Audit Report

Uninsured Employers' Fund

January 2018

OFFICE OF LEGISLATIVE AUDITS
DEPARTMENT OF LEGISLATIVE SERVICES
MARYLAND GENERAL ASSEMBLY

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OFFICE OF LEGISLATIVE AUDITS
MARYLAND GENERAL ASSEMBLY

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January 3, 2018

Senator Craig J. Zucker, Co-Chair, Joint Audit Committee
Delegate C. William Frick, Co-Chair, Joint Audit Committee
Members of Joint Audit Committee
Annapolis, Maryland

Ladies and Gentlemen:

We have conducted a fiscal compliance audit of the Uninsured Employers' Fund (UEF) for the period beginning November 14, 2013 and ending November 27, 2016. UEF is responsible for paying workers' compensation awards to claimants who failed to receive payments from their employers that did not have workers' compensation insurance, as required. UEF is also responsible for collecting assessments from certain employers and insurance companies to fund these awards as well as reimbursements from uninsured employers.

Our audit disclosed deficiencies with UEF's processes to bill and collect assessments from insurance companies and employers on certain Workers' Compensation Commission awards, and reimbursements from uninsured employers. Our audit also disclosed deficiencies with UEF's processes to make claim payments related to these awards. Virtually all of these deficiencies were commented upon in our preceding audit report dated November 7, 2014 and some have been commented upon in preceding reports dating back to May 2009. In its response to the preceding audit report, UEF agreed to implement all recommended actions.

Specifically, UEF did not conduct independent reviews to ensure awards, on which the assessment billings to insurance companies and employers were based, were accurately recorded in the accounts receivable records. Additionally, the automated accounts receivable system did not generate certain subsequent billing notices to facilitate collection of delinquent accounts and did not produce accurate accounts receivable aging reports. Also, UEF did not always refer delinquent accounts to the Department of Budget and Management's Central Collection Unit (CCU). As of January 5, 2017, we identified 3,980 delinquent accounts totaling approximately $5.2 million that had not been referred to CCU as required. UEF also had not established a process to identify and refer delinquent employers for license suspension, as permitted by State law.

UEF did not adequately review disbursements to claimants for indemnification of injuries and to providers and vendors for medical claims and related payments. For example, medical bills were processed by other vendors and UEF paid the medical providers without obtaining documentation of the medical bills. Additionally, UEF used the services of 11 vendors for claims processing and related functions without conducting competitive procurements to select the vendors and entering into formal contracts with the vendors. UEF also did not verify the propriety of the amounts billed by the vendors nor ensure the related payments were commensurate with the work performed. During the period from January 2014 through April 2017, UEF paid these vendors approximately $3.5 million.

Additionally, internal controls were not sufficient to ensure that all collections from employers and insurance companies were deposited, and information systems controls over security event monitoring and user access were not sufficient. Finally, sensitive personally identifiable information, including claimant names, addresses, dates of birth, and social security numbers, was stored without adequate safeguards.

We determined that UEF's accountability and compliance level was unsatisfactory, in accordance with the rating system we established in conformity with State law. The primary factors contributing to the unsatisfactory rating were the significance of our audit findings and the number of repeat findings. In this regard, UEF did not sufficiently address any of the 7 findings contained in its preceding audit report.

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

Respectfully submitted,

Thomas J. Barnickel III, CPA
Legislative Auditor

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Background Information

Agency Responsibilities

The Uninsured Employers' Fund (UEF) is responsible for paying workers' compensation awards (including medical payments) to claimants who failed to receive payments from their employers that did not have workers' compensation insurance as required by State law. The principal source of funding for claim payments and UEF operating expenses is an assessment (currently two percent) collected from employers and insurance companies on awards and settlement agreements approved by the Workers' Compensation Commission (WCC) involving permanent disability and death. UEF also collects fines and penalties assessed by WCC on uninsured employers and on insurers who fail to comply with certain statutory filing requirements. Finally, UEF bills uninsured employers for UEF payments made on their behalf to injured workers.

According to UEF's records for fiscal year 2016, income (primarily assessments) totaled approximately $9.5 million, claim payments (indemnity and medical payments) totaled approximately $9.5 million, and operating expenses totaled approximately $1.2 million. According to State records, UEF's fund balance as of June 30, 2016 totaled approximately $8.8 million.

Unfunded Liability

UEF's most recent actuarial study performed in January 2015 indicated that, at that time, UEF had an unfunded liability for its claims of approximately $16 million. The unfunded liability results from claim obligations being funded on a pay-as-you-go basis. Accordingly, obligations that become due in future periods will have to be paid from future assessments collected from employers and insurance companies.

Outstanding Claim Against the Subsequent Injury Fund

On April 10, 2012, UEF requested that the Subsequent Injury Fund (SIF) return $544,000 in assessments that UEF believed it had erroneously paid in connection with a 2006 memorandum of understanding (MOU). The MOU addressed the processing of workers' compensation claims associated with employees of the former Bethlehem Steel Corporation (BSC), which had filed for federal bankruptcy protection in 2001. As of June 2017, UEF's claim was still outstanding.

Under the terms of the 2006 MOU, the Chesapeake Employers' Insurance Company (CEIC), formerly the Injured Workers' Insurance Fund, on behalf of the State of Maryland, was to process workers' compensation claims of former BSC employees, and UEF was to reimburse CEIC for the claims paid. In accordance with the MOU, UEF reimbursed CEIC for the claim payments but subsequently discovered that some of these payments improperly included SIF assessments relating to BSC claims. UEF requested SIF to return the assessment payments related to these BSC claims, which it valued at $544,000.

On April 9, 2014, UEF requested an advice from the Office of the Attorney General (OAG) as to whether SIF should reimburse UEF for these assessments. While a written advice was not received, UEF management advised us that the OAG verbally recommended that the issue be directed to the Department of Budget and Management (DBM). UEF did not pursue the issue with DBM, as recommended, and made no additional attempts to recover the funds from SIF until December 2016. At that time, UEF provided SIF with details of the specific BSC assessments it was attempting to recover. SIF has preliminarily agreed to reimburse UEF for certain of these assessments totaling approximately $441,468 (which includes lost interest). UEF and SIF believe the proposed resolution should be referred to the Governor's Office for review prior to finalization. As of June 2017, the issue had not been referred to the Governor's Office.

Status of Findings From Preceding Audit Report

Our audit included a review to determine the status of the seven findings contained in our preceding audit report dated November 7, 2014. We determined that UEF did not satisfactorily address any of these findings and, therefore, these seven findings are repeated in this report.

Findings and Recommendations

Accounts Receivable

Background
The Uninsured Employers' Fund (UEF) maintains accounts receivable records for its billings to insurance companies and employers. These billings include assessments (currently two percent on certain Workers' Compensation Commission [WCC] awards), fines and penalties assessed by WCC, and reimbursements due from uninsured employers for claimant awards and medical payments made on their behalf. UEF is also required to transfer delinquent accounts to the Department of Budget and Management's Central Collection Unit (CCU) for additional collection actions. The vast majority of UEF's accounts receivable balance is related to amounts due from uninsured employers.

According to UEF's records, approximately $9.5 million was collected for fiscal year 2016, consisting of $8.7 million in assessments, $717,000 in recovery of claim payments and CCU collections, $105,000 in interest on the fund balance, and $4,000 in fines and penalties. As of January 5, 2017, UEF's records reflected an accounts receivable balance totaling approximately $77.7 million, including accounts totaling $67.8 million that had been referred to CCU for additional collection actions. UEF's detail records reflected approximately 11,700 accounts (including multiple accounts for many employers).

Finding 1
UEF did not conduct independent reviews of accounts receivable transactions.

Analysis
UEF did not conduct independent reviews of accounts receivable transactions.

- Verifications to ensure the accuracy of WCC awards entered in UEF's automated accounts receivable system were not performed. Ensuring the accuracy of award information in UEF's automated accounts receivable system is crucial since the award information is used to automatically calculate the assessments and to generate billings to employers and insurance companies.

  Our test of 10 awards received during the period from January 2015 to July 2016, totaling approximately $17.7 million, disclosed that, because UEF entered the award amounts incorrectly in its accounts receivable records, the two percent assessments for 6 awards totaling $14.2 million were improperly calculated, resulting in over-billings and under-billings totaling $54,800. For example, the two percent assessment for one award totaling $10.7 million was improperly calculated and billed as $194,520 instead of $214,520 (resulting in an under-billing of $20,000). UEF was not aware of these improper assessments until we brought them to its attention in February 2017, which was more than six months after the errors had occurred.

- The three employees responsible for processing adjustments to the accounts receivable records could do so without independent review and approval. According to UEF's records, adjustments to decrease accounts receivable balances or to alter payments applied to accounts receivable balances totaled approximately $2.4 million during the period from November 1, 2013 to November 30, 2016.

Similar conditions were commented upon in our three preceding audit reports dating back to May 2009.

Recommendation 1
We recommend that UEF establish a process to ensure the propriety of transactions recorded in its accounts receivable records. Specifically, we recommend that UEF perform independent reviews to ensure that all WCC awards and properly authorized adjustments are accurately entered into its accounts receivable records (repeat). We advised UEF on accomplishing the necessary separation of duties using existing personnel.

Finding 2
UEF did not adequately monitor and pursue collection of delinquent accounts. As of January 5, 2017, there were 3,980 delinquent accounts totaling $5.2 million that, based on their age, should have been referred to CCU.

Analysis
UEF did not bill outstanding accounts and refer delinquent accounts to CCU, as required.

- UEF's automated accounts receivable system did not generate dunning notices in accordance with CCU requirements. Although the system tracked the accumulated accounts receivable balances for uninsured employer accounts (including billings for assessments, medical payments, award payments, and penalties and fines), the system did not generate dunning notices for these accounts and UEF did not manually send dunning notices except for penalties and fines. In addition, for insurance company accounts, the system was not programmed to continue generating monthly dunning notices after the accounts were delinquent for more than 90 days, and UEF did not manually send subsequent dunning notices. CCU regulations, as amended for UEF, require that written demands be made at 30-day intervals and that outstanding accounts which remain uncollected for 180 days be transferred to CCU for further collection activity. Consequently, all required dunning notices were not generated before accounts were due to be referred to CCU.

- UEF had not referred delinquent accounts to CCU as required. Based on our analysis of UEF's records as of January 5, 2017, there were 3,980 delinquent accounts totaling $5.2 million that, based on their age, should have been referred to CCU. This included 31 delinquent accounts with balances greater than $30,000 totaling approximately $1.7 million that had been delinquent for periods ranging from 187 days to more than 9 years. One of these accounts totaling $35,300 had been delinquent for more than 25 years. Delays in the pursuit of outstanding debts may decrease the likelihood of collecting the funds.

- The account aging reports produced by UEF's automated accounts receivable system were not accurate and reliable for use in monitoring its accounts receivable. Specifically, the amount of delinquent accounts reported as having been referred to CCU on the monthly aging summary report ($67.8 million) did not agree to a detailed report of delinquent accounts that were referred ($20 million) – a difference of $47.8 million. UEF could not explain these discrepancies. An accurate monthly report to age delinquent accounts is required by the Comptroller of Maryland's *Accounting Procedures Manual* and is a critical tool to help UEF monitor unpaid accounts and related collection efforts, including delinquent accounts referred to CCU.

- UEF had not established a process to identify and refer delinquent employers for license suspension. State law permits UEF to request State licensing authorities to suspend the applicable licenses or permits of employers who failed to pay an assessment or penalty or who failed to reimburse UEF for the payment of an award. Although UEF notified delinquent employers that its license or permit could be suspended if payment was not received, UEF had not attempted to refer any employers for license or permit suspension as an enforcement tool for delinquent accounts.

Conditions regarding UEF's failure to ensure accounts are adequately monitored and pursued for collection have been noted during our three preceding audits dating back to May 2009. In addition, the conditions regarding the inaccuracy of the monthly account aging reports and the failure to refer delinquent employers for license suspension were noted in our preceding audit report. According to UEF's records, during the period from November 2013 to January 2017, accounts receivable increased $26.1 million from $51.6 million to $77.7 million.

Recommendation 2
We recommend that UEF

a. **investigate and take the necessary corrective actions to resolve the noted deficiencies (generate dunning notices and produce accurate accounts receivable aging reports) to ensure that the accounting system provides sufficient information to monitor and pursue collection activities (repeat),**
b. **refer delinquent accounts to CCU for collection as required (repeat), and**
c. **establish a process to identify and refer delinquent employers to applicable State licensing authorities for license or permit suspension (repeat).**

Claims Processing

Background
UEF pays claimants who are not reimbursed by their employers for injuries associated with their employment. The payments to these claimants are based on workers' compensation awards (including medical payments) as determined by the WCC. These awards include funds for the indemnification of injuries and for future medical claims. Indemnification of injury funds are paid to the claimants or their applicable beneficiaries in biweekly installments or as a lump sum; medical claim payments are made as incurred directly to medical providers for services provided to claimants.

UEF determines a claimant's initial eligibility by reviewing the WCC award, and periodically ensures claimants are still eligible for payment (such as by reviewing physician reports). UEF also determines the amounts of the biweekly indemnity payments and uses a third-party vendor to process medical claims received from medical providers.

UEF Claims-Related Payments
January 2014 to April 2017

Type of Payment	Amount
Indemnity Payments	$12,054,053
Medical Provider Claim Payments	13,511,542
Claims Related Services Payments	3,467,109
TOTAL	**$29,032,704**

Source: State Accounting Records

According to State accounting records, during the period from January 2014 through April 2017, approximately $29.0 million was disbursed to claimants for indemnification of injuries and to providers and vendors for medical claims and related expenses, as depicted in the preceding table. As of April 28, 2017, according to UEF's records, 78 claimants were receiving biweekly indemnity payments.

Finding 3
UEF did not adequately review indemnity and medical claim payments for propriety.

Analysis
UEF did not adequately review indemnity and medical claim payments for propriety.

- UEF did not conduct independent supervisory reviews of indemnity payments. Specifically, UEF's review of indemnity payments was performed by an individual who had the ability to modify payment records in UEF's automated accounts payable system and to approve the payments in the State's Financial Management Information System. As a result, this employee could process improper indemnity payments without detection. Indemnity payments totaled approximately $12.1 million during the period from January 2014 to April 2017.

- UEF paid each medical provider based solely on the amounts reflected on a summary report submitted by its medical bill verification vendor without obtaining any documentation to support the claims (such as, medical bills). Consequently, UEF lacked assurance that this vendor had sufficiently verified provider claims and ensured the rates billed were consistent with rates established by the WCC. Furthermore, some of those claims were paid to providers within the vendor's preferred provider network, which raises questions regarding the independence of the bill verification process.

  Medical providers submitted medical bills to the claims processing vendor, which were then forwarded to the medical bill verification vendor. The medical bill verification vendor then submitted a monthly summary report to UEF indicating how much to pay each medical provider. Medical provider claim payments totaled approximately $13.5 million during the period from January 2014 to April 2017, including payments to preferred providers. For example, one provider under the vendor's preferred provider network was paid $1.3 million during this period.

Similar conditions were noted in our two preceding audit reports dating back to September 2011.

Recommendation 3
We recommend that UEF

a. conduct independent supervisory reviews of indemnity payments to ensure the payments are valid and accurate (repeat); and
b. establish a documented procedure to verify, at least on a test basis, that medical claim payments were proper based on supporting documentation (repeat).

We advised UEF on accomplishing the necessary separation of duties using existing personnel.

Finding 4
UEF violated State procurement regulations to obtain claims processing and related services from 11 vendors, did not have written agreements with the vendors, and did not adequately monitor the vendors' services and verify their billings. During the period from January 2014 to April 2017, UEF paid these vendors approximately $3.5 million.

Analysis
UEF violated numerous State procurement regulations to obtain claims processing and related services from 11 vendors. UEF did not have current written agreements with the vendors, did not enter into competitive procurements for any of the services, and did not obtain Department of Budget and Management (DBM) and Board of Public Works (BPW) approvals. UEF also did not adequately verify the propriety of amounts billed nor ensure the related services were provided. According to State records, during the period from January 2014 to April 2017, UEF paid these vendors approximately $3.5 million, as depicted in the table.

Payments to Improperly Procured Vendors
January 2014 to April 2017

Service Provided	Number of Vendors	Payments
Claims Processing Services	1	$1,319,653
Nurse Case Management	3	796,275
Medical Bill Verification	1	667,859
Independent Medical Assessments	2	365,397
Claimant Medical Transportation	1	290,266
Claims Investigations	3	27,659
TOTAL	**11**	**$3,467,109**

Source: State Accounting Records

Continued Use of Claims Processing Vendor Procured Without Competition and Control Agency Approvals

UEF continued to use a vendor improperly procured during our preceding audit. In January 2014, UEF entered into a temporary agreement with a vendor for claims processing services. As noted in our November 2014 audit report, UEF did not solicit competitive bids for these services and did not submit the agreement to DBM for review and approval as required. In addition, the agreement did not include certain critical provisions, such as the contract term and the maximum contract value. Furthermore, although the agreement included the hourly billing rate for certain claims adjusters, it did not include the rates for numerous other individuals billed by the vendor nor scope of the work and estimated labor hours. In response to our preceding audit, UEF advised DBM that it would obtain retroactive approval for the agreement from BPW and would competitively procure a new contract for these services. However, UEF had not requested the retroactive BPW approval nor procured a new contract for these services, and continued to use this vendor for claims processing as well as for other services (as further detailed below) until July 2017. During the period from January 2014 to April 2017, UEF paid this vendor approximately $1.3 million.

Expanded Use of Claims Processing Vendor Also Circumvented State Procurement Regulations

During the current audit period, UEF allowed the claims processing vendor to select 10 other vendors to provide a variety of services (as depicted in the table on the preceding page) including assisting in efforts to verify claims. The vendors were not selected through competitive procurements, and no written agreements were established governing the scope, terms, and payment provisions for the services provided and paid for by UEF. Accordingly, there was no review and approval of the terms of these agreements by DBM or BPW. Given the diverse scope of work being provided by the vendors and the fact that UEF paid the vendors directly, these services should have been competitively procured by UEF and written contracts submitted to DBM and/or the BPW for approval as required. During the period from January 2014 to April 2017, UEF paid these vendors approximately $2.2 million.

Concerns with the procurement of certain of these services (independent medical assessments, nurse case management, and claims investigations), which were previously procured directly by UEF, were noted in our preceding audit report. Specifically, we noted that UEF had routinely procured these services from numerous vendors on an “as needed basis” without soliciting competitive bids and entering into written agreements. Four of these previous vendors were among the 10 vendors that were currently providing services without written agreements.

UEF Did Not Verify the Propriety of Amounts Paid to the Vendors nor Ensure Appropriate Services Were Provided

UEF lacked an effective means to ensure payments to all 11 vendors were proper and were commensurate with the work performed. Although UEF paid these vendors directly, it was not involved in the negotiation of costs or services for the 10 vendors selected by the claims processing vendor. For example, UEF essentially paid all vendor invoices without performing any sort of verification as to the propriety of the charges, including the reasonableness of the hours charged, or assessing if appropriate services were performed. In some cases, the payments appeared questionable.

- UEF paid for individuals not included in the temporary agreement and there was a lack of detail for certain invoices. The January 2014 temporary agreement for the claims processing vendor included two claims adjusters at hourly rates of $29.50 and $39.50. However, during the audit period, the claims processing vendor billed UEF weekly for up to 10 individuals (1 managing consultant, 4 claims adjusters, 2 investigators, 1 financial assistant, 1 data entry clerk, and 1 account collection clerk) at hourly rates ranging from $17 to $39.50.

  Additionally, UEF did not obtain or review any billing data, such as the amount of time the vendor spent on claims or the quality of the claims administration and processing services, to help monitor the vendor's performance. Finally, our test of five vendor payments totaling $57,066 disclosed that invoices for three payments totaling $34,095 did not specify the hours worked by each individual, and none of the invoices specified the hourly rates and the specific work performed by each individual.

- UEF paid for alleged cost savings without verifying the savings were actually realized. As previously mentioned in Finding 3, the medical bill verification vendor maintained a preferred provider network for medical and pharmaceutical services at reduced rates. In addition to paying this vendor $7.50 for each claim processed, UEF paid an additional 28 percent for any savings the vendor claimed was achieved by using its preferred provider network. (Payments were made separately to the preferred providers for the medical claims.) UEF did not verify the reported savings by reviewing the related medical bills submitted by the providers nor recalculate the amounts billed to ensure the payments were proper.

  For example, the vendor reported that one provider claim totaling $377,332 was reduced by $94,326 because the provider was in the vendor's preferred provider network. UEF paid the vendor $26,419 ($7.50 plus the 28 percent savings fee) for verifying this medical bill without ensuring the savings were actually realized. During the period from January 2014 to April 2017, UEF paid this vendor approximately $668,000.

- UEF paid an administrative fee to the claims processing vendor that had not been negotiated with UEF, was not provided for in the temporary agreement, and was not separately disclosed on the vendor's invoices. Although two vendors were hired by the claims processing vendor to perform independent medical assessments, which were then sent directly to UEF, the claims processing vendor also used other providers for these assessments. Under the latter arrangement, those providers sent the assessments to the claims processing vendor, which then charged an administrative fee for handling and forwarding those assessments to UEF. Based on information we obtained from the vendor, the fee UEF was billed varied from one invoice to another.

  Our review of 28 payments totaling $28,930 for independent medical assessments invoiced by the claims processing vendor disclosed that administrative fees were assessed at rates ranging from 12 to 38 percent (average of 26 percent) and totaled $7,630. For example, $800 invoiced for one assessment included $300 in administrative fees (38 percent). Payments to the claims processing vendor for independent medical assessments totaled approximately $137,000 during the period from January 2014 to August 2016 when UEF instructed the vendor to discontinue the arrangement.

New Claims Processing Vendor Was Procured Through Emergency Procurement
In March 2017, UEF became aware that its claims processing vendor was experiencing financial difficulty. UEF was concerned that critical services (including payments to claimants) could be disrupted if its claims processing vendor went out of business. On July 6, 2017, UEF notified the claims processing vendor that its contract would be terminated effective September 1, 2017.

UEF entered into an emergency contract with another vendor to obtain claims processing and related services previously performed by the aforementioned 11 vendors. The emergency contract had an estimated cost of $994,500 (plus fees) over an 18-month term beginning September 1, 2017. UEF submitted this emergency contract award to BPW for inclusion on its September 6, 2017 agenda, but the item was withdrawn before being accepted by the BPW. As of November 1, 2017, the award had not been re-submitted to BPW, even though the new contractor has been performing services under this arrangement.

In order to ensure continuity of claims processing services, UEF paid its former claims processing vendor a total of $40,000 to transfer claims data and records to the new vendor. However, UEF could not document how it determined this amount.

On August 10, 2017, the former claims processing vendor formally notified UEF that it intended to pursue damages totaling $521,545 incurred as a result of UEF terminating the contract. The claim for damages consisted of outstanding past due invoices totaling $178,265 and administrative expenses totaling $343,280. In a settlement agreement dated October 13, 2017, UEF agreed to make a lump-sum payment of $240,000 to settle the claims of the former claims processing vendor.

State procurement regulations generally require contracts in excess of $25,000 be awarded by competitive sealed bidding. Additionally, procurements exceeding $5,000 must have written contracts and include certain standard contract provisions (such as, contract term ending date and contract maximum value or estimated value). Finally, procurements for services exceeding $25,000 must be submitted to DBM for approval and contracts over $200,000 must be submitted to the BPW for approval.

Recommendation 4
We recommend that UEF

a. **comply with the procurement and contract provisions of the State procurement regulations by soliciting competitive bids and executing written contracts for the claims processing and related services that include all relevant contract provisions (repeat),**
b. **ensure that invoiced amounts are supported and agree to contract-approved rates and level of services prior to approving invoices for payment,**
c. **establish a process for monitoring vendor performance for claims processing and related functions, and**
d. **re-submit the emergency contract award to the BPW.**

Cash Receipts

Finding 5
UEF did not have adequate procedures and controls to ensure that all collections were deposited.

Analysis
UEF had not established adequate controls over its collections from employers and insurance companies. According to UEF records, collections totaled approximately $9.5 million during fiscal year 2016.

- The initial record of collections (an adding machine tape) was not forwarded directly to the employee responsible for independently verifying that all collections had been deposited. Instead, the initial record and related collections were forwarded to two employees responsible for preparing the bank deposit and for recording the deposit in the State's accounting records. Consequently, the initial record of collections could be altered to conceal misappropriations. A similar condition was commented upon in our preceding audit report.

- Although the employee responsible for verifying the deposit documented that the collections were deposited intact, during the course of our audit work we identified undeposited funds that were not detected during these verifications. Specifically, our review disclosed four checks totaling $2,655 that were recorded upon receipt but were improperly excluded from three separate deposits. In each case, UEF employees documented the deposit verifications but did not detect the errors. UEF personnel were unaware that these checks had not been deposited until notified by the bank or by us. Although, we confirmed that these funds were deposited 14 to 21 days later, there is a lack of assurance that deposit verifications are being properly performed.

- UEF did not adequately secure collections prior to deposit and allowed a contractual employee to take collections home overnight. Specifically, we observed that collections were routinely stored in an unlocked desk drawer that was accessible to numerous employees throughout the day prior to deposit. In addition, a contractual temporary agency employee took collections home overnight. This process violated the employment agreement with the temporary agency that expressly prohibited the individual from transporting collections and increased the risk of misplacement or misappropriation.

  UEF management subsequently determined the practice of allowing an employee to take collections home occurred during the period from November 2016 through February 2017, without its knowledge, enabling the employee to make the deposits on the way to work on the next business day. According to UEF's records, 56 bank deposits totaling $2.1 million were made during this period, of which 31 deposits totaling $1.2 million appeared to have been taken home by this individual including 9 deposits totaling $250,975 that may have been kept by the employee over the weekend.

- Deposits were not made timely in accordance with State policy. Specifically, our test of the aforementioned 56 bank deposits totaling $2.1 million made between November 2016 and February 2017 disclosed that 42 deposits totaling $1.4 million were made from 2 to 11 business days after receipt. As noted above, 31 of these deposits appeared to have been taken home by the contractual temporary employee, which would have contributed to the delay in deposit.

- The responsibilities for the cash receipts and accounts receivable functions were not separated. Specifically, three employees involved in the collection process were also responsible for recording their receipt and any adjustments in the related automated accounts receivable records, or had the capabilities to do so. A similar condition was commented upon in our preceding audit report.

The Comptroller of Maryland's *Accounting Procedures Manual* requires that receipts as recorded on initial records of collection be reconciled to amounts deposited by an employee independent of the cash receipts functions. Additionally, the *Manual* requires the separation of cash receipts and accounts receivable duties, that receipts be adequately safeguarded until deposited, and that deposits be made by the next business day.

Given the significance of UEF's collection activity and the aforementioned internal control weaknesses, UEF should evaluate the feasibility of using a bank lockbox account to receive collections. The Office of the State Treasurer maintains a banking contract to provide lockbox services to State agencies. A bank lockbox could be beneficial to UEF since it has the inherent control of checks being directly sent to the bank for deposit and allows its limited staff to focus on other fiscal responsibilities (such as, accounts receivable activities).

Recommendation 5
We recommend that UEF ensure that
a. the initial record of collections is forwarded directly to an independent employee to perform the deposit verification function (repeat),
b. all deposits are made intact,
c. collections are properly safeguarded and are transported directly to the bank for deposit no later than the next business day,
d. the cash receipts and accounts receivable duties are adequately separated (repeat), and
e. consider the feasibility of using a bank lockbox account to receive collections.

We advised UEF on accomplishing the necessary separation of duties using existing personnel.

Information Systems Security and Control

Finding 6
Sensitive personally identifiable information maintained by UEF was stored without adequate safeguards.

Analysis
Sensitive personally identifiable information (PII) maintained by UEF was stored in clear text. Specifically, we noted that a server hosting the accounts receivable and claim payment functions contained social security numbers stored in clear text along with names, addresses, and dates of birth as of the date of our test work in March 2017. During our review, we determined that one file contained 676,727 unique social security numbers. In addition, we were advised that this sensitive PII was not protected by other substantial mitigating controls.

This sensitive PII is commonly associated with identity theft. Accordingly, appropriate information system security controls need to exist to ensure that this information is safeguarded and not improperly disclosed.

The State of Maryland *Information Security Policy* requires that agencies protect confidential data using encryption technologies and/or other substantial mitigating controls.

Recommendation 6
We recommend that UEF properly protect sensitive PII information by encryption or other substantial mitigating controls.

Finding 7
Security event monitoring, access controls, and user access monitoring were not sufficient.

Analysis
Security event monitoring, access controls, and user access monitoring were not sufficient for the dedicated server that hosts UEF's critical applications, such as accounts receivable and accounts payable.

- Security auditing was not enabled for certain files on the dedicated server. In addition, for security events which were logged, we were advised that reports of security events were not generated for review. As a result of these conditions, there was no monitoring of security events applicable to this dedicated computer server. The State of Maryland *Information Security*

Policy requires that information systems must generate audit records for all security-relevant events, including all security and system administrator accesses, and procedures must be developed to routinely (for example, daily or weekly) review audit records for indications of unusual activities, suspicious activities or suspected violations, and report findings to appropriate officials for prompt resolution.

- Numerous users had unnecessary modification access to files and programs. We identified 21 active accounts on the aforementioned dedicated server that, via access to a utility and access inherited from a default server role, had unnecessary modification access to numerous critical system, application and data files and programs. The State of Maryland *Information Security Policy,* states that agencies must ensure that only authorized individuals (employees or agency contractors) have access to confidential information and that such access is strictly controlled, audited, and that it supports the concepts of least possible privilege and need to know.

- UEF did not periodically generate and review system security reports to identify capabilities assigned to users of its automated accounts receivable and accounts payable applications. Consequently, UEF lacked assurance that user capabilities were properly assigned to employees to provide adequate separation of duties and to restrict the capabilities to only those needed to perform their job duties. Our review of all 12 active users disclosed that 5 users could perform incompatible functions or had unnecessary capabilities. For example, three users had access to cash receipts and had the capability to update, adjust, or delete the related automated accounts receivable records, as noted in Finding 5.

- UEF permitted one employee to use another employee's assigned userid to process certain transactions (such as to create accounts payable records). This allowed the employee to process transactions that were restricted by the employee's assigned userid. This sharing of userids results in a loss of accountability and reduced assurance over the propriety of the transactions processed.

Similar conditions were commented upon in our preceding audit report.

Recommendation 7
We recommend that UEF

a. enable security auditing for files on the dedicated server which hosts UEF's critical applications (repeat);

b. generate and review, on a weekly basis, reports of critical security events, document these reviews, and retain the documentation for future reference (repeat);
c. limit modification access to critical files and programs on the dedicated server to only those employees who require such access for their job duties (repeat);
d. periodically generate system security reports and use these reports to ensure users cannot perform incompatible functions and are assigned only those capabilities needed to perform their job duties (repeat); and
e. prohibit the sharing of userids (repeat).

Finding 8
UEF did not have an information systems disaster recovery plan.

Analysis
UEF did not have a disaster recovery plan (DRP) for recovering from disaster scenarios (for example, a fire). In accordance with the State of Maryland *Information Technology* (*IT) Disaster Recovery Guidelines*, a complete DRP should address, at a minimum, concept of operations, notification and activation procedures, recovery strategies (including use of alternate sites), reconstitution procedures, and periodic testing of the DRP. Without a complete DRP, a disaster could cause significant delays (for an undetermined period) in restoring information systems operations above and beyond the expected delays that would exist in a planned recovery scenario. This same condition was commented upon in our preceding audit report.

Recommendation 8
We recommend that UEF develop and implement a comprehensive disaster recovery plan, in accordance with the *Information Technology (IT) Disaster Recovery Guidelines* (repeat).

Audit Scope, Objectives, and Methodology

We have conducted a fiscal compliance audit of the Uninsured Employer's Fund (UEF) for the period beginning November 14, 2013 and ending November 27, 2016. 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 UEF'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 assessment collections and billings, claim payments, and information systems security and control. We also determined the status of the findings contained 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 the UEF's operations, and tests of transactions. Generally, transactions were selected for testing based on auditor judgment, which primarily considers risk. Unless otherwise specifically indicated, neither statistical nor non-statistical audit sampling was used to select the transactions tested. Therefore, the results of the tests cannot be used to project those results to the entire population from which the test items were selected.

We also performed various data extracts of pertinent information from the State's Financial Management Information System (such as revenue and expenditure data). The extracts are performed as part of ongoing internal processes established by the Office of Legislative Audits and were subject to various tests to determine data reliability. We determined that the data extracted from the system were sufficiently reliable for the purposes the data were used during this audit. We also extracted data from UEF's automated accounts receivable and accounts payable system for the purpose of testing assessment accounts receivable and claim payment monitoring. 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 objectives. The reliability of data used in this report for background or informational purposes was not assessed.

UEF'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 UEF'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 UEF that did not warrant inclusion in this report.

As a result of our audit, we determined that UEF's accountability and compliance level was unsatisfactory. The primary factors contributing to the unsatisfactory rating were the significance of our audit findings, and the number of repeat findings from preceding reports. Our rating conclusion has been made solely pursuant to State law and rating guidelines approved by the Joint Audit Committee. The rating process is not a practice prescribed by professional auditing standards.

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

APPENDIX

LAWRENCE J. HOGAN, JR.
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December 6, 2017

Thomas J. Barnickel III, CPA
Legislative Auditor
State of Maryland
Office of Legislative Audits
State Office Building, Room 1202
301 West Preston Street
Baltimore, Maryland 21201

Dear Mr. Barnickel:

The Maryland Uninsured Employer's Fund (UEF) responses to the fiscal compliance audit for the period beginning November 14, 2013 and ending November 27, 2016 are enclosed herein for your review and consideration.

The UEF concurs with the audit findings.

This document details the UEF's responses to the Findings and Recommendations, and the responses detail this agency's plans for implementing procedures to bring the UEF into compliance with the audit Findings and Recommendations.

This audit accurately reflects the condition of the UEF which the current UEF Board and Executive Director discovered upon their arrival in 2016. This includes failures in the past by the agency to address and correct numerous previous audit findings and recommendations. The Board, the Executive Director and the agency's staff have recognized numerous deficiencies in the agency's function and have worked to correct those deficiencies. By any rational measure, the UEF is in a far more functional and appropriate condition than it was on November 27, 2016, the ending date of the audit (which was, also, the day before the current Executive Director's arrival at the UEF).

We continue the ongoing process of dealing with, and fixing, the many issues, deficiencies and challenges which we have discovered at the UEF.

One example of doing so involves the outstanding claim of the UEF as regards the Subsequent Injury Fund (SIF) which is noted in the audit. Working together over the past year, the two agencies finally resolved this claim in December of 2017.

The UEF recognizes, and appreciates, the efforts of the Office of Legislative Audits in examining the situation at the UEF and making recommendations for improvements and will continue to work to correct the deficiencies noted by the Office along with the other issues facing the agency.

Thank you.

Respectfully submitted,

The Honorable Michael W. Burns, Esquire
Executive Director

Encl.

UNINSURED EMPLOYERS' FUND
RESPONSES TO DRAFT AUDIT REPORT
DECEMBER 2017

Accounts Receivable

Finding 1
UEF did not conduct independent reviews of accounts receivable transactions.

Recommendation 1
We recommend that UEF establish a process to ensure the propriety of transactions recorded in its accounts receivable records. Specifically, we recommend that UEF perform independent reviews to ensure that all WCC awards and properly authorized adjustments are accurately entered into its accounts receivable records (repeat). We advised UEF on accomplishing the necessary separation of duties using existing personnel.

UEF Response to Recommendation 1

The UEF concurs. The UEF has a process in place for reviewing awards and payments that involves multiple employees who review awards and adjustments. This current system is being reviewed, evaluated and adjusted to comply with this recommendation.

Issues regarding the correct calculation and entry of assessments have already been recognized by the agency and are also being reviewed, revised, corrected and evaluated on an ongoing basis in order to insure accuracy. The UEF intends on automating the assessment process to the extent possible and has begun work on establishing that program.

Finding 2
UEF did not adequately monitor and pursue collection of delinquent accounts. As of January 5, 2017, there were 3,980 delinquent accounts totaling $5.2 million that, based on their age, should have been referred to CCU.

Recommendation 2
We recommend that UEF

a. **investigate and take the necessary corrective actions to resolve the noted deficiencies (generate dunning notices and produce accurate accounts receivable aging reports) to ensure that the accounting system provides sufficient information to monitor and pursue collection activities (repeat),**
b. **refer delinquent accounts to CCU for collection as required (repeat), and**

c. establish a process to identify and refer delinquent employers to applicable State licensing authorities for license or permit suspension (repeat).

<u>UEF Response to Recommendation 2</u>

a. The UEF concurs. The correction of deficiencies in the collection of delinquent accounts has been and remains a top priority of the agency. The UEF has been evaluating and addressing the condition and effectiveness of the entire system of collections and assessments utilized by the agency. Systems in different collection and billing areas have been examined and changes implemented – and in certain cases established or re-established - and will continue to be developed, implemented, evaluated and adjusted, and are being monitored to ensure that this recommendation is implemented.

The UEF has made substantial progress in addressing the lack of adequate and effective collection processes by the Agency. A number of systems have already been established regarding billing and collections regarding fines, penalties, assessments and employer debts. This process remains ongoing. It includes, among other items, the re-establishment of a program to suspend business licenses for enforcement purposes, which has again begun to occur and is ongoing.

In addition, the UEF, working with the Offices of the Governor and the Attorney General, has received authority to enforce criminal penalties against employers who fail to secure payment of required compensation pursuant to sections 9-1108 and 9-402 of the Labor and Employment Article. Although this has been contained in statute for decades authority for this enforcement mechanism has never been sought, or utilized, by the agency until subsequent to November 27, 2016. The process of implementing this authority is ongoing.

In order to effectively enforce collections and otherwise facilitate the function of the agency, the agency recognized the need for additional attorney staffing. The UEF has, therefore, already authorized two additional Office of the Attorney General (OAG) Assistant Attorneys General (AAG) positions who will begin service with the UEF in January of 2018. This will bring to five the number of AAGs working at the UEF. These new staff positions will play an important role in enabling the agency to effectively implement, and enforce, an effective collections process.

Finally, the UEF is developing a new protocol to deal with uninsured employer obligations much earlier in the process. The program is designed to ensure that such obligations are recognized and collection initiated in a program contemporaneous with the issuance of Workers' Compensation Commission (WCC) Orders and any resulting failure by the uninsured employer to reimburse the Fund for payments made pursuant to a claim found by the WCC to be the responsibility of that uninsured employer (and therefore the UEF). This program is planned to include business license and permit suspensions, as are available, to ensure payment by uninsured employers. By initiating collections in this fashion, instead of waiting months and years to genuinely attempt to collect these debts, it is our evaluation that uninsured employers' payments will be recovered in a quicker and more effective manner and the prior numbers of delinquent accounts subject to CCU collection will be reduced.

b. The UEF concurs. In response to a prior audit finding the UEF referred a number of accounts to the CCU for collection several years ago. As of October of 2016, the CCU had reported to this agency substantial amounts of uncollected UEF funds on its books. Collection of UEF accounts by the CCU have been generally minimal, with some exceptions, because of the nature of these debtors and accounts and, in many cases, the inability of the agency to effectively collect the debt as well as the unusual length of time between the establishment of the debt and the actual forwarding of the debt account to the CCU for collection by the agency in the past.

   The UEF has had discussions with the CCU regarding collections and working to develop a more effective process for both agencies to utilize to facilitate collection effectiveness.

   The UEF is also considering requesting a waiver be granted of the requirement that debts be forwarded to the CCU in all cases after a certain period of time in order to permit the agency to utilize all available resources authorized and available to the agency to collect the debts directly.

c. The UEF concurs. The agency has already re-established a complete program to identify employers and act to suspend business licenses. This program has already generated appeals and hearings in various locales in which the UEF is represented by the OAG. The UEF has been upheld in all appeal hearings held as of this time. This process remains ongoing and will be refined as experience indicates is appropriate.

Claims Processing

Finding 3
UEF did not adequately review indemnity and medical claim payments for propriety.

Recommendation 3
We recommend that UEF

a. conduct independent supervisory reviews of indemnity payments to ensure the payments are valid and accurate (repeat); and

b. establish a documented procedure to verify, at least on a test basis, that medical claim payments were proper based on supporting documentation (repeat).

We advised UEF on accomplishing the necessary separation of duties using existing personnel.

<u>UEF Response to Recommendation 3</u>

a. The UEF concurs. The UEF has been implanting this recommendation and continues to do so.
b. The UEF concurs. The UEF has been implementing this recommendation and continues to do so.

The agency will attempt to implement all these recommendations within the existing staffing situation but reserves the right to add staff if necessary to implement these recommendations.

Finding 4
UEF violated State procurement regulations to obtain claims processing and related services from 11 vendors, did not have written agreements with the vendors, and did not adequately monitor the vendors' services and verify their billings. During the period from January 2014 to April 2017, UEF paid these vendors approximately $3.5 million.

Recommendation 4
We recommend that UEF
a. comply with the procurement and contract provisions of the State procurement regulations by soliciting competitive bids and executing written contracts for the claims processing and related services that include all relevant contract provisions (repeat),
b. ensure that invoiced amounts are supported and agree to contract-approved rates and level of services prior to approving invoices for payment,
c. establish a process for monitoring vendor performance for claims processing and related functions, and
d. re-submit the emergency contract award to the BPW.

<u>UEF Response to Recommendation 4</u>

a. The UEF concurs. The agency has implanted this recommendation and has obtained the services of a third-party claims administrator by way of soliciting proposals and executing a written contract for services with that vendor by way of an emergency procurement. The agency is in the process of developing a Request for Proposals for these services for the issuance, bidding and award of the contract in the future.
b. The UEF concurs. The UEF is currently implementing this recommendation with the new claims services vendor and will continue to do so.

c. The UEF concurs. The UEF reviews these services and functions now but will continue to develop a process to insure adherence to this recommendation.
d. The UEF concurs. The UEF has re-submitted the emergency procurement contract for the Board of Public Works for acceptance as of December, 2017.

As of September 1, 2017, the UEF entered into an emergency procurement contract to deal with the subject matter of Recommendation 4, as well as other issues related to claims administration. This contract provides the agency with the services of a national third-party claims administration vendor, and related service providers, and provides the UEF with services related to claims processing and administration. All relevant contractual agreements with a claims processing function are now handled by the agency's third-party administrator as part of this contract. This claims administrator function and staffing has also been brought physically into the agency office for implementation and for agency interaction, supervision and review purposes. The transition to that vendor remains ongoing and the UEF will work with that vendor to respond to the noted issues in this audit report.

The UEF previously recognized that the issues in Finding 4 were valid and required addressing. By hiring an experienced third-party claims administrator company thru the emergency procurement process, the UEF now has a written contract with a nationally-experienced company to handle this work and to assist in dealing with the issues raised in this Finding.

Cash Receipts

Finding 5
UEF did not have adequate procedures and controls to ensure that all collections were deposited.

Recommendation 5
We recommend that UEF ensure that

a. the initial record of collections is forwarded directly to an independent employee to perform the deposit verification function (repeat),
b. all deposits are made intact,
c. collections are properly safeguarded and are transported directly to the bank for deposit no later than the next business day,
d. the cash receipts and accounts receivable duties are adequately separated (repeat), and
e. consider the feasibility of using a bank lockbox account to receive collections.

We advised UEF on accomplishing the necessary separation of duties using existing personnel.

<u>UEF Response to Recommendation 5</u>

a. The UEF concurs. The UEF has been implementing this recommendation and will continue to do so.
b. The UEF concurs. The UEF has been implementing this recommendation and will continue to do so.
c. The UEF concurs. The UEF has been implementing this recommendation and will continue to do so.
d. The UEF concurs. The UEF will continue to develop the agency's process so that the cash receipts and accounts receivable functions are separated.
e. The agency concurs. The agency will work to implement this recommendation after resolving all issues related to the agency's possible utilization of a bank lockbox system. This will include dealing with the requirement that certain relevant information contained on checks received (including claim number, claimant name, the statement stubs attached thereto, and other information) must be transmitted to the UEF by the bank for various critical agency purposes, including accounting and collections requirements, in order for this recommended system to be utilized.

The agency will attempt to implement all these recommendations within the existing staffing situation but reserves the right to add staff if necessary to implement these recommendations.

Information Systems Security and Control

Finding 6
Sensitive personally identifiable information maintained by UEF was stored without adequate safeguards.

Recommendation 6

We recommend that UEF properly protect sensitive PII information by encryption or other substantial mitigating controls.

<u>UEF Response to Recommendation 6</u>

The UEF concurs. The UEF will work with both our technical advisor company and DoIT to comply with this recommendation to the extent changes are required.

Finding 7
Security event monitoring, access controls, and user access monitoring were not sufficient.

Recommendation 7
We recommend that UEF

a. enable security auditing for files on the dedicated server which hosts UEF's critical applications (repeat);
b. generate and review, on a weekly basis, reports of critical security events, document these reviews, and retain the documentation for future reference (repeat);
c. limit modification access to critical files and programs on the dedicated server to only those employees who require such access for their job duties (repeat);
d. periodically generate system security reports and use these reports to ensure users cannot perform incompatible functions and are assigned only those capabilities needed to perform their job duties (repeat); and
e. prohibit the sharing of userids (repeat).

<u>UEF Response to Recommendation7</u>

a. The UEF concurs. The UEF is in the process of implementing this recommendation and will work with both DoIT and our technical advisor company to do so.
b. The UEF concurs. The UEF will continue to work with both DoIT and our technical advisor company implement this.
c. The UEF concurs. The UEF has initiated a program to implement this recommendation and will continue the process of insuring the recommendation is executed.
d. The UEF concurs. The UEF will continue to work with both DoIT and our technical advisor company to implement this recommendation.
e. The UEF concurs. The UEF has recognized previously the importance of this recommendation and will continue to develop a system to ensure it is accomplished.

The agency has attempted to implement several of these recommendations and it is its position that the agency has complied as to the dedicated server for its critical applications. The UEF will work with both our technical advisor company and DoIT to comply with this these recommendations to the extent further changes are required.

Finding 8
UEF did not have an information systems disaster recovery plan.

Recommendation 8
We recommend that UEF develop and implement a comprehensive disaster recovery plan, in accordance with the *Information Technology (IT) Disaster Recovery Guidelines* (repeat).

UEF Response to Recommendation 8

The UEF concurs. As a result of the prior audit report the UEF engaged in a process to ensure that all internal systems were recoverable. The UEF will work with both our technical advisor company and DoIT to comply with this these recommendations to develop an appropriate comprehensive disaster recovery plan, in accordance with the ***Information Technology (IT) Disaster Recovery Guidelines,*** to the extent any changes are required.

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