Audit Report

Workers' Compensation Commission

March 2012



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

March 2, 2012

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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 audited the Workers' Compensation Commission (WCC) for the period beginning March 12, 2008 and ending May 8, 2011. WCC adjudicates claims for compensation arising under the Workers' Compensation Law and is responsible for the approval and monitoring of Maryland self-insured employers. WCC expenditures are recovered from assessments to insurance companies and self-insured employers.

Our audit disclosed that WCC did not properly calculate certain assessments to insurance companies and self-insured employers. As a result, the recovery of WCC expenditures was not always performed as prescribed by State law. For example, in one case an insurance company was credited approximately $204,000 more than if the amount had been calculated according to State law. In addition, WCC did not ensure that assessments were properly recorded in the accounts receivable records. Lastly, WCC did not ensure that payments for certain auditing services were proper.

WCC'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 WCC.

Respectfully submitted,

Bruce A. Myers

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Legislative Auditor

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Background Information

Agency Responsibilities

The Workers' Compensation Commission (WCC) administers Title 9 of the Labor and Employment Article of the Annotated Code of Maryland, also known as the Workers' Compensation Law. WCC receives reports of accidents, conducts hearings of contested cases, and adjudicates claims for compensation arising under the law. WCC is also responsible for approving employers who wish to be self-insured in the State and for monitoring their activities and financial solvency. In accordance with the law, all of WCC's expenditures are recovered from assessments billed to insurance companies that issue workers' compensation insurance policies, including the Injured Workers' Insurance Fund, and to companies that self-insure for workers' compensation coverage. According to the State's records, WCC's total expenditures were approximately $13.3 million during fiscal year 2011.

Verification of Insurance Coverage

In our three preceding audit reports, we noted that WCC's legal responsibility to identify employers who had not obtained workers' compensation insurance was unclear. The WCC and its Assistant Attorney General concluded that WCC was not responsible for ensuring that employers maintained the required insurance coverage. The Joint Audit Committee referred this matter to the Maryland General Assembly Workers' Compensation Benefit and Insurance Oversight Committee for consideration. In response to inquiries from the Committee, the WCC formed a task force consisting of officials from WCC and other state agencies (such as the Department of Labor, Licensing and Regulation (DLLR) and the Uninsured Employers' Fund) to study employer compliance with workers' compensation requirements.

On November 12, 2008, the task force issued its report to the Oversight Committee. The report referenced draft legislation that would provide WCC with additional authority to verify that employers have obtained workers' compensation insurance. In addition, the report recommended interagency cooperation between WCC and DLLR, for the purpose of identifying employers who have not complied with workers' compensation insurance requirements.

The aforementioned legislation was not passed during the 2009 session. In September 2010, the WCC entered into a Memorandum of Understanding (MOU) with DLLR, the Office of Attorney General, the Comptroller of Maryland, and the Maryland Insurance Administration. However, due to the lack of statutory

authority, the MOU only involved the coordination and enhanced investigation and enforcement of employee misclassification matters. It did not address procedures to identify employers who had not obtained workers' compensation insurance.

Status of Findings From Preceding Audit Report

Our audit included a review to determine the status of the five findings contained in our preceding audit report dated March 26, 2009. We determined that WCC satisfactorily addressed these findings.

Findings and Recommendations

Assessments

Background

State law provides for the recovery of Workers' Compensation Commission (WCC) expenses via assessments on insurance companies and self-insured employers. The amount assessed generally includes WCC's appropriation for its salaries and operating expenditures, as well as the administration costs of the Commissioner of Labor and Industry's Occupational Safety and Health and Workforce Fraud programs. These costs are then allocated to the insurance companies and self-insured employers based on the insured payroll (that is, the salaries of the individuals insured by these entities).

Finding 1
Errors were made in the calculation of assessments to insurance companies and self-insured employers.

Analysis

Various errors made in the assessment calculations resulted in the misallocation of assessments made to insurance companies and self-insured employers. Specifically, we noted the following conditions:

- WCC improperly calculated refunds to insurance companies and self-insured employers for surplus funds remaining at the end of fiscal year 2007. Specifically, during our preceding audit we noted that the balance of the Workers' Compensation Fund increased by approximately $2 million (from $770,000 to $2.7 million) during fiscal year 2007. The fiscal year 2008 assessments should have been adjusted to result in a reduction of the fund balance to approximately $250,000 in accordance with State law.

  In response to the finding in our preceding audit report, WCC credited the 2009 assessments for the aforementioned Fund balance. However, the amount credited was not calculated based on the total insured payroll from the proper year as provided for in State law. As a result, credits awarded to the insurers were not properly distributed. For example, we estimated that one insurance company's credit was approximately $204,000 more than it should have been. State law provides that if, in any given fiscal year, the amount of the revenue collected by WCC and deposited into the Fund exceeds the actual appropriation for WCC the excess amount shall be used to reduce the assessment imposed by WCC for the following fiscal year.

- WCC did not reassess insurance companies and self-insured employers for certain revenue shortfalls. During fiscal year 2010, WCC did not realize approximately $712,000 in projected revenues. Although State law provided for WCC to reassess the insurance companies and self-insured employers to cover the shortfalls, WCC opted to forgo the reassessment and instead included the shortfall in its 2011 assessment calculation. This resulted in the shortfall being improperly allocated to insurance companies and self-insured employers, again because the allocation was based on the insured payroll from the wrong year. As a result, certain insurers were overcharged while others were undercharged for the aforementioned costs.

- WCC assessed insurance companies and self-insured employers $234,815 more than allowed by State law during fiscal year 2011. Specifically, WCC assessed these insurers an additional one percent of the WCC appropriation for unexpected expenditures, which is not allowed by State law. (Similar over-assessments in prior years contributed, in part, to the previously noted surplus funds accumulated in the Workers' Compensation Fund.)

Recommendation 1
We recommend that WCC

a. determine the proper amounts that should have been assessed to the insurance companies and self-insured employers and take appropriate corrective actions, and
b. ensure that future assessments are calculated in accordance with State law.

Finding 2
WCC did not ensure that assessments were properly recorded in the accounts receivable records.

Analysis
WCC did not ensure that assessments were properly recorded in the accounts receivable records or that only approved adjustments were recorded. According to WCC's records, during fiscal year 2011, assessments and related adjustments totaled $24.4 million and $12.8 million, respectively. Our review disclosed the following conditions:

- Although we were advised that independent supervisory personnel ensured that all assessments on insurance companies were properly recorded in the accounts receivable records, the review was not documented. Furthermore,

the employee who calculated the assessments was also responsible for recording the amounts due in the accounts receivable system.

- Although output reports of adjustments recorded in the accounts receivable records were generated, supervisory personnel did not use these reports to verify that only approved adjustments were processed. In addition, although adjustments were subject to review prior to processing, they were forwarded to supervisors by the employees who prepared the adjustments and there was no verification that only approved adjustments were recorded.

The failure to properly ensure that all assessments and related adjustments were properly recorded in the accounts receivable system could result in the improper allocation of assessments, the failure to bill for all assessments, or unauthorized adjustments and assessments being processed without detection.

Recommendation 2
We recommend that WCC

a. conduct documented reviews of assessments posted to the accounts receivable system to ensure the assessments are posted properly, and

b. establish procedures to ensure that only properly approved adjustments are recorded in the accounts receivable system.

Contract Monitoring

Finding 3
WCC did not ensure that payments for certain audit services were proper.

Analysis
WCC did not ensure the propriety of amounts invoiced and paid for audit services. During fiscal year 2011, WCC paid approximately $300,000 to an accounting firm for compliance audits of self-insured employers. Our review of these payments disclosed that the invoices did not include sufficient detail and supporting documentation to determine the propriety of the charges. Specifically, the invoices did not list job classifications, labor rates, or time charged by each classification as required by the contract and did not include any supporting documentation for the hours charged (for example, time records).

WCC management advised us that it never requested the supporting documentation to verify the amounts invoiced. As a result, there is a lack of assurance that the amounts paid for these services were proper.

Recommendation 3

We recommend that WCC

a. ensure that contractor invoices contain all required information, including job classifications and hours worked; and

b. verify the charges, at least on a test basis, for reasonableness.

Audit Scope, Objectives, and Methodology

We have audited the Workers' Compensation Commission (WCC) for the period beginning March 12, 2008 and ending May 8, 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 WCC'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 assessments, cash receipts, disbursements, contracts, and payroll. Our audit procedures included inquiries of appropriate personnel, inspections of documents and records, and observations of WCC'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.

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

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

APPENDIX

MARTIN O'MALLEY
Governor

ANTHONY G. BROWN
Lt. Governor

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Commissioners

February 29, 2012

Mr. Bruce A. Myers, CPA
Office of Legislative Audits
301 W. Preston Street
Room 1202
Baltimore, MD 21201

Dear Mr. Myers:

The Workers' Compensation Commission (WCC) appreciates the opportunity to provide responses to the Draft Audit Report for the period beginning March 12, 2008 and ending May 8, 2012. The WCC's responses are presented in the attachment in the same sequence as the findings identified in the Draft Audit Report. A brief description of each audit finding is listed immediately before our response in order to facilitate your review of this information.

Please do not hesitate to contact David E. Jones, Chief Financial Officer, if you or your staff should have any questions or concerns regarding the WCC's proposed strategy for addressing these issues. David's telephone number is (410) 864-5255.

Sincerely,

R. Karl Aumann
Chairman

Attachment

cc: Mary K. Ahearn, Chief Executive Officer
David E. Jones, Chief Financial Officer

Finding 1
Errors were made in the calculation of assessments to insurance companies and self-insured employers.

Agency Response

WCC improperly calculated refunds to insurance companies and self-insured employers for surplus funds remaining at the end of fiscal year 2007.

The $2.7 million fund balance resulted from collecting 1% for unexpected expenditures from insurance companies and self-insured employers from FY2002 to FY2008. In each subsequent year, if the money collected from the prior year is not used, any excess is to be credited to the insurance companies and self-insured employers. Because of a misinterpretation of § 9-319 of the Workers' Compensation law, the Commission did not refund the excess fund balance in each subsequent year. The agency refunded the $2.7 million fund balance to insurance companies and self-insured employers all on the FY2009 billing, the first billing after the error was discovered. When the agency calculated the refund due to each insurance company and self-insured employer, it should have allocated the excess fund balance based on the payroll dollars from each individual fiscal year instead of basing it all on the payroll dollars from the FY2009 billing. When advised of the error, the agency performed a calculation to correct the allocation amongst the insurance companies and self-insured employers and this adjustment was reflected on the FY2012 second billing. At the time of sending the FY2012 second billing, the agency communicated the reason for the adjustment to the insurance companies and self-insured employers. The agency received no complaints and few questions from the insurance companies and self-insured employers regarding this adjustment.

The agency determined the $2.7 million fund balance at June 30, 2008 relates to the following fiscal years:

	FY2002	FY2003	FY2004	FY2005	FY2006	FY2007	FY2008	TOTAL
Fund balance increase/decrease over prior FY	63,984	33,478	(20,791)	989,321	(299,209)	1,978,908	(59,224)	2,686,468

The balances attributable to FY2002, FY2003, and FY2004 were combined with the balance from FY2005 when determining the year each adjustment should have been booked for efficiency because of their immateriality. The Commission reflected the appropriate adjustment for each insurer on the FY2012 second billing.

Since the June 30, 2008 fund balance, the Commission has had one additional year with a fund balance. The fund balance as of June 30, 2009 was credited on the fiscal year 2010 billing in accordance with state law. The Commission will ensure that any future credits are calculated in accordance with State law.

WCC did not reassess insurance companies and self-insured employers for certain revenue shortfalls.

The Commission acknowledges that it had an unfunded liability of $712,000 at the end of fiscal year 2010. The decision was made to not reassess for $712,000 through a separate billing because of the administrative costs and time to generate and collect this amount of money (a special billing for $712,000 would result in many small invoices). After discussion with the Comptroller's Office, the agency determined that the Comptroller's Office would allow our fund balance to be negative until we billed and collected for the unfunded liability on the next regular billing. The Commission billed and collected the $712,000 in fiscal year 2011. Subsequently, the Commission performed a calculation that would collect the $712,000 to the insurance companies on record for the year in which the liability arose. This resulted in some insurance companies owing additional monies and some receiving credit for amounts incorrectly charged to them. The adjustments to these insurance companies were processed on the second billing for FY2012.

WCC assessed insurance companies and self-insured employers $234,815 more than allowed by State law during fiscal year 2011

The Commission acknowledges it billed insurers for $234,815 for unanticipated expenditures during fiscal year 2011. Historically the WCC has billed insurers for 1% of its appropriation for unanticipated expenditures, however § 9-319 of the Workers' Compensation law only allows the Commission to ***retain*** up to an additional 1% of its appropriation if this amount is in the fund balance and would not have to be billed. The Commission has reimbursed the insurance companies and self insured employers for the $234,815 and will ensure that future assessments only include costs allowed by State law.

Recommendation 1

a. The Commission determined the proper amounts that should have been assessed to the insurance companies and self-insured employers and took the corrective actions as described above.
b. The Commission will ensure that future assessments are calculated in accordance with State law.

Finding 2
WCC did not ensure that assessments were properly recorded in the accounts receivable records.

Agency Response

The Commission uses an Access database to calculate the amount of the maintenance assessment that is due from each insurer and to generate invoices for each insurer. The information from the Access database is transferred to the AS400 accounts receivable system which is used to post payments received from insurers and any adjustments to insurers' accounts receivable balances. Two systems are used because the AS400 system cannot generate invoices in the format that the WCC requires without significant programming. While the amounts due from each insurer that are posted to the AS400 system from the Access database are not verified by someone other than the individual processing the posting, the total posted to the AS400 system is reviewed and compared to the total from the Access database and maintenance assessment worksheet by the

CFO. The accounts receivable ledger is also subsequently reviewed on at least a monthly basis by the CFO. In addition, the CFO reconciles revenue received and posted in FMIS to what was billed. No unexpected irregularities were noted as part of these routine reviews and all revenue expected to be collected was collected and accounted for.

Non-cash credit adjustments and supporting documentation are reviewed and approved by someone other than the person preparing the adjustment. Once the adjustment is processed, someone other than the individual making the adjustment does not review the posting. However, the CFO subsequently reviews the accounts receivable ledger on at least a monthly basis and reconciles revenue received and posted in FMIS to what was billed in FMIS. No unexpected irregularities were noted as part of these routine reviews and all revenue expected to be collected was collected and accounted for.

Recommendation 2

a. In addition to routinely reviewing the accounts receivable ledger and performing a revenue reconciliation, someone other than the individual who posts the balances due in the AS400 accounts receivable system will verify on a test basis that the assessments posted to the AS400 accounts receivable system are accurately posted as compared to what was calculated and billed from the Access database.

b. In addition to routinely reviewing the accounts receivable ledger and performing a revenue reconciliation, someone other than the individual who posts adjustments to the AS400 accounts receivable system will verify that adjustments were accurately posted as compared to what was approved.

Finding 3
WCC did not ensure that payments for certain audit services were proper.

Agency Response
WCC agrees that supporting documentation was not requested for the invoiced amounts. The contract manager did not realize that this was a Not-To-Exceed contract. The amounts invoiced were reviewed to ensure that they did not exceed the total amount of the contract price. The audit services that were performed under this contract are now being performed using the statewide Audit Services Contract procured by DBM. Invoices submitted under this contract have the supporting documentation (timesheets and labor classification/hours) and are being reviewed by the contract manager, on a test basis, for reasonableness.

WCC will also request the documentation to support the amounts previously billed under the previous contract and take any appropriate action regarding refund of overpayments, if applicable.

Recommendation 3

a. The Commission will ensure that contractor invoices contain all required information, including job classifications and hours worked.
b. The Commission will verify the charges, on a test basis, for reasonableness.

AUDIT TEAM

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