

Audit Report

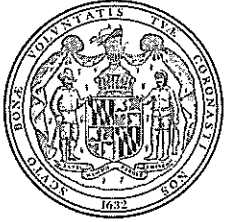
Uninsured Employers' Fund

September 2011



OFFICE OF LEGISLATIVE AUDITS
DEPARTMENT OF LEGISLATIVE SERVICES
MARYLAND GENERAL ASSEMBLY

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Karl S. Aro
Executive Director

DEPARTMENT OF LEGISLATIVE SERVICES
OFFICE OF LEGISLATIVE AUDITS
MARYLAND GENERAL ASSEMBLY

Bruce A. Myers, CPA
Legislative Auditor

September 28, 2011

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

Ladies and Gentlemen:

We have audited the Uninsured Employers' Fund (UEF) for the period beginning February 20, 2008 and ending January 31, 2011. UEF pays workers' compensation awards to claimants who failed to receive payment from uninsured employers. To fund these awards, UEF collects assessments from employers and insurance companies as well as fines and penalties, such as from uninsured employers.

Our audit disclosed that UEF lacked adequate procedures and controls over account receivable records, which are maintained on its behalf by the Subsequent Injury Fund (SIF). For example, UEF did not have procedures to verify that SIF had properly recorded transactions such as new accounts, collections, and adjustments to the accounts receivable records. UEF also lacked sufficient controls over indemnity and medical claim payments and payments to the Injured Workers Insurance Fund.

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,

A handwritten signature in cursive script that reads "Bruce A. Myers".

Bruce A. Myers, CPA
Legislative Auditor

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

Background Information

Agency Responsibilities

The Uninsured Employers' Fund (UEF) is responsible for paying workers' compensation awards (including medical payments) to claimants who failed to receive payment from uninsured employers as required. The principal source of funding for benefit payments and UEF operating expenses is an assessment (currently 2 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 WCC fines and penalties assessed by WCC on uninsured employers and on insurers who fail to comply with certain statutory filing requirements and bills uninsured employers for UEF payments made on their behalf to injured workers.

According to UEF's fiscal year 2010 annual report, total income was approximately \$7 million, including assessments of \$6.3 million, while total expenditures were \$7.5 million, consisting of compensation and medical payments to claimants (for which the uninsured employers should reimburse UEF) of \$6.4 million and operating expenses of \$1.1 million. In addition, UEF's annual report indicated that the fund balance at June 30, 2010 totaled \$10.9 million.

SIF/UEF Separation Project

The Subsequent Injury Fund (SIF) provides certain support services (such as invoice processing, payroll, processing collections for deposit, maintenance of accounting records, and data processing services) for UEF. These support services are included within the scope of the SIF audit. In February 2010, SIF and UEF entered into a memorandum of understanding, to separate the operational support services provided by SIF, with the intent for UEF to assume those functions and duties. This arrangement was approved by the Department of Budget and Management, and in August 2010, the Executive Directors of both SIF and UEF approved a project plan for the separation. This plan established certain milestones during fiscal year 2011, to effect the transfer of responsibilities for those support services to UEF. We were advised by UEF management that the separation was still in process as of August 4, 2011.

Ongoing Litigation

During the course of our audit, there was ongoing litigation with the Injured Workers Insurance Fund (IWIF) over the failure to pay certain assessments to UEF¹. The litigation involves the statutory assessment imposed on insurance companies and employers used to fund UEF. The assessment is a percentage of WCC awards (currently 2 percent). SIF historically calculated the assessment for both SIF and UEF based on the total WCC award. In April 2007, SIF management noted that IWIF was withholding a portion of their assessments. Subsequent discussions with IWIF management disclosed that the payments were withheld because IWIF believed that the assessment calculation should not consider medical costs. Based on SIF's review, as of January 31, 2011, SIF calculated that IWIF owed UEF approximately \$700,000.

UEF presented the IWIF issue to the WCC in October 2009 and the WCC ruled that the assessment should be based on the entire award including the medical costs². IWIF appealed the ruling to the Circuit Court of Maryland and on March 23, 2011 the court confirmed the WCC ruling. In June 2011, IWIF appealed the verdict to the Court of Special Appeals, and the appeal is currently pending.

Status of Findings From Preceding Audit Report

Our audit included a review to determine the status of the five findings contained in our preceding audit report on UEF dated May 6, 2009. We determined that UEF satisfactorily addressed one of these findings. The four unresolved findings from this report are repeated in this report, three of which were combined into one finding.

¹ Similar litigation is ongoing between SIF and IWIF.

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

Findings and Recommendations

Accounts Receivable

Background

The Uninsured Employers' Fund's (UEF) accounts receivable records are maintained by the Subsequent Injury Fund (SIF). SIF prepares billing statements and generates the accounts receivable aging reports. SIF also updates the accounts receivable records based on (1) billing instructions received from UEF, (2) payments received either by UEF or by SIF on UEF's behalf, (3) collections transferred from the Department of Budget and Management's Central Collection Unit (CCU), and (4) adjustments prepared by UEF.

UEF is responsible for sending certain billing statements (such as for medical payments) as it deems appropriate, maintaining its own manual records regarding delinquencies and payment plans established, and transferring accounts to CCU for additional collection actions.

The vast majority of UEF's accounts receivable balance is related to amounts due from uninsured employers for UEF payments to injured workers, and for related fines and penalties, based on awards approved by the Workers' Compensation Commission (WCC). According to UEF's records, the accounts receivable balance as of April 2011 was composed of approximately 2,500 accounts totaling approximately \$36.9 million, of which approximately \$24.7 million had been referred to CCU for additional collection actions.

Finding 1

UEF lacked adequate procedures and controls over account receivable records administered by SIF.

Analysis

UEF lacked adequate procedures and controls over account receivable records administered by SIF. Specifically, our review disclosed the following conditions:

- UEF did not perform verifications to ensure SIF accurately posted transactions to the accounts receivable records, including the posting of new accounts, collections, and adjustments. Although SIF is responsible for maintaining UEF's accounts receivable records, in our recent audit report on SIF, we commented on deficiencies in SIF's internal control and record keeping for accounts receivables. For example, we noted that there were no independent verifications performed by SIF to ensure the accuracy of WCC awards entered into the accounts receivable system. Also, non-cash credit adjustments were

not always subject to independent review and approval. A similar condition was noted in our preceding audit report.

- UEF did not maintain adequate supplemental records to facilitate appropriate debt collection efforts. In this regard, the automated accounts receivable system maintained by SIF did not provide sufficient information to ensure accounts were properly pursued for collection. Specifically, multiple claims paid on behalf of the same employer were not assigned individual due dates for each claim paid, rather all due dates were based on the original claim date. Consequently, the system-generated aging reports incorrectly calculated the due dates and the number of days past due. For example, the due date for one account totaling approximately \$136,000 appeared on an aging report as 10 months past due even though \$113,500 of these claims were less than one month old. In addition, the system did not record dunning notices, requiring UEF to maintain manual records of dunning activity and accounts forwarded to CCU. However, those records were incomplete, as they did not indicate whether the dunning notices were actually issued or whether the accounts had been forwarded to CCU. Similar deficiencies were noted in our preceding audit report.
- UEF did not adequately pursue the collection of delinquent accounts in accordance with CCU regulations. Specifically, UEF ceased sending overdue accounts to CCU as of February 2010 when its sole accounting position became vacant. In addition, our test of five delinquent accounts totaling \$198,000 from a February 5, 2011 report of delinquent accounts prepared by SIF disclosed that the required dunning notices were either not sent out at all or were not sent out in a timely manner for four of the tested accounts. CCU regulations, as amended for UEF, require that written demands for payment be made at 30-day intervals and that outstanding accounts which remain uncollected for 180 days be transferred to CCU for further collection activity. Similar conditions were noted during our two preceding audits.

The aforementioned conditions resulted in accounts receivable records that are unreliable and related activity that is highly susceptible to fraud or errors. Furthermore, as a result of these conditions, we were unable to perform certain audit procedures designed to provide reasonable assurance that accounts receivable transactions were accounted for and properly recorded in UEF's records.

Recommendation 1

We recommend that UEF

- a. establish a process to ensure that all transactions (for example, new accounts, collections, adjustments, and assessments) are properly recorded in the accounts receivable records (repeat);**
- b. ensure that the accounting system provides sufficient information to monitor collection activities (repeat); and**
- c. ensure accounts are properly pursued for collection and delinquent accounts are referred to CCU as required (repeat).**

Claims Processing

Finding 2

UEF lacked adequate procedures and controls over indemnity and medical claims.

Analysis

UEF lacked adequate procedures and controls over indemnity and medical claims. For example, we noted the following conditions:

- UEF did not perform verifications of claim payments processed for it by SIF to ensure claim payments were processed in accordance with the terms of the WCC awards. A similar comment was included in our preceding audit report.
- One employee could process indemnity and medical claims and authorize SIF to disburse the related payments without any independent approval. As a result, this employee could process improper claims without detection.

During fiscal year 2010, approximately \$4 million in UEF funds were disbursed to claimants for indemnification of injuries or for medical expenses. WCC determines the amount and duration of the awards. Indemnity funds are paid to the claimant or applicable beneficiary in biweekly installments or as a lump sum and medical claims are paid to providers as they are received. UEF determines the 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 payment and reviews medical claims received from medical providers for propriety. Once the payment amount is determined and/or the medical bill is approved, UEF sends a notification to SIF who then processes the payment.

Recommendation 2

We recommend that UEF

- a. perform verifications to ensure that claim processing services performed by SIF on its behalf are proper (repeat), and**
- b. ensure that all claims are subject to independent supervisory review and approval.**

Finding 3

UEF did not adequately monitor the propriety of amounts paid to IWIF.

Analysis

UEF did not adequately monitor amounts paid to IWIF. Specifically, UEF management advised us that its verification of IWIF's invoices is limited to charges over \$100,000. As a result, all amounts paid were not subject to adequate verification. For example, our review of five IWIF invoices, comprising 2,400 charges, totaling \$1.5 million disclosed that UEF reviewed only the two charges greater than \$100,000, which collectively totaled \$253,000.

Bethlehem Steel Corporation (BSC) filed for Chapter 11 protection under the federal bankruptcy laws in October 2001. As a result of bankruptcy filings and inadequate bond funds of \$13.1 million to cover estimated BSC claims of \$27 million, a memorandum of understanding (MOU) between UEF, IWIF and WCC, was initiated on January 11, 2006. Under the terms of the MOU, IWIF processes claims filed by former BSC employees and disburses the related claims payments. IWIF submits monthly invoices to UEF for reimbursement of the claims paid by IWIF and related administrative fees, as provided for by the MOU.

We questioned UEF management on the lack of a thorough review of all IWIF claims, and were advised that in lieu of that, UEF management had requested the Maryland Insurance Administration (MIA) to include a review of UEF's BSC activity at IWIF as part of the work that was to be performed on behalf of the State Treasurer. However, UEF did not ensure that MIA's review included UEF activity and our review of the resultant MIA report (dated January 2011) disclosed that the scope of the MIA work did not include any UEF activity. According to UEF's records, during fiscal year 2010, payments to IWIF for BSC workers' compensation claims and administrative costs totaled approximately \$2.3 million and \$228,000, respectively.

Recommendation 3

We recommend that UEF verify the propriety of amounts paid to IWIF. This verification should be documented and should include a review of appropriate supporting documentation such as evidence of medical claims paid.

Audit Scope, Objectives, and Methodology

We have audited the Uninsured Employers' Fund (UEF) for the period beginning February 20, 2008 and ending January 31, 2011. The audit was conducted in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

As prescribed by the State Government Article, Section 2-1221 of the Annotated Code of Maryland, the objectives of this audit were to examine UEF's financial transactions, records and internal control, and to evaluate its compliance with applicable State laws, rules, and regulations. We also determined the status of the findings contained in our preceding audit report.

In planning and conducting our audit, we focused on the major financial-related areas of operations based on assessments of materiality and risk. The areas addressed by the audit included accounts receivable, claims disbursements, and cash receipts. Our audit procedures included inquiries of appropriate personnel, inspections of documents and records, and observations of UEF's operations. We also tested transactions and performed other auditing procedures that we considered necessary to achieve our objectives. Data provided in this report for background or informational purposes were deemed reasonable, but were not independently verified.

Our audit did not include certain support services provided to UEF by the Subsequent Injury Fund (SIF). These support services, such as invoice processing, payroll, and maintenance of an automated data processing system are included within the scope of our audits of SIF.

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 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.

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September 22, 2011

Mr. Bruce A. Myers, CPA, Legislative Auditor
Department of Legislative Services
Office of Legislative Audits
Maryland General Assembly
301 West Preston Street – Room 1202
Baltimore, Maryland 21201

Re: Agency Response to OLA Audit
For Period ending January 31, 2011

Dear Mr. Myers:

In response to your September 2011 Audit Report of the Uninsured Employers' Fund for the period beginning February 20, 2008 and ending January 31, 2011, the Fund provides the following comments, plans and timetables:

Finding 1
UEF lacked adequate procedures and controls over account receivable records administered by SIF.

Regarding **Finding 1**, the lack of adequate procedures and controls over accounts receivable, **and Recommendations 1a, 1b and 1c**, the Fund accepts those Recommendations and has already begun implementation. As a general matter, for the first time in its more than 40-year history, the Fund will have its own internal fiscal department and its operations, processes and systems, and the review of those, will be in house. So our comments and solutions will principally look forward and not historically to the arrangement with the Subsequent Injury Fund (SIF) providing UEF with all administrative, fiscal and IT support. In particular regard here, the new UEF Accounts Receivable clerk will begin at the Fund on October 5, 2011.

Recommendation 1a – to establish a process to ensure that all transactions (e.g., new accounts, collections, adjustments and assessments) are properly recorded in the accounts receivable records.

First, the calculation, invoicing, receiving and processing of payments by insurance companies of the 2% statutory assessments under LE 9-1005, which is our principal source of revenue. We now have the direct line from the Workers' Compensation Commission to receive the Awards on issuance. We have already begun billing, receiving and processing payments. Our new accounts receivable clerk will be trained to receive and review Commission awards, to calculate and invoice assessments, and to correctly credit payments to the appropriate claim. That should take five (5) months and be fully implemented by February 28, 2012. We have already established processes for mailing invoices, receiving and recording the 2% checks on receipt, and for preparation and review of the check deposits.

Second, non-insured employer receivables are our secondary income source. We have already created an inhouse system to register our new accounts, timely issue dunning letters, post collections on monthly repayment programs (approximately 85 accounts), to make any appropriate adjustments (such as rescission of fines by the Commission), to reflect delinquencies every month and to flag timely referrals to CCU. This should require another 3 months of training and implementation for the accounts receivable clerk, and be fully implemented by May 31, 2012. We did continue our manual collection of receivables during the audit period and collected \$639,555 during FY 2009, 2010 and 2011. CCU collected an additional \$375,208.

Recommendation 1b – ensure that the accounting system provides sufficient information to monitor collection activities. The inhouse system, once reactivated and properly implemented, will contain all information fields needed to monitor collections before being sent to CCU. This will include delinquency notices when employers do not maintain timely monthly payments. This is part of the implementation under 1a and its May 31, 2012 full implementation. Additionally, monthly summaries of all inhouse aging accounts are already being prepared and will be reviewed monthly by the fiscal administrator and executive director. We will also continue the use of confess judgment promissory notes in these cases where the indebtedness exceeds \$10,000.

Recommendation 1c – ensure that accounts are properly pursued for collection and that accounts are referred to CCU as required. With the hiring of the accounts receivable clerk and the reactivation and implementation of the accounts receivable program, all accounts should be properly pursued. Additionally, the monthly summaries for the fiscal administrator and executive director will allow regular and timely collection initiatives in house and timely referral to CCU. Accounts have been pursued regularly and noninsured employer receipts have been increasing regularly.

Regarding CCU, we requested and obtained from CCU an entire listing of each account which they maintain for us. We provided a copy of that listing to your auditors. We will also be obtaining online access to our accounts with CCU on or before December 31, 2011. Many of those accounts are noncollectible and we have begun to evaluate those for review by CCU. Our informal estimate is that the approximately \$25 Million in accounts receivable are significantly noncollectible, due to bankruptcies, corporate entities without assets, and non-locatable employers due to relocation or death. We have already made a list of those accounts in excess of \$100,000 and once those are resolved, we will move to those over \$50,000 until all accounts have been reviewed for collectability. We estimate that the identification and resolution of the

first group of accounts will take nine months and be completed by June 30, 2012. The review of the entire book of more than 400 accounts we expect to take another 18 months and be complete by August 31, 2013.

Finding 2

UEF lacked adequate procedures and controls over indemnity and medical claims.

Regarding **Finding 2**, the lack of adequate procedures and controls over indemnity and medical claims, and **Recommendations 2a and 2b**, the Fund accepts them and will implement them as fully as staffing will allow, in particular as follows:

Recommendation 2a – perform verifications to ensure that claim payments are processed properly. All indemnity and medical claim payment authorizations are processed by one person in UEF, due to staffing limitations, and reviewed and authorized in writing by the executive director. The director review ensures that payments are made in compliance with the WCC Awards. (There was one payment made by the claim processor without executive director authorization, which the audit disclosed. That processor has been reminded in writing that no payments are to be made without director review and authorization.) With the hiring of the new UEF Fiscal Administrator in July 2011, all claim payments are now being processed, and verified a second time, inhouse. The executive director will also review and/or approve payments in the FMIS system. The UEF has also contacted IWIF to evaluate their online Medical Fee Guide payment program to eliminate further manual calculation of medical payments. We anticipate that the Medical Fee Guideline program review, adoption and implementation will take nine months and be fully implemented by year-end June 30, 2012. We will also be seeking FY13 budget approval for a third fiscal person to perform the accounts payable functions, for independent review by the fiscal administrator. That will be contingent on both executive and legislative approval.

Recommendation 2b – ensure that all claims are subject to independent supervisory review and approval.

Two separate supervisory reviews of payment authorizations are now in place, by the executive director and the fiscal administrator. The director's specific written authorization is required on each payment authorization prepared by the processor and he will also review the payment itself on FMIS to correlate with the authorization.

Finding 3

UEF did not adequately monitor the propriety of amounts paid to IWIF.

Regarding **Finding 3**, failure to adequately monitor the propriety of amounts paid to IWIF for its third-party administrator handling of Bethlehem Steel claim payments on behalf of the UEF, and **Recommendation 3**, the Fund has some disagreement and concern.

Recommendation 3 – verify the propriety of amounts paid to IWIF (claim and fee), to include a review of appropriate supporting documentation such as evidence of medical claims.

We cannot disagree with the desire of the auditors for full reviewability of the BS claims. But the arrangement was initially established in a 2002 MOU, not only by the three agencies recited in the Analysis, but at the instance of the Governor at the time of Bethlehem Steel's bankruptcy. The parties all recognized that liability for the claims clearly belonged to the UEF, while also clearly recognizing that UEF had woefully insufficient staffing and capability to administer the many hundreds of claims.

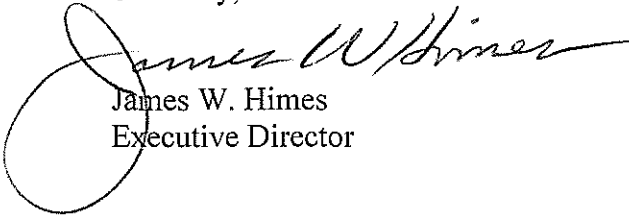
The Fund accordingly established a policy of requiring detailed justification from IWIF for all proposed settlements in excess of \$100,000, both as to indemnity and medicals. Principal counsel reviews each justification with the executive director, whose approval is required before any payment. In addition, UEF requires, and IWIF provides, detailed monthly summaries of all claims and payments for review and any questioning. Questions were, and continue to be, raised in individual claims. The Fund believes, given its severe staffing limitations, that this level of review was entirely appropriate. However, the executive director or fiscal administrator will now begin to review and total the individual payments shown on the monthly detail to match with the amount invoiced. In addition, following the 2008 audit the auditors suggested and the Fund requested to have 10 Bethlehem Steel claims audited by the Maryland Insurance Administration. Although our request met with an affirmative answer, no claims were audited. Last month, the Fund again requested the MIA audit 10 Bethlehem Steel claims. We have again received an affirmative verbal response from the MIA and are awaiting formal acceptance and written engagement. Results of the MIA audit will be provided to the legislative audit team.

In the meantime, as a result of this continuing concern, the Fund has decided, with Board approval, to bring the remaining Bethlehem Steel claims inhouse. There are approximately 45 remaining claims, reserved at \$7.75 Million by IWIF. Their 10% fee would amount to \$775,000, which the Fund would save and apply to our own budget. A special supplemental request to our FY 2013 budget is being prepared for submittal to the Department of Budget & Management, with their tentative approval. This also includes a request for additional staffing to review the Medicare Set-Aside requirements for all workers compensation claims falling under federal CMS law. If approved by DBM and the Legislature, this would be initiated as of July 1, 2012 and fully implemented by August 31, 2012.

We trust that we have adequately responded to your audit concerns, findings and recommendations. But if you should require any further or clarifying information in any respect, please let us know at your earliest opportunity.

Finally, we have appreciated the excellent work and detailed findings of the audit team. They provided clear light on directions we need to undertake.

Sincerely,

A handwritten signature in black ink, appearing to read "James W. Himes". The signature is written in a cursive style with a large, looping initial "J".

James W. Himes
Executive Director

cc: Samuel S. Hoyle, Chair, Uninsured Employers' Fund Board

AUDIT TEAM

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