$117,000 that was scheduled to be disbursed in the future, to deceased individuals.**

#### **Analysis**

SIF procedures for ensuring funds are not disbursed to deceased beneficiaries were not sufficiently comprehensive. Specifically, when matching SIF's records of individuals receiving SIF payments to the Social Security Administration (SSA) death records, SIF only included the individuals who are receiving benefits indefinitely (that is, until death). The match, which is performed every 45 days on average, did not include individuals receiving benefits for a fixed period (such as for 12 months) or who were scheduled to receive benefits in the future (for example, benefits were to start after insurance company benefits had been depleted). As of January 2011, SIF had 1,343 individuals who were receiving or were due to receive funds in the future, of which only 567 (or 42 percent) would have been subject to the death match. As a result, there was a lack of assurance that payments made, or to be made, to these individuals were proper.

We performed a match of individuals on SIF's accounts payable system as of January 6, 2011 who were receiving benefits for a fixed period or who were scheduled to receive benefits in the future against SSA's Death Master File. Based on our analysis, we noted that SIF disbursed approximately \$12,000 over an eleven-month period to one beneficiary after the individual was deceased and an additional \$5,000 was scheduled to be paid to this beneficiary in the future. In addition, we noted another \$112,000 that was scheduled to be paid to four other deceased beneficiaries in the future.

SIF management was not aware that these beneficiaries were deceased until we brought them to its attention. SIF management subsequently advised us that all but the last check issued to the aforementioned beneficiary had been cashed. Management further advised that it was pursuing recovery of the funds and would determine why the checks were cashed. In addition, SIF removed the future payments that were to be made to this and the other four beneficiaries. In accordance with the Labor and Employment Article of the Annotated Code of Maryland, SIF is not obligated to pay any claims after the death of the beneficiary.

### **Recommendation 1**

**We recommend that SIF**

- a. modify its procedures to ensure that all deceased beneficiaries are timely identified, and**
- b. pursue recovery of the aforementioned improper payments and take appropriate follow up action (including referral to the Office of the Attorney General – Criminal Division, if checks were inappropriately cashed).**

### **Finding 2**

**SIF did not conduct independent reviews of certain recurring payments to beneficiaries to ensure the payments were valid and accurate.**

### **Analysis**

SIF did not conduct independent reviews of certain recurring payments to SIF and Uninsured Employers' Fund (UEF) beneficiaries. Specifically, only the initial disbursement on recurring payments is subject to independent verification and not the remaining disbursements. This is significant because many of these biweekly payments are made indefinitely for the life of the beneficiary and the payment can be changed by SIF accounting staff without any independent approval. For example, when a recurring payment is initially entered into the accounts payable system, the SIF accounting employee only enters in the dollar amount of the payments and the period payment amount (such as, 100 weeks). When this fixed period is complete, the accounting employee manually enters in the amount due for the next period. While the initial amount entered was subject to an independent review and approval, the subsequent "renewal" was not verified to ensure the amount was proper. As a result, there is a lack of assurance that these payments were proper.

Per SIF and UEF records, during calendar year 2010, approximately 25,000 biweekly disbursements were made totaling approximately \$13.1 million<sup>3</sup>.

### **Recommendation 2**

**We recommend that an independent employee review the recurring payments, at least on a test basis, to ensure the payments are valid and accurate. We advised SIF on accomplishing the necessary separation of duties using existing personnel.**

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<sup>3</sup> This amount may include initial payments which were subject to an independent verification.

## Accounts Receivable

### **Finding 3**

**SIF did not conduct independent reviews of certain critical accounts receivable transactions.**

### **Analysis**

SIF did not conduct independent reviews of certain critical accounts receivable transactions. Specifically, our review disclosed the following conditions:

- There were no independent verifications performed to ensure the accuracy of Workers' Compensation Commission (WCC) awards entered in the accounts receivable system. This award data are used by the SIF's automated accounts receivable system to calculate the assessments and to generate billings to employers and insurance companies. Our review disclosed that one employee was responsible for reviewing WCC case information and for entering the amount and type of the award into the accounts receivable system. There was no independent review of the information entered to the related source documents to ensure the accuracy of the information entered.

In this regard, our test of ten awards entered into the system during fiscal years 2010 and 2011 totaling \$2.1 million disclosed that one award posted on July 7, 2009 totaling \$363,306 was improperly entered as \$196,307 on the system. As a result, the calculation of the related assessment was understated by \$14,195. SIF did not identify this error until April 28, 2010 at which point the accounts receivable records were adjusted and the proper amount billed. This error could have been readily detected if independent verifications had been performed. A similar condition was commented upon in our preceding audit report. During calendar year 2010 accounts receivables for WCC award assessments totaled approximately \$30 million.

- Non-cash credit adjustments recorded in the accounts receivable records were not always subject to independent review and approval. Specifically, one employee recorded the adjustments to the accounts receivable records and had the capability to update records in the accounts receivable system. Although an independent employee was supposed to review the adjustments for propriety, our test of 10 batches of non-cash credit adjustments totaling \$584,453 processed during fiscal years 2008 through 2011 disclosed that seven batches totaling \$465,509 were not subject to any independent review and approval. A similar comment regarding the need for an independent verification of the propriety of non-cash credits was commented upon in our

two preceding audit reports. According to SIF's records, net non-cash credit adjustments totaled \$5.8 million during fiscal year 2010 for SIF and for UEF.

### **Recommendation 3**

**We recommend that SIF establish independent reviews to ensure that**

- a. WCC awards are accurately entered in the accounts receivable records (repeat), and**
- b. only properly authorized non-cash credit adjustments are recorded in the accounts receivable records (repeat).**

## **Information Systems Security and Control**

### **Finding 4**

**SIF did not have a disaster recovery plan and security event monitoring was not adequate over the dedicated computer server.**

### **Analysis**

SIF did not have an information technology disaster recovery plan and security event monitoring was not adequate over SIF's dedicated computer server.

Specifically we noted the following conditions:

- An information technology disaster recovery plan did not exist for recovering from disaster scenarios (for example, a fire). SIF had a formal plan to create a disaster recovery plan and is researching alternate site arrangements. However, SIF had not yet developed a disaster recovery plan in accordance with the State of Maryland *Information Technology Disaster Recovery Guidelines*. Without a comprehensive disaster recovery plan, a disaster could cause significant delays (for an undetermined period) in restoring operations above and beyond the expected delays that would exist in a planned recovery scenario. A similar condition was commented upon in our two preceding audit reports.
- Security auditing was not enabled for certain critical files on the dedicated computer server which hosts SIF's critical applications. In addition, for security events which were logged, we were advised that reports of security events were not being generated for review. As a result of these conditions, there was no monitoring of security events applicable to the dedicated computer server.

SIF uses a dedicated computer server to provide computer processing services for several significant applications, including accounts receivable, case processing, and claims payments which are used by both SIF and UEF. In addition, to limit

in-house technical support, SIF uses a contractor for programming and operations support.

#### **Recommendation 4**

**We recommend that SIF**

- a. develop a complete disaster recovery plan in accordance with the aforementioned *Disaster Recovery Guidelines* (repeat);**
- b. enable security auditing for all critical files on the dedicated computer server which hosts the SIF's critical applications; and**
- c. generate and review, on a weekly basis, reports of critical security events, document these reviews, and retain the documentation for future reference.**



## **Audit Scope, Objectives, and Methodology**

We have audited the Subsequent Injury Fund (SIF) for the period beginning January 23, 2008 and ending January 4, 2011. 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 SIF's financial transactions, records, and internal controls, and to evaluate its compliance with applicable State laws, rules, and regulations. We also determined the status of the findings included 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, accounts receivable, accounts payable, disbursements for SIF's non-operating expenditures, and information systems security and control. Our audit procedures included inquiries of appropriate personnel, inspections of documents and records, and observations of SIF'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.

SIF provides certain support services (such as invoice processing, payroll, processing collections for deposit, maintenance of accounting records, and data processing services) for the Uninsured Employers' Fund (UEF)<sup>4</sup>. These support services are included within the scope of this audit.

SIF'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.

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<sup>4</sup> SIF and UEF are in the process of transferring the responsibility for these services to UEF. However, as of March 23, 2011, all of the aforementioned services were still provided by SIF.

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

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



MARTIN O'MALLEY  
Governor

JOHN L. ULRICH, JR.  
Director

JENNIFER A. ROWE  
Fiscal Administrator

MARK MONDOR  
Information Technology  
Director

## Subsequent Injury Fund Responses to Audit Report

### Claims

#### Finding 1

Subsequent Injury Fund (SIF) procedures for ensuring funds are not disbursed to deceased beneficiaries were not sufficiently comprehensive, resulting in at least \$12,000 being disbursed, and another \$117,000 that was scheduled to be disbursed in the future, to deceased individuals.

#### OLA Recommendation 1

*We recommend that SIF*

- a. modify its procedures to ensure that all deceased beneficiaries are timely identified, and*
- b. pursue recovery of the aforementioned improper payments and take appropriate follow up action (including referral to the Office of the Attorney General - Criminal Division, if checks were inappropriately cashed).*

#### SIF Response 1

- a. Based on OLA's recommendation, permanent partial and permanent total disability active pay status recipients will be included in the Social Security Death Master File (SSDMF) records match performed approximately every 40-days (9 per year) to ensure timely identification of all deceased beneficiaries. SIF Fiscal personnel will notify the claims department of impending payment start dates, where upon claims will contact E/I for payment end date confirmation. The agency does not authorize benefit payments until E/I confirmation. At this time, prior to issuing first payment individual permanent partial disability recipients will be added to the SSDMF record match.**
- b. Further pursuit to recover improper payments made to deceased beneficiaries will be pursued diligently including referral to the Attorney General - Criminal Division when appropriate.**

Subsequent Injury Fund  
Responses to Audit Report

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**Finding 2**

**SIF did not conduct independent reviews of certain recurring payments to beneficiaries to ensure that payments were valid and accurate.**

*OLA Recommendation 2*

*We recommend that an independent employee review the recurring payments, at least on a test basis, to ensure the payments are valid and accurate. We advise SIF on accomplishing the necessary separation of duties using existing personnel.*

**SIF Response 2**

**Effective July 2011, an independent employee reviews the recurring payments by reviewing and comparing the bi-weekly reconciliation summary sheets to ensure the payments are valid and accurate.**

**Accounts Receivable**

**Finding 3**

**SIF did not conduct independent reviews of certain critical accounts receivable transactions.**

*OLA Recommendation 3*

*We recommend that SIF establish independent reviews to ensure that*

- a. WCC awards are accurately entered in the accounts receivable records (repeat), and*
- b. only properly authorized non-cash credit adjustments are recorded in the accounts receivable records (repeat).*

**SIF Response 3**

- a. The feasibility of reviewing every assessment calculation performed at SIF remains elusive absent a dedicated employee to mirror that function. As a result of this finding, SIF reviews for accuracy all assessments for awards over \$100,000.00 and randomly tests 3% of the remaining assessments in each batch prior to mailing. Tested assessments are clearly marked by reviewers initials and date reviewed. Monthly delinquent notices will continue to be reviewed for accuracy before being mailed, and SIF's relationship with WCC Insurers regarding discrepancies remains intact with regard to resolving assessment calculation questions. In addition, SIF is working with WCC to obtain additional data fields which include award information WCC currently records in hopes of possibly automating a large portion of the assessment calculation function in the future.**

## Subsequent Injury Fund

### Responses to Audit Report

- b. Beginning May 2011, the Fund ensures all non-cash adjustments are reviewed independently and approved for accuracy prior to the update of the account receivable records. Additionally, completed adjustments are verified for accuracy and documented with date and reviewers initials.

#### Information Systems Security and Control

##### Finding 4

SIF did not have disaster recovery plan and security event monitoring was not adequate over the dedicated computer server.

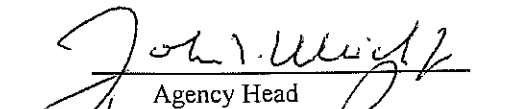
##### OLA Recommendation 4


We recommend that SIF

- a. develop a complete disaster recovery plan in accordance with the aforementioned Disaster Recovery Guidelines (repeat);
- b. enable security auditing for all critical files on the dedicated computer server which hosts the SIF's critical applications; and
- c. generate and review, on a weekly basis, reports of critical security events, document these reviews, and retain the documentation for future reference.

##### SIF Response 4

- a. Since the previous audit, SIF has created an IT department and created a formal project plan to create a DRP that was developed utilizing guidelines provided by the Maryland Department of Budget and Management Disaster Recovery Guidelines v4.0. Much research has been done identifying products and services appropriate for state security compliance. We have completed Phase 1: Pre-Planning stage of the project that involves Business Impact Analysis. We are beginning Phase 2: the Planning Phase and will continue to execute our plan.
- b. We have enabled security auditing for all critical files on the dedicated server which hosts the SIF's critical applications.
- c. We are generating and reviewing on a weekly basis the reports of critical security events and are saving the reports, review comments and any subsequent investigations as electronic document images.

  
Agency Head

  
Chief Financial Officer

September 15, 2011

Date

September 15, 2011

Date

AUDIT TEAM

**Brain S. Tanen, CPA, CFE**  
Audit Manager

**Richard L. Carter, CISA**  
Information Systems Audit Manager

**Joel E. Kleiman, CPA**  
Senior Auditor

**Michael K. Bliss**  
Information Systems Senior Auditor

**Michael J. Murdzak, CPA**  
Staff Auditor