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INDEPENDENT STATE AUDITOR'S
REPORT ON THE ADMINISTRATION OF THE
WORKERS' COMPENSATION TRUST FUND
BY THE
DEPARTMENT OF INDUSTRIAL ACCIDENTS

OFFICIAL AUDIT REPORT

APR 19 2000

ISSUED BY THE
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INTRODUCTION

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Pursuant to Chapter 572 of the Acts and Resolves of 1985, the Department of Industrial Accidents (DIA) is responsible for administering the Commonwealth's workers' compensation system. Under the system, all Massachusetts employers are required to carry workers' compensation insurance for their employees and to pay assessments into the Workers' Compensation Trust Fund, which is used to pay benefits to uninsured, injured employees and to finance the operating costs of DIA. From April 1, 1986 to June 30, 1999, the Trust Fund paid out \$65,650,745 to employees who were injured while working for uninsured employers. The law mandates that employers found to be without the insurance are to be fined and issued Stop Work Orders (SWOs), which close down the employer's business until workers' compensation insurance is obtained and the fines are paid. The purpose of our performance audit was to determine whether the DIA has been effective in administering the Trust Fund; proper controls existed over the closing down and penalizing of employers found not to have workers' compensation insurance in compliance with the law; adequate internal controls existed for the safeguarding of the DIA's information technology related assets; and the DIA had adequately addressed the issues disclosed in our prior audit report (No. 96-0222-4F).

AUDIT RESULTS

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1. Many Employers in Massachusetts Are Not Carrying Required Workers' Compensation Insurance:

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Our audit indicated that, due to inadequate enforcement policies, hundreds of businesses are operating in Massachusetts without workers' compensation insurance for their employees. As a result, the Trust Fund has paid out \$65,650,745 to employees who were injured while working for uninsured employers during the past 13 years, while those employers who do carry the insurance are paying higher insurance premiums to cover this cost, and those employers that operate without the insurance have an unfair competitive advantage (reduced operating costs) over those that do carry the insurance. During our review we noted that the DIA did not (a) adequately enforce the SWO process, (b) assess and collect all fines owed by noncomplying employers, and (c) use all available remedies to ensure employer compliance with the Workers' Compensation Act, as discussed below.

a. The DIA Did Not Adequately Enforce the SWO Process: Our audit revealed that many employers continue to operate without required workers' compensation insurance coverage. During the 18-month period of our review, the DIA issued SWOs to 2,406 employers, of whom 1,685 (70%) did not subsequently obtain the insurance. Moreover, our statistical sample indicated that 779 of these noncomplying employers have disregarded the SWOs and remained open for business. This results in increased unemployment costs for those employers who do have insurance and thus encourages noncomplying employers to continue to operate without obtaining the required workers' compensation insurance.

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b. The DIA Did Not Assess and Collect Fines Totaling Approximately \$22.2 Million Owed by Employers without Workers' Compensation Insurance: Our audit indicated that the DIA (1) did not collect all fines imposed on employers, (2) did not assess employers the full amounts owed, and (3) had inadequate collection procedures. As a result, during the period July 1, 1993 to December 31, 1997, the DIA failed to collect over \$4.4 million in fines imposed on employers that had been issued SWOs and did not assess an estimated \$17.8 million in potential additional fines.

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<p>Prudent business practices require that accounts receivable balances be supported by detailed subsidiary records, including lists of vendor or firm names, an age analysis, and the likelihood of collection for specific receivables. Although the DIA is making progress, the current system does not appear to be adequately monitored or enforced, since the recovery of past debt has been less than 20% for the past 12 years with respect to collections in the Uninsured Reimbursements Trust Fund. Based on these figures, the DIA should make every effort possible, including seeking legislative assistance or relief, to minimize the use of write-offs of its accounts receivable balances.</p>	
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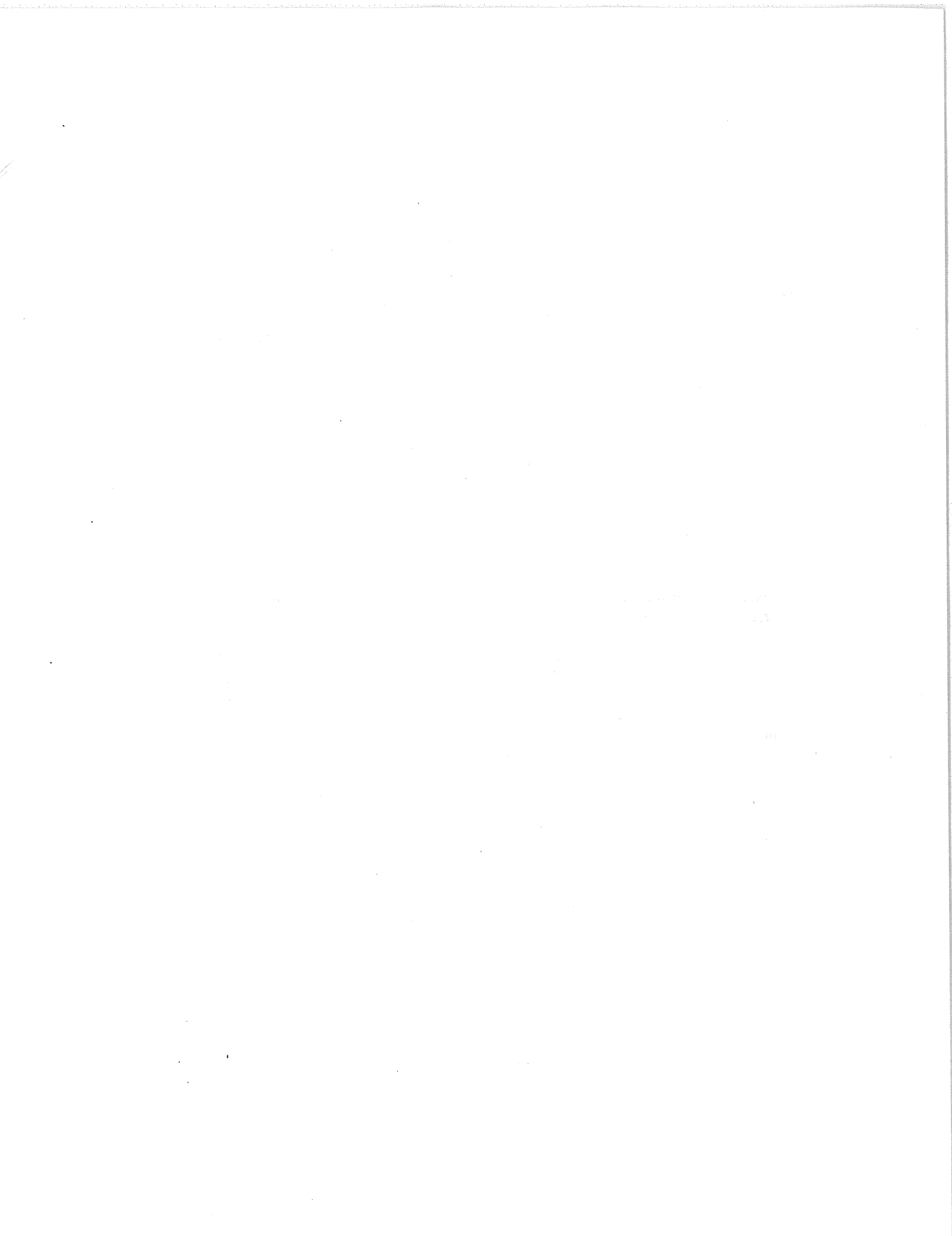
The DIA is responsible for the monitoring of mandatory workers' compensation insurance for all Massachusetts employers, which are required by state law to carry such insurance covering their employees. In addition, the DIA is required to close down businesses found to be in noncompliance by issuing SWOs and assessing fines and penalties. However, our review indicated that:

- Businesses remained open after being issued SWOs,
- Outstanding fines were not collected,
- Fines were calculated incorrectly or not assessed at all, and
- Very few businesses in violation of the law were penalized beyond the issuance of the SWO and the daily fine.

In addition, our audit revealed that the DIA needed to improve its accounts receivable system to minimize write-offs of outstanding debt.

Inadequate enforcement actions against uninsured employers increases unemployment costs to legitimate employers who do have insurance, provides the uninsured employer with an unfair and unlawful competitive advantage, and in effect encourages noncomplying employers not to obtain workers' compensation insurance.

Our audit was conducted to determine the extent of the DIA's compliance with existing laws and regulations. We understand the DIA's rationale for handling the SWO process in the manner it has chosen. However, since the DIA has not brought uninsured employers into compliance, it needs to develop procedures that will be more successful at achieving compliance with the law until the current laws are amended. Although it may not be practical to close down each and every noncomplying employer, it would seem prudent for the DIA to implement a system that allows for stern measures, payment plans, and ultimately the closure of any business that does not comply after a reasonable period of time, subsequent to the initial notification of noncompliance.



INTRODUCTION

Background

Pursuant to Chapter 572 of the Acts and Resolves of 1985 (the Workers' Compensation Act), the Department of Industrial Accidents (DIA) is responsible for administering the Commonwealth's workers' compensation system. The intent of the workers' compensation system is to ensure that medical treatment to injured workers is provided in a timely manner while balancing the needs of employers to contain workers' compensation insurance costs. The functions of the DIA are to ensure that all employers pay workers' compensation benefits; resolve disputes involving compensation cases through conciliation and adjudication; and administer, defend, and dispense benefits from the Workers' Compensation Trust Fund.

The workers' compensation system is totally funded by the Commonwealth's employers. The employers of Massachusetts, both public and private, are required to pay assessments covering the expenses of operating the DIA and for the payment of Trust Fund benefits. The DIA also derives revenue from the collection of fees (for various filing costs) and fines (for violations of the Act).

Workers' Compensation Trust Fund

Chapter 152, Section 65, of the Massachusetts General Laws established a trust fund in the State Treasury to make payments to injured employees who are not covered by workers' compensation insurance. The DIA uses two separate trust fund accounts to pay uninsured injured employees and employees who have been denied vocational rehabilitation services by their insurers. One account is reserved for payments to private sector employers (the Private Trust Fund), and the other is for payments to public sector employers (the Public Trust Fund). Each year the DIA determines an assessment rate that will yield revenues sufficient to pay the obligations of the Workers' Compensation Trust Fund and the operating costs of the DIA. This assessment rate, multiplied by the employer's standard premium, is the DIA assessment and is paid as part of an employers insurance premium. The assessment rate for private sector employers in 1997 was 4.226% of the standard premium. Public employers that participate in the workers' compensation program are assessed quarterly to support the Public Trust

Fund. A third account, the Special Fund, is for the DIA's operating expenses. Although the Special Fund is funded by the assessments to private sector employers, the operating expenses are appropriated by the Legislature each year through the General Appropriations Act.

Chapter 23E, Section 15, of the General Laws directs the Advisory Council to review the DIA's operating budget as well as the Workers' Compensation Trust Fund budgets.

DIA Administration of the Workers' Compensation Trust Fund

The mission of the Workers' Compensation Trust Fund is to provide uninsured workers with quality health care in order to return them back to work. The DIA is responsible for designing a case management system for all uninsured employees and for monitoring a debt management system to recover the money paid out of the Trust Fund. Through a capable case management and collection system, the Trust Fund can reduce the long-term expenses and assessments due from employers.

The DIA has established procedures to administer the Trust Fund and pay Trust Fund claims. The DIA's general counsel is responsible for the investigation, defense, and handling of claims made against the Trust Fund, and the Division of Administration processes requests for benefits, administers claims, and responds to claims filed before the Division of Dispute Resolution. Every claim must be accompanied by certification from the DIA's Office of Insurance that the employer was not covered by a workers' compensation insurance policy on the date of the alleged injury. Trust Fund benefits that result from claims made against employers who are uninsured are paid from the Trust Fund, which must either accept the claim or proceed to dispute resolution over the matter.

The Commissioner has appointed a Deputy Director to manage the Trust Fund and the attorneys, accountants, claims adjusters, investigators, clerks, a paralegal, and a registered nurse who are assigned there. These employees work in conjunction with the five attorneys from the Office of Legal Counsel in administering the fund. The DIA's central office is located in Boston, and there are four regional offices located in Lawrence, Fall River, Worcester, and Springfield. The four regional offices were created to organize, standardize, and consolidate proceedings that have traditionally been held in areas around the

state. Each office is electronically linked to perform the same functions as the central office, thereby increasing the DIA's accessibility to the public.

From April 1, 1986 to June 30, 1999, a total of \$65,650,745 had been paid out of the Trust Fund to employees who were injured while working for uninsured employers, of which \$9,578,886 has been recovered, leaving a shortfall of \$56,071,859.

Stop Work Order Process

All Massachusetts employers are required to carry workers' compensation insurance covering their employees, including themselves if they are an employee of their company. Employers are required to pay for workers' compensation benefits through an insurance policy, membership in a self-insurance group, or licensing as a self-insurer. This requirement applies regardless of the number of hours worked in any given week, except that domestic service employees must work a minimum of 16 hours per week in order to require coverage. The DIA's Office of Investigations enforces this mandate by investigating employers for compliance and for imposing fines and penalties for violations as set forth under Chapter 152, Section 25C, of the General Laws.

The Office of Investigations, as required by statute, will issue a "Stop Work Order" (SWO) to any business with one or more full or part-time employees that fails to provide proof of workers' compensation upon demand. This is a clear and direct order that becomes effective immediately upon service and requires that all business operations cease. The usual fine resulting from an SWO begins at \$100 per day, starting the day the stop work order is issued, and continues until the insurance coverage is obtained and the fine is paid.

The Office of Investigations is responsible for the reporting, tracking, and ultimate disposition of the debt due from the fines that are imposed. The Director of Administration oversees the office, which is staffed by a manager, a research analyst, an administrative secretary, an administrative assistant, a chief investigator, and nine investigators.

Audit Scope, Objectives, and Methodology

Our special-scope audit, which examined the Trust Fund and the SWO processes, was conducted in accordance with applicable generally accepted government auditing standards for performance audits.

The objectives of this audit were to determine whether:

- Financial and management controls over Trust Fund activities were adequate,
- Uninsured employers were reimbursing the Trust Fund after an employee has been injured, and
- Uninsured employers, once identified, obtained insurance as required by law.

Our methodology included reviewing the DIA's enabling legislation and applicable laws, rules, regulations, policies, procedures, and various management and financial records and documents, including reports pertaining to claim payments and collections and the Stop Work Order process. We also observed operations, performed selected tests, and interviewed responsible DIA officials and personnel. Our audit scope also included a follow-up review of the issues revealed in our prior audit report (No. 96-0222-4F).

In addition, our audit included a review of certain information technology (IT) general controls and financial-related controls. The areas of general controls examined were physical security, environmental protection, hardware and software inventory controls, authorized use of software, business continuity planning, and storage of magnetic media backup. The areas of controls for financial-related areas included case management, and the timeliness of claims processing and accounts receivable. The primary objective was to determine whether corrective action had been taken with respect to our prior audit results and whether adequate controls were in place and in effect over selected IT- and financial-related areas for the period July 1, 1997 to October 29, 1999.

Our audit indicated that the DIA's system of internal controls provides reasonable assurance that adequate physical security and environmental protection were being provided for the IT processing environment. Specifically, control procedures for the accounting and safeguarding of IT-related assets were adequate, and inventory controls over IT-related hardware and software provided reasonable assurance that assets were properly recorded in the inventory records. Moreover, with respect to software

use, DIA had sufficient controls in place to provide reasonable assurance that unauthorized copies of software would be prevented from being installed and used on the DIA's LAN and standalone microcomputers.

AUDIT RESULTS

1. Many Employers in Massachusetts Are Not Carrying Required Workers' Compensation Insurance

Our audit indicated that, due to inadequate enforcement policies, hundreds of businesses are operating in Massachusetts without required workers' compensation insurance for their employees. As a result, the Workers' Compensation Trust Fund had to pay out \$65,650,745 during the past 13 years to employees who were working for uninsured employers when they were injured. Employers who comply with the law and do carry the insurance are paying higher insurance premiums to cover this cost, and employers that operate without the insurance in violation of the law have an unfair competitive advantage over those that do carry the insurance. During our review, we noted that the DIA did not (a) adequately enforce the Stop Work Order (SWO) process, (b) assess and collect all fines owed by noncomplying employers, and (c) use all available remedies to ensure employer compliance with the Workers' Compensation Act. The DIA's ineffective enforcement of the Workers' Compensation Act has increased employment costs to those legitimate employers who do have insurance and appears to encourage noncomplying employers not to obtain the required workers' compensation insurance.

a. The DIA Did Not Adequately Enforce the SWO Process: Chapter 152 of the Massachusetts General Laws requires Massachusetts employers to carry workers' compensation insurance covering their employees, including themselves if they are an employee of their company. This requirement applies regardless of the number of hours worked in any given week, except that domestic service employees must work a minimum of 16 hours per week in order to require coverage. The law mandates that companies found without the insurance be fined and issued SWOs, which close down the employer's business until workers' compensation insurance is obtained and the fines are paid. An SWO becomes effective immediately upon service and requires that all business operations cease. It is accompanied by a fine that begins at \$100 per day, starting the day the SWO is issued, and continues until insurance coverage is obtained and the fine is paid.

During the period July 1, 1993 to January 31, 1998, the DIA issued SWOs to 4,062 employers that never obtained the workers' compensation insurance coverage after being issued the SWO. The DIA could not tell us how many of these employers were still operating without the insurance. However, during the 18-month period ended December 31, 1997, the DIA issued 2,406 SWOs to businesses that were found to be operating without the insurance, of which 1,685 did not subsequently obtain the insurance. Based on our sample, we found that at least 779 (46%) of these companies disregarded the SWO and were still operating without having produced evidence of having the insurance. Thus, hundreds of employers were being allowed to operate by the DIA even though they have had SWOs imposed upon them.

Allowing these businesses to operate without workers' compensation insurance (and without paying the related fines) is contrary to the Workers' Compensation Act and places the Workers' Compensation Trust Fund at financial risk. Section 65 of the Workers' Compensation Act established the Trust Fund in the State Treasury to pay injured employees who are not covered by workers' compensation insurance and to pay the costs of maintaining the Trust Fund. These costs include taking depositions, hiring private investigators, filing and serving summonses and subpoenas, retaining outside legal counsel and medical providers, and providing services relating to the management of the Trust Fund. Revenues for the Trust Fund are raised by an assessment on all employers subject to the Act.

Our audit also indicated that in fiscal year 1997, the DIA reissued nine SWOs to employers who had previously been shut down. The number of days elapsed between the original SWO and its reissuance ranged from 38 to 423 days. Two of the nine employers who were reissued SWOs paid their fines and obtained the required workers' compensation insurance. We noted, however, that as of February 4, 1998, two other employers were still operating without the insurance and without having paid any fines. One employer was a contractor who was issued an SWO on September 25, 1996 and was reissued another SWO 132 days later on February 4, 1997, and the other employer was issued an SWO on December 16, 1996, was fined \$1,500, and was reissued another SWO 38 days later. The remaining five employers that

were reissued SWOs could not be contacted. Records provided to us by the DIA revealed that, from May 24, 1996 to December 12, 1996, a total of 82 SWOs were reissued. The need to reissue SWOs to companies that should have remained closed after the first SWO was issued indicates a disregard for the law and the DIA's lack of enforcement of the law.

The workers' compensation system is totally funded by employers doing business in the Commonwealth. The employers of Massachusetts, both public and private, are required to pay assessments covering the expenses of operating the DIA and for the payment of Trust Fund benefits. Each year the DIA determines an assessment rate that will yield revenues sufficient to pay these costs. This assessment rate, multiplied by the employer's standard premium, is the DIA assessment and is paid as part of an employer's insurance premium. In fiscal year 1999, \$3.3 million was paid to uninsured claimants, and over \$65.7 million has been paid out over the last 13 years. The assessment rate for private sector employers in 1997 was 4.226% of the standard premium.

The inadequate enforcement of SWOs issued to uninsured employers increases employment costs to employers who do have insurance. Moreover, the DIA's current operating methods do not deter noncomplying employers from obtaining required workers' compensation insurance and gives uninsured employers an unfair and unlawful competitive advantage.

Recommendation: To improve compliance with the SWO process, we recommend that the DIA make use of other remedies available to it, such as levying additional fines and penalties, and bringing criminal proceedings against those employers that continue to operate after being issued an SWO.

Auditee's Response: In response, the Commissioner of the DIA stated, in part:

Follow up on SWO's to ensure compliance was a process that your audit team correctly assessed as not being effective. We had depended on the individual investigator to revisit his SWO's. This provided too little structure . . . However, there is one point I would like to clarify. The audit team sample found that 46% of their sample of businesses that had been issued an SWO were operating without the prerequisite insurance. The Department, in our concern with this finding, conducted an on-site inspection of the 2,573 active SWO's at that time and found 24, or just under 1% that were violating the SWO. Nevertheless, the finding, in itself was valid and we have taken the following corrective actions. If an SWO is not cleared within 20 days of its issue, a status query and warning are issued by letter. After 20

days but within 60 days the business is visited by the Default Investigator and determination is made and appropriate action is taken. To accomplish this we have dedicated one of our ten investigators to default investigations. All outstanding SWO's receive the warning letter and the default visit within the established time frames.

Auditor's Reply: The actions taken by the DIA should help improve compliance from businesses that have been issued SWOs. However, to ensure greater compliance when its efforts fail, the DIA should make use of the other remedies available to it under the law, particularly when a Default Investigator finds that a business is still operating without insurance and without having paid the proper fines.

b. The DIA Did Not Assess and Collect Fines Totaling Approximately \$22.2 Million Owed by Employers without Workers' Compensation Insurance: The DIA was not effectively enforcing the Workers' Compensation Act because the fines on many employers found not to have workers' compensation insurance were either not being collected, not being computed correctly, or not imposed at all. In fact, our audit revealed that during the period July 1, 1993 to December 31, 1997, the DIA failed to collect \$4,439,858 in fines imposed on employers that had been issued SWOs and collect millions of additional dollars from employers that had been issued SWOs but were never fined.

During the audit period, the DIA issued a total of 5,096 SWOs to employers that did not pay the fines after they were found not to have workers' compensation insurance. Of these employers 1,014 later obtained the insurance but did not pay the fines that had been assessed, which totaled \$4,439,858. The remaining 4,082 employers that were issued SWOs were never fined or penalized by the DIA (other than the issuance of the SWO), as shown in the following chart.

SWOs Issued to Employers

<u>Fiscal Year</u>	<u>Employers</u>		<u>Not Fined</u>
	<u>Number</u>	<u>Fined But Did Not Pay</u>	
1994 (6 mos.)	30	\$ 248,533	61
1995	319	2,195,142	752
1996	322	1,422,201	1,564
1997	211	402,672	799
1998 (6 mos.)	132	151,310	906
	<u>1,014</u>	<u>\$4,439,858</u>	<u>4,082</u>

Although the exact amount in fines that should have been assessed to the 4,082 employers after they were found by the DIA not to have workers' compensation insurance could not be exactly determined, we estimate that it would total significantly more than the \$4,439,858 in fines that were imposed on the 1,014 employers that did obtain the insurance (an average of \$4,379 each). If the same average fine were imposed on the 4,082 employers, for example, it would total over \$17.8 million.

During the 18-month period ended December 31, 1997, the DIA issued 2,406 SWOs to employers that did not have workers' compensation insurance. As previously noted, the SWO requires that all business operations immediately cease and is accompanied by a \$100 daily fine that continues to accrue until insurance coverage is obtained and the fine is paid. Of the 2,406 employers, 721 subsequently obtained the insurance and were assessed fines, but 343 of these employers did not pay the fines that were assessed. Moreover, no fines were ever imposed on the remaining 1,685 employers that did not obtain workers' compensation insurance.

Companies That Were
Issued SWOs and Subsequently:

	<u>Paid Fine</u>	<u>Did Not Pay Fine</u>	<u>Total</u>
Obtained the Insurance	378	343	721
Did Not Obtain the Insurance	0	1,685	1,685
	<u>378</u>	<u>2,028</u>	<u>2,406</u>

The obvious purpose of the fine is to penalize uninsured employers and force them to obtain insurance. However, under the DIA's current procedures, an employer can save thousands of dollars by not obtaining the required insurance until being discovered. After being issued the SWO, the employer can simply obtain the insurance while remaining open for business without paying the fine, or can even remain open without ever obtaining the insurance. This lack of enforcement may be encouraging other employers not to obtain the insurance.

(1) The DIA Did Not Collect All Fines Imposed: As noted above, during the 18-month period ended December 31, 1997, SWOs were issued to 721 employers that subsequently obtained the necessary workers' compensation insurance. All of these employers were fined \$100 a day from the day the SWOs

were issued to the day the insurance was obtained. However, 343 of these employers who did not pay the fine should have remained closed until the date the fine was paid, regardless of their obtaining the insurance. The total amount of the fines that were not paid during the audit period was \$553,982. Chapter 152, Section 25C (1), of the General Laws states that the fine is computed by "counting the date of service of the stop work order as the first day and date of payment of the penalty [fine] herein provided and of production of evidence of insurance or self-insurance as the final day."

Our statistical sample of the 343 employers that had obtained insurance but did not pay their fines, revealed that most of them were still open for business. For example, 17 employers in our sample were fined over \$5,000 each. We found that 12 of them (71%) had obtained insurance and were still in business, but had not paid any of their fines (which totaled \$115,050). In fact, our review of the SWOs issued to the 721 employers revealed that 73% of the fines have not been collected.

<u>Employers Who:</u>	<u>Number</u>	<u>Percent</u>	<u>Amount</u>	<u>Percent</u>
Paid Fines	378	52%	\$207,488	27%
Did Not Pay Fines	<u>343</u>	<u>48%</u>	<u>553,982</u>	<u>73%</u>
	<u>721</u>	<u>100%</u>	<u>\$761,470</u>	<u>100%</u>

(2) The DIA Did Not Assess Employers the Full Amount of Fines Owed: Our review also revealed that the DIA did not assess employers the full amount owed. As a result, millions of dollars in fines went uncollected.

As previously noted, for the 18-month period ended December 31, 1997 the DIA fined 343 employers \$553,982 that was not paid. These fines, however, were calculated only up to the date that evidence of insurance was obtained and not to the date that the insurance is obtained and the fine is paid. Chapter 152, Section 25C (1), of the General Laws states, in part:

[The SWO] shall take effect immediately upon its service upon said employer, unless such employer provides evidence. . . of having secured any necessary insurance or self-insurance and pays a civil penalty into the private employer trust fund in the amount of one hundred dollars per day [\$250 per day if appealed] for each day such employer was not in compliance with this chapter, counting the date of service of the stop work order as the first day and date of payment of the penalty herein provided and of production of evidence of insurance as the final day. [Emphasis added.]

In other words, the \$100-a-day fine should continue to accrue up to the day that both the fine is actually paid and the evidence of insurance is provided. The DIA's policy, however, is to compute the fine only up to the date that the insurance is obtained and not, as the law requires, up to the date of payment of the fine and the production of evidence of insurance. By so doing, the DIA has lost the opportunity to collect millions of dollars in unassessed fines, which, according to state law, continue to accumulate.

We also found that, during our 18-month audit period, the DIA did not fine 1,685 employers who were issued SWOs but did not obtain workers' compensation insurance. Although Chapter 152, Section 25C, of the General Laws requires the DIA to fine these employers up to the date they receive insurance and pay their fines, the DIA does not assess the fines until the employer obtains the insurance. Under this policy, businesses who do not get insurance will never be assessed a fine.

In accordance with state law, DIA could have levied millions of dollars in fines on those 1,685 employers without workers' compensation insurance. In fact, an average fine of only \$3,000 each would result in over \$5 million in uncollected potential revenue. To ensure that the DIA has adequate funds, the Legislature required that all employers pay assessments covering the payment of trust fund benefits and the expenses of operating the agency. In addition, revenue derived from the collection of fees (for filing costs) and fines (for violation of the Act) are deposited into the Trust Fund. Therefore, the more the DIA collects from SWO fines, the lower the assessment to employers. The policy of computing the fines only up to the date that the workers' compensation insurance is obtained, and not up to the date the fine is also paid as required by statute, significantly reduces the amount of money that should be placed into the Trust Fund.

According to the DIA, the policy of calculating the fines for SWOs only up until insurance is obtained has been in effect since 1988 and is consistent with Chapter 152, Section 25C, of the General Laws. In 1988 the DIA decided to begin accrual of the \$100-per-day fine upon issuance of the SWO, up until insurance is obtained as opposed to the date the fine is paid in full and the insurance is obtained. The noncomplying employer is handed a copy of the SWO, as well as all applicable statutory citations, and is

ordered to close business immediately and begin accrual of the \$100-per-day fine until insurance is obtained. We were informed that the reason for this policy decision, which transcends 10 years, five Commissioners, and four Directors of Administration, is that the DIA's mission is not to be overly punitive but to simply ensure that employers mandated to have workers' compensation secure a policy. We were further advised that, because it can take up to several weeks to produce a policy, an employer could be unreasonably subject to thousands of dollars for the processing time. Also, it has been the DIA's position that the "spirit of the law" is to get employers to secure coverage and not to effectively bankrupt them.

Although the DIA's explanation may have merit, the DIA's decision to not collect fines in accordance with the law results in higher costs to insured employers who comply with the law. Chapter 152, Section 25C, of the General Laws states that all civil penalties for failure to provide for payment of workers' compensation insurance shall be paid by the offending private employer into the Private Employer Trust Fund. This fund is used to pay benefits resulting from approved claims against Massachusetts employers who are uninsured in violation of the law. Fines collected in accordance with Chapter 152, Section 25C, of the General Laws are deposited into the Special Fund, which is used to pay the operating expenses of the DIA, and is also funded by private employers. In fiscal year 1997, private sector employers were assessed approximately \$17.5 million for the Special Fund and \$43 million for the Private Employer Trust Fund. The assessment would have been lower had the fines been assessed and collected in accordance with state law.

(3) Inadequate Collection Procedures: During the five-year period ended June 30, 1998 the DIA collected only \$623,692 in fines, or approximately 12% of the total fines imposed. As a result, \$4,439,858 in fines is owed to the Trust Fund, as shown below:

<u>Fiscal Year</u>	<u>Fines Imposed</u>	<u>Amount Collected</u>	<u>Balance</u>
1994	\$ 263,000	\$ 14,467	\$ 248,533
1995	2,333,750	138,608	2,195,142
1996	1,705,350	263,149	1,442,201
1997	559,250	156,578	402,672
1998	202,200	50,890	151,310
	<u>\$5,063,550</u>	<u>\$623,692</u>	<u>\$4,439,858</u>

For employers who have obtained the insurance but have not paid the fine, the DIA's collection procedure is to send three demand letters. If there is no response, the debt is supposed to be referred to an outside collection agency. To assess the DIA's collection efforts, we examined the billing documents for 20 statistically selected employers who obtained the insurance after getting SWOs but did not pay the fine. The following chart summarizes the results of our test.

<u>Days Elapsed</u>	<u>Number of Demand Letters Sent</u>			<u>Referred to Collection Agency</u>
	<u>First</u>	<u>Second</u>	<u>Third</u>	
0- 50	10	2	1	0
51-100	4	9	1	0
101-150	4	0	0	0
151-200	<u>2</u>	<u>0</u>	<u>0</u>	<u>0</u>
Total	<u>20</u>	<u>11</u>	<u>2</u>	<u>0</u>

We further examined the DIA's collection efforts for the 17 companies in our sample that were fined over \$5,000 in fiscal year 1997. In total, these companies were fined \$167,350 but paid only \$3,500, leaving an amount owed the DIA totaling \$163,850. The following chart summarizes these results of our testing of the DIA's collection efforts.

<u>Days Elapsed</u>	<u>Number of Demand Letters Sent</u>			<u>Referred to Collection Agency</u>
	<u>First</u>	<u>Second</u>	<u>Third</u>	
0- 50	4	0	0	0
51-100	1	1	0	0
101-150	5	3	0	0
151-200	4	4	0	0
201-250	1	0	0	0
251-300	<u>2</u>	<u>1</u>	<u>0</u>	<u>0</u>
Total	<u>17</u>	<u>9</u>	<u>0</u>	<u>0</u>

As shown in the preceding charts, the DIA did not follow its own procedures in sending follow-up demand letters for fines owed, and none of the employers in our sample were referred to a collection agency. In fact, none of the 343 companies that owed \$553,982 during our audit period were referred to an outside collection agency. We requested a listing of all unpaid fines preceding December 31, 1997 and noted that 237 companies had been referred to outside collection agencies. The companies were referred in three batches: March 1, 1996; July 22, 1996; and October 15, 1996. The SWOs on these companies had been issued from September 1, 1994 to December 18, 1995, with fines totaling \$988,300. Only \$87,220 (9%) of this amount was recovered for the DIA by the collection agencies. From December 19, 1995 to December 31, 1997, however, none of the 825 companies that were issued SWOs and had not paid fines were referred to a collection agency for recovery. Accordingly, since then, approximately \$3,093,754 in unpaid fines has not been referred to collection agencies for recovery.

Moreover, inadequate collection policies, coupled with an inadequate accounts receivable system, contributed to the DIA's having an accounts receivable balance of over \$14 million in outstanding assessments, fees, and fines as of June 30, 1998 and writing off over \$2 million in uncollected debt for calendar year 1998. (See Audit Result No. 2.)

Recommendation: To be more effective in collecting all of the fines from employers, to which the DIA and the Commonwealth are entitled, we recommend that, after issuing an SWO, the DIA:

- Compute the fine in accordance with statutory requirements starting with the day the SWO is issued to the day the insurance is obtained and the fine is paid.
- Devise a method of computing and collecting the fine on those employers who do not obtain insurance after being issued an SWO but continue to operate.
- Improve its collection efforts by sending demand letters more often than is presently being done.
- Make more frequent and timely use of outside collection agencies when all other efforts fail.
- Work with noncomplying employers who have obtained workers' compensation insurance but have not paid their fines in full to establish an installment repayment plan as a prerequisite for continuing their business operations.
- Consider filing legislation to amend any current Workers' Compensation Act requirements that it deems to be impractical or counterproductive.

Auditee's Response: The Commissioner of the DIA stated, in part:

In 1985, when MGL Ch. 152 was revised to establish the investigation and SWO functions, it provided for a fine to be imposed from the issue date of the SWO until insurance was obtained and the fine was paid and that the business would remain closed for that period. Additionally it provided for criminal sanctions in each case where a SWO was issued. In 1986 when the investigative element was formed it was determined by that administration that these two elements of the statute were untenable and would not be implemented. The practice that has evolved is one where fines are imposed from the issue of the SWO to the time insurance is in place and criminal complaints are invoked in severe cases where there was an established and blatant disregard for the law. These problems with the statute and the resolution, just described, were both public and open and transcend three Administrations, five Commissioners, four Directors of Administration I think a "why" is now in order and here I chose to present only this Department's rationale for continuing this policy....

Concerning the Department's policy of administering SWO's and imposing fines; there is the bureaucratic dilemma of not being able to determine the amount of the fine until the fine is paid. However, this was not a consideration in the decision. The extended forced closing of these businesses would have hammered the Massachusetts economy by closing businesses and causing loss of time or loss of job for tens of thousands of innocent employees. Based on this, the Department made a conscious and open decision to continue this policy. With the support of both labor and business, the problems with the current statute and our policy and proposed changes to the statute have been discussed with the legislature in conjunction with our Advisory Council and the Director of Labor and Workforce Development. This has resulted in several initiatives to change the statute....

Our emphasis has been in policing the estimated 200,000 plus businesses operating in Massachusetts and in keeping up with the 1,500 new corporations, the 600 new businesses and the 500 policy changes that, on average, take place here each month. To save a *thousand words* from the old cliché, may I please refer you to the attached charts to indicate our success in this endeavor. [The charts show that SWO fines collected increased from \$32,000 in fiscal year 1993 to \$521,855 in fiscal year 1998.] But this does not excuse us from our less than sterling effort to collect the fines once we had finally assessed them.... Since the audit team brought this to our attention actions have been completed that have brought all SWO fines under the DIA collection system and all outstanding debt has been collected or is in the collection process. Beginning in July of 1998, all SWO's were entered on the BARS system which automatically sent a demand letter every 20 days to businesses who received a SWO and obtained insurance, but failed to pay the requisite fine. After 3 consecutive demand letters are sent the case is automatically referred to a collection agency on state contract.

Auditor's Reply: While we understand the DIA's position, the statute is clear on how the fine should be computed. If the DIA wishes to implement a different method of computing the fine, it should petition the Legislature to change the law. Until the law is changed, the DIA is required to comply with the law and impose the fine from the date of the SWO until the insurance is obtained and the fine is paid. We

reiterate that the DIA should also devise a method of computing and collecting fines on those employers that do not obtain insurance after being issued an SWO but continue to operate.

c. The DIA Was Not Using All Available Remedies to Ensure Employer Compliance with the Workers' Compensation Act: In addition to issuing SWOs and imposing fines, the DIA is also authorized to levy additional fines and penalties, bring criminal and civil proceedings, and take other actions against employers that fail to provide workers' compensation insurance. Chapter 152, Section 25C, of the General Laws provides that, in addition to the civil penalties, an employer who fails to provide for insurance or self-insurance:

- Shall be punished by a fine of not more than \$1,500 or by imprisonment for not more than a year, or both;
- Shall have withheld by every state or local licensing agency the issuance or renewal of a license or permit to operate a business or to construct buildings in the Commonwealth;
- Shall not be allowed to enter into any contract for the performance of public work with the Commonwealth and its political subdivisions; and
- Will be immediately disbarred from bidding or participating in any state or municipal contracts for a period of three years.

Section 25C also provides that any penalties due pursuant to the issuance of an SWO, until collected, shall constitute a lien upon the entire interest of the employer's property. In addition, Section 25C allows persons who lose a competitive bid for a contract to bring action for damages against another person who is awarded the contract because of the cost advantage of not having workers' compensation coverage.

During our review we found that the DIA has made no or very little use of these tools of enforcement that have been authorized by the Legislature. In fact, at the time of our audit, the DIA had used criminal complaints against noncomplying employers only 21 times. The DIA's records indicate, however, that from July 1, 1993 to January 6, 1998, 5,096 employers could have had criminal or civil complaints, liens, or additional penalties filed against them. However, we found no evidence that the DIA had used any other penalties, such as assessing \$1,500 fines or placing liens on the property of noncomplying employers until the fines are paid. There is also no indication that any of the Commonwealth's agencies

and political subdivisions have been notified not to do business with the noncomplying employers or to deny them original or renewal business or construction licenses.

Of the 5,096 employers that were issued SWOs from July 1, 1993 to January 6, 1998 the DIA litigated only 21 cases. These criminal complaints were filed against certain employers that were issued SWOs from April 12, 1996 to January 6, 1998. These were the only companies that the DIA sought to penalize beyond the daily civil fines of \$100 and \$250 (for appeals) that are imposed when SWOs are issued. By the conclusion of our audit fieldwork, the DIA was unable to inform us of the results or status of these criminal complaints.

As noted earlier, DIA records revealed that from July 1, 1993 to January 6, 1998 5,096 employers issued SWOs could have had criminal or civil complaints, liens, or additional penalties filed against them. The DIA should levy such additional fines and penalties, bring criminal and civil proceedings, and place liens upon the entire interest of the employers that fail to provide for insurance or self-insurance, as required by Chapter 152, Section 25C, of the General Laws.

DIA officials stated that the issues surrounding reform of employer's fines and penalties under Chapter 152, Section 25C, of the General Laws are complex and offered several suggestions. Their responses with regard to those specific sections of the law follow:

Withhold Licenses and Permits: "Despite the legislative mandate, municipal licensing boards are often lax in demanding proof of workers' compensation prior to issuing a license or permit. Municipal officials should be educated on the importance of this law, and the dire effects of failing to carry out the mandate. . . . The Secretary of State should require that all persons forming a corporate entity should be required to sign a statement acknowledging the responsibility of the officers to secure and maintain adequate workers compensation insurance coverage."

Three-Year Exclusion from Public Contracts: "There was no recollection of an instance in which an employer was barred from participating in a public works project because it lacked workers' compensation insurance. Enforcing debarment requires special efforts from the Commonwealth's Division of Capital Planning and Operations (DCPO). Debarment becomes very difficult when new corporate entities are formed to avoid penalties. Efforts should be made to improve enforcement of this mandate."

Criminal Penalties: "Concern was expressed about judicial interpretation of the provisions found at Section 25C(5) establishing a fine of not more than \$1,500 or imprisonment for not more than one year. When reviewing the fines, district court judges have required the DIA to

prove that the employer intended to violate the statute. We suggest that this provision be amended to clearly state that intent is not a necessary element of the offense, and that a strict liability standard apply.... We suggest that the criminal fine be raised perhaps to \$10,000. We also suggest that a violating employer be required to pay restitution to the Trust Fund in addition to any penalties. The issue of requiring corporate officers to be personally liable to fines and restitution was discussed. Extending these penalties to individuals is difficult given legal protections afforded corporate stockholders, officers and employers."

We agree that the issues surrounding the use of fines and penalties on noncomplying employers are complex. However, Section 25C is quite clear on what those penalties are and that they should be used. We also agree that perhaps some changes in the statute would be helpful. However, by not using the civil and criminal penalties presently set forth in the law, and by not coordinating its efforts with other state agencies and municipalities, the DIA is not fulfilling its mission, and consequently there is less incentive for uninsured employers to get insurance.

Recommendation: The DIA should ensure employer compliance with the Workers' Compensation Act by making more use of all of the penalties available to it under state law, such as initiating civil or criminal proceedings, attaching liens to employer property, and assessing additional fines and penalties. However, the DIA should first notify noncomplying employers of the penalties under the law, which may increase compliance.

Auditee's Response:

In 1986 when the investigative element was formed it was determined by that administration that [the criminal sanctions provision in the statute] were untenable and would not be implemented. The practice that has evolved is one where fines are imposed from the issue of the SWO to the time insurance is in place and criminal complaints are invoked in severe cases where there was an established and blatant disregard for the law.... Concerning the criminal complaint, the courts were and are backlogged and several of the District Courts informed us they would not look favorably upon thousands of additional cases annually. In the event that these cases had been prosecuted, the Department does not have the resources to conduct investigations and the criminal prosecution of every SWO recipient. Further, it is certainly not the intent of this Administration to press criminal charges against business operators who inadvertently, or through ignorance of the law did not have workers' compensation insurance.

Auditor's Reply: As shown in our report, from July 1, 1993 to January 6, 1998, the DIA used pursued criminal complaints only 21 times, whereas records show that there were 5,096 instances in which criminal or civil complaints, liens, or additional penalties could have been pursued in accordance

with the statute. At a minimum, the DIA should notify all noncomplying employers of the remedies under the law and begin to exercise its authority to effectuate compliance.

2. Status of Prior Audit Results:

a. Inadequate Accounts Receivable System - Unresolved

Our prior audit report (No. 96-0222-4F) indicated that the DIA had not implemented, documented, and maintained a comprehensive accounts receivable system. Our follow-up review of the accounts receivable system used for the collection of insurance premiums and various fines and fees from insurers and employers indicated that, although the DIA had implemented a formal accounts receivable system, including the assistance of a collection agency, controls could be strengthened. As of June 30, 1998 there was an accounts receivable balance of \$14,238,439 for assessments, referral fees, SWOs, filing fees, and first report fines. However, the details regarding what the ending balance represented were not adequately documented, and \$2,110,303 in uncollected debt for calendar 1998 was written off without an aging or analysis of the likelihood of collections for specific accounts.

To address the prior audit results, the DIA reconstructed its files, organized and documented its accounts receivable and payable records, and developed a new debt collection system. The goals of this debt collection effort were to establish internal standing policies regarding the recovery of fees, fines, and penalties, as well as other reimbursements owed. A Debt Manager was established to centralize collection, a policy was developed and implemented, and a concerted effort commenced to automate their debt-collection system. This policy made provisions for accounting through billing, to actual collection to assignment or discharge. These things were necessary because the DIA had previously been unable to collect all of its outstanding debt, and were frequently writing off excessive portions of it.

After considering alternatives to reduce its collection write-offs, the DIA contracted with an outside collection agency to recover overdue debt. As discussed in Audit Result No. 1, outstanding debts are referred to a collection agency after the DIA's internal billing efforts have been exhausted. If the collection efforts are unsuccessful, the DIA may decide to litigate and petition the Attorney General's

Office for special Attorney General status. To maximize recovery during the litigation process, the collection agency uses asset searches of debtors when possible. The court's judgment determines the amount of debt collected. If the DIA decides that it is not economically feasible to litigate, a request for a write-off is forwarded to the Office of the State Comptroller.

Although the DIA is making progress and is using outside collection agencies, prudent business practices advocate that accounts receivable balances be supported by detailed subsidiary records, including lists of vendor or firm names, an age analysis, and collection data for specific receivables. Although the DIA has increased collections, collection of debt is less than 20% during the past 13 years. Therefore, the DIA needs to do more, including seeking legislative assistance or relief, to collect more of its debt and to minimize the write-offs of accounts receivable balances. Worker's Compensation Trust Fund records indicate that the DIA has paid \$65.7 million to uninsured claimants during the past 13 years but that only \$9.6 million had been recovered from employers.

Recommendation: The DIA should reconcile its accounts receivable balance by vendor name and conduct an age analysis. To offset future collection losses against accounts receivable, an allowance for doubtful accounts should be established.

Moreover, to improve debt collection of accounts receivables and minimize overdue balances, DIA management should evaluate and strengthen its debt management procedures. In this regard, administrators should monitor all required steps in the process, including those given to collection agencies to ensure the maximum collection of overdue accounts. Additionally, the DIA should determine whether legislative changes could assist them in pursuing various legal actions against vendors or firms with overdue accounts and unpaid balances.

b. Business Continuity and Contingency Planning - Resolved: Since our prior audit report, the DIA has developed and implemented a written disaster recovery and business continuity and contingency plan (BCCP) for restoring automated systems in the event of a loss of computer operations. Therefore, the DIA can now be reasonably sure of being able to regain critical IT processing functions, such as the

Pyramid and Diameter systems, within an acceptable period of time. The DIA also made significant efforts to address the weaknesses in the BCCP by formulating and documenting a viable recovery strategy and by performing and documenting tests of implemented plan.

c. Processing of Workers' Compensation Claims - Resolved: Since our prior report, the DIA has made progress in reducing the time it takes to process workers' compensation claims. The DIA's efforts to conclude cases within a 99-day time frame reflects due diligence in improving operations, considering the size of previous backlogs and the fact that the settlement process in some cases involves additional steps, including the impartial medical examination and hearing. Statistics supplied by the DIA for fiscal year 1998 indicated that, of the approximately 15,000 workers' compensation claims, 65% were settled within the suggested timeframe. It was noted that the appeals process, combined with complex and diverse medical problems which require intense review and extensive documentation, contribute to the remaining 35% of claims that run beyond the 99-day period. The chief administrative justice provided us with information explaining why certain cases go over the limit and provided an historical perspective on the legislatively mandated 99-day limit.

CONCLUSION

The DIA is responsible for the monitoring of mandatory workers' compensation insurance for all Massachusetts employers, which are required by state law to carry insurance covering their employees, including themselves if they are an employee of their company. Companies found to be in non-compliance are issued Stop Work Orders (SWOs) and are supposed to be fined \$100 a day (\$250 if appealed). The SWO is a cease-and-desist order that closes the violating employer's business until workers' compensation coverage has been obtained and all fines are paid in accordance with Chapter 152, Section 25C, of the Massachusetts General Laws. The DIA is responsible for enforcing this mandate by imposing fines and penalties for violations and for the reporting, tracking and ultimate disposition of the debt from SWO fines.

During our review we found that:

- Businesses remained open after SWOs were issued,
- Outstanding fines were not collected,
- Fines were calculated incorrectly or not calculated at all, and
- Very few businesses that were in violation of the law were penalized beyond the issuance of the SWO and the daily fine.

In addition, we also found that the DIA needs to improve its accounts receivable system to minimize write-offs of outstanding debt. By law, employers who did not pay the fines should have remained closed until the fine was paid. The purpose of the fine is to penalize uninsured employers who are operating at the expense of law abiding employers. Under the DIA's current procedures, a noncomplying employer can save thousands of dollars by not obtaining the required insurance until being detected. The employer can then simply obtain the insurance after being issued an SWO and remain open without any penalty being paid. As a result, noncomplying employers are able to operate without obtaining insurance until caught, which is costing the complying employers more.

Furthermore, the DIA does not calculate the fine until an employer who has received an SWO produces evidence of having obtained the insurance. Under this policy, businesses that continue to

operate without getting the insurance will never be billed for the applicable fines. As a result, the DIA is losing millions of dollars in uncollected fines. The DIA also does not calculate the fine up until the date the fine is paid as required by the law, thereby not collecting as much money from violations as it should.

The DIA has the authority under Chapter 152, Section 25C, of the General Laws to levy additional fines and penalties, bring criminal and civil proceedings, and place liens upon the entire interest of employers that fail to provide for insurance or self-insurance as required. Yet, the DIA has made little use of all of the criminal and civil proceedings available to it to secure more compliance with this law, and has done little to coordinate its efforts with other agencies and municipalities.

The lack of enforcement on uninsured employers increases unemployment costs to those legitimate employers who do have insurance, provides uninsured employers with an unfair and unlawful competitive advantage, (i.e. reduced operating costs) and noncomplying employers are able to operate without obtaining workers' compensation insurance.

Our audit was conducted to determine the extent of the DIA's compliance with existing laws and regulations. We understand the DIA's rationale for handling the SWO process in the manner it has chosen. However, we strongly recommend that the DIA file legislation to amend the current law. Although it may not be practical to close down each and every noncomplying employer, the DIA needs to develop a system that allows for fair stern measures, installment payment plans, and ultimately, the closure of any business that does not comply after a reasonable period of time, subsequent to their initial notification of noncompliance and of the remedies available under the law.