

Audit Report

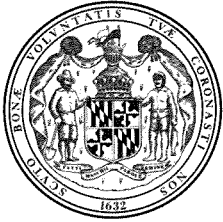
Uninsured Employers' Fund

November 2014



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

Karl S. Aro
Executive Director

November 7, 2014

Thomas J. Barnickel III, CPA
Legislative Auditor

Senator James C. Rosapepe, Co-Chair, Joint Audit Committee
Delegate Guy J. Guzzone, 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 February 1, 2011 and ending November 13, 2013. UEF is responsible for paying workers' compensation awards to claimants who failed to receive payments from their employers because they 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.

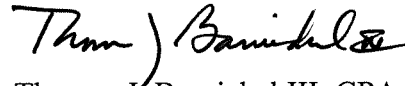
Our audit disclosed deficiencies with UEF's processes to bill, monitor, and collect assessments on Workers' Compensation Commission awards, as well as medical payments made on behalf of claimants, from insurance companies and employers. Specifically, UEF did not conduct independent reviews to ensure awards, on which the billings were based, and authorized adjustments were accurately entered into the accounts receivable records. Additionally, the automated accounts receivable system did not generate certain notices to facilitate collection of delinquent accounts and did not generate accurate accounts receivable aging reports. Furthermore, UEF did not refer delinquent accounts to the Department of Budget and Management's Central Collection Unit (CCU). According to UEF's records, the accounts receivable balance as of November 5, 2013 totaled approximately \$51.6 million, of which approximately \$12.9 million should have been referred to CCU, based on the accounts age, but had not been referred.

Our audit also disclosed that UEF did not adequately review indemnity and certain medical claims prior to payment. Additionally, collections were not properly verified to bank deposits and the responsibilities for collections and accounts receivable functions were not properly separated. Furthermore, UEF's information systems controls over security event monitoring and user access were

not sufficient. Finally, UEF did not comply with State procurement regulations when contracting for certain services.

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

Respectfully submitted,

A handwritten signature in black ink, appearing to read "Thomas J. Barnickel III". The signature is written in a cursive style with a large initial "T" and a stylized "B".

Thomas J. Barnickel III, CPA
Legislative Auditor

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

Executive Summary

Legislative Audit Report on the Uninsured Employers' Fund (UEF) November 2014

- **UEF did not conduct independent reviews of certain critical accounts receivable transactions (Finding 1) and did not adequately monitor and collect its delinquent accounts (Finding 2). For example, the automated accounts receivable system did not generate certain dunning notices for collecting on delinquent accounts, certain accounts receivable reports generated by the system were not accurate, and UEF did not refer delinquent accounts to the Department of Budget and Management's Central Collection Unit (CCU). According to its records, UEF's accounts receivable balance totaled \$51.6 million as of November 2013, of which the vast majority was due from uninsured employers.**

UEF should establish a process to perform independent reviews to ensure that accounts receivable transactions such as awards and authorized adjustments are accurately entered into the records. UEF should also investigate and take necessary corrective actions to resolve deficiencies in generating notices for collecting delinquent accounts and reporting on accounts receivable balances. Finally, UEF should refer all delinquent accounts to CCU as required.

- **UEF did not adequately review indemnity payments made to claimants and did not obtain supporting documentation for payments made to its third-party administrator for managing Bethlehem Steel Corporation (BSC) indemnification and medical expenses claims (Finding 3).**

UEF should conduct independent supervisory reviews of indemnity payments. UEF should also verify the propriety of amounts invoiced by its third-party administrator for managing BSC claims.

- **Collections were not properly verified to deposit and the responsibilities for collections and accounts receivable functions were not properly separated (Finding 4).**

UEF should perform an independent deposit verification using the initial record of collections. UEF should also separate the cash receipt and accounts receivable functions.

- **Security event monitoring, access controls, and user access monitoring were not sufficient (Finding 5). UEF also did not have an information systems disaster recovery plan and critical programs and data files were not backed up offsite (Finding 6).**

UEF should take the recommended actions to improve internal controls over its information systems.

- **UEF did not comply with State procurement regulations regarding soliciting competitive bids and executing contracts when it procured certain services (Finding 7).**

UEF should comply with the provisions of the State procurement regulations.

Background Information

Agency Responsibilities and Financial Activity

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 who 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 2013, income (primarily assessments) totaled approximately \$8.8 million, claim payments (indemnity and medical payments) totaled approximately \$7.5 million, and operating expenses totaled approximately \$1.2 million. UEF's fund balance as of December 31, 2013 totaled approximately \$11.3 million.

During our preceding audit, the Subsequent Injury Fund (SIF) provided certain support services (including processing of invoices, payroll, and collections for deposit, maintenance of accounting records, and data processing services) to UEF. In accordance with certain established milestones detailed in a separation plan approved by the Department of Budget and Management and the executive directors for UEF and SIF, effective November 1, 2011, SIF discontinued providing support services to UEF. Consequently, the scope of our audit excluded the aforementioned financial activities that were provided by SIF prior to November 1, 2011.

Actuarial Study

In its analysis of UEF's fiscal year 2015 annual budget, the Department of Legislative Services (DLS) raised concerns regarding the financial health and viability of the Fund. Considering certain historical revenue and expenditure growth rate assumptions (such as increased cost of medical expenses), DLS estimated that the Fund could be depleted as soon as fiscal year 2020, if the current trends continue. DLS recommended that UEF perform an actuarial study to further examine the financial health of the Fund and to determine whether the current two percent assessment rate on WCC awards is appropriate to maintain

the Fund's viability. DLS recommended the actuarial study be presented to the legislative budget committees by September 1, 2014. As of July 2014, UEF, in conjunction with the Department of Budget and Management, was in the process of procuring a contract for an actuarial study, and we were advised that the budget committees granted UEF an extension until February 1, 2015 to file the actuarial study.

Outstanding Claim Against the Subsequent Injury Fund

On April 10, 2012, the former UEF executive director informed the executive director of the SIF that UEF believed it had inappropriately paid \$544,000 of SIF assessments. SIF bills an assessment for each award amount against an employer or its insurer for permanent disability or death claims approved by the WCC. The disputed SIF assessments related to claims processed by Chesapeake Employers' Insurance Company (CEIC – formerly Injured Workers Insurance Fund¹) from October 2005 to approximately the fall of 2011 for former employees of Bethlehem Steel Corporation (BSC), which had filed for federal bankruptcy protection in 2001.

Under the terms of a 2006 memorandum of understanding (MOU), CEIC was to process and pay worker's compensation claims by former BSC employees on behalf of the State of Maryland, and UEF was to reimburse CEIC for the claims paid. In accordance with this MOU, UEF reimbursed CEIC for the worker's compensation claims paid, some of which included SIF assessments. Upon discovery that it had been paying SIF assessments as part of the reimbursements to CEIC, UEF contended that the payment of these assessments out of UEF funds exceeded both their authorizing law and SIF's assessment law and requested SIF to repay the assessments paid to it related to these BSC claims.

After the former UEF executive director resigned in October 2012, UEF's claim against SIF was not pursued further. UEF was unaware of the outstanding claim until we brought it to the current executive director's attention. In response to our inquiries, on April 9, 2014, UEF initiated a request for an advisory opinion from the Office of the Attorney General (OAG) regarding how to resolve this situation. As of September 2014, OAG was reviewing UEF's request for a formal opinion.

¹Chapter 570, Laws of Maryland, 2012, allowed the Injured Workers' Insurance Fund (IWIF) to convert from an independent State entity to a fully competitive, private, non-stock, nonprofit insurer. In accordance with the provisions of the law, on October 1, 2013, IWIF became the Chesapeake Employers' Insurance Company (CEIC). Presently, IWIF still exists as an instrumentality of the State, and CEIC's Board of Directors and President also serve in those capacities for IWIF.

Status of Findings From Preceding Audit Report

Our audit included a review to determine the status of the three findings contained in our preceding audit report dated September 28, 2011. We determined that UEF did not satisfactorily address these findings and, therefore, these 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 for fiscal year 2013, approximately \$8.8 million was collected, consisting of \$8.2 million in assessments, \$453,500 in recovery of claim payments and CCU collections, \$93,900 in interest on the fund balance, and \$68,400 in fines and penalties. As of November 5, 2013, UEF's records reflected an accounts receivable balance totaling approximately \$51.6 million, including accounts totaling \$24.7 million that had been referred to CCU for additional collection actions. UEF detail records reflected approximately 5,900 accounts (an employer can have multiple accounts).

Finding 1

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

Analysis

UEF did not conduct independent reviews of certain critical 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 calculate the assessments and to generate billings to employers and insurance companies. Our test of 10 awards totaling approximately \$5.3 million disclosed that, due to UEF entering an erroneous award amount in the accounts receivable records, the two percent assessment for one award totaling \$51,275 was improperly calculated and billed as \$11,625 instead of \$1,025. UEF was not

aware of this overbilled assessment (which was paid) until we brought the overbilling to its attention in February 2014 (more than two years after the error).

- The employee responsible for processing adjustments to accounts receivable records could do so without independent review and approval. Our test of 10 adjustments to the accounts receivable records, totaling approximately \$62,600, disclosed that one adjustment caused a portion of an account balance to be incorrectly deleted. Upon bringing this to UEF's attention, UEF corrected the error. According to UEF's records, adjustments to decrease accounts receivable balances or to alter payments applied to accounts receivable balances totaled approximately \$1.7 million during the period from November 1, 2011 to December 3, 2013.

Similar conditions were commented upon in our two preceding audit reports.

Recommendation 1

We recommend that UEF establish a process to ensure the propriety of transactions recorded in the accounts receivable records (repeat). Specifically, we recommend that UEF perform independent reviews to ensure that WCC awards and properly authorized adjustments are accurately entered into the accounts receivable records.

Finding 2

UEF did not adequately monitor and pursue collection of delinquent accounts.

Analysis

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

- UEF's automated accounts receivable system did not generate certain 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. 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. 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 did not routinely refer delinquent accounts to CCU. We were advised that UEF ceased routinely sending delinquent accounts to CCU in July 2012 when one of its accounting positions became vacant. Consequently, only a few accounts were referred to CCU after July 2012. The value of the accounts referred to CCU (\$24.7 million) has remained virtually unchanged since our prior audit report dated September 28, 2011.

As of October 7, 2013, based on our analysis of data from UEF's records, there were 1,954 delinquent accounts totaling approximately \$12.9 million that, based on their age, should have been referred to CCU but had not been referred. This included 57 delinquent accounts with balances greater than \$50,000 totaling approximately \$7.1 million. As of October 7, 2013, these accounts had been delinquent for periods ranging from 189 days to more than 13 years. Delays in the pursuit of outstanding debts may decrease the likelihood of collecting the funds.

- Certain account aging reports produced by UEF's automated accounts receivable system were not accurate and reliable for use in monitoring its accounts receivable. Specifically, our review of the October 2013 monthly aging summary indicated that it improperly identified accounts totaling \$5 million as less than 30 days delinquent even though these accounts had previously been reported in prior months as more than 90 days delinquent, resulting in the amount of delinquent accounts being underreported. Five of these accounts with balances totaling \$3.3 million were established between 1989 and 2009. Additionally, the amount of delinquent accounts reported as having been referred to CCU on the monthly aging summary report (\$24.7 million) did not agree to the amount on the detailed report of delinquent accounts (\$17 million)—a difference of \$7.7 million. UEF could not explain these discrepancies.
- 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 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 two preceding audits. According to UEF's records, during the period from February 2013 to February 2014, accounts receivable increased \$7.4 million from \$46.8 million to \$54.2 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.**

Claims Processing

Background

Based on workers' compensation awards (including medical payments) as determined by the WCC, UEF pays claimants who failed to receive payments from uninsured employers. 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 on a periodic basis to reimburse 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 (for example, by reviewing physician reports). UEF also determines the amount of the biweekly payments and reviews medical claims received from medical providers for propriety.

According to UEF's records, during fiscal year 2013, approximately \$3.6 million was disbursed to claimants for indemnification of injuries, \$2.5 million was disbursed for medical expenses, and \$1.4 million was disbursed to a third-party administrator for managing and paying claims related to the indemnification and medical expenses of certain claimants. As of March 31, 2014, according to UEF's records, 66 claimants were receiving biweekly indemnity payments.

Finding 3**UEF did not adequately review indemnity and medical claim payments.****Analysis**

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

- UEF did not conduct independent supervisory reviews of indemnity payments. Although indemnity payments were reviewed for propriety, this review 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 claim payments without detection.
- UEF did not obtain documentation (such as, medical bills and indemnity payments to claimants) to support monthly payments to its third-party administrator for managing Bethlehem Steel Corporation (BSC) indemnification and medical expenses claims. BSC filed for Chapter 11 protection under the federal bankruptcy laws in October 2001. Under the terms of the memorandum of understanding (MOU) initiated on January 11, 2006, Chesapeake Employers' Insurance Company (CEIC - formerly Injured Workers Insurance Fund) processes claims filed by former BSC employees and pays the claims. CEIC submits monthly invoices to UEF for reimbursement of the claims paid and for related administrative fees, as provided for in the MOU. According to UEF's records, during fiscal year 2013, payments to CEIC for BSC workers' compensation claims and administrative costs totaled approximately \$1.3 million and \$126,300, respectively.

Similar conditions were noted in our preceding audit report.

Recommendation 3

We recommend that UEF

- a. conduct independent supervisory reviews of indemnity payments, at least on a test basis, to ensure the payments are valid and accurate (repeat); and**
- b. verify the propriety of amounts invoiced by CEIC through a review of appropriate supporting documentation, and document the verifications performed (repeat).**

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

Cash Receipts

Finding 4

UEF did not have adequate procedures and controls over collections.

Analysis

UEF did not have adequate procedures and controls over its collections from employers and insurance companies. As a result, misappropriations could occur and not be readily detected. According to UEF records, collections totaled approximately \$8.8 million during fiscal year 2013.

- Collections were not verified to deposit by an employee who was independent of the collection process. Specifically, the initial record of collections (an adding machine tape) and the related checks were forwarded to two employees who were responsible for preparing the bank deposits and for recording the deposits in the State's accounting records. One of these two employees was also responsible for performing the deposit verifications and, therefore, was not independent of the collection process. Rather, the initial record of collections should be forwarded directly to an independent employee to perform the deposit verifications.
- 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 or had the capabilities to update, adjust, or delete the related automated accounts receivable records.

The Comptroller of Maryland's *Accounting Procedures Manual* requires that a reconciliation of recorded collections to amounts deposited be performed by an employee independent of the cash receipts functions and the segregation of the cash receipt processing and accounts receivable functions.

Recommendation 4

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, and**
- b. the cash receipt and accounts receivable functions are separated.**

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

Information Systems Security and Control

Finding 5

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 computer server that hosts UEF's critical applications such as accounts receivable and accounts payable.

- Security auditing was not enabled for certain critical files on the dedicated computer 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.
- Two active user accounts that had belonged to SIF employees were assigned special privileges which allowed these accounts unlimited modification access to the dedicated computer and all of its applications. Since SIF discontinued providing support services to UEF effective November 1, 2011, such access is unnecessary. In addition, four accounts (including these two aforementioned accounts) had unnecessary and unlogged modification access to critical production data files. As a result of these conditions, unauthorized modifications to production data files and programs could be made without detection by UEF management.
- 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 11 active users disclosed that 5 users could perform incompatible functions or had unnecessary capabilities. For example, one individual with access to cash receipts also had the capability to adjust the accounts receivable records (as noted in Finding 4). Furthermore, the employee's job duties did not require the capability to adjust the accounts receivable records.
- UEF permitted two individuals to use two other individuals' assigned userids to process certain transactions (such as adjust accounts receivable records). This allowed the individuals to process transactions that were restricted if they

used their assigned userids. This sharing of userids resulted in a loss of accountability and reduced assurance over the propriety of the transactions processed.

Recommendation 5

We recommend that the UEF

- a. enable security auditing for critical files on the dedicated computer server which hosts the UEF's critical applications;**
- b. generate and review, on a weekly basis, reports of critical security events, document these reviews, and retain the documentation for future reference;**
- c. delete the two active user accounts belonging to SIF employees;**
- d. restrict modification access to critical files to only personnel who require such access and ensure that this access is logged and periodically reviewed;**
- e. 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; and**
- f. prohibit the sharing of userids.**

Finding 6

UEF did not have an information systems disaster recovery plan and critical programs and data files were not backed up offsite.

Analysis

UEF did not have an information systems disaster recovery plan and critical programs and data files were not backed up offsite.

- 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.
- Backups of critical data and programs on the aforementioned dedicated server were performed on a daily basis; however, these daily backups were not stored offsite. As a result, in the event of a disaster affecting the UEF facility,

data could be lost which could not be readily recreated. The State of Maryland *Information Technology (IT) Disaster Recovery Guidelines* state that backup media should be stored offsite in a secure, environmentally-controlled location.

Recommendation 6

We recommend that UEF, in accordance with the *Information Technology (IT) Disaster Recovery Guidelines*,

- a. develop and implement a comprehensive disaster recovery plan; and**
- b. store backups of critical data and programs at an offsite, secure, environmentally-controlled location.**

Contractual Services

Finding 7

UEF did not comply with State procurement regulations when procuring certain services.

Analysis

UEF did not comply with State procurement regulations regarding soliciting competitive bids and executing contracts when it procured certain services.

- UEF routinely procured services for independent medical assessments and investigations from ten vendors without soliciting competitive bids or entering into written contracts. Instead, UEF contacted these same vendors (such as nurse case managers, independent medical examiners, and claims investigators) multiple times on an “as needed basis” to verify medical services provided to claimants, assess the medical condition of claimants, and help UEF determine the extent of any continued claim payments. According to State records, during the period from February 2011 to February 2014, UEF paid the aforementioned ten vendors approximately \$868,800. Although each time UEF used the vendors’ services, the individual payments were generally less than \$5,000 (which is the minimum dollar threshold in which responsive bids from at least two vendors should be obtained); the cumulative payments exceeded the \$25,000 threshold for competitive sealed bidding required by State procurement regulations. Since bids were not obtained, there is a lack of assurance that UEF obtained these services at the best value.
- UEF procured temporary claims processing services without soliciting competitive bids, and the related contract did not contain certain critical provisions. UEF advised us that it believed the vendor could satisfactorily

provide temporary staffing of two individuals at a reasonable price. Additionally, the contract was not approved for legal sufficiency by UEF's principal counsel nor was it submitted to the Department of Budget and Management for review and approval as required by State procurement regulations. Finally, the contract did not include an ending date or a maximum contract value. The contract began on January 31, 2014, and as of July 24, 2014, UEF had paid the vendor approximately \$56,000.

State procurement regulations generally specify that contracts in excess of \$25,000 shall 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).

Recommendation 7

We recommend that UEF comply with the procurement and contract provisions of the State procurement regulations.

Audit Scope, Objectives, and Methodology

We have conducted a fiscal compliance audit of the Uninsured Employers' Fund (UEF) for the period beginning February 1, 2011 and ending November 13, 2013. 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 billings and collections, 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 UEF's operations, and tests of transactions. 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 this source were sufficiently reliable for the purposes the data were used during this audit. We also extracted data and obtained certain reports from UEF's automated accounts receivable and claim payment system for the purpose of testing 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; however, as detailed in Finding 2, certain reports were deemed unreliable. 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.

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.

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.

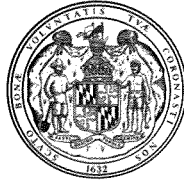
APPENDIX

STATE OF MARYLAND

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October 29, 2014

Thomas J. Barnickell, Legislative Auditor
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301 West Preston Street, Room 1202
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Re: **Supplemental Agency Response to OLA Draft Audit Report for Period
Beginning February 1, 2011 and Ending November 13, 2013**

Dear Mr. Barnickell,

Thank you for your letter regarding the OLA Draft Audit Report for Period beginning February 1, 2011 and ending November 13, 2014.

Enclosed you will find the Agency's *supplemental* response and plan for correction that addresses each audit recommendation.

If you have any questions, or require additional information, please do not hesitate to contact me.

Sincerely,

A handwritten signature in cursive script that reads 'Roxanne Pitts'.

Roxanne Pitts
Executive Director

RP/dj
Enclosure(s)

Our *Supplemental* Response to your Notice and Findings follows.

BACKGROUND:

Accounts Receivable: Finding 1 – UEF did not conduct independent review of certain critical accounts receivable transactions.

The Fund agrees with Recommendation 1 and will:

- (a) Implement its provisions with a system where the Fiscal Technicians enter the WCC Awards into the accounts receivable records with review by the Chief Financial Officer, and
- (b) Adjustments will be reviewed by the approving official and recorded in the accounts receivable records.

Accounts Receivable: Finding 2 – UEF did not adequately monitor and pursue collection of delinquent accounts.

The Fund agrees with Recommendation 2 and will:

- (a) Work with our IT Contractor to correct deficiencies associated with creating dunning notices and accounts receivable aging reports,
- (b) Refer delinquent accounts to CCU in a timely manner, and
- (c) Coordinate with the appropriate State licensing authorities to refer delinquent employers for license or permit suspension.

Claims Processing: Finding 3 – UEF did not conduct independent supervisory reviews of indemnity and medical claim payments to ensure propriety.

The Fund agrees with Recommendation 3 and will:

- (a) Ensure independent supervisory reviews of indemnity payments and adjustments are valid and accurate, and
- (b) The Function of CEIC as a third-party administrator will be discontinued in January 2015 and invoices will be processed in-house by Fund staff.

Cash Receipts: Finding 4 – UEF did not have adequate procedures and controls over collections.

The Fund agrees with Recommendation 4 and will:

- (a) Assign deposit verification to an independent employee, and
- (b) Ensure the cash receipt and accounts receivable functions are appropriately separated.

Information Systems Security and Control: Finding 5 – Security event monitoring, access controls, and user access monitoring were not sufficient.

The Fund agrees with Recommendation 5 and will:

- (a) Security auditing features are enabled for critical files;
- (b) When critical security events occur i.e. staff changes, reports will be generated, retained and each review will be documented,
- (c) User accounts for two SIF employees are deleted,
- (d) User modification access to critical files are restricted, logged and periodically reviewed,
- (e) Security reports are periodically generated and reviewed to ensure incompatible functions are not performed, and
- (f) The prohibition of sharing user IDs is strictly enforced.

Information Systems Security and Control: Finding 6 – UEF did not have a Disaster Recovery Plan and critical programs and data files were not backed up offsite.

The Fund agrees with Recommendation 6 and will:

- (a) Develop and implement a disaster recovery plan, and
- (b) Continue working with their IT Contractor to develop daily cloud storage of all critical data and programs.

Contractual Services: Finding 7 – UEF did not comply with State procurement regulations when contracting for certain services.

The Fund agrees with Recommendation 7 and will:

- (a) Solicit competitive bids for independent medical assessments and investigations and comply with State procurement regulations.

AUDIT TEAM

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Elaine D. Portnoy
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