

Audit Report

Workers' Compensation Commission

June 2015



OFFICE OF LEGISLATIVE AUDITS
DEPARTMENT OF LEGISLATIVE SERVICES
MARYLAND GENERAL ASSEMBLY

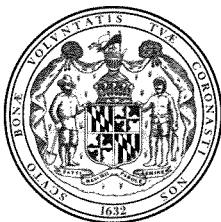
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DEPARTMENT OF LEGISLATIVE SERVICES
OFFICE OF LEGISLATIVE AUDITS
MARYLAND GENERAL ASSEMBLY

Karl S. Aro
Executive Director

Thomas J. Barnickel III, CPA
Legislative Auditor

June 1, 2015

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

Ladies and Gentlemen:

We have conducted a fiscal compliance audit of the Workers' Compensation Commission (WCC) for the period beginning May 9, 2011 and ending November 4, 2014. 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 collections were not verified to subsequent deposit. Additionally, WCC paid invoices from the Department of Labor, Licensing, and Regulation (DLLR) for the costs of certain programs without verifying the costs billed. In accordance with State law, WCC includes these DLLR program costs in its annual assessments to insurance companies and self-insured employers.

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

Respectfully submitted,

A handwritten signature in black ink, appearing to read "Thomas J. Barnickel III".

Thomas J. Barnickel III, CPA
Legislative Auditor

Background Information

Agency Responsibilities and Financial Activity

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 workplace accidents, adjudicates claims for compensation arising under the law, conducts hearings of contested workers' compensation cases, and assesses penalties against employers for failing to provide workers' compensation insurance coverage. Adjudicated claim awards involving permanent disability or death include provisions to fund Maryland's Subsequent Injury Fund (SIF) and Uninsured Employer's Fund (UEF) through assessments and penalties against employers or insurers. Finally, WCC is responsible for approving employers who wish to be self-insured in the State and for monitoring their activities and financial solvency. According to WCC's records, it received 24,113 workers' compensation claims and approved 16,664 awards totaling approximately \$365 million during fiscal year 2014.

In accordance with State law, all of WCC's expenditures and the expenditures of certain programs within the Department of Labor, Licensing, and Regulation (DLLR) are funded by assessments billed to insurance companies that issue workers' compensation insurance policies and companies that self-insure for workers' compensation coverage. According to the State's records, the fiscal year 2014 assessments totaled approximately \$25.7 million, including \$13.5 million to fund WCC expenditures, and \$12.2 million to fund DLLR programs.

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 March 2, 2012. We determined that WCC satisfactorily addressed these findings.

Findings and Recommendations

Cash Receipts

Finding 1

The Workers' Compensation Commission (WCC) did not ensure all collections were deposited.

Analysis

WCC did not have an adequate procedure to ensure all collections were deposited. Specifically, WCC did not use the initial record of receipts to perform the deposit verification. Rather, the deposited collections were only compared to the amounts recorded in the State's accounting records. As a result, there is a lack of assurance that all collections were deposited. According to State records, WCC collections, which primarily consisted of assessments, totaled \$26.1 million during fiscal year 2014.

The Comptroller of the Maryland's *Accounting Procedures Manual* requires a reconciliation of collections recorded upon receipt to the bank deposit.

Recommendation 1

We recommend that WCC perform deposit verifications of collections from the initial record of receipt to deposit in the bank.

Assessments

Finding 2

WCC paid invoices to reimburse the Department of Labor, Licensing, and Regulation (DLLR) for the costs of certain programs without verifying the costs to supporting documentation.

Analysis

WCC paid invoices to reimburse DLLR for the costs of its Occupational Safety and Health and Workforce Fraud programs without verifying the program costs to supporting documentation. Our review of DLLR's fiscal year 2014 invoice, which totaled \$12.2 million, disclosed costs of approximately \$471,700 that may have been overbilled by DLLR. We determined this potential overbilling based on available information in the State's budget and information WCC obtained from DLLR upon our request. For example, \$365,000 of the potential overbilling related to DLLR not fully reducing its fiscal year 2014 invoiced costs by excess

revenue it had received from WCC from the previous year's reimbursement. Specifically, each year's invoice includes an adjustment for the preceding year to reflect the difference between actual costs and costs reimbursed by WCC. We noted a similar potential overbilling with DLLR's fiscal year 2015 invoice.

Upon bringing these potential overbillings to WCC's attention, WCC contacted DLLR to obtain an explanation and supporting documentation for the related billings. However, WCC was unable to obtain a reasonable explanation for the potential overbillings. As of April 2015, WCC management advised us that it was working with DLLR to obtain documentation and clarification on the 2014 invoice, and it had not paid DLLR for its fiscal year 2015 invoice, which totaled \$11.3 million.

Recommendation 2

We recommend that WCC

- a. work with DLLR to establish a process for verifying the invoiced program costs to supporting documentation; and**
- b. determine the propriety of the DLLR invoiced costs for fiscal years 2014 and 2015 and take corrective actions for costs that cannot be supported, including adjusting future assessments to insurers, as provided by law, and payments to DLLR.**

Audit Scope, Objectives, and Methodology

We have conducted a fiscal compliance audit of the Workers' Compensation Commission (WCC) for the period beginning May 9, 2011 and ending November 4, 2014. The audit was conducted in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

As prescribed by the State Government Article, Section 2-1221 of the Annotated Code of Maryland, the objectives of this audit were to examine WCC'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 assessments, cash receipts, disbursements, and

payroll. We also determined the status of the findings contained in our preceding audit report.

To accomplish our audit objectives, our audit procedures included inquiries of appropriate personnel, inspections of documents and records, observations of the WCC'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) and the State's Central Payroll Bureau (payroll 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 these various sources were sufficiently reliable for the purposes the data were used during the audit. We also extracted data from WCC's assessment database for the purpose of testing assessment transactions. We performed various tests of the relevant data and determined that the data were sufficiently reliable for the purposes the data were used during the audit. Finally, we performed other auditing procedures that we considered necessary to achieve our objectives. The reliability of data used in this report for background or informational purposes was not assessed.

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 related 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

LAWRENCE J. HOGAN, JR.
Governor

BOYD K. RUTHERFORD
Lt. Governor

MARY K. AHEARN
Chief Executive Officer



WORKERS' COMPENSATION COMMISSION

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Commissioners

May 27, 2015

Mr. Thomas J. Barnickel III, CPA
Office of Legislative Audits
301 W. Preston Street
Room 1202
Baltimore, MD 21201

Dear Mr. Barnickel:

The Workers' Compensation Commission (WCC) appreciates the opportunity to provide responses to the Draft Audit Report for the period beginning May 9, 2011 and ending November 4, 2014. 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

The Workers' Compensation Commission (WCC) did not ensure all collections were deposited.

Agency Response

The initial record of receipt is an Excel spreadsheet prepared by the individual who opens the mail that contains the checks. The individual prepares a spreadsheet of all checks received for each day. The agency acknowledges that when the deposit is made, the individual reviewing the deposit did not reconcile the total of checks deposited to the Excel spreadsheet. Instead, a reconciliation of the deposit ticket to FMIS was performed. The agency selected a sample of deposits for every month in the audit period and reconciled the Excel spreadsheet to the checks that were deposited for the days selected. There were no discrepancies discovered and as a result of our testing, we conclude that the deposit collections for the audit period were accurately recorded.

Recommendation 1

WCC will ensure the individual reviewing the deposit reconciles the initial recording of the checks (Excel spreadsheet) to what was actually deposited.

Finding 2

WCC paid invoices to reimburse the Department of Labor, Licensing, and Regulation (DLLR) for the costs of certain programs without verifying the costs to supporting documentation.

Agency Response

In accordance with its statutory mandate¹ to pay for the costs of the occupational safety and health program and the workforce fraud program administered by the Commissioner of the Division of Labor and Industry, WCC paid invoices to reimburse DLLR for the costs of the two programs based upon DLLR's certification that the information it provided to WCC was, to the best of DLLR's knowledge and belief, accurate, fairly presented and that DLLR was consistent in its treatment of similar costs. Despite this certification, potential overbilling may have occurred. For instance, each year's invoice also included an adjustment for the preceding year to reflect the difference between actual costs and costs reimbursed by WCC. The invoices categorize the costs of each program according to "direct" and "indirect" costs. "Indirect costs" are derived from a mathematical allocation of personnel costs to each program and to shared administration. DLLR provides no further explanation to support its invoices, either on the invoices themselves or by supporting documents.

Fundamentally, WCC lacks the statutory mandate to oversee DLLR's administration of the two programs or its billing practices. By statute, DLLR is responsible for the administration of the two programs. Further, DLLR does not administer the programs on behalf of WCC and WCC does not pay DLLR for a service DLLR renders for WCC. By statute, WCC is the conduit by which the State pays for DLLR's programs.

WCC agrees as a policy matter that OLA should be able to exercise appropriate audit review of the two programs administered by DLLR. WCC disagrees that it is the means to that end. With this background, the WCC respectfully responds to Recommendation 2 as follows:

¹ The statutory mandate to pay for the costs of the occupational safety and health program and the workforce fraud program administered by the Commissioner of the Division of Labor and Industry is found in Md. Labor & Employment ("LE") Code Ann. § 9-315, § 9-315.1 and § 9-316. LE § 9-316 provides that out of money appropriated for the maintenance of WCC, the State shall pay the costs of the administration of the Occupational Safety and Health Program and the costs of the administration of the workforce fraud program:

Occupational Safety and Health Program

The costs of the administration of the Occupational Safety and Health Program administered by DLLR under LE § 9-316(b)(1) are required to be paid by WCC in LE § 9-315. DLLR budgets the costs and WCC pays DLLR's costs as required by LE § 5-204.

Workforce Fraud Program

The costs of the administration of the workforce fraud program administered by DLLR under LE § 9-316(b)(1) are required to be paid by WCC in LE § 9-315.1. The costs of the administration of the workforce fraud program administered by DLLR are budgeted by DLLR and paid by WCC as required by LE § 9-319.

Recommendation 2

- a. WCC agrees that it will continue its past efforts to request that DLLR verify its program costs as invoiced. Nevertheless, WCC lacks the statutory mandate to step outside its limited role as a conduit for funding DLLR's programs to *require* DLLR to provide supporting documentation for its invoiced program costs.
- b. WCC agrees that, within the limits of its statutory authority as explained above, WCC will continue to request support for DLLR's invoiced costs for fiscal years 2014 and 2015, understanding that WCC lacks OLA's statutory audit authority or procedures to make inquiries of appropriate personnel, inspections of documents and records, observations of DLLR's operations, or tests of transactions.

Auditor's Comment: As previously conveyed to WCC management, at the conclusion of our audit we discussed this matter with Department of Budget and Management (DBM) officials who generally agreed with our position, indicating that it is not unreasonable to expect WCC to verify the invoice from DLLR. Also, WCC can accomplish the necessary verification without a statutory mandate. If WCC is unable to obtain the needed supporting documentation from DLLR, WCC should seek the assistance of DBM to resolve the issue.

AUDIT TEAM

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