Audit Report

Department of Labor, Licensing and Regulation
Division of Unemployment Insurance

February 2015

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

February 27, 2015

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Executive Director

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Legislative Auditor

Senator Guy J. Guzzone, Co-Chair, Joint Audit Committee
Delegate Craig J. Zucker, Co-Chair, Joint Audit Committee
Members of Joint Audit Committee
Annapolis, Maryland

Ladies and Gentlemen:

We have conducted a fiscal compliance audit of the Department of Labor, Licensing and Regulation (DLLR) – Division of Unemployment Insurance (DUI) for the period beginning February 1, 2011 and ending February 23, 2014. DUI administers the State's Unemployment Insurance Program that is funded primarily by unemployment insurance tax contributions collected from employers.

Our audit disclosed that DUI's use of computer matching techniques to detect improper payments could be improved. For example, DUI did not complete its review of the results of five quarterly matches to identify claimants with reported Maryland wages who may be improperly receiving unemployment insurance benefits. In addition, DUI did not always perform and fully investigate the results of certain other targeted automated matches. These matches were conducted, for example, to identify claimants receiving unemployment benefits while incarcerated. Furthermore, DUI did not always refer certain delinquent benefit overpayment accounts to the State's Central Collection Unit.

Proper security and access controls were not in place over a critical database containing sensitive information. For example, approximately 646,000 unique social security numbers of unemployment insurance claimants were stored within a database in clear text. Finally, sufficient controls were not in place for employers that reimburse DUI for benefits paid to their former employees, rather than make quarterly unemployment insurance tax payments.

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DLLR's response to this audit, on behalf of DUI, is included as an appendix to this report. We wish to acknowledge the cooperation extended to us during the course of this audit by DUI.

Respectfully submitted,

Thomas J. Barnickel III, CPA
Legislative Auditor

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

Background Information

Agency Responsibilities

The Division of Unemployment Insurance (DUI) is a separate budgetary unit within the Department of Labor, Licensing and Regulation. According to its records, during calendar year 2013, DUI collected approximately $1.3 billion, consisting of approximately $813.6 million in unemployment insurance taxes from employers and approximately $482.2 million in reimbursements from certain non-profit employers, other states, and the federal government.

Unemployment insurance benefits paid to approximately 207,000 claimants during calendar year 2013 totaled approximately $1.2 billion, of which approximately $378.4 million was funded by the federal government. As of July 2014, the maximum amount of benefits an individual could receive was $430 per week for 26 weeks.

As of the end of calendar year 2013, the Maryland Unemployment Insurance Trust Fund had a balance of approximately $872.9 million. According to the State's records, DUI's fiscal year 2013 operating expenditures totaled approximately $68.9 million.

DUI's business information systems include the Maryland Unemployment Insurance Tax System (UITAX), which is used to process employers' unemployment insurance taxes owed and paid, and the Maryland Automated Benefits System (MABS), which tracks payments to and amounts due from unemployment insurance claimants.

Status of Findings From Preceding Audit Report

Our audit included a review to determine the status of the five findings contained in our preceding audit report dated September 19, 2012. We determined that DUI satisfactorily addressed three of the findings. The remaining two findings are repeated in this report and appear as one finding.

Findings and Recommendations

Automated Match Procedures

Finding 1
DUI did not appropriately perform and fully investigate the results of certain targeted benefit payment matches in a timely manner.

Analysis
DUI did not appropriately perform its automated targeted matches of benefit payments, as reflected in the Maryland Automated Benefits System, with relevant information from other databases and investigate the results in an adequate and timely manner. DUI performs these matches to help detect potential and actual improper benefit payments.

- Our test of the results of five quarterly matches (September 2013, June 2013, December 2012, June 2012, and September 2011) comparing individuals with reported Maryland wages with individuals receiving unemployment benefit payments disclosed that DUI had not performed a complete review of the results for any of these matches as of May 2014. Generally, DUI selects up to 150 matches to review from each quarter based on predetermined criteria. For example, for the June 2013 match results, of the 150 claimants selected for review by DUI, there were 127 claimants that had not been reviewed or for which the review was incomplete.

- DUI did not use wage data available through the National Directory of New Hires (NDNH) to more effectively identify Maryland claimants potentially receiving improper benefit payments while working in Maryland and other states. DUI contracted with the federal Office of Child Support Enforcement (OCSE), which operates the NDNH, to perform a weekly match of claimants with the NDNH; however, DUI included only the claimants' names and social security numbers. DUI did not request OCSE to include the most recent quarterly wage information for all employees in the match process. Including the national wage information would provide more comprehensive results and would help DUI prioritize its follow-up efforts by identifying claimants with a higher likelihood of having received significant improper benefit payments, such as claimants with both significant quarterly wages and benefits. During calendar year 2013, the NDNH computer match conducted weekly for DUI identified, in the aggregate, 19,779 instances in which a claimant's social security number and name matched an individual who was reported as being newly hired.

- During the audit period, DUI did not routinely perform certain periodic (monthly or quarterly) matches and did not adequately review the results when matches were performed. These matches were conducted to identify claimants receiving benefit payments while incarcerated, claimants with the same address, and claimants with the same address or name of DLLR employees. For example, as of March 2014, for eight quarters during the period from March 2011 to December 2013, the matches between DLLR employees and benefit payment records were not performed or the results were not fully investigated. Furthermore, our test of seven individuals identified through five monthly matches during the period from June 2012 to December 2013 comparing incarceration records to individuals receiving benefit payments identified four individuals receiving benefits totaling approximately $17,700. As a result of our test, DUI performed additional investigations of our test results and determined that overpayments totaling $10,400 were made to three individuals.

- DUI's quarterly matches to identify claimants with the same address or name of DLLR employees excluded employees working within DLLR's DUI and Division of Administration. DUI was not aware of this until we brought it to its attention. According to State payroll records during fiscal year 2013, these two divisions represent approximately 47 percent of DLLR's more than 1,900 authorized positions.

Similar conditions regarding fully investigating the results of targeted matches and requesting OCSE to incorporate national wage information into its NDNH matching procedures were commented upon in our preceding audit report.

Recommendation 1
We recommend that DUI

a. fully and timely investigate the results of all matches performed, including the aforementioned results, and take appropriate action, such as the recovery of benefit overpayments (repeat);
b. request OCSE to incorporate national wage information into its NDNH matching procedures (repeat);
c. perform the targeted matches within the established time frames, such as quarterly; and
d. include all DLLR employees in the aforementioned quarterly payroll match.

Benefit Overpayments

Finding 2
DUI did not always refer certain delinquent benefit overpayment accounts to the State's Central Collection Unit.

Analysis
DUI did not always refer certain delinquent overpayment accounts to the State's Central Collection Unit (CCU). State law allows DUI to recover benefits paid to claimants who are subsequently found to be ineligible, and to assess penalties and interest on overpayments made to claimants who either made a false statement or failed to disclose a material fact in order to obtain the benefits. According to DUI records as of December 31, 2013, the benefit overpayment accounts receivable balance totaled approximately $170.3 million, including $118.6 million that was more than a year old. Approximately $36.9 million in overpayments was recovered during calendar year 2013. During calendar year 2013, DUI referred approximately 3,600 accounts totaling $8.8 million to CCU.

Our test of 10 delinquent overpayment accounts totaling approximately $249,000 disclosed that 7 accounts totaling approximately $196,000 were not referred to CCU that should have been referred. As of July 10, 2014, these accounts qualified for referral to CCU for at least one year. DUI's collection policy states that claimants with no pending legal issues qualify for referral to CCU when the overpayment is 90 days past due. Consistent with State law, CCU has agreed to accept the referral of delinquent accounts from DUI which otherwise are excluded from CCU's collection assistance.

Recommendation 2
We recommend that DUI refer applicable delinquent benefit overpayment accounts to CCU.

Information Systems Security and Control

Finding 3
DUI stored sensitive personally identifiable information within a database in clear text.

Analysis
DUI stored sensitive personally identifiable information (PII) within a database in clear text. Specifically, we determined that DUI stored PII including full names

and social security numbers in clear text in a database used to assist staff in resolving unemployment insurance issues.

As of September 10, 2014, based on our inquiry, DUI determined that this database contained 646,577 unique social security numbers of unemployment insurance claimants in clear text along with names. This database was maintained on a local database server. This sensitive PII, which is commonly sought by criminals for use in identity theft, should be protected by appropriate information system security controls. The Department of Information Technology (DoIT) *Information Security Policy* requires each agency to protect confidential data using encryption technologies and/or other substantial mitigating controls.

Recommendation 3
We recommend that DUI encrypt all database tables containing sensitive PII.

Finding 4
Access, account, and password controls over a database were not sufficient to protect sensitive data.

Analysis
Access, account, and password controls over a database containing sensitive personally identifiable information were not sufficient to protect such data.

- A default administrative database account unnecessarily had full access to this database. Since this account includes local server administrators by default, all local administrators on the database server had full administrative access to this database which should only be provided to database administrators. Also, anyone able to achieve local administrator privileges would automatically have full administrative access to this database and could perform unauthorized modifications to critical data.

- Account and password controls over this database and the server used to host this database were not in compliance with the requirements of the DoIT *Information Security Policy*. For example, passwords for 16 accounts on the database server were stored in clear text in each account's description field. In addition, the database system account's password had not been changed since December 2, 2008 and password lifetime, length, and complexity requirements were not enforced for this account.

The DoIT *Information Security Policy* states that each agency must establish an authorization process which specifically grants access to information ensuring that access is strictly controlled, audited, and that it supports the concepts of "least possible privileges" and "need-to-know." This policy also requires that passwords must not be stored in clear text, must be changed at regular intervals, be a minimum of eight characters, and meet complexity requirements.

Recommendation 4
We recommend that DUI

a. **limit access to all critical databases to personnel whose job duties require such access, and**
b. **ensure that all databases and host servers comply with the DoIT *Information Security Policy* account and password requirements.**

Reimbursable Employers

Finding 5
DUI did not always ensure reimbursable employers provided sufficient collateral and did not perform timely collection efforts to obtain reimbursements for benefits paid.

Analysis
DUI did not exercise sufficient control over reimbursable employer accounts. According to State law, certain not-for-profit organizations and government agencies may elect to be classified as reimbursable employers. This election allows these entities to reimburse DUI for unemployment insurance benefits paid to their former employees rather than make quarterly unemployment insurance tax payments. Reimbursable employers are required to provide DUI with collateral as security in the event the employers default on these reimbursements. DUI is allowed to terminate an employer's reimbursable status if the required amount of collateral is not submitted within 120 days or the employer is delinquent on reimbursable payments.

DUI did not always ensure reimbursable employers provided sufficient collateral which is generally based on the employer's taxable wages for the previous year. According to DUI records, which we determined were reliable for our purposes, additional collateral totaling $2.8 million was needed for 88 employer accounts to be fully collateralized as of July 16, 2014. Although DUI was aware of such accounts, because of recent staff turnover, it did not contact the employers to obtain additional collateral. Subsequent to our review, we were advised that DUI had begun to take corrective actions on these accounts.

Additionally, our test of eight reimbursable employer accounts with delinquent balances totaling approximately $504,300 disclosed that, although DUI had made three unsuccessful attempts to collect the amounts due, for six of these accounts with balances totaling $470,600, it did not take certain additional actions. For example, DUI did not terminate the reimbursable status for four accounts and convert these accounts to contributory accounts (requiring quarterly unemployment insurance tax payments). DUI also did not redeem available collateral for three accounts, including one account for which the reimbursable status was not converted. According to DUI procedures, after three unsuccessful attempts to collect the accounts, available collateral on the accounts was to be redeemed and, in some cases, the reimbursable status was to be terminated. As of June 24, 2014, the balances on these six accounts had increased to approximately $775,600 because additional benefits had been paid (including accrued interest and penalties) and had been delinquent for periods ranging from one to four years.

According to DUI records, as of July 16, 2014, 1,278 reimbursable accounts were required to have collateral totaling approximately $117.3 million. Additionally, as of June 30, 2014, the receivable balance for reimbursable employer accounts totaled approximately $1.9 million.

Recommendation 5
We recommend that DUI

- **a. ensure reimbursable accounts are fully collateralized, and**
- **b. timely pursue delinquent reimbursable accounts (including the aforementioned accounts) by offsetting delinquent balances with available collateral and terminating the reimbursable status on accounts after unsuccessful attempts to satisfy the debts.**

Audit Scope, Objectives, and Methodology

We have conducted a fiscal compliance audit of the Department of Labor, Licensing and Regulation (DLLR) – Division of Unemployment Insurance (DUI) for the period beginning February 1, 2011 and ending February 23, 2014. 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 DUI's financial transactions, records, and internal control, and to evaluate its compliance with applicable State laws, rules, and regulations.

In planning and conducting our audit, we focused on the major financial-related areas of operations based on assessments of significance and risk. The areas addressed by the audit included employer unemployment contributions, reimbursements from government agencies and certain non-profit organizations, benefit claims and payments, and recovery of benefit overpayments. We also determined the status of the findings included in our preceding audit report.

To accomplish our audit objectives, our audit procedures included inquiries of appropriate personnel, inspections of documents and records, observations of DUI's operations, and tests of transactions. We also extracted data from the Maryland Automated Benefits System, the Maryland Unemployment Insurance Tax System, and state employee payroll data from the Central Payroll Bureau for the purpose of testing transactions. We performed various tests of the relevant data and determined that the data were sufficiently reliable for the purposes the data were used during the audit. Finally, we performed other auditing procedures that we considered necessary to achieve our audit objectives. The reliability of data used in this report for background or informational purposes was not assessed.

Our audit did not include certain support services provided to DUI by the DLLR – Office of the Secretary. These support services (such as payroll, purchasing, maintenance of accounting records, and related fiscal functions) are included within the scope of our audits of the Office of the Secretary. In addition, our audit did not include an evaluation of internal controls for federal financial assistance programs and an assessment of DUI's compliance with federal laws and regulations pertaining to those programs because the State of Maryland engages an independent accounting firm to annually audit such programs administered by State agencies, including DUI.

DUI'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.

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

DLLR's response, on behalf of DUI, 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 DLLR regarding the results of our review of its response.

APPENDIX

STATE OF MARYLAND
DLLR
DEPARTMENT OF LABOR, LICENSING AND REGULATION

OFFICE OF THE SECRETARY
500 NORTH CALVERT STREET
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BALTIMORE, MD 21201

February 25, 2015

Mr. Thomas J. Barnickel III, CPA
Legislative Auditor
301 West Preston Street, Room 1202
Baltimore, MD 21201

Dear Mr. Barnickel:

Enclosed is the agency response to the draft audit report on the Department of Labor, Licensing and Regulation – Division of Unemployment Insurance for the period beginning February 1, 2011 and ending February 23, 2014.

The agency response is included as an appendix. Responses are prepared in accordance with the Policy on Agency Responses to Reports Issued by the Office of Legislative Audits.

An electronic version of this response will be sent to response@ola.state.md.us

Best Regards,

Kelly M Schulz

Kelly M. Schulz
Secretary

Enclosure

cc: David A. McGlone, Assistant Secretary, Division of Unemployment Insurance, DLLR
Dennis C. Morton, Deputy Assistant Secretary, Division of Unemployment Insurance, DLLR
Barbara A. Kittrell, Director, Office of Budget & Fiscal Services, DLLR
Samuel K. Smith, Internal Auditor, DLLR

KMS/dm

Automated Match Procedures

Finding 1
DUI did not appropriately perform and fully investigate the results of certain targeted benefit payment matches in a timely manner.

Response – DUI agrees with the findings:

a. **Multiple claimant address crossmatch and employee/claimant crossmatch reports**
    1) **As of August 2014, DUI is utilizing the Department of Corrections' (DOC) website and two contacts in DOC to verify the results of the crossmatch and detect overpayments.**
    2) **In September 2014, new employees were hired to ensure the investigation of all accounts detected in the Maryland and National Directory of New Hire, and the claimant address crossmatch.**

b. **The Office of Child Support Enforcement has incorporated national wage information into its NDNH matching procedures as of October 2014.**

c. **As of October 2014, reports of targeted matches have been modified to ensure timeliness and consistency. All matches are being investigated.**

d. **As of January 2015, all DLLR employees are included in the quarterly payroll match.**

Benefit Overpayments

Finding 2
DUI did not always refer certain delinquent benefit overpayment accounts to the State's Central Collection Unit.

Response – DUI agrees with the finding:

DLLR is currently reviewing and modifying internal guidelines for referral of debts to the Central Collections Unit (CCU) for collection. The modifications will clarify which cases are suitable for referral to CCU.

All automated and administrative changes will be complete in May 2015. DLLR anticipates these improvements will result in a significant increase in the number of referrals to CCU.

Since January 2015, DLLR has increased the number of suitable cases manually transferred to CCU.

Information Systems Security and Control

Finding 3
DUI stored sensitive personally identifiable information within a database in clear text.

Response – DUI agrees with the finding:

DLLR accepts the recommendation. OIT plans to upgrade the database software and implement available options that will encrypt the data. OIT plans to complete this by end of October 2015.

Information Systems Security and Control

Finding 4
Access, account, and password controls over a database were not sufficient to protect sensitive data.

Response – DUI agrees with the finding:

a. **DLLR accepts this recommendation and as part of the database software upgrade process will limit the access to personnel that require such access. OIT plans to complete this by end of October 2015.**
b. **DLLR accepts this recommendation and has already implemented part of the recommendation. The passwords have been erased from the description and will implement complex password policy as part of the database software upgrade process. OIT plans to complete this by end of October 2015.**

Reimbursable Employers

Finding 5
DUI did not always ensure reimbursable employers provided sufficient collateral and did not perform timely collection efforts to obtain reimbursements for benefits paid.

Response – DUI agrees with the finding:

a. **As of the end of January 2015 the Reimbursable Employers Unit has reviewed all outstanding accounts that were not fully collateralized. Those accounts that have failed to meet the collateral requirements have had their reimbursable status terminated and converted to contributory accounts. As of December 2014 the Reimbursable Employers Unit has deployed a new collateral application that will provide a monthly listing of accounts that are not fully collateralized. The new system will provide an aging of accounts that are not fully collateralized so that a determination can be made to close or change to contributing.**

b. **As of the end of December 2014 the Reimbursable Employers Unit had reviewed all accounts that were delinquent and have either secured payment or had the available collateral applied to the delinquent balance and terminated the reimbursable status. Going forward the Reimbursable Employers Unit will send dunning notices at 30 and 60 days. A final notice will be sent at 90 days advising the employer their option to reimburse has been terminated and any available collateral will be redeemed. A monthly aging report will be generated each month and reviewed for collection efforts.**

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