

# **Audit Issues Pertaining to Injured Workers Insurance Fund**

**Presentation to House Economic Matters Committee**

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# **Injured Workers Insurance Fund (IWIF) issues included in Office of the State Treasurer's Audit Report dated July 24, 2007**

## **Background:**

- Under 1990 agreement with the Board of Public Works (BPW), IWIF provides claims processing services for workers' compensation claims filed by State employees (approximately \$40 million annually)
- STO administers the agreement on behalf of BPW
- IWIF receives funds at start of year for anticipated claims and costs
- Agreement provides that administrative costs be based on the proportionate share of IWIF's administrative costs (based on the State's portion of all claims expenses); these costs are approximately \$10 million annually
- Periodically, the State makes payments to IWIF to be held on account to reduce the State's unfunded long-term liability (which was estimated to be \$230 million at June 30, 2006)

## **Audit Report Finding 5 (Policy Issue)**

The services provided by IWIF for the State have not been subject to competitive bid. Using IWIF for claims processing services has not been analyzed to determine if this practice is the most beneficial to the State and if the related costs are commensurate with the services rendered.

- Services have been provided under the same agreement for more than 17 years
- Services are available from private insurance companies
- IWIF as an entity has become more autonomous since this agreement was first entered into
- Funds on account to liquidate the State's long term workers' compensation liability are held by IWIF

## **Audit Report Finding 6**

Monitoring of the agreement was inadequate:

- No verification of propriety of claims
- Administrative costs were not verified
- No verification that the State received all interest earnings due

## Excerpt from OLA Audit Report (Dated July 24, 2007) on the Office of the State Treasurer

### **Injured Workers' Insurance Fund (IWIF)**

#### **Background**

Under the terms of a 1990 agreement between the IWIF and the Board of Public Works (BPW), IWIF provides claims processing services for workers' compensation claims filed by State employees. The State is self-insured for such claims. The agreement provides that the State Treasurer's Office is responsible for administering the agreement, on behalf of the Board.

As required by the agreement, at the start of each fiscal year, the Office sends a payment to IWIF for State workers' compensation claims for the upcoming year. The payment includes an amount to pay for anticipated workers' compensation claims and an amount for IWIF's administrative costs associated with providing claims processing services to the State. Payments for anticipated claims are based on the actual amount of claims paid, as reported by IWIF, in a prior fiscal year. Payments for administrative costs are based on the Office's proportionate share of IWIF's administrative costs (allocated based on the State's proportionate share of actual losses incurred by the State to actual losses incurred by all insureds of IWIF, including the State). According to the Office's records, during fiscal years 2004 through 2006, payments to IWIF for workers compensation claims and administrative costs totaled \$137.4 million (\$105.3 million for claims, \$30.6 million for administrative costs and an additional \$1.5 million for costs related to the State's risk management program). Claim and administrative costs are recovered through State agency assessments prepared by the Office.

In addition, based on funds included in the State budget, the Office makes payments to IWIF to reduce the State's long-term liability for workers' compensation claims. The long-term liability is the difference between what actuaries have determined is adequate to cover future liability and amounts the State has transferred to IWIF for the liability. According to its records, during fiscal year 2006, the Office paid \$10 million to IWIF to reduce the unfunded liability, which according to IWIF's actuary is estimated at \$230 million as of June 30, 2006.

#### **Finding 5 (Policy Issue)**

**The services provided by IWIF have not been subject to a competitive bid process and the appropriateness of making advance payments to IWIF has not been adequately assessed.**

#### **Analysis**

Certain aspects pertaining to the use of IWIF for claims processing services have not been analyzed to determine if they are the most beneficial to the State.

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- The contract with IWIF to administer all workers' compensation claims filed against the State has been in effect for over 16 years and has not been subject to a competitive bid

process. (We were advised by Office management that these claims processing services have never been competitively bid.) Since this contract was entered into, IWIF has become more autonomous from the State. For example, the requirement that the State Treasurer be the custodian of the IWIF was repealed from State law effective October 1, 2000. Office management advised us that obtaining competitive bids was not considered because the contract with IWIF was approved by BPW and because using IWIF to process workers' compensation claims has been a long-standing practice. While competitive bids are not required for contracts between units of State government, considering the significant amounts paid to IWIF annually (\$10.9 million for administrative costs in fiscal year 2006), as well as the availability of this service from private insurance companies, we believe that a competitive bid process should be used to determine if the State is receiving a fair price for services rendered.

- There was no apparent reason for the State to allow IWIF to hold funds in reserve for its long-term workers' compensation liability rather than maintaining the funds in the State Treasury. As of August 30, 2006, according to information received from IWIF, State funds on deposit with IWIF for the State's long-term workers' compensation liability totaled \$25 million in an account that is interest bearing to the State. Officials in the Office could not provide any reasonable justifications for this practice. Consequently, it was unclear as to the benefit to the State to have IWIF hold the funds as opposed to allowing the funds to be held and invested by the Office.

Under the contract, IWIF is responsible for investigating, defending, and making payment for claims that the State is legally obligated to pay for damages resulting from bodily harm to or death of an employee of the State, resulting from the employee's employment, such as it would for other clients. The contract provides that the State can terminate the contract for any reason after giving IWIF 90 days written notice.

#### **Recommendation 5**

**We recommend that the Office, in conjunction with BPW, consider obtaining competitive bids for the claims processing services for workers' compensation claims filed by State employees, and take the necessary actions to ensure that these services are obtained in the manner that is most beneficial to the State. We also recommend that the Office determine the appropriateness of allowing IWIF to hold funds in reserve.**

**Finding 6**

**The Office did not adequately monitor the agreement to ensure the propriety of amounts paid to IWIF.**

**Analysis**

The Office did not take any action to assess the propriety of amounts paid to IWIF. Essentially, the Office's only involvement with the agreement was to make payments to IWIF and to recover the assessments from State agencies.

- The Office did not verify that claims reported by IWIF were for actual payments made on behalf of State employees who suffered work-related injuries. Since claims reported by IWIF serve as the basis for payments of approximately \$40 million per year to IWIF, it is essential that the Office verify the propriety of the reported claims.
- Administrative costs requested by, and paid to, IWIF were also not subject to independent verification. Specifically, the Office did not receive documentation that the administrative costs billed by IWIF properly represented the State's share of total administrative costs incurred by IWIF. Since such amounts exceeded \$30 million over a three-year period, these costs should also be periodically verified.
- Although, under the terms of the agreement, amounts paid to IWIF shall be held in a separate account and the State is to receive interest earned on money on deposit with IWIF, the Office did not verify that the State received all interest to which it was entitled. Since the Office pays IWIF at the start of each fiscal year and claims would be expected to be paid throughout the year, interest earnings could be significant.

**Recommendation 6**

**We recommend that the Office, at least on a test basis, review amounts previously paid to IWIF for propriety and, in the future, determine the propriety of amounts paid to IWIF. This verification should be documented and include a review of appropriate supporting documentation such as evidence of amounts paid for injured State workers and documentation of the propriety of administrative costs billed by IWIF. We also recommend that the Office verify that the State receives all interest to which it is entitled.**





## Excerpt from the Response of the Office of the State Treasurer

### Injured Workers Insurance Fund (IWIF):

#### **Finding #5 (Policy Issue)**

**The services provide by IWIF have not been subject to a competitive bid process and the appropriateness of making advance payments to IWIF has not been adequately assessed.**

#### **Recommendation:**

We recommend that the Office, in conjunction with BPW, consider obtaining competitive bids for the claims processing services for workers' compensation claims filed by State employees, and take the necessary actions to ensure that these services are obtained in the manner that is most beneficial to the State. We also recommend that the Office determine the appropriateness of allowing IWIF to hold funds in reserve.

#### **Response:**

The Office agrees that this is a policy issue, and respectfully suggests that the policy decision is one for the General Assembly, first, and the Board of Public Works, second. It is not a policy decision to be made by the Office, which simply serves as the administrator for the State's contract with IWIF.

The State's workers' compensation claims processing services have *never* been competitively bid. IWIF's predecessor, the State Accident Fund ("SAF"), was established by the General Assembly in 1914 as the State agency charged with guaranteeing workers' compensation coverage for all of Maryland's employers and their employees. In addition to serving the State, the SAF and IWIF have served as workers' compensation insurers of last resort for Maryland employers for 93 years.

Until 1988, the SAF was part of the Department of Personnel. The Office of Legislative Audits (OLA) conducted regular audits of SAF and IWIF until 2002, when the General Assembly granted IWIF greater autonomy. In fact, as a result of OLA recommendations, the General Assembly reorganized the SAF in 1988, and the SAF contract with the State was renegotiated in 1990.

Although there is no statutory mandate that the State contract with IWIF for workers' compensation claims processing services, it is the evident intent of the General Assembly that IWIF provide such services for the State. The General Assembly created IWIF, granted and amended its powers, periodically reorganized its structure and responsibilities, and annually appropriates funds to pay for its services. In light of the State's historic 93-year relationship with the SAF and IWIF, the Office believes that it would be inappropriate to competitively bid such services absent legislative direction to do so.

The Office concurs with the Auditors' statement that the Office determine the appropriateness of allowing IWIF to hold funds in reserve. However, after a review of the Agreement and in consultation with the Office's Assistant Attorney General, we have determined that if the Office withdraws the funds from the Unfunded Liability Account and deposits them in an account invested by the Office, any interest earned on those funds must be credited to the General Fund. The Treasurer is required to credit interest earned directly to the General Fund except as otherwise specifically provided by law. The Office could find no provision for an exception in this case even if the funds were held in a separate account in the State Treasurer's Office, and, therefore, such interest could no longer be dedicated to the reduction of the long term liability.

In light of the explicit intent of the Governor and the General Assembly to eventually eliminate the unfunded liability, and absent an explicit change in that intent, the Office believes it lacks authority to unilaterally withdraw these funds, thereby resulting in the loss of interest income dedicated to reducing the unfunded liability.

**Finding #6**

**The Office did not adequately monitor the agreement to ensure the propriety of amounts paid to IWIF.**

**Recommendation:**

We recommend that the Office, at least on a test basis, review amounts previously paid to IWIF for propriety and, in the future, determine the propriety of amounts paid to IWIF. This verification should be documented and include a review of appropriate supporting documentation such as evidence of amounts paid for injured State workers and documentation of the propriety of administrative cost billed by IWIF. We also recommend that the Office verify that the State receives all interest to which it is entitled.

**Response:**

As noted in response to Finding #5, the Agreement between the State and IWIF was renegotiated in 1990. Under that Agreement, IWIF serves as third-party administrator for claims brought against the State under Maryland's Workers' Compensation Law.

The Agreement describes three primary responsibilities which involve the Office. The first requires that the Treasurer decide all matters relating to contract administration and performance. The second requires IWIF to submit an annual invoice to the Treasurer reflecting the amount of actual losses incurred by the State, as well as an invoice reflecting the balance of the State's account. The third requires IWIF to compile whatever reports the Treasurer determines to be necessary to:

- (a) monitor the performance of the claims administration activity;
- (b) assess the financial liability of the program to the State;
- (c) project loss experience for the purposes of establishing budgets and agency premiums; and
- (d) analyze the causes of losses.

A review of the BPW's files, including the January 31, 1991 agenda item and transcript, does not reveal any other information defining the requirements of this provision, with the sole exception of a general comment made by Treasurer Maurer to the effect that the STO's Insurance Division was working closely with IWIF. Additionally, there is no record to reflect whether these performance reports have ever been deemed "necessary", or have been requested or produced.

Since the inception of the Agreement in 1990, the Office has received an annual report, via the Department of Budget and Management, that identifies the amount the Governor, through DBM, has proposed and the General Assembly has appropriated for workers' compensation coverage, including any appropriation for the unfunded liability. The Office prepares a disbursement transmittal, wires this amount to IWIF, and subsequently collects from each agency its share of the appropriated amounts. In the event that an agency questions the amount of its premium, it is directed back to IWIF to request a report listing all claims for their agency.

While the Office has not routinely requested performance reports from IWIF, a report on the State Assessment for Workers' Compensation was prepared by the Department of Budget and Management in August of 2001 and was submitted to the Office. This report reviewed, analyzed and commented on the amounts the State paid and the administrative costs charged by IWIF. In addition, as a State agency, IWIF was subject to periodic Legislative Audits until 2002. It is now subject to audit by MIA. The Office monitors these audits and notes that, to date, there have been no findings questioning the propriety of IWIF premiums or administrative charges.

The Treasurer acknowledges a 1990 contractual provision regarding monitoring claims administration activity, but notes that there is no definition in the historical records of what this monitoring process was intended to entail and there is no record of a performance report ever having been requested or submitted. Since the Treasurer's responsibilities are based on the 1990 agreement *between IWIF and the BPW*, there are a number of ways to resolve this issue. The Office believes discussions with the Board of Public Works for direction on what type of oversight or information the State deems necessary would be appropriate at this time and will initiate them. If detailed monitoring and oversight, including independent verification that the State's financial interests are adequately protected against a catastrophe, are deemed to be necessary, as the Auditors suggest, it is likely to require identifying and supplying staff and monetary resources that the Office does not currently have.

The Office concurs with the Auditor's recommendation to verify that the State receives all interest to which it is entitled and will follow-up directly with IWIF to obtain the necessary confirmation.