

Audit Report

Subsequent Injury Fund

September 2017



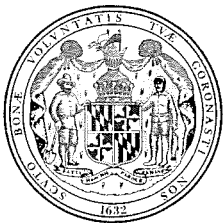
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DEPARTMENT OF LEGISLATIVE SERVICES
MARYLAND GENERAL ASSEMBLY

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DEPARTMENT OF LEGISLATIVE SERVICES
OFFICE OF LEGISLATIVE AUDITS
MARYLAND GENERAL ASSEMBLY

Warren G. Deschenaux
Executive Director

Thomas J. Barnickel III, CPA
Legislative Auditor

September 26, 2017

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

Ladies and Gentlemen:

We have conducted a fiscal compliance audit of the Subsequent Injury Fund (SIF) for the period beginning October 29, 2013 and ending November 13, 2016. SIF pays workers' compensation awards in connection with certain claims for employees' subsequent occupational injuries or deaths, and collects assessments from certain employers and insurance companies to fund these awards and its operating costs. During fiscal year 2016, assessment collections totaled approximately \$27.1 million and claim payments totaled approximately \$21.7 million.

Our audit disclosed that SIF's procedures were not adequate to ensure that claim payments made for injured persons were proper and that assessments were properly billed to and collected from employers and insurers. The supervisory review of claim payments did not include verifying that the payments agreed with the Workers' Compensation Commission (WCC) award amounts, which allowed certain overpayments to go undetected. In addition, SIF did not ensure that assessments to employers and insurers were established in the accounts receivable records for all awards approved by the WCC. Furthermore, delinquent assessment accounts were not properly pursued for collection and referred to the State's Central Collection Unit (CCU). From October 2013 to October 2015, only 126 delinquent accounts were referred to CCU and, as of January 2017, there were 1,976 accounts totaling \$3.4 million that were older than 90 days.

Finally, SIF did not have adequate controls over assessment collections to ensure they were safeguarded and deposited, and did not properly separate the responsibilities for processing these collections and certain accounts receivable functions.

SIF'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 SIF.

Respectfully submitted,

A handwritten signature in black ink, appearing to read "TJ Barnickel III". The signature is fluid and cursive, with the first letters of the first and last names being capitalized and prominent.

Thomas J. Barnickel III, CPA
Legislative Auditor

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

Background Information

Agency Responsibilities and Financial Activity

The purpose of the Subsequent Injury Fund (SIF) is to encourage the employment of individuals with pre-existing health conditions by limiting an employer's liability should a subsequent occupational injury render an individual permanently disabled or result in the individual's death. Specifically, the employer's liability under these circumstances is limited to compensation for damages from the current injury. SIF incurs the liability associated with the combined effects of all injuries. The administration of the SIF is supervised by the Subsequent Injury Fund Board, which consists of three members appointed by the Governor.

The principal source of funding for claim payments and SIF's operating expenses is assessments collected for each award against an employer or its insurer for permanent disability or death and each amount payable by an employer or insurer under a settlement agreement approved by the Workers' Compensation Commission (WCC). SIF calculates these assessments, which are currently 6.5 percent of the aforementioned award amounts.

According to State records, during fiscal year 2016, assessment collections totaled approximately \$27.1 million, claim payments totaled approximately \$21.7 million, and SIF operating expenses totaled approximately \$2.3 million. SIF's fund balance as of October 31, 2016 totaled approximately \$87.5 million.

Claim obligations are funded on a pay-as-you-go basis so, as obligations become due in future periods, the obligations must be paid from future assessments collected from employers and insurance companies. In this regard, SIF's most recent actuarial study performed in March 2016 indicated that, at that time, SIF had an unfunded liability for permanent injury and death claims of approximately \$181.2 million (discounted at three percent). This unfunded liability represents a 29 percent decrease from the preceding actuarial study performed in June 2011. A September 8, 1992 advice of the Attorney General concluded that, should fund awards ever exceed the amount of monies in the SIF, the State would not be liable to appropriate its own funds to pay claims.

Outstanding Claim Against the Subsequent Injury Fund

On April 10, 2012, the Uninsured Employers' Fund (UEF) requested that SIF return \$544,000 in assessments that UEF believed it had erroneously paid in connection with a 2006 memorandum of understanding (MOU). The MOU addressed the processing of workers' compensation claims associated with

employees of the former Bethlehem Steel Corporation (BSC), which had filed for federal bankruptcy protection in 2001. As of June 2017, UEF's claim was still outstanding.

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

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

Status of Findings From Preceding Audit Report

Our audit included a review to determine the status of the five findings contained in our preceding audit report dated August 8, 2014. We determined that SIF satisfactorily addressed two of these findings. The remaining three findings are repeated in this report.

Findings and Recommendations

Claim Payments

Background

Based on workers' compensation awards as determined by the Workers' Compensation Commission (WCC), the Subsequent Injury Fund (SIF) pays claims for subsequent occupational injuries that render an individual permanently disabled or that result in the individual's death. Claim payments are made for injured persons either as a lump sum or as recurring payments. Recurring biweekly payments are made for a set period or indefinitely for the life of the injured person.

According to its records, claim payments processed by SIF during fiscal year 2016 totaled approximately \$21.7 million (\$16.6 million for recurring biweekly payments and \$5.1 million for lump sum settlement payments). We were advised that as of June 30, 2017, 883 claimants were receiving biweekly payments.

Finding 1

SIF did not ensure claim payments agreed with amounts awarded by WCC, resulting in overpayments going undetected.

Analysis

SIF had not established a procedure to ensure its claim payments agreed with the amounts awarded by WCC, including changes to these award amounts, allowing certain overpayments to go undetected. SIF employees recorded new claim payment awards in SIF's accounts payable system based on information transmitted from WCC on a daily basis. Recurring payments were established for a fixed payment period (such as 100 weeks) and were manually adjusted at the expiration of that period.

The supervisory reviews of new claim payments (both lump sum and recurring) only ensured that the recipients were authorized to receive the funds and did not include any verification that the payments were consistent with the amounts awarded by WCC. In addition, there was no supervisory review performed of adjustments to award amounts for recurring biweekly payments (such as for cost-of-living increases or expiration of the payment period). As a result, unauthorized or erroneous payments could be issued and not readily detected.

Our test of recurring biweekly payments to 10 claimants totaling \$12,715 disclosed that the biweekly payments to 2 claimants totaling \$2,571 were overstated by \$215. As a result, these two claimants received overpayments of

approximately \$9,800 during the period from September 2008 through December 2016. For example, an erroneous entry in SIF's accounts payable system for one of these claimants, dating back to September 2008, resulted in this individual receiving \$8,897 in excess of the amount awarded by WCC. After bringing these errors to SIF's attention, future recurring payments were corrected, and SIF management advised us that overpayments would be considered for recovery on a case-by-case basis, in consultation with its Board. Our test of 15 lump sum payments disclosed that the payments agreed with WCC awards.

Recommendation 1

We recommend that SIF

- a. establish a supervisory review procedure that ensures that new claim payments and adjustments to claim payments were in accordance with the amounts awarded by WCC; and**
- b. initiate a review of all current recurring claim payments to determine if the biweekly payment amount is accurate, correct any inaccuracies and, in conjunction with the SIF Board, consider recovering any overpayments identified, including the overpayments noted above.**

Finding 2

SIF did not always pursue recovery of claim payments improperly disbursed to deceased individuals.

Analysis

SIF did not always pursue recovery of claim payments improperly disbursed to deceased individuals. SIF submitted a monthly social security number query to the U.S. Social Security Administration (SSA) to match its records of injured persons receiving (or scheduled to receive) claim payments with SSA's death records. SIF terminated future payments, and issued stop payment orders or attempted to recover claim payments made to deceased individuals. During the period from January 2014 to October 2016, these matches identified 43 deceased individuals who were receiving payments from SIF.

Our test of 10 of these deceased individuals disclosed that payments totaling \$18,937 had been made after the individuals' reported dates of death and, as of December 2016, SIF could not document any attempts to recover payments totaling \$12,709 made to 6 of these deceased individuals. According to SIF management, it was aware of these improper payments; however, follow-up actions were not initiated in these 6 cases because of their low dollar amounts. The improper payments made to the other 4 individuals had been recovered. In

all 10 cases, SIF ceased making the recurring payments to these individuals upon receipt of the SSA match results.

In accordance with the Labor and Employment Article of the Annotated Code of Maryland, SIF is not obligated to pay any claims after the death of the beneficiary. A similar condition was commented upon in our preceding audit report.

Recommendation 2

We recommend that SIF investigate the results of the monthly death matches and actively pursue recovery of funds in a timely manner (repeat).

Assessment Billings and Collections

Finding 3

SIF did not ensure that all assessments were recorded in its accounts receivable system and did not conduct independent reviews of adjustments to these accounts. Additionally, SIF did not properly separate certain accounts receivable and cash receipts functions.

Analysis

SIF did not ensure that all assessments were recorded in its accounts receivable system, did not perform independent reviews of adjustments to assessment accounts, and did not properly separate the responsibilities for processing assessment adjustments and handling the related collections. According to SIF's records, during fiscal year 2016, accounts receivable recorded for WCC award assessments totaled \$28.1 million and net adjustments reduced accounts receivable by \$533,000.

- SIF did not have a process to ensure that assessments were entered into its accounts receivable system for all awards issued by the WCC. SIF personnel recorded the WCC awards (including settlement agreements) in its accounts receivable system; the system automatically calculated and recorded the assessment amounts, which were based on 6.5 percent of the award amounts. SIF generated billings to employers and insurance companies based on these assessments. However, SIF did not compare the number of assessment accounts created in the accounts receivable system with the number of awards received from WCC to ensure that all assessments were recorded.
- Adjustments to the assessment accounts were not independently reviewed for propriety and approved prior to their recordation in the accounts receivable

records, nor were the recorded adjustments subject to independent review. Furthermore, two employees who processed these adjustments had access to the related cash receipts prior to deposit. As a result, funds could be misappropriated without being readily detected. The Comptroller of Maryland's *Accounting Procedures Manual* requires independent review and approval of adjustments to accounts receivable records and separation of the accounts receivable functions from the cash receipts functions. A similar condition was commented upon in our four preceding reports dating back to October 5, 2005.

Recommendation 3

We recommend that SIF

- a. establish an independent procedure to ensure assessments are recorded in the accounts receivable records for all WCC awards received;**
- b. establish independent review and approval to ensure the propriety of adjustments to be recorded and, on a test basis, ensure only approved adjustments have been recorded in the accounts receivable records (repeat); and**
- c. ensure that the assessment collection and accounts receivable functions are properly separated (repeat).**

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

Finding 4

SIF did not document its efforts to collect delinquent assessment accounts and did not refer all delinquent accounts to the State's Central Collection Unit.

Analysis

SIF did not document its efforts to collect delinquent assessment accounts and did not refer all delinquent assessment accounts to the Department of Budget and Management's Central Collection Unit (CCU). As of January 13, 2017, there were 3,786 outstanding assessment accounts totaling \$6.5 million, of which 1,976 accounts, totaling \$3.4 million, were older than 90 days. Similar conditions were commented upon in our preceding audit report, and outstanding accounts have significantly increased since that time. Specifically, as of December 31, 2013, there were 1,891 assessment accounts totaling \$3.1 million, of which 720 accounts totaling \$1.3 million were older than 90 days.

- Although SIF advised us that it sent dunning notices for delinquent accounts in accordance with CCU regulations, SIF did not maintain any documentation of these notices, and SIF's automated accounts receivable system did not identify whether notices had been generated.
- According to SIF records, as of January 2017, SIF had not referred any delinquent assessment accounts to CCU since October 2015, and only 126 delinquent accounts were referred to CCU from October 2013 through October 2015. Our test of ten delinquent accounts, totaling \$594,000, which had been delinquent for periods between 174 and 1,170 days, disclosed that none had been referred to CCU for collection assistance.

State regulations generally require that three written demands for payment be made on accounts at 30-day intervals and, if no payments are received, the accounts should be considered delinquent and immediately referred to CCU for collection assistance. The failure to pursue outstanding debts may decrease the likelihood of collecting the funds.

Recommendation 4

We recommend that SIF

- document its efforts to send written demands for payment at 30-day intervals (repeat); and**
- refer all delinquent accounts to CCU for collection assistance, as required (repeat).**

Finding 5

SIF did not have adequate procedures and controls over collections processed by remote deposit.

Analysis

SIF did not have adequate procedures and controls over its collections, which were processed by remote deposit. Remote deposit is a process in which the images of checks are scanned and electronically transmitted to the State's bank for deposit. According to State accounting records, SIF deposited approximately \$25.6 million during fiscal year 2016.

SIF did not ensure that its collections were adequately safeguarded and deposited. Specifically, SIF did not restrictively endorse checks until after they had been scanned into the remote deposit system. In addition, SIF did not ensure that all checks had been deposited and subsequently destroyed. In this regard, the initial record of collections received was not reconciled to the corresponding bank

records and to the record of checks destroyed after deposit. Such verifications should be performed by employees independent of the cash receipts processing functions. Finally, SIF retained deposited checks for approximately three months before they were destroyed.

The Office of the State Treasurer's *Policy on the Use of Remote Deposit Services by Maryland State Agencies* requires that agencies ensure checks are restrictively endorsed prior to scanning. The *Policy* further requires agencies to independently reconcile both the checks deposited at the bank and the checks destroyed to the incoming check receipt log, and to destroy scanned checks within 30 days of deposit unless there is an exigent circumstance or the bank provides other guidance.

Recommendation 5

We recommend that SIF comply with the *Policy on the Use of Remote Deposit Services by Maryland State Agencies*. Specifically, we recommend that SIF

- a. restrictively endorse checks immediately upon receipt,**
- b. independently reconcile checks deposited and checks subsequently destroyed with the initial receipt log, and**
- c. destroy checks within 30 days of bank deposit.**

Audit Scope, Objectives, and Methodology

We have conducted a fiscal compliance audit of the Subsequent Injury Fund (SIF) for the period beginning October 29, 2013 and ending November 13, 2016. The audit was conducted in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

As prescribed by the State Government Article, Section 2-1221 of the Annotated Code of Maryland, the objectives of this audit were to examine SIF's financial transactions, records, and internal control, and to evaluate its compliance with applicable State laws, rules, and regulations.

In planning and conducting our audit, we focused on the major financial-related areas of operations based on assessments of significance and risk. The areas addressed by the audit included assessment collections and billings, claim payments, and information systems security and control. We also determined the status of the findings contained in our preceding audit report.

To accomplish our objectives, our audit procedures included inquiries of appropriate personnel, inspections of documents and records, observations of the SIF's operations, and tests of transactions. Generally, transactions were selected for testing based on auditor judgment, which primarily considers risk. Unless otherwise specifically indicated, neither statistical nor non-statistical audit sampling was used to select the transactions tested. Therefore, the results of the tests cannot be used to project those results to the entire population from which the test items were selected.

We also performed various data extracts of pertinent information from the State's Financial Management Information System (such as revenue and expenditure data). The extracts are performed as part of ongoing internal processes established by the Office of Legislative Audits and were subject to various tests to determine data reliability. We determined that the data extracted from the system were sufficiently reliable for the purposes the data were used during this audit. We also extracted data from SIF's automated accounts receivable and accounts payable system for the purpose of testing assessment accounts receivable and claim payment monitoring. We performed various tests of the relevant data and determined that the data were sufficiently reliable for the purposes the data were used during the audit. Finally, we performed other auditing procedures that we

considered necessary to achieve our objectives. The reliability of data used in this report for background or informational purposes was not assessed.

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

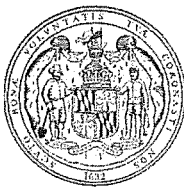
SIF's response to our finding and recommendations is included as an appendix to this report. As prescribed in the State Government Article, Section 2-1224 of the Annotated Code of Maryland, we will advise SIF regarding the results of our review of its response.

APPENDIX

STATE OF MARYLAND

LAWRENCE J. HOGAN, JR.
GOVERNOR

EDGAR G. DODD, III
DIRECTOR



MARGARETA A. CRAMPTON
VALERIE L. FRALING
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THE SUBSEQUENT INJURY FUND

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September 25, 2017

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

Dear Mr. Barnickel:

The Subsequent Injury Fund responses to the fiscal compliance audit for the period beginning October 29, 2013, and ending November 13, 2016, are submitted for your review and consideration.

The Subsequent Injury Fund concurs with the audit findings.

The responses detail the procedural changes that will bring the Subsequent Injury Fund in full compliance with the audit findings and recommendations.

Respectfully submitted,

A handwritten signature in black ink, appearing to read "Edgar G. Dodd, III".

Edgar G. Dodd, III
Executive Director

EGD/seg

Claim Payments

Finding 1

SIF did not ensure claim payments agreed with amounts awarded by WCC, resulting in overpayments going undetected.

Recommendation 1

We recommend that SIF

- a. establish a supervisory review procedure that ensures that new claim payments and adjustments to claim payments were in accordance with the amounts awarded by WCC; and*
- b. initiate a review of all current recurring claim payments to determine if the biweekly payment amount is accurate, correct any inaccuracies and, in conjunction with the SIF Board, consider recovering any overpayments identified, including the overpayments noted above.*

SIF Response 1

- a. SIF concurs. Beginning 6/5/2017, SIF Claims Department personnel began reviewing a new report detailing all claimant disbursement transactions for the previous week, except biweekly claimant payments. A second report is reviewed that identifies changes in the current Bi-Weekly payments compared to the last. This new process confirms compliance with payment changes ordered by the WCC and identifies any erroneous or unauthorized transactions.**
- b. SIF concurs and has initiated a review of all recurring payments and is recording the results. Any identified discrepancies will be forwarded to the Legal Department to confer with the SIF Board for recovery procedures.**

Finding 2

SIF did not always pursue recovery of claim payments improperly disbursed to deceased individuals.

Recommendation 2

We recommend that SIF investigate the results of the monthly death matches and actively pursue recovery of funds in a timely manner (repeat).

SIF Response 2

SIF agrees with OLA's recommendations. SIF has developed a procedure (checklist) to immediately cease further claimant payments, recover any outstanding payments that have not been presented for payment and document all collection activity. SIF will actively pursue recovery of funds disbursed to deceased beneficiaries in a timely manner including legal action and referral of the account to CCU, if necessary.

Assessment Billings and Collections

Finding 3

SIF did not ensure that all assessments were recorded in its accounts receivable system and did not conduct independent reviews of adjustments to these accounts. Additionally, SIF did not properly separate certain accounts receivable and cash receipts functions.

Recommendation 3

We recommend that SIF

- a. establish an independent procedure to ensure assessments are recorded in the accounts receivable records for all WCC awards received;*
- b. establish independent review and approval to ensure the propriety of adjustments to be recorded and, on a test basis, ensure only approved adjustments have been recorded in the accounts receivable records (repeat); and*
- c. ensure that the assessment collection and accounts receivable functions are properly separated (repeat).*

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

SIF Response 3

- a. SIF concurs. SIF will establish a procedure to review the assessment awards on a daily basis. We will determine that the total number of assessment awards on the WCC web-site equal the total number of assessment awards in the SIF Accounts Receivable system. Any discrepancies will be investigated and resolved on a weekly basis.**
- b. SIF concurs. SIF will be following the provided recommendation by modifying our applications (SIF2QB) to automate the adjustment process with the proper separation of duties.**

- c. SIF concurs. SIF will correct the permission oversight.

Finding 4

SIF did not document its efforts to collect delinquent assessment accounts and did not refer all delinquent accounts to the State's Central Collection Unit.

Recommendation 4

We recommend that SIF

- a. document its efforts to send written demands for payment at 30-day intervals (repeat); and*
- b. refer all delinquent accounts to CCU for collection assistance, as required (repeat).*

SIF Response 4

- a. SIF agrees. SIF plans to modify their Accounts Receivable application to record invoice reprint counts to enable us to know when to refer the invoices to CCU.**
- b. SIF agrees. SIF has a formal Delinquent Accounts Receivable Collection plan in place. SIF will comply with OLA's Recommendation to pursue accounts for collection in accordance with State regulations.**

Finding 5

SIF did not have adequate procedures and controls over collections processed by remote deposit.

Recommendation 5

We recommend that SIF comply with the Policy on the Use of Remote Deposit Services by Maryland State Agencies. Specifically, we recommend that SIF

- a. restrictively endorse checks immediately upon receipt,*
- b. independently reconcile checks deposited and checks subsequently destroyed with the initial receipt log, and*
- c. destroy checks within 30 days of bank deposit.*

SIF Response 5

SIF concurs. We have initiated a transfer of assessment collections to a bank at a downtown Baltimore Post Office Lockbox which will be accomplished soon.

AUDIT TEAM

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Audit Manager

Richard L. Carter, CISA
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