



Commonwealth of Massachusetts
Office of the State Auditor
Suzanne M. Bump

Making government work better

Official Audit Report – Issued August 21, 2014

Department of Industrial Accidents—Review of Certain Aspects of the Workers’ Compensation System

For the period July 1, 2010 through September 30, 2012





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Suzanne M. Bump

Making government work better

August 21, 2014

Mr. George Noel, Director
Department of Industrial Accidents
1 Congress Street, Suite 100
Boston, MA 02114-2017

Dear Mr. Noel:

I am pleased to provide this performance audit of the Department of Industrial Accidents. This report details the audit objectives, scope, methodology, findings, and recommendations for the audit period, July 1, 2010 through September 30, 2012. My audit staff discussed the contents of this report with management of the agency, and their comments are reflected in this report.

I would also like to express my appreciation to the Department of Industrial Accidents for the cooperation and assistance provided to my staff during the audit.

Sincerely,

A handwritten signature in blue ink, appearing to read 'SMBump'.

Suzanne M. Bump
Auditor of the Commonwealth

TABLE OF CONTENTS

EXECUTIVE SUMMARY	1
OVERVIEW OF AUDITED AGENCY	3
AUDIT OBJECTIVES, SCOPE, AND METHODOLOGY	7
DETAILED AUDIT RESULTS AND FINDINGS WITH AUDITEE’S RESPONSE	10
1. The Department of Industrial Accidents’ process for establishing and verifying the accuracy of workers’ compensation insurance assessments needs improvement.....	10
2. Monitoring of self-insurers needs improvement.....	14
APPENDIX A	18
APPENDIX B	19
APPENDIX C	20
APPENDIX D.....	21

EXECUTIVE SUMMARY

In accordance with Chapter 11, Section 12, of the Massachusetts General Laws, the Office of the State Auditor has conducted a performance audit of certain activities of the Department of Industrial Accidents (DIA) for the period July 1, 2010 through September 30, 2012. In some instances, it was necessary to go outside this period to gather pertinent information to achieve our audit objectives. Our audit objectives were to determine whether (1) DIA's internal controls and systems were effective in ensuring that all employers who are required to do so carry workers' compensation insurance or an acceptable alternative, (2) DIA's system for the review and collection of assessment fees and stop-work-order fines was adequate, (3) DIA's procedures for determining the amount of surety bonds or deposits of self-insurers complied with applicable statutory requirements, and (4) DIA was only paying various injury-related claims to eligible claimants and these payments were being approved by appropriate DIA officials.

Summary of Findings

- DIA does not ensure that assessment amounts paid by insurance companies are accurate. Companies calculate their own assessments, and the online template and other information that DIA has established for them to use to calculate assessments does not provide sufficient guidance to ensure that they are accurately calculated; in fact, we found a number of instances where insurance companies had calculated and paid incorrect assessments. Further, DIA does not review the accuracy of these assessments in a timely manner but rather relies on private accounting firms to review the data. These reviews typically take place several years after the submission of the payments, so any incorrect payments can remain unresolved for extended periods of time.
- DIA performs reviews of self-insurers' liabilities annually, instead of semiannually as required. Without performing these reviews at least semiannually, DIA may not be able to get the timely information it needs to assess an insurer's financial position and, if necessary, require it to make adjustments to funds it has deposited with the State Treasurer to ensure that it can pay all of the required benefits.

Recommendations

DIA should take the following actions:

- Review quarterly assessment calculations and payments on a timely basis to ensure that the correct assessment rates are used and correct payments are submitted.
- Modify its online reporting template so that when an insurance company enters a policy's inception date, the assessment rate applicable to that policy's year is automatically loaded.

- Educate insurance providers to minimize the risk of recurring mistakes with assessment rates, standard premiums, and classification codes.
- Conduct reviews of calculated assessments and payments made by all companies, including those it considers small and medium-sized companies.
- Unless Chapter 152, Section 25A, of the General Laws is amended to change the required frequency of reviews of self-insurers' deposit and surety bond amounts, review the amounts semiannually in order to ensure compliance with this statutory requirement.

Post-Audit Action

After we completed our audit, DIA informed us that it had hired two additional auditors to improve its review processes for assessment billings, which will include the review of small and medium-sized insurance companies. DIA also indicated that it was developing an algorithm that would improve its reporting template and was regularly updating its website and issuing circular letters to insurance providers so that errors would be minimized. Further, DIA indicated that its legal staff was working to formally amend Chapter 152, Section 25A, of the General Laws so that only annual reviews of self-insurers' liabilities and corresponding deposit amounts would be required.

OVERVIEW OF AUDITED AGENCY

Background

The Department of Industrial Accidents (DIA), within the Executive Office of Labor and Workforce Development, administers and oversees the state workers' compensation system in accordance with Chapter 152 of the Massachusetts General Laws, known as the Workers' Compensation Act (the Act). DIA is organized into functional areas, including, among others, the Offices of Claims Administration, Investigations, Legal Counsel, Insurance, Self-Insurance, Education and Vocational Rehabilitation, Health Policy, Safety, and Conciliation; the Impartial Medical Unit; and the Division of Dispute Resolution. DIA has offices in Boston, Lawrence, Springfield, Worcester, and Fall River.

All private-sector employers operating in Massachusetts are required to carry workers' compensation insurance¹ and pay for workers' compensation benefit claims by individuals through a commercial insurance policy, self-insurance, or membership in a self-insurance group. Although exempt from the Act, the Commonwealth has elected to cover its employees under the Act, paying claims from the Commonwealth's General Fund. Further, although exempt from the Act, most municipalities and certain other political subdivisions have elected to cover employees under the Act, though some cities and towns have not adopted coverage for all employee groups.

DIA regulates insurers and self-insurers under 452 Code of Massachusetts Regulations (CMR) 5.00 and annually licenses self-insurers. The state's Division of Insurance (DOI) licenses commercial insurance carriers, determines rates, and approves the terms of workers' compensation policies. DOI also regulates self-insurance groups. DOI is assisted by the Workers' Compensation Rating and Inspection Bureau (WCRIB),² to which DOI has delegated the authority to determine standard policy terms, classifications, and basic industry rates. WCRIB also maintains statistical data on behalf of the Commissioner of DOI.

DIA also serves as the primary adjudicatory body for resolving workers' compensation disputes. Cases filed at DIA include employees' claims for benefits, insurers' claims for modification of

¹ Seamen on vessels engaged in interstate or foreign commerce, athletes whose contracts provide for disability benefits arising from their employment, and unincorporated sole proprietors are exempt from the insurance requirement. Also, certain corporate officers and directors may elect to opt out of the worker's compensation system.

² WCRIB is a private, nonprofit, unincorporated association of insurers that is licensed by DOI as a rating organization for workers' compensation insurance in Massachusetts.

benefits, third-party claims, and requests for third-party settlements or Section 37/37A (second injury) requests. The dispute-resolution process at DIA can involve one or more of the following stages: conciliation, conference, hearings, and review. All dispute-resolution orders are enforceable in the Superior Court.

The Office of Investigations (the Office) within DIA is charged with enforcing the statutory requirement that employers maintain workers' compensation insurance. The Office has access to a database maintained by WCRIB that shows all current workers' compensation policies written by Massachusetts insurance companies. On the basis of its review of the database, the Office may conduct field investigations of employers suspected of not providing workers' compensation coverage. DIA also established a Web-based application that allows the public to check whether a business has a current workers' compensation policy, and investigations may be initiated by the public through a tip hotline, online referral, or letter.

The Office imposes fines and penalties for employers not carrying workers' compensation insurance. The Office is required by statute (Chapter 152, Section 25C, of the General Laws) to issue a stop-work order (SWO) to any business with one or more full- or part-time employees that is unable to provide proof of workers' compensation insurance coverage on demand. The SWO directs the noncomplying business to cease operations immediately and pay a \$100-per-day fine until the insurance coverage is obtained and the fine is paid. In addition, noncomplying employers are debarred from bidding on contracts with the Commonwealth of Massachusetts for three years from the date of the SWO. In addition to fines and debarment, DIA can file a criminal complaint against an employer, which could result in a fine of up to \$1,500, imprisonment for up to a year, or both. The Office is overseen by a director, who is assisted by a deputy director, 2 chief investigators, 13 investigators, 2 research analysts, a compliance officer, and an administrative assistant.

DIA is a member of the Joint Enforcement Task Force on the Underground Economy and Employee Misclassification, which was established by Executive Order 499 in 2008. This task force was developed under the theory that employers that violate labor and employment laws are also likely to violate licensing, insurance, occupational safety, and tax laws and that the enforcing agencies should share information and coordinate their investigative efforts. The other members of the task force are the Departments of Labor Standards, Unemployment Assistance, Public Safety, and Revenue; the Divisions of Banks, Professional Licensure, and Capital Asset Management and

Maintenance; the Office of Business Development; the Office for Refugees and Immigrants; the Supplier Diversity Office; the Alcoholic Beverage Control Commission; the Commission against Discrimination; the Fair Labor Division of the Attorney General's Office; and the Insurance Fraud Bureau, an insurance-industry-supported entity authorized by the Commonwealth to prevent, detect, and help prosecute insurance fraud. In addition, on September 1, 2011, the task force entered into an agreement with certain agencies of the United States Department of Labor to share information and make referrals of suspected violations.

DIA administers funds known as the Workers' Compensation Special Fund (the Special Fund) and the Workers' Compensation Trust Fund (the Trust Fund). The Trust Fund has a private component (the Private Trust Fund) and a public component (the Public Trust Fund). Assessments levied against private employers are deposited into the Special Fund and into the Private Trust Fund in proportion to each fund's share of the total budgeted amount determined for each fiscal year. The Special Fund reimburses the General Fund for DIA administrative costs (payroll, fringe benefits, rental, consultants, indirect costs, etc.). The Private Trust Fund makes payments to uninsured injured employees and to employees denied vocational rehabilitation services by their insurers. The Private Trust Fund paid a total of \$15,479,068 to uninsured injured employees in fiscal years 2011 and 2012. In addition, the Private Trust Fund reimburses insurers for costs of employee latent and second injury claims and certain cost-of-living adjustments. In fiscal years 2011 and 2012, the Private Trust Fund reimbursed insurers a total of \$83,465,663 for these costs.³ Chapter 152, Section 65(2), of the General Laws allows non-insuring public employers and self-insurers or self-insurance groups to opt out of the obligation of paying assessments to the Trust Fund by filing a notice of nonparticipation with DIA. As of July 1, 2005, all public employers (including the 351 cities and towns) had opted out of paying additional assessments to the Public Trust Fund, which had a balance of \$407,887 as of June 30, 2012. By opting out, the entity is precluded from making certain claims against the fund.

Chapter 572 of the Acts and Resolves of 1985 created the Massachusetts Workers' Compensation Advisory Council, which has 16 members, 10 of whom are voting members. Of the voting members, 5 represent employees and 5 represent employers. Nonvoting members include one

³ See Appendices A, B, and C for Private and Public Trust Fund and Special Fund financial activity for the two-fiscal-year period ended June 30, 2012.

representative from each of the following groups: the Workers' Compensation Claimants' Bar, the insurance industry, medical providers, and vocational rehabilitation providers. Fourteen council members are appointed by the Governor. The Secretary of Labor and Workforce Development and the Secretary of Housing and Economic Development are ex officio (nonvoting) members. All council members serve five-year terms. The council is responsible for monitoring, making recommendations, giving testimony, and reporting regarding all aspects of the workers' compensation system. The council is required to issue an annual report evaluating the operations of DIA and the state of the Massachusetts workers' compensation system, including reviewing DIA's annual operating budget, submitting independent recommendations, reviewing insurance rate filings, and participating in insurance rate hearings.

DIA has three primary sources of revenue: assessments levied on the premiums of each workers' compensation policy,⁴ fines on assessments not paid within 30 days of their due dates, fines related to SWOs and late injury reports,⁵ and referral fees (filing fees) for cases that must be adjudicated because they cannot be resolved at the conciliation level. Assessments, which totaled \$81,341,709 in fiscal year 2011 and \$82,117,762 in fiscal year 2012, typically constitute over 90% of DIA's total revenue.⁶ These revenue sources fund DIA's operating expenses, expenditures for claims, and other statutory payments.

⁴ Assessment rates are calculated by a consultant from data supplied by DIA, DOI, and WCRIB. In fiscal years 2011 and 2012, the rates applied to private insurance premiums were 6.8% and 5.9% respectively. For employers that are self-insured or members of a self-insurance group, an "imputed premium" is calculated by WCRIB and special assessment rates are determined.

⁵ Chapter 152, Section 6, of the General Laws requires employers to complete a report when an employee is injured or alleges an injury and is unable to earn full wages for five or more calendar days. The form must be filed within seven calendar days (not counting Sundays and legal holidays) from the fifth day of the disability. The form, called a First Report of Injury/Fatality, must be submitted to DIA, the employee, and the insurer.

⁶ Financial information was extracted from the Workers' Compensation Advisory Council's annual report for fiscal year 2012.

AUDIT OBJECTIVES, SCOPE, AND METHODOLOGY

In accordance with Chapter 11, Section 12, of the Massachusetts General Laws, the Office of the State Auditor has conducted a performance audit of certain activities of the Department of Industrial Accidents (DIA) for the period July 1, 2010 through September 30, 2012. In some instances, we extended our review to before or after this period in order to achieve our audit objectives.

We conducted this performance audit 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.

Our audit objectives were to determine whether (1) DIA's internal controls and systems were effective in ensuring that all employers who are required to do so carry workers' compensation insurance or an acceptable alternative, (2) DIA's system for the review and collection of assessment fees and stop-work-order (SWO) fines was adequate, (3) DIA's procedures for determining the amount of surety bonds or deposits of self-insurers complied with applicable statutory requirements, and (4) DIA was only paying various injury-related claims to eligible claimants and these payments were being approved by appropriate DIA officials.

To achieve our audit objectives, we reviewed state laws and regulations pertinent to our audit objectives. We gained an understanding of the internal controls we deemed significant to our audit objectives and evaluated the design and effectiveness of those controls. We conducted interviews with DIA's staff and management and reviewed reports prepared by the Massachusetts Workers' Compensation Advisory Council.

We also reviewed assessment information, SWOs, and debarment lists. We analyzed payment vouchers related to injury claims to ensure that payments were authorized by appropriate DIA officials and made to eligible claimants. We used a combination of statistical and non-statistical methods in selecting samples from the various populations as follows:

- We selected a statistical sample of 48 SWO fines out of the 6,681 SWOs issued and found no exceptions.

- In reviewing injury claims, we chose a statistical sample of 74 payments from a population of 4,088 payments and found no exceptions.
- We chose 33 companies out of the 430 companies licensed to write workers' compensation insurance in Massachusetts for our assessment billing test and found eight errors (see Audit Finding 1). Because our sample was chosen non-statistically, we cannot project the sample results to the population.
- From the 94 licensed self-insurers in the Commonwealth, we chose 15 non-statistically to determine whether DIA conducted semiannual reviews of deposit and surety bond adequacy. We determined that DIA only conducted such reviews annually and that one company selected for review needed to increase its surety bond (see Audit Finding 2). We could not project the sample results to the population because the sample was chosen non-statistically.

DIA uses a database maintained by the Workers' Compensation Rating and Inspection Bureau (WCRIB) (on behalf of the Division of Insurance) that lists all companies that have been issued a valid workers' compensation insurance policy. DIA uses this database to establish whether a company carries workers' compensation insurance. We examined hard copies of insurance policies and determined that they were included in the WCRIB database, giving some indication of the system's reliability. This procedure does not constitute a full-scope data reliability assessment, but it was sufficient for our purposes. DIA maintains a computer application and database called the Case Management System (CMS), which it uses to administer and control SWO fines, claim information, and case management. We traced hardcopy documents such as SWOs, investigator review notes, insurance policies, and claim and case materials to CMS. Although these procedures do not constitute a full-scope assessment of CMS-generated data, we believe our procedures were adequate to conclude that CMS data were sufficiently reliable for our purposes.

In fiscal year 2010, DIA established a Web-based billing application (Assessments on Line) for assessment fees that allows insurance companies to self-compute assessment bills. The companies log in and enter policy and premium information and assessment rates in a standard template developed by DIA and WCRIB. We recalculated a sample of the quarterly billings and traced summary billings to actual cash deposits and cash receipt input forms. Our recalculations disclosed errors related to company input of assessment rates (see Audit Finding 1). We did not test premium information submitted by insurance companies or the algorithms used in this computer application, but our sample testing of quarterly billings and review of total assessments collected indicated that the automated assessment billing information was sufficiently reliable for our purposes, subject to the limitations and exceptions described above.

Like other state agencies, DIA uses the Massachusetts Management Accounting and Reporting System (MMARS). We confirmed MMARS cash receipt data by comparing it to hardcopy bank deposit information, cash receipt input forms, SWO fines, and assessment bills. We confirmed MMARS trust fund payment data by comparing it to payment vouchers, DIA legal office approval forms, or judicial orders. Although these procedures do not constitute a full-scope assessment of the reliability of MMARS computer-generated data, we believe our procedures were adequate to conclude that MMARS data were sufficiently reliable for our purposes.

Based on our audit, we have concluded that for the period July 1, 2010 through September 30, 2012, DIA ensured that it was only paying injury-related claims to eligible claimants, was properly approving these claims, and had established adequate internal controls and systems to ensure that all employers who were required to carry workers' compensation insurance or an acceptable alternative were doing so. However, we found problems with the process DIA uses to help insurers establish their workers' compensation assessments and its review of those assessments, as well as its process for determining the amount of surety bonds or deposits of self-insurers that need to be deposited with the State Treasurer. These problems are discussed in the Detailed Audit Results and Findings section of this report.

DETAILED AUDIT RESULTS AND FINDINGS WITH AUDITEE'S RESPONSE

1. The Department of Industrial Accidents' process for establishing and verifying the accuracy of workers' compensation insurance assessments needs improvement.

The Department of Industrial Accidents (DIA) does not ensure that assessment amounts paid by insurance companies are accurate. Insurance companies that provide workers' compensation insurance in Massachusetts are required to pay the Commonwealth quarterly assessments. Each insurance company calculates its assessment by multiplying a rate established by DIA by each issued policy's annual standard premium.⁷ This assessment must be paid by policyholders to their insurance companies, which in turn must remit it to DIA. The online template and other information that DIA has established for insurance companies to use to calculate their assessments does not provide sufficient guidance to ensure that assessments are accurately calculated; in fact, we found a number of instances where insurance companies had calculated and paid incorrect assessments. Further, DIA does not review the accuracy of assessments in a timely manner but rather relies on private accounting firms to review the data. These reviews typically take place several years after the submission of the payments, so any incorrect payments can remain unresolved for extended periods of time. Moreover, during our audit period, it was DIA's policy not to review the assessment calculations and payments of what DIA characterizes as small and medium-sized insurance companies. As a result, any errors in the assessment calculations for those companies may never be detected and corrected.

Current Practices

Every year, DIA engages a consulting firm to establish an assessment rate that it estimates will yield sufficient revenue to pay for its anticipated operating costs and workers' compensation expenses in the next fiscal year. During fiscal year 2010, DIA replaced its process of manually billing insurance companies by mail with a Web-based billing system (Assessments on Line). Each insurance company is provided with a unique username and password to log in to the DIA website and complete its quarterly assessment filings. Assessments are calculated by insurance companies each quarter, and payments are due 30 days after the end of each quarter. In addition to the quarterly assessment form, insurance companies must complete a template that requires the following

⁷ 452 Code of Massachusetts Regulations 7.02 defines "standard premium" as "the direct written premium equal to the product of payroll by class code and the currently applicable manual rates multiplied by any applicable experience modification factor."

information for each policy: number, effective dates, standard premium, DIA assessment rate, and assessment amount due. Payments can be made either by automated clearinghouse debit (the insurance company provides its bank-account information to DIA, and DIA withdraws the amount due) or by automated clearinghouse credit (DIA provides bank-account information to the company, and the company sends its assessment to DIA's account).

We reviewed assessment billing and payment information from a non-statistical sample of 33 of the 430 companies licensed to issue workers' compensation insurance in Massachusetts during our audit period. We found that 8 companies incorrectly calculated a quarterly assessment and therefore remitted an incorrect amount, as shown in the following table.

Insurance Company*	Quarter Ending	Total Assessable Premium	Assessment Paid to DIA	Correct Assessment	Over-/(Under-) Paid
Company A	9/3/2010	\$ 1,522,674.00	\$ 103,541.00	\$ 108,250.89	(\$ 4,709.89)
Company B	3/31/2012	1,208,847.00	76,427.00	71,820.07	4,606.93
Company C	9/30/2010	29,661.50	2,016.98	2,135.63	(118.65)
Company D	9/30/2011	9,105.00	619.14	548.44	70.70
Company E	6/30/2012	2,983,203.39	176,009.00	179,149.92	(3,140.92)
Company F	12/31/2012	10,091,070	181,284.00†	426,213.58	(244,929.58)
Company G	6/30/2010	2,082,169.46	149,916.20	144,405.50	5,510.70
Company H	6/30/2010	42,265.00	2,922.87	2,969.70	(46.83)
		<u>\$ 17,968,995.35</u>	<u>\$ 692,736.19</u>	<u>\$ 935,493.72</u>	<u>(\$ 242,757.53)</u>

Note: One-cent discrepancies in some table totals are an effect of rounding.

* Names of insurance companies have been omitted at DIA's request.

† The invoice summary sheet indicated a calculated assessment of \$181,284, but attachments accompanying the invoice showed an assessment calculation totaling \$426,213.58. DIA initially could not explain this difference. Several months after its discovery, DIA sent the Office of the State Auditor a memorandum that stated that the company appeared to owe DIA \$244,929 because of an error in its filing and that it initiated an audit of this company.

DIA does not review the accuracy of these assessments but rather hires private accounting firms to review the assessments calculated and paid by what it determines to be large companies. However, these reviews typically take place several years after the submission of the payments. In a report issued by the Massachusetts Workers' Compensation Advisory Council for fiscal year 2012, reviews by private accounting firms resulted in recoveries totaling \$14,348,188 by DIA during fiscal years 2000 through 2012. DIA also gave us a schedule of recovered funds that were received in fiscal years

2010 and 2011 based on the reviews conducted by private accounting firms.⁸ This schedule showed that 11 companies were reviewed and \$2,161,535 was recovered. A copy of one of the actual reviews performed by a private accounting firm, which generated \$1,500,918 of the total \$2,161,535 recovered, found 60 instances in which incorrect assessment rates were used; it also identified numerous other errors such as incorrect reporting of standard policy premiums. This review, which was dated June 24, 2010, covered the 22 quarters ended December 31, 2003, which suggests that DIA may have a significant backlog in reviewing quarterly assessments and payments.

During our audit period, DIA did not review assessments calculated and paid by what it considers small and medium-sized companies. After we completed our audit, DIA officials informed us that the agency had hired two additional employees who would be reviewing the small and medium-sized insurance companies.

Legal Requirements

Chapter 152, section 65(12), of the Massachusetts General Laws states,

The [director of DIA] shall supervise, monitor and establish procedures for all aspects of the assessment of insured and self-insured employers and self-insurance groups including but not limited to the proper reporting of base amounts; the determination of proper assessment rates; the calculation, billing and collection of assessment payments; proper accounting; reporting and transmittal by insurers of assessment payments by insured employers; and all other matters necessary to assure proper compliance with this section. . . .

In addition, DIA's internal control plan states,

The goal of the Assessment Unit is to ensure that companies writing workers' compensation insurance in Massachusetts pay assessments in a timely and accurate manner.

DIA's internal control plan also instructs staff to verify that "rates used to calculate assessments are the current year rate as published by DIA."

Reasons for Incorrect Assessment Calculations and Lack of Timely Review

Chapter 152, Section 65, of the General Laws says that assessment rates for insured employers apply to standard premiums for policy years beginning on or after July 1 following the determination of the rates. DIA and the Workers' Compensation Rating and Inspection Bureau's (WCRIB's)

⁸ We requested all 11 CPA reports, but DIA gave us only 1. That CPA report indicates that the review was an "agreed upon procedures" engagement conducted in accordance with attestation standards established by the American Institute of Certified Public Accountants.

interpretation of this statute is that the assessment rate applicable at the policy inception date will apply for the full term of the policy notwithstanding the new rate that is determined every July 1. Thus quarterly assessment calculations require the application of different years' rates depending on the policy inception dates. However, the quarterly assessment forms displayed on DIA's website show the assessment rate computed as of July 1 of the current fiscal year, without any information on assessment rates that would apply to policies issued in prior periods. This may mislead insurance companies into believing that the current year's rate should be applied to all policies.

DIA officials stated that the risk of under- and overpayments was minimal and that a more extensive review of billings would not be an effective use of agency resources. DIA also believes the reviews done by CPA firms are producing the desired results.

Recommendations

DIA should take the following actions:

- Review quarterly assessment calculations and payments on a timely basis to ensure that the correct assessment rates are used and correct payments are submitted.
- Modify its reporting template so that when an insurance company enters the policy inception date, the assessment rate applicable to that policy's year is automatically loaded.
- Educate insurance providers to minimize the risk of recurring mistakes with assessment rates, standard premiums, and classification codes.
- Conduct reviews of calculated assessments and payments made by all companies, including those it considers small and medium-sized companies.

Auditee's Response

Since 2012, the department has hired two additional internal auditors to conduct continuous reviews on all insurance companies, including small- and medium-sized companies, to ensure the accuracy and validity of the assessment data and the submission of quarterly filings. Since onboarding these additional auditors, the Internal Audit Unit has collected \$1,014,809 in assessment payments for SFY13 and SFY14. Going forward, the Internal Audit Unit will continue to audit the top 25% of all insurance companies, which represent 80% of the premium base. Their goals are to increase compliance and become current with the reviews.

To ensure that correct assessment rates are used and correct payments submitted, the DIA's Financial, Legal and IT units are working collectively to standardize the Form 50, and the back-up documentation that is provided to the agency by insurance companies. Standardizing these reporting mechanisms will be implemented using an algorithm developed by IT. This algorithm will capture what a company's assessment filing should amount to on the Form 50, and cross-reference that data with information reported in the supporting documentation. If there is a

variance in the data, an automatic email will be generated to the Assessment Unit, and the filing company, informing them of the variance and a further review of the data will commence. DIA's Legal Unit is drafting a circular letter that will inform the insurance industry of the department's revisions to standardize the back-up documentation for the Form 50 document.

In order to educate insurance providers to minimize the risk of recurring mistakes with assessment rates, standard premiums, and classification codes, the DIA issues circular letters and interagency data sharing and collaboration with WCRIB, DOI and the Advisory Council. DIA has developed an informative website that publicizes all changes and provides detailed assessment information. The information provided includes, but is not limited to:

- *Standard premium templates*
- *Historical assessment rates*
- *ACH payment instructions*
- *Assessment program overview*
- *Examples of forms*
- *Detailed information pertaining to the assessment process, and online filing*

2. Monitoring of self-insurers needs improvement.

DIA performs reviews of self-insurers' liabilities annually, instead of semiannually as required. Every employer that chooses to be self-insured for workers' compensation claims is required by Chapter 152 of the General Laws to furnish a bond with a surety company or keep a specified amount in securities on deposit with the State Treasurer. DIA is required to review, at least semiannually, self-insurer personal injury liabilities incurred or to be incurred and to determine, if necessary, any additional change to the deposit needed to ensure that the amount of securities (cash, stock, or bonds) or surety bond on deposit with the State Treasurer is sufficient to pay benefits provided for under Chapter 152 of the General Laws. Despite this requirement, during our audit period DIA only reviewed this self-insurer information once each year as part of its annual licensing of self-insurers. Without performing these reviews at least semiannually, DIA may not be able to get the timely information it needs to assess an insurer's financial position and, if necessary, require it to make adjustments to its deposit with the State Treasurer to ensure that it can pay all of the required benefits.

Current Practices

DIA developed 452 Code of Massachusetts Regulations (CMR) 5.04(2), which establishes certain requirements for an employer to be eligible to become a self-insurer. The employer must

- have more than 300 employees;
- have been in business for at least five years and not have been declared insolvent or bankrupt in the past five years;
- have demonstrated profitability in the three most recently completed fiscal years;
- have an acceptable rating from Standard and Poor's, Moody's, or Dun and Bradstreet;
- submit an actuarial study showing an acceptable state experience modification factor;⁹ and
- be required to pay a workers' compensation premium (unmodified manual premium) of \$750,000 or more if it does not become self-insured.

Under 452 CMR 5.02(2), self-insurers must also annually submit such information as payroll reports, audited financial statements, sworn statements of assets and liabilities, a history of workers' compensation claims, the nature and kind of their business, and organizational information (e.g., type of entity, officers and directors, geographic locations). DIA also requires each employer to carry reinsurance to cover losses from catastrophic events or to provide for claims if the employer moves out of state. DIA uses this information to determine the employer's ability to be a self-insurer.

During our audit period, there were 94 companies doing business in Massachusetts that chose to be self-insurers rather than paying workers' compensation insurance premiums or being part of a self-insurance group. We chose a judgmental sample of 15 of these companies and determined that DIA was only performing a review of liabilities and deposits as part of its annual licensing process rather than semiannually. In our sample, the amounts of the bonds posted ranged from \$560,000 to \$11,600,000. DIA required an increase of \$920,000 (from \$8,820,000 to \$9,740,000) in the bond amount of 1 of the 15 employers, determined that 1 employer could decrease its surety bond deposit, and did not require any changes to the surety bond deposits for the remaining 13 employers.

⁹ Experience rating is a system of comparing the claim history of each employer against the average claim experience of all employers within the same industry classification and mathematically computing a risk factor. Under 452 CMR 5.04, any self-insurer with a state experience modification factor higher than 1.25 must submit a corrective action plan to DIA.

Legal Requirements

Chapter 152, Sections 25A(a) and 25A(b), of the General Laws (applicable to deposits and bonds, respectively) requires a semiannual review of the liabilities of the self-insurer and an increase in the deposit or surety bond if personal injury liabilities exceed amounts provided for.

Reasons for Problems with Monitoring

DIA finds that the annual licensing process for self-insurers is a convenient time to evaluate deposit and bond amounts, since all companies are required to submit information at that time. Moreover, in 2008, DIA engaged a consultant¹⁰ to review its method of evaluating self-insurers' financial information and its calculation of deposit and bond amounts. DIA officials stated that, based on the consultant's work, they had implemented a new method whose results only required such a review to be performed once a year. DIA believes that the required semiannual review puts an undue burden on the self-insured companies as well as its own staff without any tangible benefit. DIA added that it would propose legislation to amend the General Laws so that only an annual review would be required.

Recommendations

Unless Chapter 152, Section 25A, of the General Laws is amended, DIA should conduct semiannual reviews of self-insurers' deposit and surety bond amounts to ensure compliance with this statutory requirement.

Auditee's Response

Since the inception of the self-insurance program in 1943, DIA has always determined self-insurance requirements annually. As stated in the Auditor's report, in 2008 the department worked collectively with a consultant to revise the bond calculation methodology to ensure that on an annual basis, both the self-insurer's and the Commonwealth's potential liability exposure was limited. With Deloitte and Touche, LLP's direction, the department developed a formula which consists of built in development factors, Incurred But Not Reported (IBNR) components and financial stability indicators that make up a self-insurer's reported claim exposure. Together, the aforementioned components extrapolate liabilities reported for the given year, ensuring more than sufficient bonding coverage.

¹⁰ DIA engaged Deloitte & Touche LLP, with Deloitte Consulting LLP as its subcontractor, to assist in performing actuarial analysis on calculating minimum bond requirements for self-insured companies. The consultant delivered a report dated November 13, 2008.

Based on the current business structure of the self-insurance licensing operation, all of the documents that self-insured clients are required to furnish are provided on an annual basis to the agency. This includes bond deposits, securities, reinsurance policies and reinsurance certificates.

DIA continues to work on a legislative change to amend the statute from semi-annually to annually so that the department can effectively utilize resources, continue to ensure sufficient levels of bonding coverage from self-insureds and minimize duplicative and ineffective burdens on businesses.

APPENDIX A

Workers' Compensation Trust Fund— Private Trust Fund¹¹ Statement of Revenue, Expenditures, and Changes in Fund Balance July 1, 2010 through June 30, 2012

	Fiscal Year 2011	Fiscal Year 2012
Revenue		
Interest	\$ 19,778	\$ 17,723
Assessments	60,945,330	63,987,699
Reimbursements from Uninsured Employers	1,242,706	1,047,058
Vocational Rehabilitation Services	53,358	—
Total Revenue	<u>62,261,172</u>	<u>65,052,480</u>
Expenditures		
Legal Claimants	7,668,940	7,810,128
Legal Insurers	38,897,833	44,567,830
Office of Education and Vocational Rehabilitation	1,725	801
Legal Defense	5,493,490	5,331,082
Adjustments	(81)	(800)
Total Expenditures	<u>52,061,907</u>	<u>57,709,041</u>
Balance July 1	16,558,296	26,757,561
Add: Fiscal Year Revenue	62,261,172	65,052,480
	<u>78,819,468</u>	<u>91,810,041</u>
Less: Fiscal Year Expenditures	(52,061,907)	(57,709,041)
Balance June 30	<u>\$ 26,757,561</u>	<u>\$ 34,101,000</u>

¹¹ Our review was not intended to enable us to express, and we do not express, an opinion on the Private Trust Fund Statement of Revenue, Expenditures, and Changes in Fund Balance. The disclosures of revenue, expenditures, and changes in fund balance represent information reported in the Massachusetts Workers' Compensation Advisory Council Annual Report for the fiscal year ended June 30, 2012 and are intended solely for informational purposes.

APPENDIX B

Workers' Compensation Trust Fund— Public Trust Fund¹² Statement of Revenue, Expenditures, and Changes in Fund Balance July 1, 2010 through June 30, 2012

	Fiscal Year 2011	Fiscal Year 2012
Balance July 1	\$406,711	\$407,329
Interest	618	558
Balance June 30	<u>\$407,329</u>	<u>\$407,887</u>

¹² Our review was not intended to enable us to express, and we do not express, an opinion on the Public Trust Fund Statement of Revenue, Expenditures, and Changes in Fund Balance. The disclosures of revenue, expenditures, and changes in fund balance represent information reported in the Massachusetts Workers' Compensation Advisory Council Annual Report for the fiscal year ended June 30, 2012 and are intended solely for informational purposes.

APPENDIX C

Workers' Compensation Special Fund¹³ Statement of Revenue, Expenditures, and Changes in Fund Balance July 1, 2010 through June 30, 2012

	Fiscal Year 2011	Fiscal Year 2012
Revenue		
Interest	\$ 8,037	\$ 7,275
Assessments	20,396,379	18,130,063
Filing Fees	3,730,233	3,706,666
First Report Fees	137,905	115,300
Stop-Work Orders	1,836,225	1,439,180
Late Assessment Fines	329,257	411,921
Total Revenue	<u>26,438,036</u>	<u>23,810,405</u>
Expenditures		
Computer	7,691	—
Salaries	13,222,297	13,076,720
Fringe Benefits	4,147,248	4,264,090
Indirect Costs	367,840	477,585
Non-Personal Costs	4,428,114	3,800,005
Adjustment Fringe	75,469	39,348
Total Expenditures	<u>22,248,659</u>	<u>21,657,748</u>
Balance July 1	7,952,135	12,141,512
Add: Revenue Fiscal Year	26,438,036	23,810,405
	<u>34,390,171</u>	<u>35,951,917</u>
Less: Expenditures Fiscal Year	(22,248,659)	(21,657,748)
Balance June 30	<u>\$ 12,141,512</u>	<u>\$ 14,294,169</u>

¹³ Our review was not intended to enable us to express, and we do not express, an opinion on the Special Fund Statement of Revenue, Expenditures, and Changes in Fund Balance. The disclosures of revenue, expenditures, and changes in fund balance represent information reported in the Massachusetts Workers' Compensation Advisory Council Annual Report for the fiscal year ended June 30, 2012 and are intended solely for informational purposes.

APPENDIX D

Executive Office of Labor and Workforce Development Agencies and Affiliated Organizations¹⁴

Agencies under the Executive Office of Labor and Workforce Development Secretariat

Labor Agencies:

Department of Labor Standards—Promote and protect workers' safety and health, wages and working conditions, and to support employers and workers in the utilization of apprenticeship as a workforce development tool.

Department of Industrial Accidents [DIA]—Oversees the Workers' Compensation system in Massachusetts.

Department of Labor Relations—Administers the Commonwealth's collective bargaining statutes and protects the Commonwealth's workers.

Workforce Agencies:

Department of Career Services—Oversees the Commonwealth's network of 33 One-Stop Career Centers that serve job seekers and businesses.

Department of Unemployment Assistance—Administers the Unemployment Insurance program, providing temporary financial assistance to unemployed workers.

Other Related Labor and Workforce Organizations

Massachusetts Workforce Investment Board—“Advises the Governor on building a workforce development system aligned with education policies and economic development goals.” The board members review, revise, and advise the executive branch on methods for creating and sustaining the workforce Massachusetts needs to succeed in the world economy. The Secretary of the Executive Office of Labor and Workforce Development is an ex officio member of the board.

Commonwealth Corporation—“A quasi-public agency whose programs and services build upward mobility pathways for youth and adults to prepare for high demand careers.” The Secretary of the Executive Office of Labor and Workforce Development has general oversight of the Commonwealth Corporation.

¹⁴ Quoted material in this appendix is taken from the Executive Office of Labor and Workforce Development's Preliminary Strategic Plan 2013–2015 at mass.gov/lwd/eolwd/eolwd-strategic-plan-final-version.pdf.

Massachusetts Workers' Compensation Advisory Council—An entity responsible for evaluating the operations of DIA and the state of the workers' compensation system. The Secretary of the Executive Office of Labor and Workforce Development is an ex officio member of the council.

Joint Enforcement Task Force on the Underground Economy and Employee Misclassification—A collaboration of 14 state agencies and the Insurance Fraud Bureau designed to combat violations of labor, licensing, and tax laws. The Secretary of the Executive Office of Labor and Workforce Development is the chair of the task force, and the director of DIA is a task-force member.