

# MAINE STATE LEGISLATURE

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**INDEPENDENT ACCOUNTANTS' REPORT ON APPLYING  
AGREED-UPON PROCEDURES  
FOR  
STATE OF MAINE, WORKERS' COMPENSATION BOARD  
FISCAL YEARS BEGINNING JULY 1, 1997  
AND  
ENDING JUNE 30, 2007**

**Blake Hurley McCallum & Conley, LLC · Certified Public Accountants**

344 Main St. Westbrook, Maine 04092 · (207) 854-2115/Fax 854-2118

December 19, 2007

Mr. Paul R. Dionne  
Executive Director  
Workers' Compensation Board  
Deering Building, AMHI Complex  
27 State House Station  
Augusta, ME 04333-0027

Re: Agreed-upon procedures

Dear Mr. Dionne:

On behalf of our firm, I want to thank you and your staff for the courtesy, cooperation and forthrightness extended to us during the completion of our field work with respect to our agreed-upon procedures engagement. In particular, with respect to the areas we examined, we found staff to be organized, diligent and dedicated in the manner they carried out the mission of the Workers' Compensation Board. We commend you, and the staff, for those efforts.

Throughout our report, we noted areas where, in our opinion, efficiencies and safeguards could be improved, both in the administrative sector, and in the legislative sector.

With respect to administrative functions, we refer you to our report on the internal controls related to the billing and collection of assessments, which is included as Appendix A of the report. In that report, we recommend that stricter controls over cash receipts be implemented, that WCB add an audit function with respect to the examination of assessment remittance reports and collections, and that WCB transition to a professional accounting software package so that billings and receipts can be tracked and reconciled in a more efficient and accurate manner.

With respect to the statute, we noted that the reserve accounting and refund requirements do not account for the inherent time span over which estimated assessments are collected.

We noted that the application of the refund statute can lead to the case where costs incurred to refund an over-collection exceed the nominal amount of the refund.

We noted that the statute favors self-insurers over insurance carriers' customers in that self-insurers share in the division of over-collections, even though self-insurers do not contribute to the over-collections.

December 19, 2007

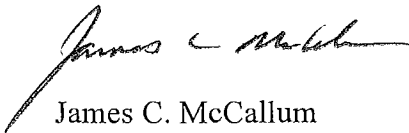
Mr. Paul R. Dionne  
Executive Director  
Workers' Compensation Board  
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We noted that employers who transition to self-insurer status, by virtue of the statutory mechanics, permanently escape one year of assessment.

Finally, we noted that, in the aggregate, the costs and administrative burdens of all stakeholders would be lessened if insurance carriers were assessed in the same manner as self-insurers.

Thank you again, Mr. Dionne, for your time, consideration and patience. We look forward to discussing these issues with you and with the Labor Committee in the near future.

Sincerely,

A handwritten signature in dark ink, appearing to read "James C. McCallum", with a stylized flourish at the end.

James C. McCallum

**STATE OF MAINE-WORKERS' COMPENSATION BOARD**

**Independent Accountants' Report On Applying Agreed-Upon Procedures**

**Fiscal Years Beginning July 1, 1997 and Ending June 30, 2007**

**Procedures, Results, Observations & Recommendations**

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To the Board of Directors  
State of Maine-Workers' Compensation Board

We have performed the procedures described herein, which were agreed to by the State of Maine-Workers' Compensation Board, solely to assist you with respect to the following items:

Procedure 1: Written evaluation of the internal controls under which assessments are levied, distributed and refunded.

Procedure 2: Accuracy of recording of assessment collections by applicable year.

Procedure 3: Agreement of WCB schedule of collected assessments to DAFS trial balance.

Procedure 4: Accounting for assessments collected in excess of the statutory cap.

Procedure 5: The consistency of actual expenditures in relation to legally adopted budgets.

Procedure 6: The review of the schedule of the reserve activity.

Procedure 7: Report on development of assessment rates.

Procedure 8: Report on adequacy of resources-Monitoring, Audit and Enforcement Program and Workers' Advocate Program.

The procedures and results, along with observations and recommendations, are described in detail in the pages accompanying this report.

The State of Maine-Workers' Compensation Board's management is responsible for the Board's accounting records. This agreed-upon procedures engagement was conducted in accordance with attestation standards established by the American Institute of Certified Public Accountants.

We were not engaged to, and did not, conduct an audit, the objective of which would have been the expression of an opinion on specific elements of the accounting records of the State of Maine-Workers' Compensation Board. Accordingly, we do not express such an opinion. Had we performed additional procedures, other matters might have come to our attention that would have been reported to you.

This report is intended solely for the information and use of the State of Maine-Workers' Compensation Board and is not intended to be and should not be used by anyone other than this specified party.

Blake Hurley McCallum & Conley, LLC  
Westbrook, Maine

December 19, 2007

# **STATE OF MAINE-WORKERS' COMPENSATION BOARD**

## **Independent Accountants' Report On Applying Agreed-Upon Procedures**

**Fiscal Years Beginning July 1, 1997 and Ending June 30, 2007**

### **Procedures, Results, Observations & Recommendations**

After reviewing the applicable statutes and documenting our understanding of the procedures used in the computation, distribution, billing, collection and recording of assessments, the development of assessment rates, the calculation of assessments collected in excess of statutory amounts, the calculation of the reserve account balance, and the adoption of and implementation of budgeted expenditures, we performed the following requested procedures:

#### **Procedure 1: Evaluation of Internal Controls-Levy, Distribution and Refund of Assessments**

Our report on the evaluation of internal controls is included as Appendix A of this report.

#### **Procedure 2: Accuracy of Recording of Assessment Collections by Applicable Year**

We were requested to review a schedule of assessment collections by fiscal year to determine whether they had been tracked appropriately by tracing assessments per the report to the source documents to determine the reasonableness of the report. We were requested to agree total assessment by fiscal year to the Board's minutes.

WCB requested that we develop a sample for testing. Our sample resulted in the tracing of all significant collections (>\$310,000), as well as the random tracing of smaller collections.

The population of collected assessments for the ten fiscal years approximates \$78 MM, and is comprised of \$51 MM of insurance company collections and \$27 MM of self-insurer collections. Using dollar unit sampling, we obtained a sample resulting in a tracing of approximately \$43 MM of total collections (\$28 MM of total insurance company collections and \$15 MM of total self-insured collections). In percentage terms, our tracing sample consisted of approximately 55% of total collections recorded in the Workers' Compensation Board (WCB) collections database.

#### **Procedure 2-Results:**

##### **Tracing of self-insurer collections to source documents.**

WCB does not copy checks before remitting deposits to the Department of Administrative and Financial Services (DAFS). WCB is not required to save, and does not save, payer remittance advices once the State Audit is completed.

Beginning with the 2004 fiscal year, DAFS began saving copies of checks and began recording receipts in its system by payee, date and amount, and by category of payment. Prior to that fiscal year, no source documents existed at DAFS which could be tied to the WCB database. Accordingly, with the exception of a few cash receipts applicable to the WCB's 2003 FY but received by DAFS in 2004, we could not trace pre-2004 self-insurer cash receipts per the WCB database to any other document or accounting system. However, as noted later in this report, we were asked to perform, and did perform, a reconciliation of ten years of net receipts per the WCB database with net receipts reported per DAFS, arriving at a relatively minor and explainable variance.

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For fiscal years beginning July 1, 2003 and ending June 30, 2007, we agreed our detailed sample of self-insured collections per the WCB database to the cash receipts report generated by DAFS, without exception.

We did note the following exception. The 2007 assessment called for self-insurers to pay an aggregate of \$3,425,483 in assessments. While tracing collections of self-insurer assessments to the master spreadsheet, we noted in the detailed 2007 fiscal year spreadsheet that the collections of self-insurer assessments fell short from the anticipated collection by an amount of \$284,161. This occurred because, after the original assessment was finalized and mailed, WCB discovered that two self-insurers were no longer self-insured as of May 1, 2006. The shortfall was apportioned among the remaining self-insurers in anticipation of a supplemental assessment. To date, the supplemental assessment has not been made. We also noted the occurrence of this event in two other fiscal years. However, those short falls were less than \$10,000 in each instance.

WCB obtains a list of all previous year self-insurers from the Bureau of Insurance in April, along with claims paid for that year. Staff indicated that letters are mailed in April to all self-insured employers, asking them to confirm the dollar amount of claims reported to WCB from the Bureau of Insurance, and to notify WCB if they are no longer self-insured. WCB assumes that the employer is still self-insured if no reply is received.

In this case, the two employers dropped self-insurance at some point between the date the Bureau of Insurance notified WCB of their status, and May 1, which is the cut-off date for assessment. The two employers did not notify WCB of their change in status until they received the assessment. Staff indicated that, usually, these letters are sent to employers via certified mail. In this year, the letters were sent by ordinary mail, and receipt by the employers in question could not be verified. We were told that, because receipt could not be verified, WCB did not pursue payment from these employers. We question whether the law will allow such a pursuit, as the statute indicates that the employers would not be liable for the assessment.

#### Tracing of insurance company collections to source documents.

We traced receipts and refunds recorded in the database for each of the insurance companies included in our sample to the source documents remitted to WCB by the applicable insurance company. With the exception of minor posting errors in the nature of transposition errors or input errors, and rare postings to the wrong insurance company (usually located above or below the appropriate cell of the database), we were able to successfully trace source documents to the WCB database.

#### Tracing of total assessment by fiscal year to the Board's approved minutes.

We agreed the total assessment by fiscal year to the Board's approved minutes without exception.

# STATE OF MAINE-WORKERS' COMPENSATION BOARD


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#### Observation

##### Need for Audit Function

With respect to insurance companies, assessments are, similar to income taxes, self-assessed. However, unlike the income tax collection process, which functions on a "trust but verify" basis, no audit function exists at the WCB. Accordingly, insurance companies report and pay assessments on the honor system. 


We noted that insurance company remittance reports are recalculated by WCB for mathematical accuracy, and math errors are brought to the attention of the insurance company for resolution. Ultimately, the collected assessment agreed to the corrected remittance report. However, WCB does not request documentation from the insurance company to substantiate that the correct amount of premiums, upon which the assessment is based, are being reported on the remittance report.

In one instance, we noted that an insurance company reported fourth quarter premiums written in the amount of negative \$16,816,586, (approximately 75% of the premiums reported by the company over the first three quarters of the fiscal year). A refund of \$312,000 was allowed, as the insurance company submitted the report along with reports of related insurance companies reporting assessments, and one check, net of the \$312,000, was received and deposited by WCB. Ultimately, the company's September reconciliation report reflected a true-up liability of \$282,000, and the fourth quarter refund, if erroneous, may have been negated with the reconciliation payment. *Example*

Another example of non-compliance appears to exist in the reporting and payment of audit premium assessments. Staff informed us that some insurance companies never report and pay audit premium assessments, because they are either unaware of the requirement, or they ignore the requirement.


#### Recommendation

When insurance companies underpay their assessments, and are not held accountable, stakeholders who comply with the law ultimately pay for the non-compliers' underpayments. We recommend that, if the present assessment regimen is retained, WCB should institute an audit function to improve compliance with the assessment statute.

Of course, if insurance companies were assessed on the same basis as self-insurers, thus paying one assessment, once per year, 95% of the insurance companies' reporting and payment requirements would be eliminated, thus eliminating the need for WCB to institute an audit function with respect to assessment collections. We recommend that the Legislature give serious consideration to this proposal. 

#### Observation

##### Statutory Loophole Allows Escape From Assessment

A loophole exists in the statute allowing an employer transitioning to self-insured status to escape assessment for the initial year of self-insurance. The statute requires that the self-insurers' assessment be 

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apportioned among the self-insurers' pool based upon the proportionate amount of total benefits paid by the self-insurers in the previous year. A new self-insurer will not have a previous years' history of claims paid. Therefore, that employer will not be liable for an assessment with respect to its initial year of self-insurer status. In an extreme case, an employer could change status every other year and avoid paying the assessment every other year.

#### **Recommendation**

We recommend that the statute be amended to require self-insurers to remain in the self-insurer pool for assessment purposes in the year after they no longer are a self-insurer, in order to true up their assessment. Alternatively, self-insurers could be assessed in the initial year of self-insurer status, using the prior year's amount of claims paid on its behalf by its former carrier as its basis for assessment.

#### **Observation**

##### **Misallocation of Resources-Estimated Assessments-Insurance Companies' Customers**

The time consumed in administrating the billing and collection of assessments from insurance companies dwarfs the time consumed in administrating the collection of assessments from self-insurers. Close to 40% of an annual assessment is paid by the self-insurers. Yet, billing and collecting from self-insurers takes up only about 5% of WCB's total time to administer the billing and collection process.

Pursuant to the statute, self-insurers always pay exactly what they owe. They are assessed for their portion of the entire assessment, based upon their proportion of total disability cases reported in the previous year, and they pay their assessment once per year.

Insurance companies, on the other hand, pay WCB as they bill their customers for assessments. They pay three quarterly payments, a fourth quarter estimated payment, and finish the process with a final reconciliation report, which reflects a final payment or refund for the applicable year. In addition, in subsequent years, as insurance companies complete their customers' premium audits, they prepare additional reports and remit additional payments or refund requests, based upon the results of the audits. Audit remittances can trickle in for up to five years after the close of a fiscal year.

On a cumulative basis, thousand of hours are expended by WCB and the insurance companies to meet the compliance requirements of the assessment and payment statute. This cost to the system can be eliminated if insurance companies paid one bill, once per year, on the same basis as the self-insurers. Of course, the assessment would become a liability of the insurance companies. However, it would seem to be a more efficient use of resources for all stakeholders if the insurance companies adjusted their premium charges in order to pass one exact assessment on to their customers.

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#### Recommendation

Again, we recommend that the Legislature consider amending the assessment statute to require insurance companies to pay assessments on the same basis as self-insurers. This change would reduce the WCB's and the insurance companies' administrative costs.

#### Procedure 3: Reconciliation of WCB Receipts to DAFS Receipts

Originally, we were requested to trace annual assessment collection totals from WCB schedules to DAFS prepared trial balance accounts. However, while documenting our understanding of the procedures relating to the recording of insurance company collections at WCB, we discovered that WCB records collections only by the fiscal year to which the collections apply. For example, if WCB receives an audit premium assessment in June 2007 that applies to the 2003 fiscal year, WCB records the receipt in the 2003 database. DAFS, on the other hand, will record the collection in the 2007 fiscal year. In addition, assessments billed by the WCB in May and collected in June of any fiscal year are applied to the following fiscal year. DAFS will record that collection in the year of receipt, which is WCB's previous fiscal year. To complicate matters further, many times a customer will pay the assessment in July or a later month, which is after the due date of the payment. In that case, DAFS will have recorded the receipt in the same year as it is recorded on the WCB database.

Accordingly, it is impossible to trace the WCB totals to the DAFS trial balance without reconstructing the entire WCB database to reflect collections by applicable fiscal year AND by fiscal year of receipt.

Our documentation of procedures revealed that WCB does record the date of receipt of each self-insured collection. Because the vast majority of self-insured collections are received in a three-month period spanning only two fiscal years, and consists of a one time payment for the WCB's applicable fiscal year, we determined it would be feasible to attempt to reconcile self-insured collections for the 2004 through 2007 fiscal years to the applicable DAFS trial balance. This is possible because, beginning with the 2004 fiscal year, DAFS recorded the detail of self-insured receipts by name and date received. Accordingly, WCB's management requested that we attempt to reconcile the FY 2004 through 2007 WCB self-insured collections to the DAFS books of record.

WCB's management also requested that we attempt to perform a reconciliation of the aggregate net receipts recorded by WCB by applicable fiscal year to the aggregate net cash receipts reported by DAFS for the ten fiscal years in question, so that WCB could determine whether a reasonable and acceptable variance resulted from the reconciliation.

#### Procedure 3-Results:

We were able to reconcile the total of self-insured collections reported by WCB for the 2004-2007 fiscal years, noting the following variances:

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For the 2007 FY, the DAFS cash receipts report reflected three self-insured collections, totaling \$62,328, which were erroneously posted to DAFS insurance company collections account. After accounting for this error, we arrived at a variance of \$2,087 from the \$3,141,362 reported collected by WCB.

We reconciled the 2006 FY total self-insured collections to the DAFS reports, without exception.

We reconciled the 2005 FY total self-insured collections to the DAFS reports to within \$733.

We reconciled the 2004 FY total self-insured collections to the DAFS reports to within \$51.

For the period beginning July 1, 1997 and ending November 9, 2007, we attempted to reconcile the collections reported by WCB, as applicable to that period, with the total collections received by DAFS during that period.

During that period, DAFS recorded \$82.7 MM of cash receipts. After accounting for obvious reconciling items (e.g. June payments recorded in FY 1997 by DAFS but applicable to WCB's succeeding fiscal year), we reconciled the WCB collections to DAFS collections to within \$285,000. The variance equals .33% of the approximately \$82 MM received by DAFS during the period tested, and most likely is attributable to input errors, as well as timing differences which have not been identified, but should have been excluded from or included in the reconciling items.

### **Observation**

#### **Need for Accounting Software**

As we note in our internal control report (see Appendix A), the use of Microsoft EXCEL to track the database of detailed billings and collections does not facilitate accurate recording and reporting of billings and collections. By its nature, the task of manual data entry is error prone. Data entry errors can only be discovered and corrected if a reconciliation function is present. As designed, the EXCEL database does not allow for a reconciliation function.

During our first pass at reconciling the WCB collections to DAFS collections, we arrived at a variance of approximately \$1.3 MM. That variance narrowed to \$285,000 after we discovered, and the WCB corrected, Excel cell references in the master summary sheet, linked to incorrect cells from the detailed FY databases.

It is critical that the master summary sheet reflect accurate balances. The report tracks assessment collections by applicable year, and, among other uses, the data is used to determine whether or not the 10% cap has been exceeded for any particular year.

### **Recommendation**

We recommend that WCB transition to a professional accounting software package, beginning with the commencement of the assessment process for the 2009 FY. WCB should coordinate with the Controller's

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office to determine the feasibility of accounting for billings and collections using the State's accounting system. Alternatively, WCB could use QuickBooks in place of its EXCEL database.

#### Procedure 4: Accounting for Assessments Collected in Excess of Statutory Amounts

We were requested to determine whether collections exceeded statutory amounts, and, if so:

a) determine whether collections exceeding the statutory cap by more than 10% were properly refunded,

or

b) determine whether collections exceeding the statutory cap by less than 10% and above the allocated WCB budget were appropriately reserved in the WCB operating account.;

and

c) State whether refunds and distributions met statutory requirements.

#### Procedure 4-Results:

Procedure 4 (b) was performed in conjunction with the performance of Procedure 5. Please refer to that section of the report for those results.

WCB uses EXCEL to generate a report summarizing historic assessments and collections by fiscal year. We refer to this report as the "Master Summary Spreadsheet". This spreadsheet is linked to underlying detailed spreadsheets, which track collections by fiscal year. The spreadsheet also contains a formula to compute the difference between the amount of fiscal year collections and the Statutory amounts allowed to be collected for that particular fiscal year.

We tested the accuracy of all relevant components of the Master Summary Spreadsheet when performing Procedures 1 and 2. After correcting for errors discovered during the completion of those procedures, WCB produced an updated Master Summary Spreadsheet. Our review of this schedule resulted in the following determinations:

With respect to fiscal years 1998, 2005, and 2006, collections, net of refunds, to date, have exceeded the statutory cap in excess of 10% by the amounts of \$790,940, \$198,849 and \$135,536, respectively. In each of the remaining fiscal years at issue, at this point in time, net collections are not in excess of the statutory cap plus 10%.

To date, no collections in excess of 10% of the statutory cap have been refunded. Because refunds have not been issued, Procedure 4 (c) is moot. The 1998 estimated excess collection was "refunded" by reducing planned assessments in 1999 and 2000. WCB intends to issue refund checks with respect to the 2005 FY excess collection, as well as the tentative 2006 excess collection.

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#### Observation

##### **Statutory Refund Language Can Lead to Misallocation of Resources**

The statute states that over-collections "must be refunded to those who paid the assessment" (39-A MRSA Sec. 154 (6).) Taken literally, this section requires WCB to issue refunds to the insurance companies and the self-insurers in proportion to the assessments paid by them with respect to the year of excess collection, no matter how small the amount of the refund.

An apportionment of the FY 2005 \$198,000 over-collection among every eligible employer in the State would result in refunds to some which would amount to pennies. In many cases, where a credit to an account is not possible, postage would be greater than the amount of the refund.

In addition, aggregate administrative costs of all parties involved in the delivery and acceptance of the refund could conceivably outweigh the benefit of the refund. Insurance companies will need to apportion their piece of the refund among all of their customers and issue refunds to those who are no longer customers, and issue credit memos to those who are still customers.

Finally, some of these employers may no longer exist. (In fact, WCB states that some of the insurance companies who remitted assessments in 2005 are no longer in business. WCB is attempting to determine who the successor company is, or if a successor company exists.) In these cases, insurance companies and the WCB will need to file abandoned property reports and remit the refunds to the State Treasurer.

#### Recommendation

We recommend that the Statute be amended to eliminate the 10% cap language and the refund requirement, and, instead, require WCB to reduce future assessments when it determines that an excess reserve balance has accumulated.

#### Observation

##### **When Should the Refund Settle?**

The refundable amount of an over-collection is a moving target. Because insurance companies conduct premium audits in years subsequent to the year of assessment, the actual amount of assessment WCB collects, net of refunds, relative to an applicable fiscal, will not be known until five years after the close of the applicable fiscal year. Until that time, the refundable amount of over-collection is a moving target.

For example, WCB is processing a refund in the amount of \$201,000 for the 2005 fiscal year. This refund amount was arrived at in October, and was based upon the historic results known at that time. Today, the schedule reflects an excess collection of \$198,849, and this amount is sure to change over the next one to two years. An accurate refund can be issued only if the results of the fiscal year have settled.

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**Recommendation**

The statute does not impose a definitive time at which WCB must issue a refund. If the refund statute is not eliminated, we recommend that the statute should be amended to require WCB to refund only the amount in excess of the 10% cap which has been collected as of October 31 of the following fiscal year. The excess collected after that point would be added to the reserve account.

The practical reason for adopting this method is that insurance companies will more likely be able to track down their customers while the over-collection is fresh. If WCB must wait five years before the exact amount of over-collection settles, by then, many customers will have changed insurance companies, sold, merged or terminated their existence. Insurance companies will be vexed in their attempt to forward refunds to these customers.

**Observation**

**Who is Entitled to a Refund of Over-Collected Assessments?**

The statutory language is flawed in that it requires that an over-collection in excess of the 10% cap to be refunded to all who paid assessments in the applicable year of over-collection. Yet, self-insurers do not overpay their assessment, and should not be entitled to any portion of a refund.

Self-insurers pay exactly what they owe. Insurance companies' customers pay their share of the assessment based upon an estimate of premium dollars to be written for that year. Logically, any collection in excess of the annual assessment must have been paid by the insurance companies' customers, and, based on a principle of equity, only they would be entitled to a refund.

**Recommendation**

At a minimum, we recommend that the statute be amended to require that collections in excess of the 10% cap be remitted only to the insurance company customer base. The easiest and obvious solution, however, is to amend the law and place insurance companies on a par with self-insurers for assessment purposes.

**Observation**

**Reducing a Subsequent Year's Assessment Does Not Comply With Statute**

The statute (39-A MRSA Sec. 154 (6).) requires that assessments over and above the 10% cap "must be refunded to those who paid the assessment". With respect to the 1998 over-collection, WCB concluded that reducing the 1999 assessment was a proper means of refunding a previous year's collection in excess of the 10% cap.

We believe that WCB's 1999 action was at odds with the statute. The statute requires that refunds be issued "to those who paid the assessment". A refund in the form of a future year's assessment reduction

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will never result in an exact apportionment of an over-collection "to those who paid the assessment". WCB intends to refund over-collections with respect to the 2005 and 2006 fiscal years.

#### **Procedure 5: The Consistency of Actual Expenditures in Relation to Legally Adopted Budgets**

We were requested to examine WCB expenditure activity to determine if WCB has operated within its legally adopted budgets each year, assess whether internal expenditures have been consistent with legally adopted budget, and examine whether WCB expenditures authorized through the use of financial orders comply with M.R.S.A. Title 39-A. §154, paragraph 6.

#### **Procedure 5-Results:**

By relying on reports generated by the Appropriation Inquiry function of the State Budget and Financial Management System, we determined that the WCB has operated within its legally adopted budgets each year, as adjusted for authorized financial orders. Expenditures in each fiscal year were less than the allotted amounts. The excess allotments ranged from \$67,224 to \$555,975.

The Bureau of the Budget also provided us with the original adopted budgets and adjustments for financial orders for the fiscal years ended June 30, 2004 through June 30, 2007. We traced and agreed these amounts to the Appropriation Inquiry reports, which were provided to us by the State Controller' Office, without exception.

Adopted budgets and approved and recorded financial orders for the fiscal years beginning July 1, 1998 and ending June 30, 2003 were recorded on an outdated Financial Management system. The Bureau was not able to provide this information to us before the due date of our report. Accordingly, we were not able to trace Appropriation Inquiry totals to actual budget documents for those years. However, we were assured by the Controller's office that its system of internal controls act to prohibit WCB from spending any amount above and beyond its allocation, including approved financial orders.

#### **Procedure 6: The Calculation of the Reserve Account Balance**

We were requested to review a schedule of reserve activity in order to determine whether the reserve ever exceeded the 25% cap, and to examine compliance with the reserve language in M.R.S.A. Title 39-A. §154, paragraph 6.

Prior to fiscal year ending 2002, WCB did not perform a formal calculation of the reserve activity and ending reserve balance. As of the end of FY 2002, and through FY 2007, WCB began performing formal calculations, and we were provided with copies of these calculations. WCB informed us that, in consultation with Berry Dunn, it arrived at an estimated reserve balance of \$1,775,000 as of June 30, 2002. We reviewed the report issued by BDMP and agree with their conclusion that the accumulated reserve dollars are not easily identifiable prior to FY 2002.

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WCB requested that we modify our procedure and instead review the calculation of the reserve balance for the fiscal years 2003 through 2007, using the assumption that the estimated June 30, 2002 balance was accurate within reason.

#### **Procedure 6-Results:**

We reviewed the calculations of the estimated reserve balance as of the end of the 2003 through 2007 fiscal years. The schedules reflect balances not in excess of the statutory limit. The items affecting the change in reserve from year to year appear reasonably stated.

#### **Observation**

##### **Reserve Statute Implies Immediate Collection of Assessments**

The reserve statute is poorly designed. The statute requires that the following year's assessment be reduced when the reserve exceeds 25% of the previous year's budget. The statute implies that a fiscal year's assessment is fully collected by the close of the fiscal year. In fact, the assessment is collected over several years.

The WCB attempts to comply with the spirit of the statute by using good faith estimates to calculate an estimated reserve balance. Only in hindsight, many years down the road, will the WCB know if a calculated estimated reserve balance as of the end of any fiscal year compares favorably with actual reserve balance for that year.

#### **Recommendation**

WCB and the State Controller informed us that confusion abounds with respect to understanding of the accounting for reserves. They recommended, and we agree, that, in order to achieve more transparency, the statute should require WCB to calculate its reserve at October 31 of every year (a date by which WCB has collected ~~the~~ the vast majority of its receipts for the preceding fiscal year). Once the reserve has been calculated, that amount could be transferred from the operating account to a separate account. The reserve account balance would be trued up on each October 31<sup>st</sup>.

We recommend that the statute be amended to reflect the reality of the timing of collections. The statute should recognize that the reserve calculation is, by necessity, an estimate. Accordingly, an excess reserve could simply be declared to exist in an amount to be determined by the legislature, in consultation with the Board, or by the Board itself, thus eliminating the need for the 25% excess reserve language.

We also note that, by operation of statute, self-insurers also benefit from a subsequent year's assessment reduction when the reserve exceeds the 25% cap. As noted in our observations at Procedure 4, self-insurers pay exactly what they owe each year. Over-collections which are less than the 10% cap accumulate in the reserve. Over-collections exist only because the insurance companies' customers have overpaid previous years' assessments. However, the statutory language provides that self-insurers will benefit from

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assessment reductions due to an excess reserve adjustment, to the detriment of the insurance company customers.

This inequity can be remedied by assessing insurance companies' customers and self-insurers in the same manner.

#### Procedure 7: Report on Development of Assessment Rates

We were requested to report on how the assessment rates used to fund the Workers' Compensation Fund and Supplemental Benefits Fund (SBF) are developed. To accomplish this task, we reviewed the statutory language, the annual assessment reports, and the "Final Report of the Commission To Review The Budget Process of the Workers' Compensation Board". We also interviewed staff to obtain their understanding of the process. With respect to the Supplemental Benefits fund, we obtained a copy of the assessment letter issued by that organization. We also spoke with Kevin Cyr, The Supplemental Benefits Fund's financial analyst, to obtain his understanding of how the SBF assessment is developed.

#### Procedure 7-Results:

In the April or May of the preceding fiscal year beginning July 1, WCB determines the amount needed to fund its budgeted expenditures for the next fiscal year, and, after accounting for anticipated investment earnings and fines and revenue from sales of publications, it arrives at its target assessment, which must be less than the statutory cap for that fiscal year.

After adjusting for additions to or subtractions from the estimated reserve balance, the board arrives at a final assessment amount.

Next, the Board apportions the assessment among the self-insured pool and the insurance carrier pool. The apportionment rate is equal to each pool's share of the prior years' disabling cases as reported by the Department of Labor.

The self-insurers' share of the assessment is apportioned among them based on each member's share of the amount of total claims paid in the previous year.

The insurance carriers' customers' share of the apportionment must be further refined. The law requires that insurance carriers pass the assessment through to their customers as a percentage of the premium billed to their customers. To arrive at this rate, WCB obtains from the Bureau of Insurance a report stating the amount of previous years' premiums written in Maine. Using this report as well as other information which helps to establish a trend in the market, WCB arrives at an estimate of premiums to be billed in the next fiscal year. Using the final estimate of premiums to be billed as the denominator, and the insurance carriers' share of the assessment as the numerator, the WCB arrives at the percentage or rate which each carrier must apply to its customers' net premiums. WCB requests feedback from a number of the carriers before the assessment rate is adopted.

*How Assessment Rates are Derived*

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SBF's representative informed us, and its assessment form indicates, that it develops its assessment rates in the same manner as WCB, as required by the statute, based upon its' Board's estimate of the amount needed to reimburse qualified insurers in the subsequent fiscal year.

#### **Procedure 8: Report on Adequacy of Resources-Monitoring, Audit and Enforcement Program and the Workers' Advocate Program**

We were requested to report on the adequacy of the resources devoted to these programs. To accomplish this goal, we attended a four hour presentation and a two hour follow up meeting with staff to obtain information on the history of the programs, the objectives of the programs, the positions assigned to each program, and to ascertain the additional resources needed to meet the goals and objectives of the programs, as mandated by the statute. Below, we briefly summarize the history and responsibilities of the programs, and point out unmet statutory obligations.

#### **Procedure 8-Results**

**Monitoring, Audit & Enforcement Program:** In 1997, Public Law 1997, Chapter 486 was enacted to establish the Office of Monitoring, Audit, and Enforcement (MAE). The basic goals of MAE are to: (1) provide timely and reliable data to policymakers; (2) monitor and audit payments and filings; and (3) identify insurers, self-administered employers, and third-party administrators (collectively "insurers") that are not complying with minimum standards.

**Monitoring Program:** The Monitoring Division monitors the claims administration of insurers, self-insurers and third-party administrators to measure and report on their compliance with the Maine Workers' Compensation Act. It also provides basic compliance training to insurers, self-insurers, third-party administrators and employers to promote compliance with the obligations of the Maine Workers' Compensation Act.

The Maine Workers' Compensation Board measures compliance on four key performance indicators:

- 1) Filing of First Reports of Injury
- 2) Payment of Initial Indemnity Benefit
- 3) Filing of Initial Memoranda of Payment
- 4) Filing of Initial Indemnity Notices of Controversy (NOCs)

By 2003, the Monitoring Division's responsibilities had increased from simply updating insurer data and issuing reports, to providing in-depth analysis of Workers' Compensation trends (as directed by the Legislature), insurer work system analysis, workers compensation research, development and management of insurer "Corrective Action Plans" and development of communications methods to the insurer community.

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#### Monitoring Program: Unmet Statutory Obligations:

As of today, the program employs 3 monitoring specialists. Five (5) additional positions are required to meet increased demand for training and to meet outstanding statutory obligations.

The key unmet statutory obligations are:

1. Sec. 152 (10) requires WCB to continually monitor individual cases to ensure that benefits are provided in accordance with the Act.
2. Sec. 153 (1) requires WCB to perform the actions required by this section to ensure just and efficient administration of claims.
3. Sec. 213 requires WCB to create a work system to identify and monitor all claims requiring a permanent impairment ("PI") rating and assessment.
4. Sec. 359 (3) requires WCB to implement a monitoring program to evaluate and compare the cost, utilization and performance of the workers' compensation system for each calendar year beginning with 1988. The information compiled must include the number of injuries occurring and claims filed as compared to employment levels, the type and cost of the benefits provided, attorney involvement and litigation levels, and the long-term, post-injury economic status of injured workers, as well as any other data that is actuarially valid and can be utilized to accomplish the purposes of this Act, including rulemaking and recommending legislation.

#### Unmet Monitoring Program Needs.

As noted earlier, to fulfill its duties in a manner consistent with the statute, WCB needs 5 additional monitoring specialists (Management Analyst II).

In addition, in order to comply with the statutory obligations of the Act, the position of a Deputy General Counsel (as authorized by Title 2 Sec. 6(E)), is required to provide sorely needed legal support for both the Monitoring and the Auditing Programs.

Finally, WCB needs the services of a Communications/Education Officer to serve both the Monitoring and the Auditing Programs. This position would address the information "void" between WCB and the insurer community. This Officer will inform the insurance community of Electronic Data Interchange changes and instructions, performance benchmarks, legal decisions and Board positions. The Officer would also generate newsletters, maintain the Forms and Petitions Manual and conduct "Open" and "Rehabilitation" Training workshops.

**Audit Program:** The Audit Division conducts compliance audits of insurers, self-insurers and third-party administrators to ensure that obligations under the Workers' Compensation Act are met. In addition, the

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Audit Division provides advanced compliance training to insurers, self-insurers and third-party administrators to promote compliance with the obligations under the Workers' Compensation Act.

The functions of the audit program include, but are not limited to, ensuring that reporting requirements of the WCB are met, auditing the timeliness of benefit payments, auditing the accuracy of indemnity payments, and evaluating claims-handling practices.

#### **Audit Program: Unmet Statutory Obligations:**

As of today, the auditing program employs 4 auditors. Four additional auditors and one new audit manager position are required to meet the three year audit cycle, to meet increased demand for training, and to meet other outstanding statutory obligations.

The key unmet statutory obligations are:

1. Sec. 208 (2) requires WCB to ensure that health care providers file a medical report within five days of the date of visit. Failure to do so results in excessive denials of claims by insurers, thus creating an administrative burden on WCB and the insurers.
2. Ensuring that a health facility or health care provider is paid pursuant to statutory and regulatory requirements file petitions for payment, resulting in unnecessary disputes.
3. Sec. 213 requires that WCB to ensure that all cases involving permanent injury include an impairment rating, verify information provided to WCB by the insurers, and to audit compliance with threshold adjustments, benefit determinations and durational limits.
4. Sec. 359 (1) requires that WCB audit claims on an ongoing basis to determine whether insurance entities are meeting their obligations under the Act. Specifically, WCB is required to identify the disputes that arose, the reasons for the disputes, the method and manner of their resolutions, the costs incurred, the reasons for attorney involvement, the services rendered by the attorney, and repeated unreasonably contested claims.

#### **Unmet Auditing Program Needs.**

As noted earlier, to fulfill its duties in a manner consistent with the statute, WCB needs 4 additional auditors, and 1 new audit manager.

In addition, in order to comply with the statutory obligations of the Act, the position of a Deputy General Counsel (as authorized by Title 2 Sec. 6(E)), is required to provide sorely needed legal support for both the Monitoring and the Auditing Programs.

Finally, WCB needs the services of a Communications/Education Officer to serve both the Monitoring and the Auditing Programs.

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**Workers' Advocate Program:** History: 1992 legislation eliminated the "prevail" standard for injured workers' attorney fees. After 1992, attorney fees became the responsibility of the injured worker. Injured workers could not afford to obtain legal counsel unless the case involved a significant amount of money. The exodus of private lawyers for employees resulted in approximately 40% of injured workers being unrepresented.

In 1996 the Workers' Compensation Board administratively established a pilot worker Advocate Program. The program provided employees with the use of one non-attorney advocate to assist employees through the mandatory mediation process. In 1997, again with respect to mediation, the WCB expanded the program from one to five non-attorney advocates, with one advocate to be located at each regional office. In 1997, legislation was enacted to expand the advocate program to include litigation as well as mediation services.

Worker Advocates are similar to Public Defenders for injured workers. They provide legal services, advise and inform about statutory benefits and the claims process, represent injured employees in disputed workers compensation claims, and represent injured workers at Mediations and Formal Hearings.

By all accounts, the program has been successful in meeting its goals. Advocates now participate in approximately 50% of all mediation hearings (2,000 cases per year) and approximately 35% of formal hearings (approximately 700 cases per year).

#### **Unmet Workers' Advocate Program Needs:**

As of today, the program employs 12 Advocates (8 attorneys and 4 non-attorneys). However, WCB feels that the intent of the statute is to place the injured employee at legal parity with the employer and insurance carrier. To achieve this goal, WCB needs the addition of one deputy staff attorney and four paralegals.

The addition of one deputy staff attorney would allow each field office to have access to an on-site working supervisor. The additional paralegals would put the WCB attorneys on par with the typical private law firms, which, in general, assign a paralegal to each of its attorneys.

#### **Recommendation**

WCB's staff represented to us throughout our engagement that these programs need additional staff in order to function as intended by the legislation. We found their presentations to be convincing and compelling. We agree with staff that more resources are needed to fulfill unmet statutory requirements.

The WCB's Executive Director recognizes that State Government is entering an era of belt tightening. For this reason, we recommend that WCB attempt to fill these positions on an incremental basis. We recommend that staff prioritize these resources to serve as a blueprint for implementation once economic circumstances improve. The Executive Director concurs with this recommendation and agrees that the implementation can be carried out over time as the economic climate improves.

## **Appendix A-Evaluation of Internal Controls With Respect to Assessments**

### **Blake Hurley McCallum & Conley, LLC · Certified Public Accountants**

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To the Board of Directors  
State of Maine-Workers' Compensation Board

In planning and performing our agreed-upon procedures engagement, we considered internal control over collections and recording of assessments (internal control) as a basis for performing some of the agreed-upon procedures, but not for the purpose of expressing an opinion on the effectiveness of the Organization's internal control. Accordingly, we do not express an opinion on the effectiveness of the Organization's internal control.

Our consideration of internal control was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in internal control that might be significant deficiencies or material weaknesses. However, as discussed below, we identified certain deficiencies in internal control that we consider to be significant deficiencies, as well as material weaknesses.

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or a combination of control deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the entity's financial statements that is more than inconsequential will not be prevented or detected by the entity's internal control. We consider the following deficiencies to be significant deficiencies in internal control:

#### **1. Segregation of Duties**

We noted that one person is responsible for billing, collecting and recording assessment receipts. Although the size of WCB's accounting staff may limit the ability to separate duties, we believe certain steps could be taken to separate incompatible duties. The basic premise is that no one employee should have access to both physical assets and the related accounting records, or to all phases of a transaction.

An employee who has custody of checks as well as responsibility for recording cash receipts and tracking assessment receivables can easily convert cash to personal use and escape detection.

## **Appendix A-Evaluation of Internal Controls With Respect to Assessments**

### **Page Two**

#### **1. Segregation of Duties (Concluded)**

##### **Recommendation**

We suggest that the clerk who opens the mail also perform the following tasks:

1. restrictively endorse all checks upon receipt,
2. prepare the deposit ticket to accompany the remittance to the Controller's office
3. give the remittance reports and a copy of the deposit ticket to the accounting department.
4. Accounting should tie its daily postings per its software's report to the deposit ticket as well as to the Controller's daily cash received report and resolve any discrepancies.

WCB's management indicates that it will implement this recommendation.

#### **2. Change in Accounting Software**

Currently, no practicable methodology exists whereby one can reconcile each year of WCB record of cash receipts to each year of DAFS recorded cash receipts. Because WCB can not reconcile its data base entries to DAFS' cash receipt report on a daily basis, data input errors are not discovered. It is critical that the data input be accurate, as the 10% cap and 25% cap measurements are performed using reports generated from the data base.

##### **Recommendation**

The Controller's office has suggested that WCB should contact their people and schedule a review of WCB's accounting software needs. They believe they can design an accounting function within the State's current accounting software system which would allow WCB to post and track all billings and collections on both an "applicable year" and a "cash basis" format.

WCB's management indicates that it will follow through with this recommendation.

#### **3. Implement Audit Function**

We noted that insurance company remittance reports are recalculated by WCB for mathematical accuracy, and math errors are brought to the attention of the insurance company for resolution. However, WCB does not request documentation from the insurance company to substantiate that the correct amount of premiums are being reported.

**Appendix A-Evaluation of Internal Controls With Respect to Assessments**  
**Page Three**

We noted one instance where a remittance report, and the refund request accompanying it, did not on its face appear reasonable, yet the report was not challenged.

Staff also informed us that some insurance companies never report and pay audit premium assessments, because they are either unaware of the requirement, or they ignore the requirement.

WCB has a fiduciary responsibility to maintain the integrity of the assessment process. When insurance companies underpay assessments, and are not held accountable, stakeholders who comply with the law ultimately pay for non-compliers' underpayments.

**Recommendation**

We recommend that, if the present assessment regimen is retained, WCB should institute an audit function to improve compliance with the assessment statute. Audit techniques could include requiring an insurance company to submit an internal accounting document supporting the remittance report, or on-site audits of insurance companies. WCB should also contact all insurance companies which do not submit audit reports and inquire as to the reasons for non-submission.

WCB's management indicates that it will implement this recommendation.

**Material Weaknesses**

A material weakness is a significant deficiency, or a combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the entity's internal control.

We believe that the following deficiencies constitute material weaknesses.

Items 1, 2 and 3, above.

This communication is intended solely for the information and use of management of the State of Maine-Workers' Compensation Board and others within the organization and is not intended to be and should not be used by anyone other than these specified parties.

*Blake Hurley McCallum & Conley, LLC*  
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Westbrook, Maine

December 19, 2007