ALASKA STATE LEGISLATURE

LEGISLATIVE BUDGET AND AUDIT COMMITTEE

Division of Legislative Audit

P.O. Box 113300
Juneau, AK 99811-3300
(907) 465-3830
FAX (907) 465-2347
Internet e-mail address:
legaudit@legis.state.ak.us

October 31, 1999

Members of the Legislative Budget
and Audit Committee:

In accordance with the provisions of Title 24 of the Alaska Statutes, the attached report is submitted for your review.

DEPARTMENT OF LABOR AND WORKFORCE DEVELOPMENT
DIVISION OF WORKERS' COMPENSATION

October 31, 1999

Audit Control Number

07-4601-00

This report summarizes our review of the workers' compensation program administered by the Department of Labor and Workforce Development, Division of Workers' Compensation (DWC). This audit evaluates the State's workers' compensation program and the operations of DWC in the context of the legislative intent that accompanied the 1988 statutory changes made to the Workers' Compensation Act. In the report we discuss the reporting process, second injury fund issues, enforcement of uninsured employer sanctions, compensation issues, frivolous controversions, rehabilitation of injured workers, and insurance rates.

The audit was conducted in accordance with generally accepted government auditing standards. Fieldwork procedures utilized in the course of developing the findings and discussion presented in this report are discussed in the Objectives, Scope, and Methodology section.

Pat Davidson

Pat Davidson, CPA
Legislative Auditor

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OBJECTIVES, SCOPE, AND METHODOLOGY

In accordance with Title 24 of the Alaska Statutes and a special request by the Legislative Budget and Audit Committee, we conducted a performance audit of the workers' compensation program administered by the Department of Labor and Workforce Development. Alaska Statute 23.30 requires employers to maintain insurance coverage for the purpose of compensating workers injured in the course and scope of their employment. The Division of Workers' Compensation (DWC) administers the program with oversight by the Alaska Workers' Compensation Board (AWCB). Our review also considered workers' compensation insurance issues administered by the Department of Community and Economic Development (DCED), Division of Insurance (DOI).

Objectives

The objective of our audit was to evaluate the workers' compensation program and assess agency administration and enforcement, as well as the functional application of the Alaska Workers' Compensation Act as it relates to legislative intent.

Scope and Methodology

The scope of the audit encompassed all major operations of the workers' compensation program, including the administrative, reemployment benefits, and adjudicatory sections of DWC. Our scope also included reviewing the regulation of insurance companies by DOI.

We gained an understanding of the workers' compensation program to identify opportunities where operations could be improved to better serve stakeholders. Our examination involved the review and analysis of operating policies, practices, control activities and the current organizational structure and staffing. Specifically, we obtained and/or reviewed:

- Alaska Workers' Compensation Act (AS 23.30).
- Alaska insurance statutes (Title 21).
- Relevant state regulations.
- Budget documents.
- Organizational charts.
- Job descriptions.
- AWCB annual reports.
- AWCB bulletins.
- Case files.
- Compromises and releases.
- Workers' compensation rates and rating value filings.
- National Council on Compensation Insurance Annual Statistical bulletins.
- Audio tapes from the governor's workshop on workers' compensation held August 6-8, 1998.

To understand and evaluate the current climate of the program, we considered legislative intent outlined in Chapter 79, SLA 1988. We reviewed analysis, comments, and various other documents considered by the legislature during the 1988 statutory revisions. Additionally, we reviewed various Alaska Superior and Supreme Court rulings and Alaska Workers' Compensation Board decisions and orders to provide historical perspective and to better understand the public policy rationale behind the statutory changes made. We considered the operational practices of the divisions in conjunction with the legislative intent and the law and discussed these practices with workers' compensation attorneys. Discussions with the attorneys were to obtain their perception of workers' compensation in Alaska. We interviewed DWC hearing officers about the effect of certain court decisions on board deliberations and decision making.

To promote our understanding, we attended hearings and prehearings and interviewed staff about the workers' compensation claim process. We reviewed each step of the claim process including identifying the various forms required by law or regulation and the associated legal and regulatory timelines. We considered the effect of these timelines towards meeting legislative intent.

We tested controls over the verification of the annual reports filed by insurers or adjusters. We analyzed insurer or adjuster annual reports for timeliness, completeness, and accuracy. When penalties were assessed on annual reports, we tested the accuracy of the amount assessed. We recalculated program receipts including penalties and late fees as well as expenditures. We traced this data from the state accounting system to supporting documents to ensure expenditures made on behalf of injured workers were in accordance with the orders and awards of the Workers' Compensation Board. We tested revenues to ensure accurate accounting.

We analyzed regulation changes made during the past five years and evaluated prescribed forms for clarity and consistency with regulation timelines. We evaluated these changes for any impact on efficiency and complexity of the claim process.

We developed an understanding of the reemployment benefits process through interviews with staff and review of case files to evaluate the program's effectiveness. We also investigated the potential cost shifting to the Division of Vocational Rehabilitation for reemployment training.

We evaluated the manner in which physicians are identified and selected to perform second independent medical evaluations. We reviewed the physicians' application file for compliance with the law and regulations.

We evaluated the effectiveness of procedures used to identify uninsured employers and to enforce compliance with legal requirements. We also reviewed the extent of prosecutorial referrals to the Department of Law.

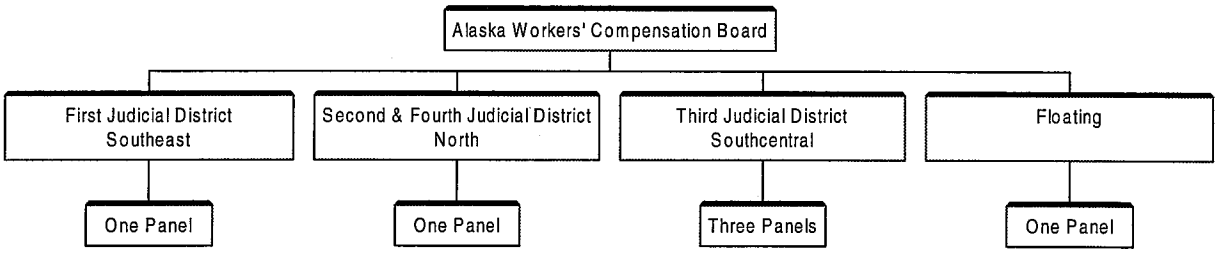
We discussed procedures for evaluating the reasonableness, adequacy, and fairness for proposed rates with DOI. We reviewed statistical trends related to workers' compensation premiums in Alaska and investigated the intent of a 2.7% tax assessed on workers' compensation insurance premiums. We attended proceedings of the Alaska Workers'

Compensation Review and Advisory Committee to obtain an understanding of its role in advising the director of DOI.

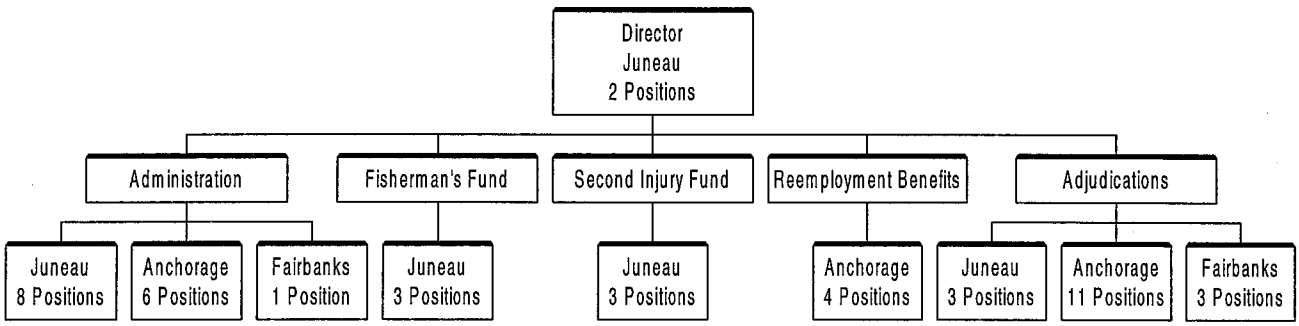
We reviewed recent prosecutions of workers' compensation fraud cases and discussed investigative procedures with the DOI representatives.

We also documented changes in staffing including turnover and budgeted positions. We also scheduled funding appropriated to DWC over the past nine years and analyzed authorized capital funding.

Alaska Workers' Compensation Board



Division of Workers' Compensation



ORGANIZATION AND FUNCTION

The Department of Labor and Workforce Development

Under the provisions of Title 23 of the Alaska Statues, the Department of Labor and Workforce Development (DLWD) is charged with fostering and promoting the welfare of the wage earners of the State, improving working conditions, and advancing opportunities for profitable employment. The department is responsible for administering:

- employment services, unemployment insurance, and workers' compensation programs;
- enforcing laws and regulations dealing with job safety, hours of work, wages, work conditions, and public employer/employee labor relations; and
- collecting, analyzing, and disseminating labor and population statistics.

Included in the provisions of Title 23 is the Alaska Workers' Compensation Act. This law requires employers to pay medical costs and part of lost wages if an employee is injured, or becomes ill, because of work conditions. In cases of death, dependents receive benefits.

The Division of Workers' Compensation (DWC) and the Alaska Workers' Compensation Board (AWCB) were organized in the Department of Labor and Workforce Development in response to, and derive their purpose from, the Alaska Workers' Compensation Act. (See organizational chart on the facing page.)

Purpose of the Workers' Compensation Act

The primary purpose of the Workers' Compensation Act is to ensure that Alaska workers who suffer injury or illness arising from their employment are provided adequate medical care, prompt payment of benefits and, if needed, voluntary rehabilitative services. An employer must buy the insurance from a licensed insurance company or be self-insured. An employer cannot require an employee to pay any part of the insurance premium. Neither DWC nor AWCB pay benefits.

The Division of Workers' Compensation

The Alaska Workers' Compensation Board

The Alaska Workers' Compensation Act established a 13-member board to adjudicate disputes between employees and employers, or their insurers. Twelve members are equally composed of representatives from the industry and labor markets. The commissioner of DLWD sits as the 13th member for the board as a whole, serving as chairman and executive officer of the board.

The 13 member AWCB is divided into six panels composed of three members per panel for the purposes of presiding over claim hearings. Each panel includes the commissioner of DLWD as chairman of the panel, a representative of industry, and a representative of labor. In practice, the commissioner typically designates a DWC hearing officer as his designee on

the panels. Except for the commissioner or his designee, each representative is appointed by the governor for a three-year term and is subject to confirmation by a majority of the legislature. The terms of an industry and labor member of each panel may not expire in the same year. The management and labor members are entitled to compensation in the amount of $50 a day for each day or portion of a day spent in actual meetings or on pre-authorized actual business.

A southern panel sits for the first judicial district, a northern panel sits for the second and fourth districts, three southcentral panels cover the third judicial district, and one panel serves as a floating panel for any judicial district.

AWCB is supported administratively by DWC. In the event of a dispute over a claim for benefits, AWCB panels schedule, hear and decide disputed cases. AWCB issues orders, including formal decisions and orders (D&O), to resolve such disputes. Its decisions are binding and reversible only by appeal to the state courts.

Administration

DWC is the administrative arm of AWCB in enforcing the Alaska Workers' Compensation Act. It collects and disseminates information about the workers' compensation program and provides administrative support to the board.

In Juneau, positions are primarily responsible for entering data, such as notices of occupational injury or illness and related physician reports, as well as employer required reporting including compensation reports and annual reports. In Anchorage, where the majority of claims are processed, the staff focuses on maintaining claim files and related form filings.

Adjudications

DWC works with employees and employers to mediate disputes and resolve issues before it becomes necessary to appear before AWCB. If disputes cannot be mediated, then AWCB hears the case and issues D&Os that are binding on all parties.

The adjudication staff assists injured workers in understanding their rights and responsibilities when filing a claim. Workers' compensation officers educate injured workers of the claim process and preside over pre-hearings prior to the claim being heard by AWCB. As the designated chairman of the AWCB panel, the hearing officers review cases prior to the hearing date and are responsible for issuing the AWCB's decision on behalf of the presiding panel.

Reemployment Benefits

DWC also oversees the administration of a voluntary vocational rehabilitation or reemployment program for workers unable to return to previous employment.

An employee may request an evaluation for reemployment benefits after reporting an injury to his/her employer. The Reemployment Benefits Administrator (RBA) may assign a rehabilitation specialist to evaluate the injured worker. Injured workers eligible for reemployment benefits are entitled to undertake a reemployment plan, the costs of which are paid for by the insurer. The RBA helps resolve disputes between injured workers and insurers.

Second Injury Fund

The Second Injury Fund encourages the employment of previously injured workers by protecting employers from disproportionate liability in the event a workplace injury produces a condition significantly worse than the second injury alone. Injured workers with a qualifying preexisting condition may join the fund, which reimburses the employer for the costs of benefits related to the preexisting condition. The fund provides a mechanism of shifting the risk of providing benefits related to the second injury and the total paid to the injured worker by reimbursing benefit costs beyond 104 weeks of compensation.

An employer must demonstrate that it had written documentation that an employee had a qualifying pre-existing condition, the employee was hired or retained with full knowledge of the condition, and a subsequent injury resulted in a condition substantially greater than the pre-existing condition alone.

Fisherman's Fund

The Fishermen's Fund was established in 1951 and provides for treatment and care of Alaska's licensed commercial fishermen who are injured or become ill due to fishing-related activities on shore in Alaska or in Alaskan waters.

The fund is not an insurance program, but an emergency fund payer of last resort. Benefits are awarded only after other coverage is fully considered from private health or vessel insurance, and public programs (except Medicaid). Benefits from the fund are financed from each commercial fisherman's license/permit fee.

As stated in the Objective, Scope and Methodology section of this report, the Fisherman's Fund was not included in our audit.

The Department of Community and Economic Development

The Department of Commerce and Economic Development was reorganized into the Department of Community and Economic Development (DCED) in FY 00. DCED is charged with the duty to work with Alaska's private sector and communities in creating new

jobs for Alaskans, strengthening Alaska's competitiveness in the world marketplace, and maintaining a fair and consistent business regulatory environment in the State.

The Division of Insurance

Title 21 of the Alaska Statutes provides DCED's Division of Insurance (DOI) with the authority and responsibility of regulating all aspects of the insurance industry in the State. The mission of the division is to protect and serve Alaska by developing, interpreting, and enforcing the insurance statutes and regulations, protecting and educating the Alaskan consumer, and enhancing the insurance business environment.

Filings Review Section

The primary duties of the filings review section involve reviewing and approving insurance rates, including workers' compensation. The section publishes consumer information detailing how insurance rates are calculated in Alaska.[1]

DOI licenses organizations that provide data collection and rate-making services to insurers. This oversight is carried out under provisions in Alaska law requiring rates not to be excessive, inadequate, or unfairly discriminatory. The National Council on Compensation Insurance, Inc. is the approved workers' compensation insurance rating organization for the State of Alaska, as well as 37 other states.

Financial Examination Section

The responsibility of the financial examination section is to enforce financial, tax, and trust requirements for insurance entities providing services in Alaska. The section also conducts examinations of insurance companies and agencies to determine whether the requirements of Alaska insurance law on financial areas are being met. The section is responsible for issuing certificates of authority to domestic insurers and to insurance companies who wish to be admitted to do business in the State. The section also collects all premium taxes and fees charged to insurance companies and brokers under Title 21.

The premium tax is deposited into the General Fund. Tax revenues attributable to workers' compensation were $4.1 million, $3.4 million, and $3.4 million for calendar years 1996 through 1998, respectively.

Investigation Section

The investigation section enforces statutes and regulations by investigating claims of fraud and other violations, including incidences of workers' compensation fraud.

[1]The *Workers' Compensation Rating Guide* may be obtained by contacting DOI or visiting its website at http://www.dced.state.ak.us/insurance/pubs.htm.

Consumer Services Section

The consumer services section examines insurance companies' records to ensure the consumer is treated fairly and the contract of insurance is adhered to. The section is responsible for investigating frivolous controversion determinations referred to the division by the AWCB.

Market Examination Section

The market examination section conducts compliance examinations and analyzes the non-financial operations of admitted insurers and other entities in the State. Examinations may be limited or comprehensive and include evaluating the performance and compliance with Alaska laws and regulations.

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BACKGROUND INFORMATION

Workers' compensation laws require employers to obtain insurance or a certificate of self-insurance in order to conduct business. The insurance is paid for by the employer and is designed to compensate employees who are injured or disabled while working. The insurance serves to protect employers from costs involved in litigating the questions of negligence and fault each time an employee is hurt on the job. The workers' compensation law is intended to provide benefits, paid by the employer's insurer, to cover the medical costs related to treating the injury involved and the worker's loss of earning capacity. These laws also provide benefits for dependents of workers who are killed because of work-related accidents or illnesses. However, the law is not intended to compensate either the injured workers or their families for pain and suffering.

In the 1980s there were concerns about the cost of workers' compensation insurance

Various representatives of Alaska's leading businesses established the Workers' Compensation Committee of Alaska (WCCA) in 1981. The mission of WCCA was *"to utilize every legitimate step to protect businesses and jobs by keeping insurance premiums low."* In 1982, WCCA joined with representatives of state chapters affiliated with the American Federation of Labor and Congress of Industrial Organizations to select representatives for an ad hoc committee. The committee was to recommend changes to the Alaska workers' compensation statutes for the legislature.

The ad hoc committee was composed of five members each from labor organizations and businesses. Several members of WCCA served on the ad hoc committee as business representatives. In 1986, in response to concerns over increasingly high insurance rates, the ad hoc committee asked WCCA to develop a list of issues to address. WCCA believed its recommendations represented a balance between employees and employers. The Department of Labor and Workforce Development (DLWD)[2] supported WCCA and agreed to work with the organization reflecting the perspective of Governor Cowper.[3] DLWD agreed to assist, with the proviso that the process examine the entire workers' compensation system and not have its sole aim the reduction of premiums.

Three central factors were identified as contributing to higher premiums

In its efforts to address the concern of high insurance rates in Alaska, WCCA identified three nationwide factors that contributed to increasing premium costs for workers' compensation insurance:

- Rising medical costs;
- Extended disability payments to individuals capable of returning to work; and

[2]The Department of Labor was reorganized into the Department of Labor and Workforce Development in FY 00. In this section, we will use the new acronym for the agency, DLWD.

[3]Suggested legislative revisions to the existing law was tempered by Governor Cowper's insistence that any bill affecting workers' compensation must lower costs to Alaska's employers.

- Vocational rehabilitation costs to retrain injured individuals for alternative work.

In 1988 the legislature comprehensively revised the workers' compensation statutes

Based upon its investigation and research in these three areas, WCCA developed model legislation for consideration. The legislation was aimed primarily at reducing the costs of premiums. After legislative deliberations, the comprehensive rewrite of the law adopted most of WCCA's recommendations and responded in total to the concerns set out by the group. The legislature included significant cost containment measures that put more requirements on injured workers, and provided employers' insurers more discretion and authority regarding the medical treatment sought by injured workers.

Changes in the law accompanied by extensive legislative intent

In addition to substantially amending the State's workers' compensation statutes the legislature adopted extensive intent that accompanied the law. Changes made to the statutes reflected the sentiments set out in the intent. For example, the first intent statement is as follows:

> *(a) It is the intent of the legislature that AS 23.30 be interpreted so as to ensure* ***the quick, efficient, fair, and predictable*** *delivery of indemnity* ***and medical benefits to injured workers*** *at a* ***reasonable cost to the employers*** *who are subject to the provisions of AS 23.30.* [Emphasis added.]

The new law reduced the number of times an injured worker could change attending physicians before obtaining the employer's approval (presumably making the process more ***quick and efficient***). The new law limited the frequency of treatment an injured worker could receive from an attending physician. WCCA believed, and the legislature evidently concurred, that requiring substantiation for continuing treatment would reduce costs. Workers who continually sought medical opinions to support their claims of injury, it was believed, were driving costs higher. By making treatment and physicians subject to review, the process was thought to be more ***fair*** *and* ***predictable.*** This pre-approval requirement would result in benefits *at a* ***reasonable cost to the employers***.

Legislative intent wanted courts to give more deference to board decisions

The second element of the adopted legislative intent was directed at the state courts. Apparently there was some feeling that the old workers' compensation law served as a basis for decisions that were too often of excessive benefit to injured workers. Given the separation of powers doctrine, the impact of legislative intent on court decisions may have been problematic, at best. However, we have reviewed court decisions that considered legislative intent. Specifically, the intent stated:

> *(b) The legislature declares that the* ***workers' compensation laws must not be construed by the courts in favor of any party.*** *It is the* ***specific intent*** *of the legislature that workers' compensation cases be decided on their*

> ***merits,*** *except when otherwise provided by statute. It is also the intent of the legislature that the board possess the greatest possible authority in the exercise of its fact finding responsibilities and that* ***the board's decisions be conclusive*** *unless the court finds that a reasonable person could not have reached the conclusion made by the board.* [Emphasis added.]

WCCA, in developing the model legislation that was adopted in large measure by the legislature, felt it was important that the Alaska Workers' Compensation Board (AWCB) have the weight of fact-finding authority. Under the revised statutes AWCB decisions are conclusive unless the courts find that a reasonable person could not have reached the conclusion made by the board. If supported by evidence, the legislature wanted the courts to uphold AWCB rulings, called decisions and orders, as decided. In those instances when the court was called upon to decide a case, the legislature emphasized the courts should do so on the merits of the case and within the confines of the statute.

Legislative intent addressed perceived disincentives to return to work

The third legislative intent statement commented that another element of the statutory revisions was to minimize perceived disincentives to return to work. The legislature set out:

> *(c) It is the intent of the legislature in amending AS 23.30.175 regarding benefits payable to recipients not residing in the state to*
>
> *(1) recognize the levels of workers' compensation benefits brought about by the high cost of living that exist in the state as compared to other localities;*
>
> *(2) increase incentives to* ***return to work****; and*
>
> (3) *remove obstacles to the* ***utilization of vocational rehabilitation*** *that may be brought about by the payment of worker's compensation benefits at the high levels provided by the Alaska worker's compensation law to individuals residing in localities with living costs lower than those in Alaska.* [Emphasis added.]

WCCA believed that disincentives to return to work were inherent in the old law and needed to be removed. The organization believed benefits paid to individuals residing outside the State were too high, given that they were based on typically higher Alaskan wage rates. The new law also intended to remove obstacles to providing rehabilitation benefits. It was believed the provisions in the new statute were structured to provide benefits to those truly in need and most likely to benefit. The new legislation sought to expedite the vocational rehabilitation process by incorporating relatively brief timelines with the expectation of producing more successful outcomes. The law was also directed at eliminating what was seen as the growing trend towards injured workers "extorting" higher settlements in lieu of the employer providing mandatory vocational rehabilitation training.

Legislative intent emphasized enforcement of legal requirements and obtaining accurate data

After including an intent statement that it wanted the new laws to encourage workplace safety, the legislature gave particular emphasis to the importance of enforcement and record keeping. Specifically, the legislature set out its intent as follows:

> *(d) It is the intent of the legislature in amending AS 23.30.075(b) and AS 23.30.155 that the division of workers' compensation, division of insurance, and Department of Law* ***strictly enforce the punishment*** *authorized under AS 23.30.075(b)* ***and the reporting requirements and penalties for noncompliance*** *under AS 23.30.155.* ***Strict enforcement is necessary*** *because*
>
> *(1) the* ***state has failed*** *to impose the punishment authorized under AS 23.30.075(b) against those employers who fail to obtain workers' compensation insurance or to qualify as a self-insurer; and*
>
> *(2) there is a* ***lack of specific data*** *from the division of workers' compensation and division of insurance to adequately assess the efficiency and costs of the workers' compensation system.* [Emphasis added.]

The old law required reporting on a claim-by-claim basis as well as an interim and anniversary basis. This process hindered the division's ability to collect, summarize, and analyze the data that resulted in the increasing insurance rates. While developing its model legislation, WCCA found the lack of data discouraging in its attempt to understand the reasons for increasing premiums. The organization believed that an annual standard reporting process for insurers would provide a basis for comparability and understanding of insurance premium trends. It appears WCCA encouraged the legislature to require collecting the total amount of all compensation by type, medical and related benefits, vocational rehabilitation expenses, legal fees, and penalties paid on all claims during the preceding calendar year.

The legislature wanted to encourage compliance with the reporting requirements by assessing penalties against insurers who fail to comply with reporting requirements as well as provisions for those who demonstrate good faith intent to comply with the requirements.

Responsibilities under the Workers' Compensation Act

Employers are legally required to provide compensation to employees injured in the course and scope of their employment. When an employee is injured or becomes ill as a result of work conditions, they are required to submit a completed report of occupational injury or illness to the employer and the Division of Workers' Compensation (DWC). An employee is required to give notice of the injury to DWC and the employer within 30 days after the injury. However, failure to give notice does not prohibit a claim from eventually being made.

An average of 28,100 Notices of Occupational Injury or Illness are filed annually

Based on an analysis of the DWC records covering the previous four fiscal years (July 1 to June 30) as reported in the agency's annual report, an average of 28,100 reports of occupational injury or illness are processed annually.

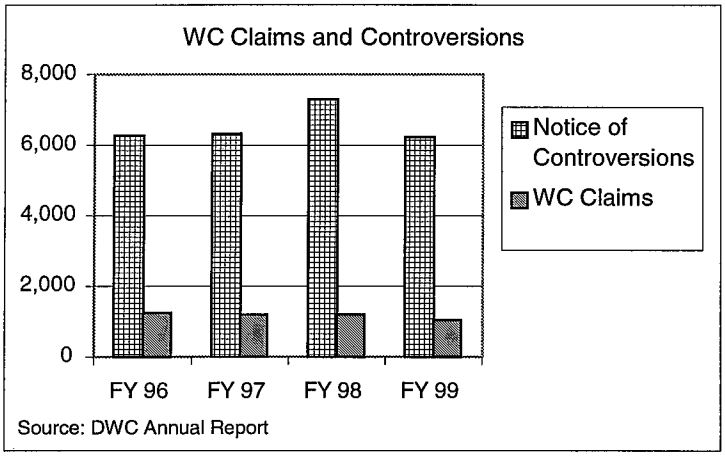
Notice of Occupational Injury or Illness

Type of Injury/Illness	FY 96	FY 97	FY 98	FY 99
Time Loss	8,984	9,654	10,003	9,490
Fatality	21	38	33	31
No Time Loss	18,989	19,214	18,529	17,516
Total	27,994	28,906	28,565	27,037

Source: DWC Annual Reports

As reflected by the figure above, about a third of notices represent claims involving time loss from work. A relatively small number involve worker fatalities.

Nearly 1,200 workers' compensation claims filed annually



If benefits for time loss or payment for medical treatment are controverted, that is, not paid by an insurer, an injured worker can file a claim to seek compensation for the work-related injury or illness. Compensation can take many forms including paying a physician for treatment on behalf of an injured worker or paying the injured worker wages while unable to work.

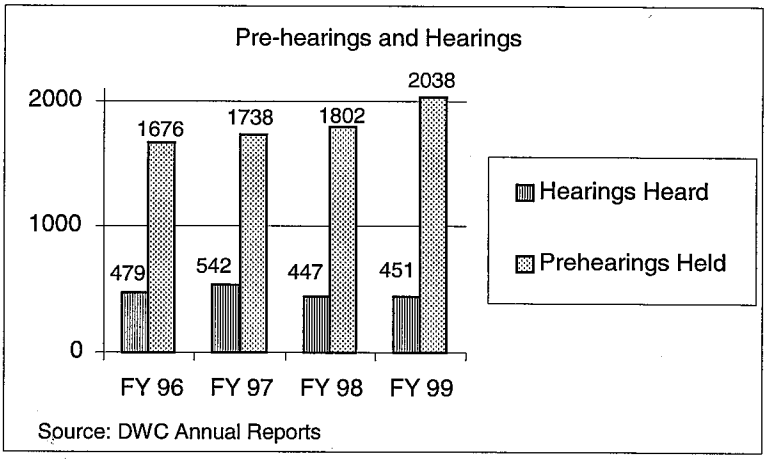
A claim presents the dispute to DWC and its adjudicatory authority, AWCB. DWC processes an average of 1,175 claims per year. A controversion notice, completed by the employer's insurer and served to DWC and the injured worker, informs the injured worker that benefits will not be paid based upon a specific dispute surrounding the injury or illness.

DWC processed an average of 6,500 controversion notices during FY 96 through FY 98. It is important to note that the number of controversion notices do not relate directly to the number of claims. A controversion can be filed on report of occupational injury or illness, a claim, or for a specific medical treatment and as such, there can be more than one controversion per claim.

On average, 1,800 pre-hearings and 479 hearings are heard annually to settle disputes

Requests for conferences answered by the employer or insurer, are scheduled for a pre-hearing with a workers' compensation officer I or II.

Pre-hearings are designed to identify and simplify the issues to present to AWCB. For those requests that were not answered by the employer, DWC schedules a hearing before AWCB within 60 days of the filing of the request.



There is not a direct correlation between the number of pre-hearings held and the number of hearings scheduled. Each claim can have multiple pre-hearings. On average, AWCB conducts 1,800 pre-hearings per year. Approximately 570 hearings are scheduled each year, however on average only 479 (85%) are actually conducted. Additionally, 4% are partially resolved or settled and 11% are continued into the next calendar year. In total, over the past three years AWCB has issued an average of 370 decision and orders per year.

AWCB approves approximately 570 compromise and release agreements annually

At any point in the pre-hearing and hearing process, the parties may agree to settle before formally presenting their case to the board. This settlement is referred to as a compromise and release (C&R). AWCB has approved approximately 570 C&Rs per year for the past three years. During the same period, AWCB denied an average of 90 C&Rs per year. However, the parties can revise the C&Rs and re-present them to AWCB for approval. Therefore, the number of approvals per year can include the C&Rs that were also included in the total denied C&Rs for the year.

A party can request an appearance in front of AWCB for reasons other than filing a claim for benefits. A petition provides the avenue for an injured worker to request the joiner of claims for multiple injuries into one claim or for a party to join an existing claim such as a physician who has not been paid because the claim for medical treatment has been controverted. A petition also allows the employer to request approval to terminate existing benefits altogether or for either party to request a second independent medical evaluation. DWC processed an average of 351 petitions per year over the previous three years.

Approximately 500 injured workers are evaluated annually for reemployment benefits

Between 30% to 40% of workers' compensation reports of injury DWC receives each year involve serious injuries that result in time-loss away from the job. Serious time-loss injuries

may permanently preclude a worker from returning to the position held at the time of injury. In such cases the injured worker may be eligible for reemployment benefits.

An injured worker or employer may request an eligibility determination from the Reemployment Benefits Administrator (RBA). An employer may request a determination at anytime, however an employee is required to make the request within 90 days of the workplace injury unless unusual and extenuating circumstances prevents the employee from making a timely request.[4] Each year, approximately 1,000 claimants seek reemployment benefits, but only about half are actually referred for an eligibility determination.

Once an acceptable request has been made and a medical report is received stating the worker may not be able to return to their prior occupation, the injured worker is assigned a rehabilitation specialist for an eligibility determination. Rehabilitation specialists must be Certified Disability Management Specialists or Certified Rehabilitation Counselors. Rehabilitation specialists sometimes perform contractual work outside the DWC reemployment benefits program for other rehabilitative agencies or private insurers.

The rehabilitation specialist obtains information regarding the worker's job duties at the time of injury and positions held or trained for in the previous 10 years. The determination also examines whether the worker received rehabilitation training through a previous work injury. Finally, the employer is queried whether substitute work within the claimant's physical capacities is available. The rehabilitation specialist uses the information in concert with statutory eligibility requirements and recommends the RBA either rule the worker eligible or ineligible for reemployment benefits.

Those determined eligible and choose to accept reemployment benefits select a rehabilitation specialist to design a plan incorporating the interests and goals of the worker. Reemployment plans may consist of academic, vocational, on the job training, or self-employment. The workers' compensation law limits the cost of a plan to a maximum of $10,000 (excluding evaluation and monitoring costs) and requires the plan be completed within a two-year period. A plan may begin upon employer and employee approval. If the parties cannot agree, the employer may submit a second rehabilitation plan and either party may request their plan be reviewed by the RBA for approval. All things being equal, the RBA must approve the plan that ensures remunerative employability in the shortest possible time.[5] Any appeals above that level must go before AWCB for hearing.

Upon reaching medical stability, reemployment benefit participants participate in the cost of their rehabilitation by receiving their permanent partial impairment (PPI) benefits at the temporary total disability (TTD) benefit rate. If PPI benefits are exhausted before completion or termination of the plan, benefits decrease to "41(k)" wages, calculated at 60% of the

[4] The RBA has interpreted unusual and extenuating circumstances to include instances where the treating physician did not inform the injured worker that there was a possibility that he or she may be permanently precluded from returning to their job as a result of the injury.

[5] Alaska Statute 23.30.041(i) references remunerative employability, which is defined in AS 23.30.041(q)(7) as *"having the skills that allow a worker to be compensated with wages or other earnings equivalent to at least 60 percent of the worker's gross hourly wages at the time of injury...."*

employee's spendable weekly wages.[6] However, if the plan is completed or terminated, the injured worker is entitled to their PPI benefits in a lump sum.[7]

The progress of plan participants is monitored by rehabilitation specialists and reported to the RBA. Participants must cooperate with plan objectives and responsibilities, such as maintaining acceptable grades and contact with the rehabilitation specialist. Participants who do not cooperate may have their plan terminated or benefits suspended. However, such actions may be appealed to the RBA and ultimately to AWCB.

A C&R between the employer and employee can be signed at any time during the reemployment process.

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[6]Alaska Statute 23.30.041(k) states in part, *"[i]f an employee reaches medical stability before completion of the plan, [TTD] benefits shall cease and permanent impairment benefits shall then be paid at the employee's [TTD] rate. If the employee's permanent impairment benefits are exhausted...the employer shall provide wages equal to 60 percent of the employee's spendable weekly wages but not to exceed $525, until completion or termination of the plan."*

[7]Alaska Statute 23.30.041(k) states in part, *"[a] permanent impair benefit remaining unpaid upon the completion or termination of the plan shall be paid to the employee in a single lump sum."*

REPORT CONCLUSIONS

Our analysis of the workers' compensation program considered laws, legislative intent accompanying the amended statute, and regulations related to state operations. As discussed in the Background Information section, extensive legislative intent accompanied the comprehensive revision to the Workers' Compensation Act (WCA) in 1988. We focused on key aspects of this intent, which provided a context for our evaluation of the State's workers' compensation program. These key concepts were as follows:

- quick, efficient, fair, and predictable delivery of indemnity and medical benefits;
- reasonable costs to employers;
- laws not being construed by the courts in favor of any party;
- compensation cases decided on merits;
- strict enforcement of reporting requirements; and
- strict enforcement of punishment for uninsured employers.

Our analysis of the 1988 changes in the workers' compensation program identified the primary objective of the legislature in changing the law was to lower workers' compensation costs to Alaskan employers. It was widely reported that the pre-1988 law favored injured workers, at the expense of state businesses and economic development.

In our view, the 1988 revisions were not made with the specific intent of disadvantaging injured workers. Rather, the statute was to be balanced between the interests of injured workers and the insurance companies who provided protection to employers. Workers' compensation premiums paid by employers were on the rise primarily due to increasing medical costs, extended disability payments made to workers thought capable of returning to work, and the costs of retraining individuals for alternative work.

The legislature, as discussed in this section, achieved its policy objective of lower workers' compensation costs. However, in achieving this goal, a situation has developed due to a variety of circumstances that have left injured workers disadvantaged by the statute. Such circumstances, that we believe are an unintended by-product of the 1988 amendments, have resulted in a situation where more consideration is provided to employers and insurance companies than to injured workers.

As set out in this report, circumstances have developed that limit the protections the legislature meant to be in place, and strictly enforced, to the benefit of workers. Specifically, as discussed in this section:

1. The policing of uninsured employers is largely ineffective due to administrative shortcomings in the Division of Workers' Compensation (DWC) and the prosecutorial philosophy of the Department of Law.
2. Sanctions against frivolous controversions have been rendered ineffective by the policies and practice of the Division of Insurance.

3. In addition to these administrative and interagency coordination problems, in places where the statutes may lack clarity, they have been interpreted and applied to the benefit of the insurance companies. Specifically, when calculating penalties and penalty "forgiveness" provisions of the statutes, DWC does so in a manner most beneficial to insurance companies.

Meanwhile, provisions put in the 1988 statutes as part of a legislative desire to control, if not lower workers' compensation insurance rates have, over time, become increasingly contrary to the interests of injured workers. Specifically, as discussed later in the section:

1. The caps on injury awards and burial costs set out in statute in 1988, have eroded over time by inflation.

2. The complexity of the disputed claims process has generally, in our view, worked to the disadvantage of injured workers who often cannot obtain appropriate representation, or who are inordinately affected by delays in the quasi-judicial process.

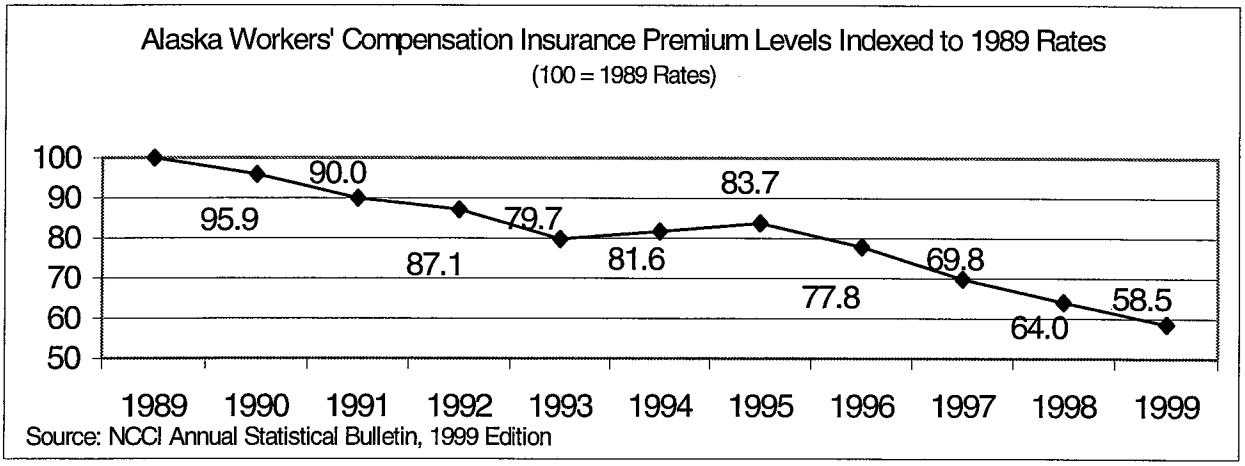
3. Constraints on the eligibility requirements for injured workers to qualify for retraining and reemployment benefits have proven to be overly restrictive.

Accordingly, the underlying theme to the Findings and Recommendations section of the report addresses this unbalanced situation. We suggest where state agencies could improve their procedures to tighten the enforcement of the statute as intended by the legislature. We also identify where the statutes could possibly be amended to add clarity or additional enforcement authority in order to provide a better, overall, even-handed mechanism for implementing the workers' compensation law.

A complete discussion of conclusions of this review is as follows.

The public policy objective of decreasing workers' compensation premiums has been achieved

As discussed in Background Information section of this report, the primary public policy issue triggering the 1988 revision to the Workers' Compensation Act were high insurance premium rates. In our view, the primary goal of the act has been achieved. According to statistics provided by the National Council on Compensation Insurance, Inc. (NCCI), workers' compensation insurance rates in Alaska have decreased in eight of the last ten years. As evidenced on the graph on the following page, overall this equates into a decrease of 41.5% since 1989. However, it is important to appreciate the fact the cost of providing workers' compensation insurance in Alaska is typically higher than many other states for which comparable data was available. Ultimately this is realized in insurance premium rates.



Compensation inequities in the law result in an imbalance toward injured workers

The 1988 comprehensive rewrite of the workers' compensation laws was intended to arrive at a balance between injured workers' interests and employers' rising insurance costs. The rewrite successfully addressed the concerns over rising workers' compensation insurance costs. However, achievement of this public policy objective has caused an imbalance that results in hardships to some injured workers. Our review of the law indicates that certain aspects of the workers' compensation system are not consistent with the explicit legislative intent that addresses fairness. Some of the inequities to injured workers result from inflation in addition to compensation policy decisions established at the time the law was adopted.

The value of benefits paid to injured workers has declined for some types of compensation where the law sets a maximum. In two of these areas, the established cap has remained unchanged since the laws were adopted in 1988. With regard to funeral expenses, the compensation has remained unchanged since adoption in 1983. Some examples of statutes establishing an upper limit, where benefits are affected by inflation include:

- Alaska Statute 23.30.190: In case of an impairment partial in character but permanent in quality, and not resulting in permanent total disability, the whole person value of $135,000 is multiplied by the employee's percentage of permanent impairment of the whole person.[8]

- Alaska Statute 23.30.215: With regard to compensation for death, reasonable and necessary funeral expenses are not to exceed $2,500.

[8]This section is titled compensation for permanent partial impairment; rating guides. The section states that the percentage of permanent impairment of the whole person is the percentage of impairment to the particular body part, system, or function converted to the percentage of impairment to the whole person. The existence and degree of permanent impairment shall be made strictly and solely under the whole person determination as set out in the *American Medical Association Guides to the Evaluation of Permanent Impairment.*

- Alaska Statue 23.30.041(l): Provides a cap for reemployment plan costs. The employer is to pay the costs of the plan, however total costs of the plan may not exceed $10,000.

Based on the consumer price index, the value of the dollar has decreased by 40% since 1988. As an example, at today's dollars, the whole body value would be increased from $135,000 to approximately $189,660.

Other policy decisions or omissions that adversely affect an injured worker and are seemingly unfair include:

- Alaska Statute 23.30.220(a)(4)(A): Exclusion of overtime or premium pay, if at the time of injury, the employee's earnings were calculated by the day, hour, or by the output of the employee.

- Alaska Statute 23.30.155(d): Interim benefit payments only when a payment of temporary disability benefits is controverted solely on the grounds that another employer or another insurer of the same employer may be responsible for all or a portion of the benefits.

An example of an inequity with regard to overtime occurs when an injured worker, paid on an hourly basis, may work seven days a week, two weeks on and two weeks off. The employer may pay overtime for weekend work. However, the overtime pay rate is not included in the calculation of gross weekly earnings. The gross weekly earnings are computed by dividing the employee's base pay rate, not including overtime or premium pay, earned during any period of 13 consecutive calendar weeks within the 52 weeks immediately preceding the injury that is most favorable to the employee.

With regard to interim pay, if an employer controverts an injured worker's right to compensation, payment is normally discontinued[9] or not initiated. By statute, the injured worker has the presumption of compensability, however if there is substantial evidence to the contrary[10] and a dispute exists between the injured worker and the employer, the injured worker is penalized by not receiving benefits until a decision is made in his or her favor on the claim. Any delay works against an injured worker, as an insurer has financial incentive to delay payment of a claim.

Legislative intent per Chapter 79, SLA 1988 states the law is to ensure, in part, fair delivery of indemnity and medical benefits to injured workers. The provisions discussed above appear to be inconsistent with this intent. (See Recommendation No. 2.)

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[9]Unless the payment was for a temporary disability payment controverted solely on the grounds that another employer or another insurer of the same employer may be responsible for all or a portion of the benefits.

[10]Attorneys representing injured workers reported "substantial evidence" has a lower threshold than clear and convincing evidence.

The workers' compensation disputed claim process is complicated to claimants

The Alaska Supreme Court has said that DWC has the responsibility to fully advise the claimant of his right to compensation and how to pursue that right under the law.[11] Additionally, DWC's mission statement is to assure prompt benefits and care to injured Alaskan workers.

DWC Mission Statement

To assure that Alaskan workers who suffer work related injuries or illnesses are provided adequate medical care, prompt payment of benefits, and if needed voluntary rehabilitative services.

As discussed in the Background Information section, an average of 28,100 reports of occupational injury are processed annually by DWC. For the majority of injuries, the process is relatively straightforward. Of the 28,100, approximately only 1,175 are disputed through the workers' compensation claim process (see Exhibit A on the following page). However, the process for resolving a claim dispute is confusing for the claimants due to the complicated and litigious nature of the process. A claim dispute typically begins when an insurer chooses not to pay medical or benefit compensation that an injured worker believes is due. Although work related injuries have a presumption of compensability, an insurer can deny benefits with substantial evidence to the contrary. Once denied, a litigious-like process often begins involving factors such as discovery, serving of documents, employer-requested medical examinations, and second opinions.

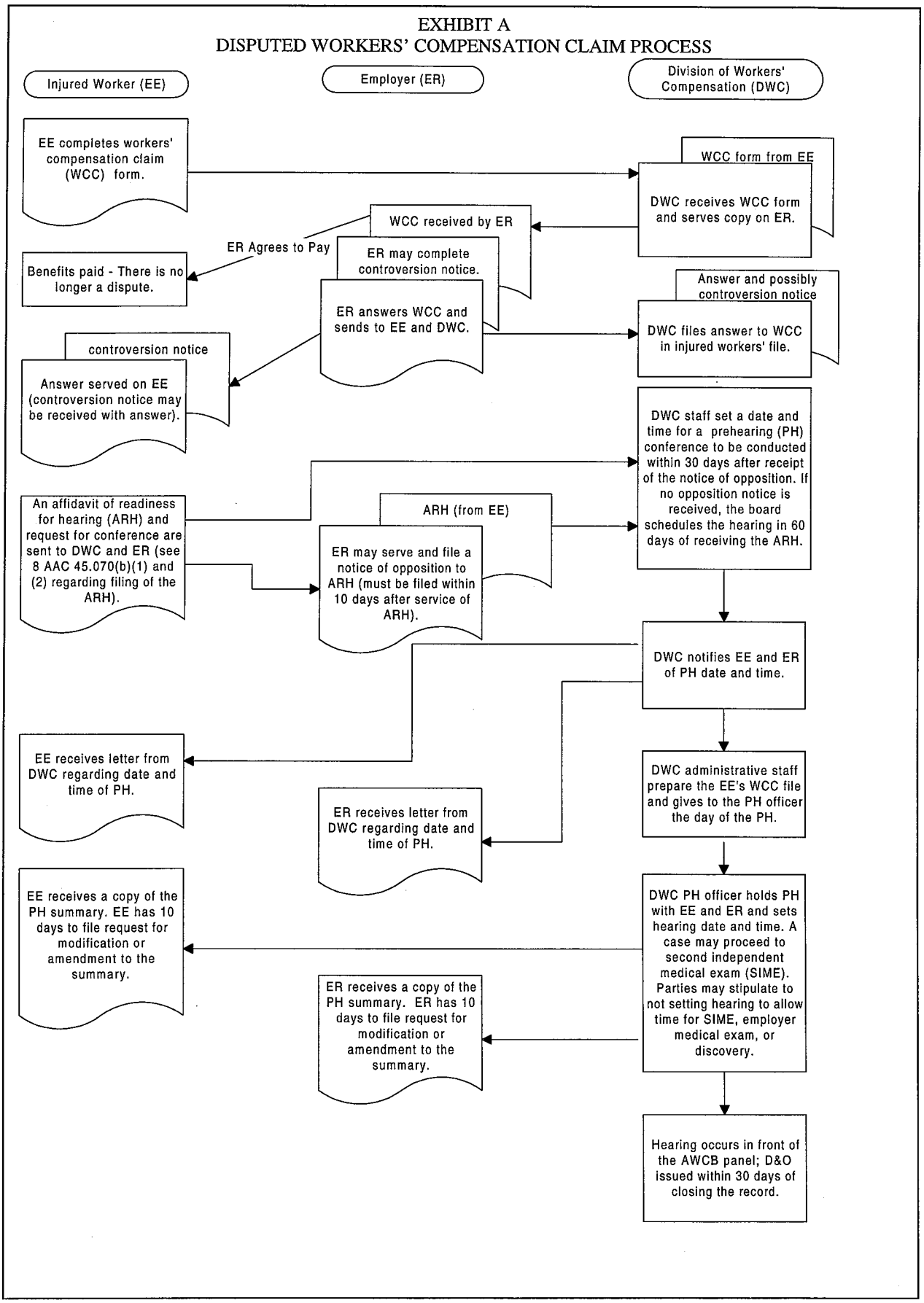
Injured workers involved with disputed claims expressed frustration with understanding the statutes and regulations, including the associated timelines, legal documents, and hearings. Some injured workers also described difficulty in securing legal counsel due to either complexity of the injured worker's case, or size of the attorney's current caseload. Attorneys expressed the need to specialize in worker's compensation cases due to the complexity of the process.

Specifically, testimonial evidence about the complicated nature of the process was obtained from the following sources:

- Audio taped testimony by injured workers and doctors at the governor's workshop on workers' compensation held August 6, 1998 through August 8, 1998.
- Interviews with workers' compensation attorneys.
- Discussions with numerous injured workers and treating physicians in unsolicited phone conversations.
- Discussions with DWC hearing officers.

[11] *Richard v. Fireman's Fund Insurance Company*, 384 P.2d 4 (Alaska 1963). A workers' compensation board or commission owes to every applicant for compensation the duty of fully advising him as to all the real facts which bear upon his condition and his right to compensation so far as it may know them, and of instructing him on how to purse that right under the law.

EXHIBIT A
DISPUTED WORKERS' COMPENSATION CLAIM PROCESS



There is limited published information available to the public describing the claims resolution process step-by-step, to make it less imposing and more user friendly. Such information is needed to augment the limited staff time available to assist injured workers. DWC literature does not provide enough substance for someone to adequately understand all of the nuances of the process given its litigious nature. [12]

Guidance for the injured worker is also provided in the WCA outlined in statutes, and the Department of Labor and Workforce Development (DLWD) regulations. The WCA is a legal process that incorporates judicial procedures that the average layperson is not likely to understand. Although regulations are intended to further define the process, they identify as many as 25 timelines specific to the disputed claims and reference civil court rules, further complicating the process.

DWC should consider the complexity of the program and the Alaska Supreme Court mandate describing its responsibility to fully advise the claimant of his or her right to compensation and how to pursue that right under the law. (See Recommendation No. 3.)

Laws against uninsured employers have not been "strictly" enforced

Alaska Statute 23.30.075 requires employers not exempted[13] to insure and keep insured for the employer's liability to injured employees. Upon conviction, violators are subject to a $10,000 fine and imprisonment for not more than one year.

The law is consistent with legislative intent, codified in Chapter 79, SLA 1988 which states, in part:

> *It is the intent of the legislature in amending AS 23.30.075(b)...that the division of workers' compensation, ...and Department of Law strictly enforce the punishment authorized under AS 23.30.075(b)....Strict enforcement is necessary because (1) the state has failed to impose the punishment authorized under AS 23.30.075(b) against those employers who fail to obtain workers' compensation insurance or to qualify as a self-insurer....*

DWC has one position that oversees enforcement of the mandatory insurance clause of the WCA (see inset on next page). The position is responsible for identifying potentially uninsured employers, working with the employer to obtain compliance, and when necessary, filing accusations and seeking prosecution against uninsured employers. Once an accusation is filed, a hearing is scheduled before the Alaska Workers' Compensation Board (AWCB). If

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[12] *Workers' Compensation and You* brochure is provided in both paper format at DWC offices, and on the internet at http://www.labor.state.ak.us/wc/wcbrochr.htm. This brochure provides the injured worker with information identifying their responsibilities and the responsibilities of the employer.

[13] Alaska Statute 23.30.230 exempts certain employee/employer relationships from the Workers' Compensation Act. Specifically, part-time baby-sitters; cleaning persons; harvest help and similar part-time or transient help; a person employed as a sports official on a contractual basis and who officiates only at sports events in which the players are not compensated; a person employed as an entertainer on a contractual basis; a commercial fisherman, certain taxi drivers; certain Alaska Temporary Assistance Program recipients engaged in required work activities; certain players or coaches employed by a professional hockey team.

DWC Had an Extended Vacancy in the Position Responsible for Monitoring Uninsured Employers

DWC has one employer enforcement position responsible for carrying out the division's investigative function. DWC held the position vacant for 11½ months during FY 98. During the time the position was vacant, it was reclassified to a workers' compensation (WC) officer I from a WC officer II. Additionally, nearly 200 complaints concerning uninsured employers accumulated while the position was vacant.

Prior to reclassification, the position supervised two WC officer I positions. Currently, the position has no subordinates.

The position description questionnaire (PDQ) document describes the position's primary duties as identifying employers who have not filed notice of insurance, to contact such employers to advise them of insurance requirements, to request coverage information, and to work with the employers to promote voluntary compliance. Employers who fail to comply are reported to the supervisor for enforcement action.

Currently, the position represents the totality of the division's enforcement effort. The PDQ states 85% of the position's time is to be spent on investigations. However, actual time spent is approximately 50%.

In addition to employer investigation, the position coordinates second independent medical examinations, serves as a pre-hearing officer, reviews adjudicated cases for frivolous controversion determinations, and more recently, performs limited Year 2000 remediation efforts.

the employer has not obtained insurance by the hearing date, AWCB may issue a stop order, barring the employer from using further employee labor.[14]

We noted the following weaknesses in how DWC monitored uninsured employers:

- Identification of potentially uninsured employers is effective, but additional follow through is necessary.

Between June 1998 and mid-September, 1999, over 31,000 potential employers were identified through the cross match process discussed in inset on the next page. Most of these employers are in compliance with the law, filing required policy information with DWC.[15] However, approximately 4.5% of employers have not submitted proof of coverage. As of the date of this report, DWC had filed 56 accusations, however over 900 non-responsive, potentially uninsured employers remain. This leaves the status of insurance coverage for a significant number of Alaskan workers in question. (See Recommendation No. 4.)

- DWC has not sought prosecution against uninsured employers in recent years.

In a 1993 memo, the Department of Law (DOLaw) criminal division administrator set forth guidelines whereby uninsured employers will be referred for prosecution. The guidelines require DLWD investigators to submit a report to the prosecutor documenting that the uninsured employer knew of the requirement to obtain workers' compensation insurance but failed to do

[14]Alaska Statute 23.30.080(d) states *"If an employer fails to insure...the board may issue a stop order prohibiting the use of employee labor by the employer until the employer insures...If an employer fails to comply with a stop order issued under this section, the board shall assess a civil penalty of $1,000 per day."*

[15]Alaska Statute 23.30.085(a) states *"An employer subject to this chapter, unless exempted, shall initially file evidence of compliance with the insurance provisions of this chapter with the board, in the form prescribed by it. The employer shall also give notice of compliance within 10 days after the termination of the employer's insurance by expiration or cancellation."* Filing an insurance/adjuster notice (form 07-6119) constitutes proof of insurance.

so. Current DWC procedures do not effectively document violations or enforcement efforts. In our view, DWC's actions are not consistent with legislative intent that sanctions be strictly enforced.

Prior to FY 98, DLWD's Labor Standards and Safety (LSS) Division provided DWC with resources to investigate employers and pursue litigation on those determined to be uninsured.[16]

The agencies involved were unable to provide sufficient information to identify quantitative and qualitative outcomes of LSS investigative resources. However, successful prosecutions occurred while the cooperative effort was in effect. Since the contractual relationship with LSS ceased, DWC has not referred any uninsured employers to DOLaw for prosecution.[17] (See Recommendation Nos. 4 and 5.)

- Effectiveness of employer enforcement efforts is not appropriately measured.

In the FY 00 operating budget documents, DWC provided data that appeared to indicate a decline in uninsured injuries during FY 99. However, when the data is examined on a calendar year basis, it actually indicates an increase over a three-year period leading into FY 99.[18] Moreover, our review found the data to be inaccurate and unreliable.

When an injury report is received for which the DWC data entry clerk cannot locate an insured employer, the injury is recorded as uninsured. Because of various factors including a backlog of recording insurance policy information, unreported alternate business names, and employer misspellings, many of these injuries are likely insured but are erroneously recorded as uninsured. DWC has not adequately researched injury reports initially recorded as uninsured to determine an accurate count of uninsured injuries.

DWC Utilizes Sound Procedures to Identify Uninsured Employers

Aside from soliciting public complaints, DWC has used a business name cross match process using DLWD's unemployment insurance and workers' compensation databases to identify uninsured employers.

DWC has initiated steps to improve the efficiency of the cross match process. This includes modifying the insurance/adjuster notice form to capture employer's federal employer identification number (FEIN). DLWD's employment security database uses the FEIN, which will also be captured in the new workers' compensation database. Cross matching the FEIN field in the two databases should improve the efficiency of the cross match process.

DWC has also identified the advantage of enabling system queries for employers whose insurance is about to expire. If properly utilized, the feature could function as an improved proactive enforcement tool to identify uninsured employers early and seek voluntary compliance before uninsured accidents occur.

[16]Reimbursable services agreements (RSA) funded aggregate LSS personal services and travel costs for $6,500, $24,000, and $23,800 for FY 95, FY 96, and FY 97, respectively. For FY 98 $23,600 was budgeted, however DWC did not establish or execute the RSA, so further LSS investigative resources were not provided.

[17]However, there have been prosecutions of uninsured employers as a result of LSS enforcement of the contractor licensing program.

[18]The workers' compensation information system indicates the number of uninsured injuries were 82, 89 and 102 in calendar years 1996, 1997, and 1998 respectively. Although examination of the data on a calendar year basis indicates an increase in uninsured injuries, DWC provided data in its operating budget documents that indicate a decline during FY 99.

- Data entry backlog and untimely insurer filing contributes to inaccurate management information.

Alaska statute requires employers to provide proof of coverage and policy information to the division. To accomplish this, DWC utilizes an insurance/adjuster notice to document policy information including the dates of policy coverage, and the names of businesses insured by the policy. Although statute puts the burden on filing policy information with employers, insurers actually file these insurance/adjuster notices.

At the time of fieldwork, DWC was experiencing a 42-day backlog on recording insurance/adjuster notices. The backlog can contribute to insured employers appearing to be uninsured for which an injury notice is received. Additionally, the system generates automatic notices to employers when a policy expires and updated policy information is not input into the system within 21 days. If updated policy information is not recorded in the system within another 10 days, a second, resolute notice is sent. (See Recommendation No. 4.)

The aforementioned problem is further exacerbated by the fact that insurers are submitting insurance/adjuster notices in an untimely manner. Alaska Statute 23.30.085(a) requires notices to be filed within 10 days of a policy expiration or cancellation. A sample of 22 insurance/adjuster notices providing proof of coverage found that on average, insurers filed notification 38 days late. In contrast, policy cancellation notices were typically filed in a timely manner. [19] Not receiving policy information in a timely manner has the potential for insured injuries to appear uninsured. There exists a potential that injured workers inquiring about the insurance status of their employer may be reluctant to file a claim for fear it will cause their employer to be sanctioned for not having insurance.

<u>The Division of Insurance (DOI) within the Department of Community and Economic Development has not enforced insurer compliance provisions of the Workers' Compensation Act</u>

Alaska Statute 23.30.155(o) states:

> *The board shall promptly notify the division of insurance if the board determines that the employer's insurer has frivolously or unfairly controverted compensation due under this chapter. After receiving notice from the board, the division of insurance shall determine if the insurer has committed an unfair claim settlement* ***practice*** *under AS 21.36.125.*[20] [Emphasis added.]

As discussed in the Background Information section, the intent accompanying the 1988 revision of the Workers' Compensation Act clearly directs DOI to exercise strict enforcement of requirements and penalties under AS 23.30.155. This suggests to us that the

[19]Insurers have incentive to file cancellations. Alaska Statute 23.30.030(5) states *"A termination of the policy by cancellation is not effective as to the employees of the insured employer covered by it until 20 days after written notice of the termination has been received by the board."*

[20]Alaska Statute 21.36.125 outlines illegal claims practices.

legislature wanted determinations of frivolous controversions referenced in AS 23.30.155(o) to be actively pursued to protect the public and provide balance to the workers' compensation law.

The term "frivolous controversion" is not defined in statute. However, the Alaska Supreme Court has determined that an employer must have specific evidence for a good faith controversion.[21]

DOI has the authority to pursue unfair claim settlement ***practices***. The agency has defined the term "practice" referenced in AS 23.30.155(o) to require repetitive unfair acts. Such an approach is inconsistent with the legislature's desire that prohibitions against frivolous controversions be strictly enforced.

We reviewed the four frivolous controversion determinations referred to DOI by AWCB between 1997 and July 1999 (see Exhibit B on following page). To date, DOI has not demonstrated effective resolution of frivolous controversion complaints. This practice has resulted in one component of the important balance of fairness in the law between the interests of insurers and protection of injured workers to fall on the side of insurers.

Unfair claim practice complaints arising out of frivolous controversion determinations referred to DOI stay in a seemingly perpetual state of limbo. Although warranted, no enforcement action has been initiated. Such practices foster frustration on the part of injured workers and contribute to a public perception of ineffective government.

Aside from frivolous controversions, the WCA mandates certain other insurer requirements. For example, AS 23.30.030(4) states, in part:

> *The insurer shall provide claims facilities through its own staffed adjusting facilities located within the state, or by independent, licensed, resident adjusters with power to effect settlement within the state.*

The WCA does not provide for how compliance is to be accomplished. Although enforcement responsibility of this requirement is not explicitly assigned, it is most congruous with the statutory purpose of DOI. The provision does not fit within the existing definition of an unfair claim settlement practice and has not been strictly enforced.

Internal controls over processing of annual reports received from insurers are weak

Annual reports filed by insurers or adjusters are to be filed on *"a form prescribed by the board."* [22] The reports identify the compensation by type, the number of claims received, and the percentage controverted. As stated in the Background Information section of this report,

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[21]The court ruled in *Harp v. ARCO Alaska, Inc.*, 831 P.2d 352 (Alaska 1992) that a controversion notice must be filed in good faith to protect an employer from imposition of a penalty. The court determined that for a controversion notice to be filed in good faith, the employer must possess sufficient evidence in support of the controversion that, if the claimant does not introduce evidence in opposition to the controversion, the board would find that the claimant is not entitled to benefits.

[22]See Alaska Statute 23.30.155(m).

EXHIBIT B

Frivolous Controversion Investigations are not Consistent with Legislative Intent

DOI complaint number 97-00659MJ was opened in December 1997 as a result of AWCB decision & order no. 97-0212. The DOI consumer services specialist investigating the case originally concluded that the case was not a frivolous controversion. DOI recorded the complaint disposition as "company position upheld" on the division's database. However, a Department of Law (DOLaw) review found the controversion was without merit. DOLaw cited two Alaska Supreme Court cases that indicated it was inappropriate for DOI to relitigate facts decided by another administrative tribunal (in this case, AWCB). DOLaw stated that if the insurer appealed the AWCB order, and the order had been stayed pending the outcome of the appeal, DOI should wait until the appeal was resolved prior to reaching any conclusions in the investigations. The employer/insurer did not appeal the decision, however the injured worker appealed his seasonal employment status to the superior court. DOI wrote the injured worker in September 1998 inquiring about the status of his appeal. The injured worker did not respond, and entered into a compromise and release agreement the same month. The consumer services specialist said the complaint should have been closed and recorded as "insufficient information" due to the non-responsiveness of the injured worker.

DOI compliant number 98-00543DB was opened in December 1998 as a result of AWCB decision & order no. 98-0092. The controversion was not based on any medical evidence, but rather only consisted of the adjuster's belief that an ear infection could not have been employment related. The complaint appears to indicate a clear violation of AS 21.36.125(4) in that the insurer did not conduct a reasonable investigation of the claim within 30 days (as required by 3 AAC 26.050). DOI has not taken any enforcement action on the case.

DOI complaint number 98-00542GC was opened in December 1998 as a result of AWCB decision & order no. 98-0095. The basis for the controversion was that the injured worker's chiropractor exceeded the treatment frequency outlined in 8 AAC 45.082. The most recent correspondence in the complaint file was dated January 1999. The consumer services specialist initially working on the case retired in March 1999. Any analysis of the case, if performed, was not documented in the complaint file. A note on the cover of the complaint file stated that the case was "ready to review and close." A consumer services specialist asserted the director would review the complaint, as there did appear to be a violation of the insurance code.

A fourth frivolous controversion determination was made in May 1999 as a result of AWCB decision & order no. 99-0108. Although AWCB referred the determination two days later, it was not received by DOI. After our inquiry, the case was referred a second time and a complaint file was established subsequent to the date of this report.

these reports also identify the medical and related benefits, vocational rehabilitation expenses, legal fees, including fees paid to attorneys and other costs of litigation, and penalties paid on all claims during the preceding calendar year.

We identified internal control weaknesses with regard to administering and reviewing insurers' annual reports. Internal control is a process designed to provide reasonable assurance regarding the achievement of objectives in financial reporting, effectiveness of operations, and compliance with applicable laws and regulations. Control activities are critical to ensure that policies, procedures, and directives are carried out.

We identified instances where DWC did not enforce AWCB directives[23] and other instances where the agency was unable to produce adequate support for amounts reported on the annual report summary, or had conflicting supporting schedules. Specifically, we made the following observations:

- The Second Injury Fund (SIF) administrator reported DWC spent approximately three weeks compiling data and creating the annual report for an insurer not filing on the form prescribed by the board.

- Annual reports are accepted from insurers in as many as six different formats.

- Adjuster reports were submitted on behalf of multiple insurers, instead of requiring a discrete annual report for each insurer code as set out in the AWCBB. [24]

- Annual report amounts provided to the board concerning uninsured employers were unsupported.

- A count of annual compensation types on DWC's penalty summary schedule did not reconcile to the DWC data system, resulting in an unexplained difference of 383 compensation types.

- Multiple insurer codes were assigned to single insurers. For example, Fireman's Fund – American Auto Insurance was assigned both insurer code 2 and 384; and Alaska Airlines was assigned both code 901 and 775.

An additional weakness exists with regard to other internal control procedures. A significant portion of the data disclosed on annual reports is not independently verified for accuracy. Some of the annual report information could be, however is not, reconciled to the compensation reports, such as information pertaining to medical, rehabilitation plan costs, interest, and employer and employee attorney fees. Other information on the annual report is

[23]The process and format are outlined in Alaska Workers' Compensation Board Bulletins (AWCBB) 95-06 and 96-10. These bulletins require annual reports to be submitted electronically, in a specific format. A waiver of the electronic filing requirement can be requested by insurance companies. However, if the electronic filing requirement is waived, the insurer still must file on a form prescribed by the board.

[24]The attachment to AWCBB 96-10 states that *"An annual report needs to be filed for each* [discrete insurer] *code."* An insurer code is a number assigned by DWC for each insurer/adjuster combination.

not captured on a compensation report by DWC such as information pertaining to evaluation costs, rehabilitation specialist fees, litigation, and other costs. As such, there is no supporting information allowing DWC to verify the accuracy of the annual report for these areas.

A final issue regarding internal controls over the annual reports deals with the calculation of contributions to the SIF. Insurer's contributions to the SIF are based upon an annual contribution percentage[25] multiplied by the permanent and temporary disability payments as reported on the annual report. After insurers submit contributions to the SIF, the contribution calculations are verified for accuracy by the data system. However, the system is programmed to disregard calculated variances under 10% from annual reports. Theoretically this practice would permit insurers to remit only 90% of contributions payable to the SIF without identifying the variance in an exception report.

The legislature intended strict enforcement of reporting requirements. In the past, a lack of specific data impaired the ability to adequately assess the efficiency and costs of the workers' compensation program. Sufficient internal controls are integral to an accurate and sound reporting system. (See Recommendation No. 7.)

DWC is waiving late compensation report penalties in a manner inconsistent with the law

Insurers file two types of reports with DWC. Insurers file compensation reports as defined under AS 23.30.155(c) when compensation to an injured worker has begun or has been increased, decreased, suspended, terminated, resumed, or changed in type. Penalties are imposed for each instance a compensation report is filed late.[26] However, compensation report penalties are not assessed until after the insurer's or adjuster's annual report is filed.

On an annual basis, insurers file a second report, called the annual report, required under AS 23.30.155(m), which presents the total amount of compensation by type, as well as other information previously described.

A percentage of accumulated compensation report penalties may be waived, but only if the annual report meets certain statutory requirements. The first requirement[27] is for DWC to determine whether the annual report is (1) timely, (2) complete, and (3) accurate. If an annual report is determined to be timely, complete, **and** accurate, only then may the commissioner evaluate the timeliness of compensation reports. A percentage of the late compensation report penalties may be waived if at least 95% of compensation reports were filed timely.

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[25]A contribution amount is based upon the contribution percentage in effect at the time of the injury.

[26]Alaska Statute 23.30.155(c) states *"If the board and the employee are not notified within 28 days prescribed by this subsection for reporting, the insurer or adjuster shall pay a civil penalty of $100 for the first day plus $10 for each day thereafter that the notice was not given. Total penalties under this subsection may not exceed $1,000 for failure to file a required report."*

[27]Alaska Statute 23.30.155(m) provides *"If the annual report is timely and complete when received by the board and provides accurate information about each category of payments, the commissioner shall review the timeliness of the insurer's or adjuster's reports filed during the preceding year under (c) of this section."* Section (c) outlines the process for filing compensation reports with the State.

DWC is circumventing the first requirement by disregarding the requisite for timely, complete, and accurate criteria. Consequently, penalties are calculated and waived regardless of whether the annual reports are timely, accurate, and complete. We identified 17 instances where annual reports were determined to be incomplete, however late compensation report penalties were still waived.

If the annual report is timely, complete, and accurate, statutes dictate a second step for calculating the amount of late compensation report penalties to waive. The amount waived is to be based upon the percent of reports filed timely. To calculate the percentage, DWC is to divide the number of timely compensation reports by the number of total compensation reports filed. [28]

However, DWC is inappropriately using two inherently different units of measure for the calculation. That is, the number of late compensation reports is divided by a system-generated count of the total number of compensation types reported on all compensation reports filed by a particular insurer or adjuster. A compensation report may have several compensation types disclosed on a single report. [29] In short, DWC uses an inaccurate and inflated compensation type count as a base, rather than the actual total compensation reports filed. The practice results in an improved timeliness calculation since the percentage of late reports is lower than if the units of measure were consistent. The improved timeliness calculation provides the insurer or adjuster an undue benefit by artificially distorting the calculated timeliness of compensation reports.

We reviewed a sample of 72 compensation reports, which had a total of 89 compensation types. This indicates the number of compensation reports filed is overstated by 23.6%. Likewise, workload reports presented to the board which indicated 18,549 compensation reports filed is probably closer to 15,000. We applied this data to the most recently completed reporting year and concluded late compensation report penalties were likely understated by approximately an additional $11,500. This includes calculating penalties on each insurer code individually rather than by adjuster but does not include a $23,000 impact of incomplete annual reports (which is discussed in Recommendation No. 12).

Legislation amending the reporting statutes in 1988 intended strict enforcement of the reporting requirements and penalties for noncompliance under AS 23.30.155. Strict enforcement was deemed necessary due to the lack of specific data from DWC and DOI to adequately assess the efficiency and cost of the workers' compensation system. (See Recommendation No. 8.)

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[28]Alaska Statute 23.30.155(m) states, in part, *"If during the preceding year the insurer or adjuster filed at least 99 percent of the reports on time, the penalties assessed under (c) of this section shall be waived. If during the preceding year the insurer or adjuster filed at least 97 percent of the reports on time, 75 percent of the penalties assessed under (c) of this section shall be waived. If during the preceding year the insurer or adjuster filed 95 percent of the reports on time, 50 percent of the penalties assessed under (c) of this section shall be waived."*

[29]Compensation types include temporary total disability, temporary partial disability, permanent partial impairments, permanent total disability, AS 23.30.041(k) and 25% late payment penalties to injured workers.

Inappropriate Second Injury Fund-related accounting and administrative practices exist

The SIF is organizationally structured to include three personnel to oversee the administrative duties of the fund. Alaska statute requires administrative expenses of the SIF to be expended from the fund.[30] A review of SIF personal services charges indicated a total of nine individuals had all or part of their payroll funded from the SIF during FY 98 and FY 99. Although most of the personal services charges to the SIF appeared reasonable, the amounts were estimates of actual time spent on SIF duties and were not supported by adequate documentation. Additionally, a review of the actual job duties of the administrative clerk II[31] indicated the position's job duties consisted almost entirely of keying insurance/adjuster notice forms into the workers' compensation system. We could not identify any reasonable correlative purpose for the position's personal services charges to the SIF in light of the intent of the SIF and actual job duties. (See Recommendation No. 9.)

DWC continues to pay "supplemental" benefits to individuals who may not be entitled

Alaska Statute 23.30.172 was created by Chapter 51, SLA 1974 and was amended before being repealed by Sec. 11 Chapter 75, SLA 1977.[32] The law provided supplemental benefits to injured workers receiving workers' compensation payments from their insurer at the time the section was added.[33] The section was effectively a mechanism to provide a cost of living allowance to supplement injured workers' primary indemnity payments. Specifically, AS 23.30.172 originally read as follows:

> *Benefits for temporary and permanent disability shall be calculated under this chapter according to currently existing benefit rates regardless of the benefit rates in existence at the time of the injury, unless this calculation would cause a decrease in the actual benefits receivable.*

The legislation stated that funds needed to carry out the provisions of AS 23.30.172 were to be appropriated annually from the General Fund.

Currently, approximately 25 individuals are still receiving benefits under this program.[34] However, our review concluded only one recipient was still receiving ongoing primary compensation from their insurer.[35] Despite the fact most recipients no longer receive the primary benefits originally qualifying them for state payments under AS 23.30.172, DWC

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[30]Alaska Statute 23.30.040(h) states *"Administration expenses of the state under this section and AS 23.30.205 must be paid from the second injury fund."*

[31]This position organizationally reports to the SIF administrator and has historically been funded 100% from the SIF.

[32]Chapter 252, SLA 1976 added a prerequisite in that only individuals receiving temporary total disability for more than two years or permanent total disability were eligible for the "supplemental" benefits.

[33]Section 2, Chapter 51, SLA 1974, provides *"The provisions of this Act apply to persons receiving benefits under AS 23.30 before the effective date of this Act."*

[34]Additionally, two law offices receive nominal monthly payments from the program, presumably as a result of securing AS 23.30.172 benefits for clients.

[35]During FY 99, two supplemental benefit recipients were receiving ongoing compensation from their insurers. However, one of the individuals died in December 1998.

has requested and the legislature has continued to appropriate funding to pay supplemental benefits to these individuals. DWC was appropriated $204,600 to pay supplemental benefits during FY 99.

Many of the supplemental benefit recipients no longer reside in Alaska. Our attempts to contact recipients were unsuccessful in over 30% of the cases. Nine of the monthly general fund warrants are mailed in care of third parties or to financial institutions for direct deposit. DWC does not verify individuals are still living and remain disabled. Such practices increase the likelihood of the fraudulent receipt of benefits. DWC was notified in January 1999 of a particular supplemental benefit recipient who was deceased. Despite notification, DWC continued to pay monthly supplemental benefits through April 1999. One of the posthumous warrants was fraudulently endorsed. Additionally, our review concluded most benefit calculations were not supported by evidence of actual earnings. See Recommendation No. 10 for further discussion.

Relatively few injured workers qualify for reemployment training benefits

As discussed in the Background Information section of this report and expressed in the intent accompanying the 1988 comprehensive revision to the workers' compensation law, the legislature wanted to increase incentives for injured workers to return to work and remove obstacles to the utilization of vocational rehabilitation or reemployment benefits.

A primary concern regarding reemployment benefits was perceived disincentives for injured workers to return to work. The law was crafted to provide reemployment benefits to workers most likely to use the benefit, and truly desire and need the services. Accordingly, a $10,000 limit on reemployment benefit costs was implemented and other rules were put in place that served to limit accessibility to reemployment benefits to such individuals.

During 1997, 474 injured workers were referred to a rehabilitation specialist for eligibility determinations. Of this total, almost 60% were determined eligible for reemployment benefits, while nearly a third were determined ineligible, and the remaining 9% were placed in suspension status for various reasons such as pending medical information. From our review, it appears the statute has succeeded in limiting access to reemployment benefits.

Some efforts to extend fair benefits were overturned by Alaska Supreme Court interpretations.

Alaska Statute 23.30.041(e)(2) requires that while assessing the eligibility for reemployment benefits, consideration must be given to other jobs the worker "*has held or received training for within 10 years before the injury.*" Similarly, AS 23.30.041(e)(1) requires an injured worker to be unable to carry out the demands of the job at the time of injury in order to be eligible for reemployment benefits. If the worker can return to any of these jobs, he or she is deemed ineligible for benefits. The ten year "look back" provision in AS 23.30.041(e)(2) adversely affects younger workers that are more likely to have held entry-level positions within 10 years prior to the injury.

EXHIBIT C

Alaska Supreme Court Decisions Provide Comments and Guidance Regarding the Provision of Reemployment Benefits

Konecky v. Camco Wireline, Inc., 920 P.2d 277 (Alaska 1996)
Konecky became injured while working as a hoist operator that required actual duties characterized as "very heavy level." Konecky was unable to perform his actual job duties, but could perform the "medium work level" as the position was described in *Selected Characteristics of Occupations Defined in the Revised Dictionary of Occupational Titles* (SCODDOT). A labor market survey found the hoist operator occupation did not exist at a "medium work level," indicating the SCODDOT job description was inaccurate. The Alaska Supreme Court concluded legislative intent that the law *"ensure the quick, efficient, fair and predictable delivery of...benefits to injured workers at a reasonable cost to the employers..."* could not overcome the clear language of the statute that SCODDOT must be used as a reference when determining an injured workers' physical capacity under subsection (e). As such, Konecky was ultimately found ineligible for reemployment benefits.

Moesh v. Anchorage Sand & Gravel, 877 P.2d 763 (Alaska 1994)
Previously the reemployment benefits administrator (RBA) only considered positions which paid a "remunerative" wage while performing the ten year "look back" provision required by AS 23.30.041(e)(2).[36] In the ten years prior to his injury, Moesh held two positions he could still perform. However, the positions paid less than 60% of his wage at the time of injury. As such, Moesh could not be considered employed at the "remunerative" wage referenced in AS 23.30.041(i), which requires that reemployment benefits ensure remunerative employability in the shortest time possible. Rehabilitation plans must meet this criterion to be considered viable.

Originally the RBA found Moesh eligible for reemployment benefits. The insurer appealed, contending remunerative employability was not expressly listed in AS 23.30.041(e), and as such it could not be a factor in determining reemployment benefits eligibility. Furthermore, the insurer argued that the "look back" requirement was unambiguous and must be applied as written. The Alaska Supreme Court concurred, ruling:

> *[I]n order for remunerative employability to be considered a factor in determining reemployment benefits eligibility, the Alaska legislature must amend the statute to expressly include remunerative employability under AS 23.30.041(e).*

Accordingly, Moesh was found ineligible for reemployment benefits and case law dictates remunerative employability is not applicable until after an injured worker is determined eligible for reemployment benefits.

Rydwell v. Anchorage School District and Scott Wetzel Services, 864 P.2d 526 (Alaska 1993)
Alaska Statute 23.30.041(f)(3) states that a person is not eligible for reemployment benefits if, at the time of medical stability, no permanent impairment is identified or expected. After a workplace injury, Rydwell had physical capacities less than the physical demands of her position and was unable to return to work. However, the impairment did not translate to a permanent impairment under the *American Medical Association's Guides to the Evaluation of Permanent Impairment* (AMA Guides) cited in AS 23.30.190(b). Consequently, her doctor gave her a permanent impairment rating of zero. The Alaska Supreme Court ruled the same criteria of AS 23.30.190(b) is applicable under AS 23.30.041(f)(3). Accordingly, Rydwell was ineligible for reemployment benefits.

[36]According to AS 23.30.041(q)(7): *"remunerative employability" means having the skills that allow a worker to be compensated with wages or other earnings equivalent to at least 60 percent of the worker's gross hourly wages at the time of the injury . . ."*

Statute requires the use of the United States Department of Labor publication *Selected Characteristics of Occupations Defined in the Revised Dictionary of Occupational Titles* (SCODDOT) while defining injured workers' physical capacities under subsection (e) (see *Konecky vs. Camco Wireline,* Exhibit C on facing page). SCODDOT definitions may and have differed from the actual physical demands of injured workers' job duties. The publication contains a disclaimer serving to warn that descriptions within the publication may not coincide with actual job descriptions. Specifically, the disclaimer states:

> *The user should be cautious in interpreting the information in this publication. Occupational definitions...are composite descriptions of occupations as they may typically occur and may not coincide with a specific job as actually performed in a particular establishment or in a given industry.*

The RBA reported Alaska is unique in that it is the only state that has injured workers' reemployment benefit eligibility contingent upon SCODDOT descriptions.

During the course of our review, we examined a sample of 43 ineligible determinations made during 1997. For each determination, we attempted to identify the reason for ineligibility. We made the following observations:

1. Ten year "look back" is the predominant reason for ineligibility determinations. From a sample of 43 ineligible determinations made during 1997, 21 or 49% of the individuals were found ineligible under the provisions of AS 23.30.041(e)(2).

   However, the summary information maintained by DWC did not provide the level of detail necessary to determine the number of instances, if any, whereby the injured worker could not perform the actual duties of jobs under the "look back" provision, but was found ineligible because of an inaccurate SCODDOT description. Additionally, we were unable to assess whether any individuals were determined ineligible for reemployment benefits because they could return to a position held in the last ten years, but the position could not be expected to provide remunerative employment (see *Moesh v. Anchorage Sand & Gravel,* Exhibit C on facing page).

2. Many injured workers are determined able to return to the job performed at time of injury. In our sample of 43 ineligible determinations, 9 or 21% were found ineligible under the provisions of AS 23.30.041(e)(1).

   Despite serious injuries, reportedly, many injured workers attempt to return to the same or similar job as that performed at the time of injury. Again, DWC records precluded us from assessing whether any injured workers were determined ineligible for reemployment benefits due to SCODDOT descriptions which differed significantly from actual job duties (see *Konecky v. Camco Wireline, Inc.* Exhibit C on facing page).

3. Some reasons for ineligibility determinations were not documented. For seven individuals, or 16% of our sample, the reason the individual was determined ineligible for reemployment benefits was not documented.

4. Other reasons were cited for ineligibility determinations. For the remaining six, or 14%, there were other reasons for ineligibility determinations cited under AS 23.30.041(f). These include instances where the employer offered the injured worker a position within his or her physical capacities, the injured worker was previously rehabilitated, or no permanent impairment was identified at the time of medical stability.

   DWC does not maintain records to determine the number of instances, if any, whereby the injured worker could not perform the duties of the position held at the time of injury but upon medical stability did not qualify for an impairment rating under the *American Medical Association Guides to the Evaluation of Permanent Impairment* referenced in AS 23.30.190(b) (see *Rydwell v. Anchorage School District and Scott Wetzel Services*, Exhibit C on page 36). (See Recommendation No. 11 for further discussion.)

Injured workers receiving assistance outside DWC results in nominal cost shifting.

During the course of our review, it came to our attention that injured workers have applied for benefits from both the DWC reemployment benefits program and the DLWD Division of Vocational Rehabilitation (DVR).

To appreciate the extent of the practice, we attempted to cross match DVR records with 43 individuals that applied, but were determined ineligible for, reemployment benefits during calendar year 1997.

The cross match indicated nine individuals, or approximately 20.9% sought similar reemployment or vocational rehabilitation benefits from the two agencies. However, upon closer examination of the statistics, only six, or 14% sought DVR assistance after the workplace injury that prompted their request for DWC reemployment benefits. DVR records indicated a total of $9,323 was expended for these six applicants.

Federal regulations governing DVR operations require the agency to assess whether "comparable benefits" are available for an applicant prior to expending federal or state matching funds.[37] However, DVR cannot categorically deny applicants based upon the availability of workers' compensation reemployment benefits. In fact, there have been instances whereby DVR funds have been used to supplement a plan initiated through the reemployment benefits program. In these cases, the amount of DVR funds expended on applicants is likely less than that expended on the aforementioned individuals determined ineligible for DWC reemployment benefits.

DWC has not proactively investigated opportunities provided by Electronic Data Interchange

In FY 00, DWC had 38 budgeted full-time staff in the following sections: administration, adjudications, reemployment benefits, and SIF. Three additional full-time positions were

[37]Comparable benefits may consist of a number of sources, including Medicaid, Medicare, private health or disability insurance, and workers' compensation.

budgeted in the fisherman's fund section. Up to four administrative staff perform data input into the database. Currently, DWC staff must input information off report of injury forms, compensation reports, medical summaries, and insurance policy notices, among other forms. Data input and reconciliation is a labor-intensive process. In mid-October, 1999, DWC administrative staff reported to us that it had over a 30 day backlog on many types of forms (see also Recommendation No. 4 on uninsured employers).

Our review of workers' compensation practices in other states identified a trend towards electronically submitted benefit payment records from insurance carriers. These benefit payment records are submitted on nationally standardized electronic reporting forms developed in 1993 by the International Association of Industrial Accident Boards and Commissions (IAIABC) Electronic Data Interchange (EDI) Project. The IAIABC project was an effort to standardize the reporting forms and data requirements among the states and firms that report to states' workers' compensation agencies.

DWC recently developed a new computer data system, reportedly to alleviate Year 2000 compliance issues. The extent of system modification necessary to accommodate EDI is unknown. If determined compatible, incorporation of EDI standardized data could result in significant savings for both the state agencies and the insurance carriers. (See Recommendation No. 1.)

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FINDINGS AND RECOMMENDATIONS

Recommendation No. 1

The Division of Workers' Compensation (DWC) management should develop a strategic plan to better accomplish the agency's operating mission.

From our review of DWC operations we identified various inefficiencies that in our view should be addressed in a long-term manner as part of a comprehensive strategic plan. Strategic planning is the process of determining long-term goals and then identifying the best approach for achieving those goals.

DWC sets out in its mission statement the agency's responsibility to assure Alaskan workers who suffer work related injury or illness are provided adequate medical care, prompt payment of benefits and, if needed, voluntary rehabilitative services. To meet this mission, DWC adjudicates disputed claims in a quasi-judicial process, tracks and records aspects of compensation payments made to workers, investigates uninsured employers, and oversees the Second Injury Fund, among other administrative tasks.

Manual processing of much of the paperwork related to claims and payments is inefficient

As discussed in the Report Conclusions section of this report, DWC has a paper intensive process used to account for work related injuries. The division receives, reviews, and records in one fashion or another paperwork related to approximately 28,100 workplace injuries each year including such things as reports of injuries, medical summaries, compensation reports, and annual report data from insurance companies.

During the course of our review, we identified other states that took a much more automated approach to such paperwork – termed electronic data interchange (EDI). Utilization of an EDI system makes more extensive use of electronic filing for both injured employers and insurance companies. This eliminates much of the manual processing of workers' compensation paperwork. Electronically processing data from reports of injuries, compensation reports, and proof of coverage statements, with appropriate controls would result in more accurate data, while also allowing DWC to redirect resources within its current budget.

As additional states adopt the nationally standardized forms, the number of insurance carriers that are adopting the standard is also increasing. Benefits are realized on the part of both the insurance carriers and workers' compensation divisions. These benefits include reduced data entry costs, reduced errors, improved error detection, reduced filing space requirements, faster management reporting, automatic reconciliation, high productivity without increased staff, uniform and timely communications, rapid exchange of business data, reduced paper usage, reduced mail sorting, and delivery activities. Benefits resulting in savings eventually will be realized through decreased workers' compensation premiums and agency savings.

Some of the resources utilized by DWC to review, accumulate, and record payment information from insurance companies can be effectively used to improve weaknesses addressed in the following recommendations. These recommendations address in part, improved agency outreach and assistance to Alaskan workers injured on the job, increased monitoring of the annual and compensation reporting process, and better enforcement of uninsured employer compliance.

Additionally, DWC could perhaps consider developing an alternative resolution process for workers. Development of a mediation process where workers and insurers can attempt a resolution of disputed claims in an informal setting, would seemingly be in the interest of both parties. Workers claiming injury could avoid the lengthy, quasi-judicial hearing process currently in place. This process is full of procedural delays and, often antagonistic, legal stratagems that are of little benefit to the injured worker. Also, insurers would realize savings from having to utilize less legal resources.

Strategic plan would have to reflect a commitment to real and relevant performance goals

By recognizing efficiencies in one area of operations, resources can be utilized to expand services to injured workers and employers. Development of a comprehensive strategic plan that reflects a commitment to both adopt relevant performance measures and data collection systems would allow the agency to ensure operational objectives are being achieved. Current performance measures utilized by DWC as reflected by the agency's budget documents, primarily measure outputs rather than outcomes. DWC's budget documents use the number of injury-related reports handled and the timelines for hearings as measures of operational effectiveness. Program performance measures that reflect program costs and efficiencies could be added to the identified budget document program measures.

There is currently significant interest in the legislature for developing, measuring, and reviewing relevant operational performance measures as part of the budget review process. A DWC strategic plan should reflect the following key concepts:

(1) a primary intent to develop initiatives to better assist and inform injured workers;
(2) commitment to progressing with technological improvements in paper handling that achieves necessary cost savings;
(3) demonstration that the agency is achieving key operational objectives that fulfill the tenets of the division's mission statement.

A strategic plan which includes the aforementioned elements would demonstrate DWC's good-faith commitment to fully achieving the division's mission statement in an efficient, creative, and dynamic manner. Development of such a plan along with demonstrated program achievements, would likely go a long way to identify efficiencies that could be attained and the opportunities for reallocation of resources to address other workers' compensation needs.

Recommendation No. 2

DWC's director should propose legislative changes to improve balance in the workers' compensation laws.

As stated in the Report Conclusions section of this report, the 1988 comprehensive rewrite of the workers' compensation laws was intended to arrive at a balance between the injured workers' interests and the employers' rising insurance costs. Over the intervening period, the policy objective of lowering workers' compensation rates has been achieved. However, in achieving this goal, circumstances have developed that shift the balance between injured workers and employers to the disadvantage of the injured workers.

To reiterate our concerns regarding deficiencies, we identified the following areas where, in our view, the Workers' Compensation Act, as administered currently and in today's economy, works to the disadvantage of injured workers.

1. Fixed benefit amounts have not kept pace with the inflation and cost of living. Some examples of fixed benefit amounts that have not changed since the act came into law in 1989 include compensation for permanent partial impairment, death benefits, and rehabilitation plans. In the case of an impairment partial in character, but permanent in quality,[38] and not resulting in a permanent total disability, the compensation equals $135,000 multiplied by the employee's percentage of permanent impairment of the whole person.

   In the case of death, compensation known as a death benefit includes reasonable and necessary funeral expenses not exceeding $2,500. Finally, the reemployment plan is paid on an expense incurred basis and may not exceed $10,000. Based upon the consumer price index, the value of today's dollar has decreased 40% since 1988. Therefore, the value of the 1988 whole body compensation of $135,000 would equal $189,662 in today's dollars. Furthermore, with regard to reemployment plans, the average cost of tuition at the University of Alaska has increased by over 150% between 1988 and 1999.

2. Overtime and premium pay is excluded in the determination of spendable weekly wage. For employee's earnings that are calculated by the day, hour, or by the output of the employee, overtime and premium pay is excluded in the determination of spendable weekly wage.[39] As an example, an hourly employee injured while working on the North Slope is likely working an unusual work week, which would encompass overtime and shift differential pay. The compensation could include hazard pay as well. Any overtime or premium pay would not be included in the compensation calculation, yet may be an integral component of what the worker relies upon in each paycheck. The statute

[38] See AS 23.30.190.

[39] Alaska Statute 23.30.220(4)(A) states that *"if at the time of injury, the employee's earnings are calculated by the day, hour, or by the output of the employee, the employee's gross weekly earnings are the employee's earnings most favorable to the employee computed by dividing by 13 the employee's earnings, not including overtime or premium pay, earned during the period of 13 consecutive calendar weeks within the 52 weeks immediately preceding the injury."*

implicitly ignores the loss of pay, health insurance, leave and retirement contributions when calculating a worker's average weekly spendable wage. These exclusions in the calculation have a significant impact on the injured worker.

3. Interim compensation is allowed under limited circumstances. Interim compensation is allowed only for temporary disability benefits that are controverted solely on the grounds that another employer or another insurer of the same employer may be responsible for all or a portion of the benefits.[40]

The above examples show how the current law does not meet the legislative intent as prescribed in Chapter 70, SLA 1988 which states the law is to ensure the *"fair delivery of indemnity and medical benefits to injured workers."*

We recommend that DWC revisit the current maximum compensation benefits with consideration of today's cost of living. Additionally, certain aspects in the determination of spendable weekly wage and interim pay should be evaluated. DWC should then develop a comprehensive legislative package for the consideration of the legislature. This proposed legislation could either: (1) change the fixed upper limit amounts in statute, or (2) eliminate the fixed upper limit amounts in statute and establish a regulatory process where changes based upon the consumer price index could be periodically addressed.

Recommendation No. 3

DWC's director should increase outreach, education, and technical assistance to injured workers with regard to their rights and responsibilities under the workers' compensation laws when a disputed claim occurs.

As described in the Report Conclusions section of this report, the Alaska Workers' Compensation Act is a complex law that describes the process to follow when seeking compensation for work related injuries. The act incorporates judicial procedures that the average layperson has difficulty understanding. If a dispute arises between an employer's insurer and the injured worker, the litigious process of filing a claim for benefits[41] frustrates many claimants. There is limited published information available to the public that explains the claims process step-by-step to make it more user friendly.

The courts have stated AWCB has a duty to instruct the injured worker on how to pursue the injured worker's rights under the law.[42] Current information does not provide the injured worker with adequate, easy-to-understand direction, on the process to follow.

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[40]See AS 23.30.155(d).

[41]Alaska Statute 23.30.110. Procedure on claims. Subject to the provisions of AS 23.30.105, a claim for compensation may be filed with the board in accordance with its regulations at any time after the first seven days of disability following an injury, or at any time after death, and the board may hear and determine all questions in respect to the claim.

[42]See footnote 10 on page 22.

DWC should provide more outreach and public education of the injured workers' rights and responsibilities under the law. Informative prehearings[43] could be used as a means to educate an injured worker even if a claim, petition, or request for prehearing has not been filed. DWC should consider developing a procedures reference manual, which is less legalistic than the *Alaska Workers' Compensation Laws and Regulations Annotated* however more comprehensive than the *Workers' Compensation and You* brochure, which provides guidance to the injured workers and providers. A video could be developed that sets forth procedures in a clear and concise manner. During the course of our review, an insurer's attorney reported interest among the insurance community in assisting in the production and funding of such a venture.

Recommendation No. 4

DWC's director should take proactive measures to identify and monitor uninsured employers.

Another responsibility of DWC is the enforcement of state laws that require businesses and other employers with employees to obtain and maintain workers' compensation insurance. Workers who are injured while working for uninsured, as compared to insured, employers have greater difficulty obtaining funds to cover medical costs and lost wages. Although DWC has been successful in identifying uninsured employers, opportunities exist to improve the process used to monitor Alaskan employers. As of mid-October, 1999, DWC has not completely resolved the insurance status of approximately 900 potentially uninsured employers. Additionally, procedural problems have contributed to inefficient enforcement efforts. Specifically, enforcement efforts could be improved substantially if DWC:

1. Eliminated the backlog that contributes to significant inefficiencies. At the end of fieldwork, the data entry backlog for recording insurance policy information exceeded 40 days. This backlog has contributed to insured injuries being erroneously recorded as uninsured in the workers' compensation system, prompting unnecessary review by employer enforcement personnel.

   The workers' compensation system automatically generates notices when a policy expires and updated policy information is not recorded into the system. The backlog has resulted in unnecessary notices, which in turn has increased expenses and caused complaints from insured employers.

   Recording updated policy information when received will result in less effort expended to investigate insured employers, improve the accuracy of management information and produce favorable relations with compliant employers.

[43] In 8 AAC 45.065 it provides for informative prehearings *"even if a claim, petition, or request for a prehearing has not been filed, the board or its designee will exercise discretion directing the parties or their representatives to appear for a prehearing."*

2. Fully resolved injuries reported as uninsured and corrected system data to promote accurate uninsured injury statistics. Injury reports involving employees of apparently uninsured employers should be quickly confirmed and if erroneous, the insurance status disposition should be corrected in the system. Injuries that are ultimately determined to be uninsured should be fully investigated with appropriate corrective and enforcement action pursued.

3. Developed amendments to AS 23.30.085 for legislative consideration that institute penalties for filing insurance/adjuster notices in an untimely manner.[44] Although statute places the burden of filing insurance/adjuster notices on the employer, insurers typically file new and renewed policy information.[45] Notices that are filed untimely can cause insured injuries occurring shortly after a scheduled policy expiration to appear uninsured. A sample of 22 insurance/adjuster notices providing proof of coverage found that on average, insurers filed notification 38 days late.

   Currently, the Workers' Compensation Act does not provide sanctions for noncompliance. In contrast to this lack of disincentive, insurers have a vested interest to file cancellations promptly. Specifically, AS 23.30.030(5) states:

   > *A termination of the policy by cancellation is not effective as to the employees of the insured employer covered by it until 20 days after written notice of the termination has been received by the board.*

   Our review indicated policy cancellation notices were typically filed timely, over 20 days in advance of scheduled policy expirations.

   Shifting the requirement of filing policy information to insurers and establishing a penalty for untimely filing would reduce unnecessary investigative efforts and improve the integrity of the workers' compensation system.

4. Documents the entirety of employer enforcement correspondence and effort. Adjudications related to uninsured injuries often require the DWC employer enforcement officer to testify as to the interaction of DWC with the uninsured employer. The level of enforcement action undertaken and the amount, frequency, and timing of correspondence with employers often was not documented. A review of the 1998 uninsured injury report indicated at least 37 employers appeared to remain uninsured at the time of our review, or could not be located in the workers' compensation system. Additionally, agency records did not identify any documentation that the employer was contacted in 25 (68%) of these cases. Not having adequate documentation and enforcement follow through increases the

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[44] A penalty mechanism exists but is not effective. Alaska Statute 23.30.085(b) states *"If an employer fails, refuses, or neglects to comply with the provision of this section, the employer shall be subject to the penalties provided in AS 23.30.070 for failure to report accidents...."* The statutory reference (AS 23.30.070) does not impose a penalty unless a compensable injury occurs and an award is issued by the board.

[45] Alaska Statute 23.30.085(a) requires employers to file evidence of compliance with the insurance provisions of the Workers' Compensation Act within 10 days after the termination of the employer's insurance by expiration or cancellation.

State's exposure, potentially resulting in liability for compensation when an uninsured employer has inadequate resources to pay significant indemnity awards.[46]

5. Sought revisions to the Alaska business license. The Department of Law (DOLaw) has established criteria requiring prosecutorial referrals include documentation that the employer knew of the mandatory insurance clause of the Workers' Compensation Act. Lack of such documentation of due notice has reportedly served as a barrier to prosecutorial referrals. Accordingly, DWC and the Department of Community and Economic Development, Division of Occupational Licensing should work cooperatively to implement a new business license application[47] that puts an employer on notice it must obtain workers' compensation insurance for its employees. Such notification can serve as documented proof that the employer knew of its responsibilities under the Workers' Compensation Act, thus eliminating a significant barrier to prosecution.

Recommendation No. 5

The legislature should consider amending AS 23.30.075 to empower the Alaska Workers' Compensation Board (AWCB) to sanction uninsured employers.

Current documentation maintained by DWC precludes an accurate quantification of uninsured injuries reported to AWCB. As discussed in the prior recommendation, we suggest DWC adopt measures to improve the employer investigative function including pursuing the amendment of AS 23.30.085 to allow the agency to sanction insurers that file notification of insurance in an untimely manner. In addition, we believe further statutory changes should be considered to give AWCB greater authority in dealing with uninsured employers.

We recognize finite prosecutorial resources coupled with stringent DOLaw referral requirements inevitably means not all uninsured employers will be prosecuted. However, under these circumstances uninsured employers are not subject to any sanctions for failing to insure employees.

Some states sanction uninsured employers while still avoiding costly and time-consuming criminal prosecutions. For example, California employers are required to pay penalties of $1,000 per employee in noncompensable cases and $5,000 per employee in compensable cases. Other states have adopted legislation that automatically increases compensation payable to uninsured injured workers by 50% or calculates penalties at several times what the employer would have paid for insurance during the period it illegally failed to secure coverage.

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[46] Two Alaska Supreme Court decisions found DLWD, formerly the Department of Labor, negligent for failing to abate known workplace safety violations, see *Wallace v. State of Alaska,* 557 P. 2d 1120 (Alaska 1976) and *Adams v. State of Alaska*, 555 P. 2d 235 (Alaska 1976).

[47] An Alaska business license is required to legally conduct business within the State. To obtain a business license, a business entity must complete an Alaska business license application (form 08-4181). A State of Alaska contractor's license application (form 08-4027) informs applicants of the requirements to provide workers' compensation insurance as well as provide proof of coverage or explain why the business entity is exempt from the requirement.

In our view, sanctioning employers that have violated the mandatory insurance clause of the Workers' Compensation Act would likely have a significant deterrent effect and achieve compliance with the law in a way that cannot otherwise be accomplished.

Recommendation No. 6

The Department of Community and Economic Development's director of the Division of Insurance (DOI) should implement policies and procedures that ensure timely enforcement of insurer-compliance provisions of the Workers' Compensation Act.

As discussed in the Report Conclusions section of this report, AWCB is required to notify DOI when frivolous controversion determinations are made. Our review concluded DOI investigation efforts of frivolous controversion complaints have not been consistent with legislative intent that prohibitions against such acts be strictly enforced.

Alaska Statute 21.36.320 vests the director of DOI with the authority to conduct investigations and determine whether an insurer engaged in an unfair or deceptive act or practice. Although the term "frivolous controversion" is not defined in statute, the cases we reviewed contained apparent violations of the Insurance Act. Unfair or deceptive activity need not reach the high threshold of a general business practice before corrective action is initiated. Authority to impose significant sanctions for a single unfair or deceptive violation rests with the director.[48]

The consumer service specialist interviewed asserted the maximum penalty would not offset the administrative expense of holding a hearing and consequently would be imprudent to conduct. However, utilizing proceedings in conjunction with imposing sanctions authorized by the Insurance Act would likely have a significant deterrent effect to unfair or deceptive acts, including frivolous controversions. If DOI believes the maximum penalty authorized by current law is inadequate to discourage unfair claims acts, the agency should draft statutory amendments with sufficient sanctions for legislative consideration.

The director should implement policies and procedures that include prudent investigative standards and timeframes in which complaints are fully resolved. Procedures should incorporate the exercise of corrective enforcement authority vested with the director. Additionally, DWC and DOI should coordinate efforts and produce a collective agreement of each agency's responsibility for enforcement of all provisions of the Workers' Compensation Act. The frivolous controversion determinations thus far forwarded to the division should be addressed in an expeditious manner.

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[48] Alaska Statute 21.36.320(d) states in part *"...the director may, after a hearing, order restitution, assess a penalty of not more than $2,500 for each violation or $25,000 for engaging in a general business practice in violation of this chapter."* Alaska Statute 21.36.320(e) states *"If the director determines after a hearing that the person charged knew or should have known that the person was in violation of this chapter, in addition to the penalty prescribed in (d) of this section, a suspension or revocation of the person's license and a penalty of not more than $25,000 for each violation or $250,000 for engaging in the general business practice in violation of this chapter may also be ordered by the director."*

Unresolved frivolous controversion investigations have fostered frustration on the part of injured workers and contribute to the public's perception of government ineffectiveness. Strict enforcement of the Insurance and Workers' Compensation Acts is essential to fulfilling the legislative intent and maintaining a balance between the interests of insurers and the protection of the public.

Recommendation No. 7

DWC's director should improve controls over review of insurers' annual reports.

DWC has weak controls over collection, review, and recording of data included in insurers' annual reports. Alaska law requires the board establish a format on which to receive the annual reports. The board has established the format in AWCB Bulletins. However, the format as prescribed is not enforced.

In addition to DWC's lack of enforcement of board prescribed directives, we also identified other issues associated with the submission of annual reports such as:

- Lack of support for uninsured employer compensation
- System provided count of compensation types did not reconcile to penalty summary schedules.
- Insurers were assigned multiple codes.
- Independent verification of data was not performed.
- High threshold (10%) on exception report variances.

The annual reporting is a labor intensive and cumbersome process for DWC staff. For calendar year 1997, there were approximately 180 insurers/adjusters required to submit summary information by injured worker. Insurers or adjusters must submit information on all claims paid during the year. This information needs to be reported by type of cost, as prescribed in statute.

Internal control procedures provide reasonable assurance regarding the achievement of objectives with regard to effectiveness of operations and compliance with applicable laws and regulations. It is crucial for DWC to establish internal control procedures, and to enforce those already established, in order to ensure accurate and efficient reporting.

We recommend DWC enforce its established procedures by requiring insurers to submit their information as prescribed by AWCB Bulletins. We also recommend amounts reported to the board be adequately supported, independent verification be performed, annual report summary amounts are reconciled to the workers' compensation data system, and reasonable exception report variances established.

Recommendation No. 8

DWC's director should adopt a methodology for assessing compensation report penalties that is consistent with statute.

DWC is assessing compensation report penalties in a manner inconsistent with law. Alaska Statute 23.30.155(m) reads in part:

> *If the annual report is **timely** and **complete** when received by the board and provides **accurate** information about each category of payments, the commissioner shall review the timeliness of the insurers or adjusters reports filed during the preceding year under (c) of this section.* [Emphasis Added.]

This requirement states that complete, timely, and accurate annual report information is necessary ***prior to*** review of the compensation reports for timeliness. However, DWC is waiving penalties on late compensation reports whether or not the annual reports are accurate, timely, and complete. In our testing, we identified 17 instances where an annual report was determined to be incomplete, however late compensation report penalties were still waived. As a result of this practice, DWC inappropriately waived approximately $105,000 in second injury fund (SIF) penalty revenues during FY 99.

We also question the methodology used by DWC to waive the penalties on the compensation reports. Alaska Statute 23.30.155(m) also reads in part:

> *If during the preceding year the insurer or adjuster filed at least 99 percent of the **reports** on time, the penalties assessed under (c) of this section shall be waived. If during the preceding year the insurer or adjuster filed at least 97 percent of the **reports** on time, 75 percent of the penalties assessed under (c) of this section shall be waived. If during the preceding year the insurer or adjuster filed 95 percent of the **reports** on time, 50% of the penalties assessed under (c) of this section shall be waived.* [Emphasis Added.]

Based upon this statute, the waiver should be based on the total number of late compensation reports per adjuster or insurer compared to the total number of compensation reports for each particular adjuster or insurer. However, to calculate the percentage to waive, DWC is using inherently different units of measure. As explained in the Report Conclusion section, DWC is dividing the number of late compensation reports for a particular insurer or adjuster by a system generated count of the total number of compensation types reported on all compensation reports filed by a particular insurer or adjuster. Using the inflated count of compensation types per report as the percentage base instead of a count of discrete reports, the percentage of late reports will be lower than it should be. We estimate late compensation report penalties were understated by approximately $11,500 due to this practice.

Late compensation report penalties are deposited into the SIF. The effect of the combined penalty under-assessments discussed above is that the balance in the SIF will be less than it

would have been if penalties were imposed accurately. This results in the need for a higher contribution rate to collect additional revenue from all insurers.

Additionally, we identified a component goal in the FY 00 budget documents of the SIF is to:

> *reduce the amount of penalties currently paid by insurance companies for late compensation report filings by increasing communication with insurance companies and increasing their awareness of the reporting requirements according to law.*

We recommend DWC reconsider its methodology for assessing penalties to ensure compliance with the law. We also recommend DWC establish goals to increase reporting compliance rather than reducing the amount of insurer penalties.

Recommendation No. 9

The director of the Division of Workers' Compensation should correct inappropriate administrative and accounting practices.

Alaska Statute 23.30.040(a) states:

> *Money in the second injury fund may only be paid for the benefit of those persons entitled to payment of benefits from the second injury fund under this chapter.*

Although one administrative clerk II is organizationally placed under the SIF, the position's actual job duties are not related to the administrative duties of the SIF. Since the job duties of the position do not benefit injured workers who have joined the SIF, the appropriateness of allocating the position's personal service costs to the SIF is questionable. DWC's current practice decreases the retention rate of the fund, which ultimately could inflate the amount of contributions insurers pay. During FY 99, inappropriate SIF personal services totaled $28,143.

The director of DWC should ensure personal service charges are supported by adequate documentation. Additionally, all personal services charged to the fund should be true administrative expenses of the SIF.

Recommendation No. 10

The director of the Division of Workers' Compensation should resolve the legality of "supplemental" benefits and rectify internal control weaknesses over such expenditures.

Alaska Statute 23.30.172 was effectively a mechanism to provide a cost of living allowance to supplement injured workers' primary indemnity payments. Fiscal Year 99 budget documents indicate $204,600 allocated for 35 claimants. During FY 99, 26 individuals received supplemental benefits. [49] In FY 98 and FY 99, General Fund expenditures totaled $171,155 and $168,143, respectively. During FY 99, $36,500 of the allocation was transferred to other DWC operations. Our review identified several areas that need to be addressed. Specifically, the director should initiate the following measures:

1. Obtain the attorney general's opinion when assessing the legality of issuing supplemental benefits under AS 23.30.172 to individuals who no longer receive primary workers' compensation benefits from their insurer. Our review concluded 24 of the 26 recipients that received supplemental benefits during FY 99 no longer receive primary benefits from their insurer. DWC continues to pay supplemental benefits despite the fact recipients do not receive the primary benefits that originally qualified them for benefits under AS 23.30.172.

   Most of the supplemental benefit recipients have likely settled their claim through a compromise and release (C&R) order, discharging their insurer from further benefit payments. DWC asserts a C&R order would only release the insurer from further indemnity payments, not the State. Such an interpretation is not supportable in the absence of documentation specifically binding the State to indefinite supplemental benefits.

   In our view, the totality of benefits discussed herein represent one homogeneous indemnity benefit with the only distinction being the payer. The supplemental benefits the State issues are merely a counter inflation component of the original benefit and should cease when insurer-issued benefits are terminated, regardless of the reason such primary benefits are discontinued (whether due to the worker recovering from their disability or settling through a C&R order).

   At the end of fieldwork, only one of the supplemental benefit recipients continued to receive primary compensation from their insurer. Supplemental benefits paid to this single recipient total $370 per month. Confining benefit payments strictly to eligible recipients receiving benefits from their insurer would realize annual general fund savings of $153,091.

2. Exercise a greater level of monitoring over the expenditure of supplemental benefits. It is likely that at least one individual is legally entitled to supplemental benefits under AS 23.30.172. As discussed in the Report Conclusions section of this report, internal controls over such expenditures are inadequate. DWC should implement policies and procedures to reduce the risk of the fraudulent receipt of benefits.

   Nine recipients have monthly warrants sent to third parties or financial institutions for direct deposit. The potential magnitude of the internal control weaknesses are

[49] See footnote 34 on page 34.

underscored by the fact that DWC does not periodically contact recipients and our attempts to establish contact with recipients were not successful in over 30% of the cases. General fund warrants exceeding $6,020 were issued to a supplemental benefits recipient after DWC received notification of the recipient's death. One warrant in the amount of $1,505 was fraudulently endorsed.

A procedure consisting of periodic confirmation that recipients continue to be eligible should be adopted. Such confirmation could be accomplished by soliciting physician affidavits certifying beneficiaries continue to be permanently totally disabled.

3. Adequately support benefit calculations based upon workers' wages. Most of the supplemental benefit calculations were based upon unsupported employee average weekly earnings. For example, one individual with unsupported wages reported average weekly earnings of $600 per week at the time of his 1962 injury. Given that the 1975 Alaska average weekly wage was only $248, the amount of the unsupported average weekly earnings is suspect. Benefit expenditures should not be initiated without adequate supporting documentation.

Appropriations should only be sought for activities that constitute a genuine public purpose and expenditures only made for valid obligations of the State. Accordingly, paying supplemental benefits should be discontinued for individuals not legally entitled and controls should be implemented to adequately safeguard resources.

Recommendation No. 11

DWC's reemployment benefits administrator should capture ineligibility determination statistics for policymakers and stakeholders.

Balancing the statutory language of the law and legislative intent of quick, efficient, fair, and predictable service sometimes represents a dichotomy.

Intuitively an injured worker who cannot perform the actual physical requirements to return to his or her job at the time of injury should be entitled to reemployment benefits. However, Alaska Supreme Court rulings have underscored instances of perceived unfairness in the law, highlighting the existence of sometimes-conflicting goals.

Having adequate information is essential for making informed decisions while considering future revisions of the Workers' Compensation Act. Accordingly, the reemployment benefits administrator should capture the reasons an injured worker is determined ineligible for reemployment benefits. Statistics should be maintained to measure the frequency and extent of perceived inequitable outcomes. Specifically, the reemployment benefits administrator should note whenever an individual is unable to return to his or her job at the time of injury, but is ineligible for reemployment benefits for the following reasons:

- The injured worker is physically capable of performing job duties of the position at the time of the injury, as described in *Selected Characteristics of Occupations Defined in the Revised Dictionary of Occupational Titles.*

- The individual has held or received training for a position in the past 10 years which he or she is capable of performing, however the position does not pay 60% of his or her salary at the time of injury, consequently not meeting the threshold of remunerative employability.

- At the time of medical stability,[50] the injured worker does not qualify for an impairment rating under the guidelines set forth in the *American Medical Association's Guides to the Evaluation of Permanent Impairment.*

Additionally, having accurate information as to the success of reemployment training would be beneficial to policymakers.

Arctic Adjusters Annual Report

Insurer	(In)Complete Annual Report Penalty
Lumbermen's Mutual	**Incomplete**
American Motorists	**Incomplete**
US Fidelity and Guaranty	Complete
American Manufacturers Mutual Insurance	Complete
Continental Insurance	Complete
Insurance State of PA	Complete
St. Paul Fire and Marine	Complete
Federal Express	**Incomplete**
Columbia Health Care	**Incomplete**

This schedule represents an annual report penalty summary for Arctic Adjusters. Arctic Adjusters files on behalf of specific insurers. However, annual report penalties are calculated based upon adjuster instead of insurer. This is not consistent with the board's directive to file a report for each insurer code.

In this example, instead of assessing a civil penalty of $1,000 for each incomplete annual report totaling $4,000, the DWC assessed a civil penalty to Arctic Adjusters of just $1,000.

Recommendation No. 12

DWC's director should seek legal clarification with regard to the methodology for assessing annual report penalties.

DWC accepts annual reports from adjusters on or before March 1 of each year. Alaska Statute 23.30.155(m) reads in part that *"the insurer or adjuster shall file a verified annual report on a form prescribed by the board."* DWC provided us with an AWCB Bulletin 96-10 which prescribed the form for submitting the annual report. This board directive states in part:

> *Attached is a new format and records layout indicating the necessary report fields, including the new rehabilitation cost fields.*

[50]Alaska Statute 23.30.395(21) defines medical stability as *"the date after which further objectively measurable improvement from the effects of the compensable injury is not reasonably expected to result from additional medical care or treatment, notwithstanding the possible need for additional medical care or the possibility of improvement or deterioration resulting from the passage of time; medical stability shall be presumed in the absence of objectively measurable improvement for a period of 45 days; this presumption may be rebutted by clear and convincing evidence."*

The attachment states that *"an annual report needs to be filed for each code."*

Our interpretation of the statute indicates to us that the board could prescribe the form which insurers or adjusters should follow in submitting the annual report. More specifically, the board could prescribe whether these reports were submitted by adjusters on behalf of a number of discrete insurers, or by discrete insurer code. The statute, in our view, allows the board to dictate the form.

However, DWC accepts adjuster's reports on behalf of multiple insurers instead of a discrete annual report for each insurer code and assess penalties in that manner. Several adjuster annual reports for the calendar year 1997 were reviewed and found to be incomplete, with problematic data attributable to particular insurers. DWC asserts that the statute allows filing by insurer or adjuster regardless of the form prescribed by the board in the AWCB Bulletin. Additionally, the statutes state that *"If the annual report is incomplete when filed, the insurer or adjuster shall pay a civil penalty of $1,000."*

DWC assesses penalties by adjuster instead of by insurer code. Calculations based upon insurers instead of adjuster would have resulted in an additional $23,000 in FY 99 general fund revenue being collected (see inset on facing page). The strictest of enforcement would require civil penalties for incomplete reports to be assessed for each insurer.

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STATE OF ALASKA

Tony Knowles, Governor

Department of Labor and Workforce Development

OFFICE OF THE COMMISSIONER

P.O. Box 21149
Juneau, AK 99802-1149
Phone: (907) 465-2700
Fax: (907) 465-2784

February 4, 2000

Ms. Pat Davidson
Legislative Auditor
Division of Legislative Audit
P.O. Box 113300
Juneau, AK 99811-3300

Dear Ms. Davidson:

Re: Response to Preliminary Audit Report - 07-4601-00
Division of Workers' Compensation

We have reviewed the preliminary audit report on the Division of Workers' Compensation (DWC), and appreciate this opportunity to comment on the recommendations presented. In general, with some major exceptions, we concur with the background information and conclusions presented. We also agree with many of the recommendations outlined in the Preliminary Audit Report. Our specific comments on the Background, Conclusions, and Recommendations follows:

BACKGROUND INFORMATION AND REPORT CONCLUSIONS

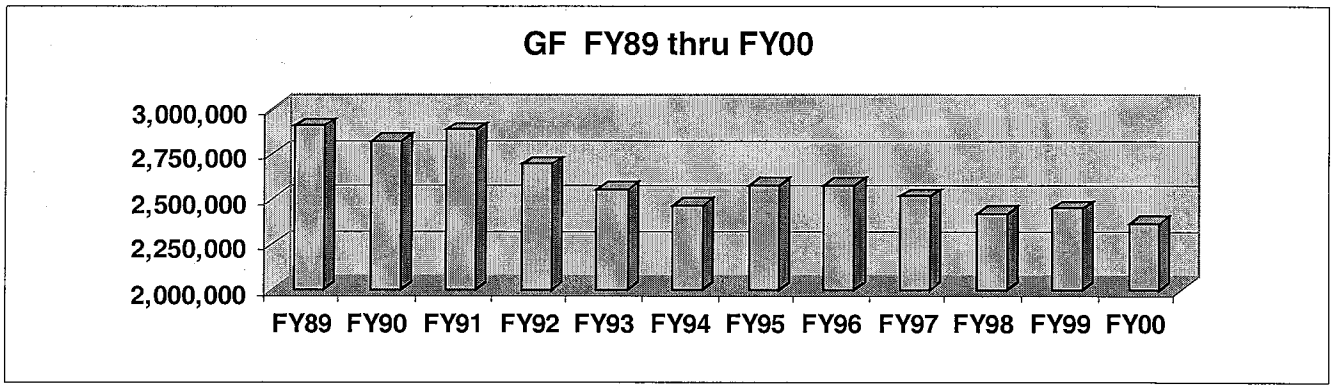
The background information presented captures the essence of the intent of the 1988 statute changes, and we appreciate its inclusion in the audit report. We believe the audit does a good job outlining the history and changes that occurred regarding the 1988 amendments to the workers compensation act. There was a reduction of indemnity and medical benefits with the intention to lower cost to employers and still be fair to employees. The DWC feels the audit did a fair assessment of the legislative intent and we agree with the outline of the responsibilities under the workers compensation act, and the workload portrayed.

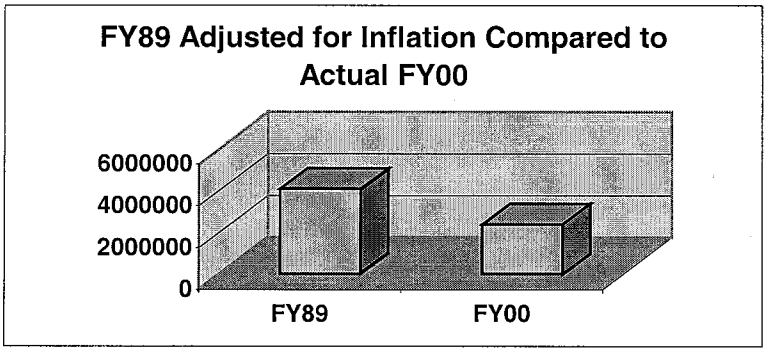
We are less in concurrence with the Conclusions presentation and strongly object to the conclusion of ineffectiveness due to administrative shortcomings in the DWC. Conspicuously absent in your analysis are the impacts on the DWC from the 1988 law changes, and whether the DWC is adequately funded to perform the many statutory mandates imposed. We believe presentation of this information and the changes in funding and positions since the statute change would more fairly represent the constraints under which the DWC now operates.

In FY89, the first year the 1988 reforms went into effect, the DWC had a staff of 48 employees and a general fund budget of 2.9 million. Currently, in FY00, the DWC has 39 employees and a general fund budget

of 2.367 million. This is a decline of 9 employees and over 500,000 dollars in general fund support. This is approximately an 18.5% decline in actual dollars during the period of time analyzed in the audit. This becomes further problematic when you consider the audit discussion on the impacts of inflation during that period of time. Taking the audit's reported 40% increase in the consumer price index for this period, the DWC should have received 4.066 million in FY00 to maintain funding at FY89 levels. This amounts to a reduction in funding of over 40% when adjusted for inflation.

To illustrate this graphically:





The DWC does agree with the audit conclusion on the compensation inequities in the law. The most obvious problem is the setting of upper limits to compensation such as permanent impairment, death benefits and reemployment benefits, which are negatively impacted by inflation. The auditors indicate that these benefits have decreased by 40% since the 1988 amendments went into effect, based on the consumer price index. We would add that maximum and minimum weekly compensation rates as set in Alaska Statute 23.30.175(a) would be impacted by inflation in the same way.

The DWC takes exception to some of the other conclusions in the report, but will address the specifics of those disagreements while responding to the recommendations of the audit.

Recommendation No. 1

DWC management should develop a strategic plan to better accomplish the agency's operating mission.

DWC agrees with the overall recommendation of a strategic plan in principle. The division does strategic planning from year to year, but the efficacy of that planning is impacted by budgetary constraints and cuts.

Manual processing of much of the paperwork related to claims and payments is inefficient.

DWC believes the report is correct in stating that tremendous efficiencies could be gained through adoption of Electronic Data Interchange (EDI) technologies. The current backlog in processing injury reports, establishing claims, and entering compensation reports is not likely to improve given current staffing shortages and budgetary constraints. As stated in the audit conclusions, the International Association of Industrial Accident Boards and Commissions (IAIABC) is working with states and industry to adopt ANSI standards for EDI transactions involving proof of insurance, claims, and compensation reports. Implementation of EDI technology could radically improve the division's efficiency in entering insurance notices, claims, and compensation reports without any increases in personnel services.

Although the current computer system was designed to be compatible with Internet access, EDI capability will still take considerable capital investment. The DWC believes this investment could result in efficiencies allowing current resources to be focused on other problem areas.

The DWC has started investigating some electronic data filing issues and is looking into a pilot project with Fisherman's Fund in an attempt to move in this direction. But, in order to make such a project realistic DWC must secure capital project funding.

The audit suggests the DWC should consider developing an alternative resolution process for workers' compensation. The DWC does use an alternative resolution process through the current prehearing process. Workers' compensation officers attempt to resolve and settle cases at the prehearing level to reduce the number of cases that need to be scheduled for formal hearings. This, again, is impacted by budgetary constraints. As a result, the number of workers' compensation officers available for alternative resolution has declined.

Strategic plan would have to reflect a commitment to real and relevant performance goals.

DWC agrees this is a good idea, but has to be considered along with realistic budgetary considerations. If the only certainty is further cuts to general funds it makes very little sense to develop goals that

are unattainable, and the strategic plan becomes an exercise in futility.

Recommendation No. 2

DWC's Director should propose legislative changes to improve balance in the workers' compensation laws.

We concur with this conclusion and recommendation. The 1988 amendments to the workers' compensation act substantially reduced benefits to injured workers'. This resulted in a reduction of overall premium rates to employers. While the reduction in premium resulted in a favorable situation to employers, the reduction of benefits has become problematic to employees. This situation compounds as inflation erodes the fixed benefits such as permanent impairment benefits, reemployment benefits, funeral expenses, maximum and minimum compensation rates. The auditor's research indicates that the consumer price from 1988 to the present rose 40%. We don't dispute that number or the resulting problems to injured workers from diminished benefits. The DWC believes, and the auditor's report seems to concur, these problems would be best addressed by indexing these benefits. As an alternative to indexing, benefits should be reviewed by the legislature on a regular basis to prevent levels from being drastically reduced due to inflation. At the very least, the current problem with benefit inadequacy should be addressed by the legislature.

As noted above, over the same period of time, there was significant reduction in funding to the DWC. This further frustrates injured workers, employers and insurers because the DWC is less able to provide adequate services in a quick and efficient manner.

The DWC must be adequately funded to fully inform employees of their rights, to address disputes, investigate uninsured employers, and provide all of the services that are required by law.

The DWC believes that the Director should work with the legislature to introduce legislation to solve the current budgetary problems through alternative funding, such as user fees.

Recommendation No. 3

DWC's Director should increase outreach, education, and technical assistance to injured workers with regard to their rights and responsibilities under the workers' compensation laws when a disputed claim occurs.

We do not fully concur with this recommendation. We do agree that the workers' compensation law is very complex, and that the DWC has a responsibility to provide assistance in understanding the process. We believe DWC meets this intent, within the constraints of process

complexity and funding limitations, through use of hard copy and Internet documents, and by providing technical assistance.

The audit report acknowledges the level of complexity inherent in the workers compensation process, using the following statements:

- "…the complicated and litigious nature of the process."
- "…difficulty in getting an attorney to accept cases due to either complexity of the injured worker's case,…".
- "Attorneys expressed the need to specialize in worker's compensation cases due to the complexity of the process."
- "The WCA is a legal process that incorporates judicial procedures that the average layperson is not likely to understand."

The audit states that "DWC literature does not provide enough substance for someone to understand all of the nuances of the process given its litigious nature". We believe it is the inherent complex litigious nature, acknowledged by the audit report, that precludes literature with enough substance for the average lay person to understand all of the nuances. Complex legal processes do not lend themselves to over simplified explanations that retain accuracy and can address every claimant situation.

The second area we find problematic with this recommendation is the realistic potential for implementing desirable alternatives, such as videos, for increased outreach and education. As discussed above in the Background section, funding and position reductions have occurred over the last decade. We believe that alternatives need to be considered within the context of these reductions, which limit the likelihood of developing and implementing labor-intensive or costly options.

DWC, however, believes this may be a good recommendation provided funding can be obtained for these types of projects. This funding needs to be maintained over time because any video, or publication has to be updated as the law changes through the legislative process and court action.

Recommendation 4

DWC's Director should take proactive measures to identify and monitor uninsured employers.

This recommendation had five subsections that will each be addressed separately. Legislative Audit stated enforcement action could be improved substantially if DWC:

1. Eliminates the backlog that contributes to significant inefficiencies.

The data entry backlog in processing insurance notices has been eliminated. The primary cause of the backlog was due to alpha and beta testing of DWC's new database system May through August. Current processing occurs within 2-3 days of receipt of notice.

2. Fully resolves injuries reported as uninsured and corrected system data to promote accurate uninsured injury status.

With the implementation of a new database in September of 1999, there are now procedures to quickly identify and resolve uninsured claims. As noted in the audit report, new features include capture of DOL UI account and federal Employee Identification Numbers (EIN) to help identify employers listed on insurance notices. It is projected to take approximately a one-year cycle to adequately clean up the data. In addition, the new system triggers a system reminder message to the Workers' Compensation Officer II (WCO) noting the creation of an uninsured claim. This allows the WCO to follow up and resolve the issue in a timely manner.

We object to the audit statement that 31,000 employers were identified as potentially uninsured, and that 900 employers remain non-responsive. We believe this statement is misleading. First, there are only about 16,000 registered employers in the state. Second, of the referenced 900 non-responsive employers 450 responses were available at the time of audit. Third, the source of the data was not DWC official records. The business name cross match process described in the audit was a first attempt screening tool to assist in designing a method for identifying uninsured employers. It was not ever intended as a definitive method for identifying potential uninsured employers, nor were the results assumed to be accurate. For example, an employer listed under similar but slightly different names in the two systems causes a false assumption of "uninsured" upon crossmatch. The accurate method for identifying uninsured employers is the EIN cross match feature described above.

3. Develops amendments to AS 23.30.085 for legislative consideration that institute penalties for filing insurance/adjuster notices in an untimely manner.

DWC supports the concept of instituting insurer penalties for filing insurance/adjuster notices in an untimely manner. DWC attempted to address this through adoption of regulation in FY99, however, DOLaw informed DWC that the regulation was not supported by current statutory language and felt this type of approach would require statutory change.

4. Documents the entirety of employer enforcement correspondence and effort.

We concur that documenting full employer enforcement effort is a good idea. When the new computer system is fully implemented the system will track enforcement actions that took place regarding individual employers.

We take objection, however, to information presented in the Audit conclusions. The conclusion section correctly presents a decrease in DWC prosecution referrals, but does not fairly present the reasons. The cessation of the contractual relationship for investigation services with DOL's Labor Standards and Safety Division is a direct result of reduced funding. Also, as noted in the audit conclusion section, DOLaw has set forth guidelines for prosecution referral. Although Legislative Audit's view is that these guidelines are not consistent with legislative intent that sanctions be strictly enforced, DOL must operate within the limitations of the guidelines established by DOLaw.

We also believe the statement that "DWC has not sought prosecution against employers in recent years" is erroneous and misleading. There was in fact a successful prosecution last year and DWC is currently working on cases for prosecution. Also, it must be noted that there were **no** prosecutions of uninsured employers prior to 1995, and since then there have been a number of successful prosecutions.

Nevertheless, the DWC agrees that increased regulation and prosecution of uninsured employers would improve the system. This does require adequate funding and budgetary solutions as well as statutory fixes.

5. Seek revision to the Alaska business license.

We concur that DWC, Department of Community and Economic Development, and the Division of Occupational Licensing should work cooperatively to implement a new business license application that puts an employer on notice it must obtain workers' compensation insurance for its employees.

Recommendation 5

The legislature should consider amending AS 23.30.075 to empower the Alaska Workers' Compensation Board (AWCB) to sanction uninsured employers.

The DWC agrees with this recommendation. The added penalties would likely provide a deterrent to uninsured employers. The DWC feels the 50% penalty tacked onto compensation due an employee is an especially good idea. The injured worker is the most adversely affected by the employer being uninsured and should therefore receive the benefit of the penalty.

Recommendation 6 - The Department of Community & Economic Development, Division of Insurance is Primary Responder.

Recommendation 7

DWC's Director should improve controls over review of insurers' annual reports.

This recommendation addressed several issues. The following responds to each separately:

1. Recommend that DWC enforce its established procedures requiring insurers to submit their information in board-established format. **DWC requires annual report data to be submitted in the board-prescribed format.** About 80% of insurers submit annual reports by electronic media, as allowed by regulation. The ease of using the electronic data is impacted by three factors: the difference between DWC and the submitter's data system/software, the wide range of data processing knowledge among submitters, and the medium on which reports are submitted such as, diskettes, 9 track, and magnetic tape. In addition, about 20% of insurers submit their reports on paper when electronic submission is not possible due to manual systems or incompatible file types. DWC does acknowledge that on going improvement in data systems and procedures will contribute to improving the efficiency of the annual report submission process.

The audit conclusion states that the SIF administrator spent three weeks creating an annual report for an insurer not filing on the form prescribed on the board. This misrepresents the situation. The insurer filed all the required information in the required format on paper. Electronic submission did not occur because file types were incompatible. This information was then manually entered in the Workers Compensation System.

2. Recommend independent verification be performed. **We agree that there is a need for better independent verification of the annual report.** Data submitted on the annual report (suspense file) is compared to data from the DWC database (extract file). Suspense file data does not have a corresponding data extract for some of the payments made such as medical benefits paid, vocational rehabilitation benefits, or legal fees. This information is not entered on the DWC database due to three factors: the old computer system did not have the capacity to capture this data; the insurers/adjusters/employers do not report this data; and there is inadequate staffing to enter this data. The insurers/ adjusters/employers could be required to report this information but additional funding is needed for system programming and for data entry staff.

3. Recommend annual report summary amounts should be reconciled to workers' compensation data system. **The audit report did not provide enough information for us to address this recommendation.**

4. Recommend reasonable exception report variances be established. **Reasonable variances are established and used.** The auditors state that the 10% allowable variance between the suspense file and the extract

file is too high and inconsistent with legislative intent. The 10% variance, however, was established and is permitted under 8 AAC 45.136. We therefore consider this a reasonable measure to use.

5. Insurers were assigned multiple codes.

DWC agrees there are "insurers assigned to multiple codes", and that this is to be expected. This is because one insurance company can have multiple insurer/adjuster codes, depending on how many adjusters are handling claims for the insurer. Additionally, insurance companies change adjusters periodically. DWC acknowledges that the use of codes resulted in some duplications and errors in the old system. **DWC is designing an Annual Report component for the new system that will record annual reports based on the unique combination of insurer/adjuster name instead of insurer/adjuster codes.**

Recommendation 8

DWC's Director should adopt a methodology for assessing compensation report penalties that is consistent with statute.

DWC believes the current methodology for assessing penalties is consistent with statute (AS 23.30.155(c) and (m)). The auditors, however, raise a valid question of interpretation for which DWC will seek clarification.

The DWC acknowledges the audit may be correct in its interpretation of what constitutes a compensation report. The DWC interprets each compensation payment, listed on a report form, as a separate report. This interprets the statute broadly, and it was the only way the old computer system counted the compensation reported. The new system will have the capacity to count compensation payments listed on a report form as just one report. Again this is subject to interpretation and the disaffected parties have a right to appeal this issue to the Board and then the court. This could also lead to an unintended consequence. If DWC adopts the audit's interpretation of AS 23.30.155(m) and (c), and the Board and the court's rule this is a correct interpretation, the insurers/adjusters/employers could file each payment on a separate compensation report form. This would effect the same count result as our current interpretation, but would require additional staff time to enter data because of the increase in forms filed.

The Audit failed to point out that prior to 1995 these penalties were not collected. While there may be disputes or disagreements regarding interpretation of AS 23.30.155(m) and (c), the Division has made major improvements in collecting these penalties since 1995.

Recommendation 9

The Director of the Division of Workers' Compensation should correct inappropriate administrative and accounting practices.

The DWC believes there are no administrative expenses that are inappropriately being charged to the SIF. In fact, if anything, the DWC is very conservative in charging staff time to the second injury fund. The audit correctly quotes AS 23.30.040(a) *Money in the second injury fund may only be paid for the benefit of those persons entitled to payment of benefits from the second injury fund under this chapter.* The audit fails to mention that AS 23.30.040(h) says: *Administration expenses of the state under this section and AS 23.30.205 must be paid from the second injury fund.*

The audit suggests one Administrative Clerk II (ACII) position may be charging more personal services to SIF than is appropriate. It is also suggested that "the Director of DWC should ensure personal service charges to the SIF are supported by actual documentation.

The basis for charging time against the SIF was reviewed in the past to determine an equitable cost allocation. The SIF uses the Workers Compensation system data for determining benefits eligibility, for tracking payments to the second injury fund and for assessing penalties that are paid to the SIF. The data entry for this and other related data is performed by five positions. It is estimated that SIF related work is the equivalent of one full time position. As a result, we determined it is more efficient to charge one position to the SIF rather than require detailed time charging by five employees. This allows for adequate charge back for use of Workers' Compensation resources with minimal administrative and management oversight.

Recommendation 10

The Director of the DWC should resolve the legality of "supplemental" benefits and rectify internal control weaknesses over such expenditures.

DWC concurs with the recommendation that a system which better monitors the AS 23.30.172(172) grant expenditures is needed. The DWC believes that these cases should be monitored periodically by division staff to ascertain the payments are being accurately paid to the correct person and to take corrective action if needed. DWC staff is implementing a system that will contact the individual claimants regularly to assure that they remain entitled to payments.

The DWC does question some of the findings and recommendations of the audit. The audit contends that because 24 of the claimants being paid under 172 entered into a compromise and release with an insurer they probably are not entitled to further payments from the State. The audit further contends that the claimants are not receiving primary payment from the employers/insurers and are therefore probably not entitled to 172 payments. DWC submits this is an oversimplification and may be jumping to an unsubstantiated and possibly erroneous conclusion. A compromise and release can be submitted on a claim and the injured worker may still be entitled to 172 payments. The compromise and release may allow for the purchase of an annuity, a

common practice in long term cases. An annuity payment does not show up on the workers' compensation system, yet payments can be made to the claimant for life. If the compromise release had such an annuity proviso, the state, in all likelihood, remains responsible for payment of compensation under 172.

This situation is further complicated by the fact that the state may need to file a valid (legally supported) controversion (see AS 23.30.155(a), (c) and (o)) before it can stop these compensation payments. Even if the State finds valid legal cause to controvert these payments, the fact that the State has made these over such a long period of time (payments date back to as early as the mid 1970's) the State may have waived its right to terminate these benefits.

Nevertheless, DWC feels this matter should be investigated. DWC will attempt to obtain copies of all compromise and releases regarding these cases. These documents may be in archives or a copy might be obtained from the employers/insurers/adjusters. After these documents are obtained, if it is possible to obtain them, they will be referred to the Attorney General along with a request for an opinion as to whether the State has a right to stop these payments.

Recommendation 11

DWC's Reemployment Benefits Administrator should capture ineligibility determination statistics for policymakers and stakeholders.

DWC concurs with this recommendation. We agree that it is worth while to research certain reemployment benefits determinations to provide information on whether the use of *Selected characteristics of occupations as described in the Dictionary of occupational titles* (SCODOT) is fair and appropriate. The law requires the use of the SCODOT to describe the physical requirements of a job at the time of injury. This must be done even if the actual physical requirements of the job are not the same as those described in the SCODOT. This has led to reemployment benefit ineligibility determinations when an injured worker can not physically return to work.

The law also requires a determination of ineligibility if the injured worker can return to any job he/she had in the ten years prior to injury. This is required even if the past job pays less than a remunerative wage (defined in law as 60% of spendable wage at time of injury).

Further, the law requires a permanent impairment ratable under the AMA Guides to Rating Permanent Impairment (Guides) as a prerequisite to entitlement to reemployment benefits. Some workers could be disabled and not have a ratable impairment under the Guides, and therefore found ineligible for reemployment benefits. Certain injuries and illnesses are not ratable under the Guides.

The DWC has some information on the above three issues, but the statistics are not complete. We know the three situations exist and have resulted in reemployment benefits ineligibility determinations, but we don't know how large a problem this is. Again, this would require funds for staff and computer programming to capture this information in a fully quantifiable way.

Recommendation 12

DWC's Director should seek legal clarification with regard to the methodology for assessing annual report penalties.

We do not concur with this recommendation. AWCB bulletins are advisory in nature and do not carry the force of law. AS 23.30.155(m) allows for either the insurer or adjuster to file annual reports and states that penalties shall be paid by the insurer or adjuster. It is DWC's practice to charge penalties to the party who submitted the annual report. The DWC has interpreted this within the latitude allowed by statute to avoid litigation on this point. If the DWC adheres to the audit's interpretation of AS 23.30.155(m) the disaffected adjusters, insurers and employers have a right to appeal this to the Workers' Compensation Board and the Courts. DWC believes this could increase staff time and litigation costs, and in the end the Board and the Courts would likely rely on statute rather than the auditor's interpretation.

We appreciate the courtesy and professionalism of the audit staff, particularly their efforts to minimize the impact of their inquiries on DWC operations.

If you have any questions or require additional information, please contact JoEllen Hanrahan, Internal Auditor, at 465-5673, or Director Paul Grossi, at 465-2790.

Sincerely,

Ed Flanagan
Commissioner

EF/JH:ets

cc: JoEllen Hanrahan, Internal Auditor
Paul Grossi, Workers' Compensation Director
Remond Henderson, ASD Director

Tony Knowles, Governor

Alaska Department of Community and Economic Development

Division of Insurance
P.O. Box 110805, Juneau, AK 99811-0805
Telephone: (907) 465-2515 • Fax: (907) 465-3422 • Text Telephone: (907) 465-5437
Email: Insurance@dced.state.ak.us • Website: www.dced.state.ak.us/insurance/

February 4, 2000

VIA FACSIMILE (907) 465-2347

Ms. Pat Davidson, C.P.A., Legislative Auditor
Alaska State Legislature
Legislative Budget and Audit Committee
Division of Legislative Audit
P.O. Box 113300
Juneau, AK 99811-3300

Dear Ms. Davidson:

Commissioner Sedwick of the Department of Community and Economic Development has asked me to respond to the Division of Legislative Audit's Preliminary Audit Report (the report) dated October 31, 1999, and specifically to Recommendation No. 6, which relates directly to the operations of the Division of Insurance (DOI). This letter explains the DOI's plan for prompt and effective response to AS 23.30.155(o) referrals by the Alaska Workers' Compensation Board (AWCB), within the limits of the current statute, AS 21.36.125. The DOI is already going forward with this plan and has also taken action as discussed in this letter to implement other parts of the report's recommendation to the DOI on pages 48-49.

The report's conclusions on page 19 include the statement that sanctions against frivolous controversions have been rendered ineffective by the policies and practice of the DOI. In support of this conclusion, the report asserts that the legislature intended frivolous controversion referrals to be actively pursued, and notes that DOI has not yet resolved any of the four cases (listed on Exhibit B) referred to it between December of 1997 and July of 1999. See report pages 28-30. The DOI agrees that AS 23.30.155(o) directs it to actively investigate frivolous controversion referrals by the AWCB. The DOI has developed investigative standards and time guidelines for doing so, and is now actively investigating insurer conduct in five cases referred by the AWCB. The DOI's plan for prompt investigation of pending and future referrals is discussed in Section I of this letter.

However, the DOI respectfully disagrees with the report's interpretation of the term "practice," which is referenced in AS 23.30.155(o), but is derived from and is an essential part of the statutory language of AS 21.36.125. For the reasons described in more detail in Section II below, the DOI believes that AS 21.36.125, as interpreted by regulation, as well as court decisions and published commentary, requires repeated acts, not just a single incident, to constitute an unfair claims settlement practice. The report asserts on page 29 that this approach "is inconsistent with the legislature's desire that frivolous controversions be strictly enforced." If the DOI's interpretation is inconsistent with the legislature's desire to strictly enforce prohibitions on frivolous controversions, then the legislature should clarify this by changing the statute.

I. DOI Revamps Past Frivolous Controversion Complaint Handling Practices.

The DOI agrees that it is responsible under AS 23.30.155(o) to examine whether insurer controversions that the AWCB has determined to be frivolous are unfair claims settlement practices prohibited under AS 21.36.125, and to take administrative actions to impose penalties where indicated. The DOI is now actively investigating all the frivolous controversion decisions referred to it by the AWCB, though it has not yet completed any investigation or determined whether further administrative action is warranted. Please see the attached reply to Exhibit B for the current status of each of the referrals.

When the first frivolous controversion finding by the AWCB under AS 23.30.155(o) came to the DOI in December, 1997, it differed significantly from other unfair claims settlement practices complaints the DOI handles. Frivolous controversion referrals were a tiny (but very important) slice of the more than 1,000 consumer complaints received and handled by DOI over a two year period beginning in December 1997. In the typical consumer complaint, the DOI collects facts and determines whether the insurer's conduct toward the consumer justifies the DOI's intervention. In most cases, the DOI pursues consumer complaints only if the consumer remains actively interested in seeking relief from the insurer.

The DOI now understands clearly that it has enforcement responsibilities under AS 23.30.155(o), which make frivolous controversion referrals different from other kinds of consumer complaints. The DOI agrees that its investigation is mandatory under AS 23.30.155(o). The DOI will not re-examine a determination of frivolous controversion by the AWCB. The DOI's statutory duty is to determine whether the frivolous controversion found by the AWCB constitutes an unfair claim settlement practice in violation of AS 21.36.125, and if so, what penalties are appropriate. The DOI will conduct this investigation without regard to whether there is a consumer complainant asking to pursue the matter.

The DOI therefore made significant improvements in its handling of these cases in November 1999. Upon receipt of a referral from the AWCB for unfair or frivolous controversion under AS 23.30.155(o), the DOI will review to determine jurisdiction. Unless it lacks jurisdiction, the DOI will then review the facts of the case to look for violations of AS 21.36.125, and will determine what company records or other materials to examine for evidence of similar controversions, or of other actions that constitute unfair claims settlement practices. After required documents are received, the DOI will promptly review the materials and recommend appropriate disposition, including initiation of administrative actions seeking penalties if warranted.

The decision to initiate an administrative proceeding does not depend on the expense of the hearing. The decision concerning whether to hold a hearing is made by the director with advice of counsel, and will include consideration of the deterrent effect on unfair and deceptive acts including frivolous controversions. The director will also consider the legislative intent, as described in the report and the intended equitable balance between the interests of insurers and the protection of the public.

The DOI will develop additional procedures for handling frivolous controversion referrals from the AWCB, including guidelines for investigation and administrative procedures, as it gains experience with investigations of these cases. The DOI's goal for frivolous controversion referrals currently under investigation is to initiate administrative action if warranted, or resolve by settlement or closure, within six months. For cases received in the future, the six month time line will begin from receipt of the AWCB referral.

II. An Unfair Claims Settlement Practice Under AS 21.36.125 Means Repeated Unfair Acts.

The DOI's responsibility under AS 23.30.155(o) is to determine whether an insurer that unfairly or frivolously controverted a worker's compensation claim (as determined by the AWCB) has also committed or engaged in an unfair claims settlement practice within the meaning of AS 21.36.125.[1] This section is set out below, with emphasis added to the language that states the repetitive action requirement. **An unfair controversion determined by the AWCB does not by itself equate to an unfair claim settlement practice under AS 21.36.125 because what this statute forbids is some form of repetitive practice.** More than ten years

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[1] Sec. 21.36.125. Unfair claim settlement practices. A person may not commit or engage in with such frequency as to indicate a practice any of the following acts or practices:

(1) misrepresent facts or policy provisions relating to coverage of an insurance policy;

(2) fail to acknowledge and act promptly upon communications regarding a claim arising under an insurance policy;

(3) fail to adopt and implement reasonable standards for prompt investigation of claims;

(4) refuse to pay a claim without a reasonable investigation of all of the available information and an explanation of the basis for denial of the claim or for an offer of compromise settlement;

(5) fail to affirm or deny coverage of claims within a reasonable time of the completion of proof-of-loss statements;

(6) fail to attempt in good faith to make prompt and equitable settlement of claims in which liability is reasonably clear;

(7) compel insureds to litigate for recovery of amounts due under insurance policies by offering substantially less than the amounts ultimately recovered in actions brought by those insureds;

(8) attempt to make an unreasonably low settlement by reference to printed advertising matter accompanying or included in an application;

(9) attempt to settle a claim on the basis of an application that has been altered without the consent of the insured;

(10) make a claims payment without including a statement of the coverage under which the payment is made;

(11) make known to insureds or claimants a policy of appealing from arbitration awards in favor of insureds or claimants for the purpose of compelling them to accept settlements or compromises less than the amount awarded in arbitration;

(12) delay investigation or payment of claims by requiring submission of unnecessary or substantially repetitive claims reports and proof-of-loss forms;

(13) fail to promptly settle claims under one portion of a policy for the purpose of influencing settlements under other portions of the policy;

(14) fail to promptly provide a reasonable explanation of the basis in the insurance policy in relation to the facts or applicable law for denial of a claim or for the offer of a compromise settlement; or

(15) offer a form of settlement or pay a judgment in any manner prohibited by AS 21.89.030 .

ago, after extensive public comment in a regulatory proceeding, the DOI adopted a regulation interpreting the frequency requirement of this statute. The DOI's regulation proceedings, regulation and public comment, the model from which AS 21.36.125 was developed,[2] caselaw interpreting similar statutes in other states[3] and published commentary[4] all confirm the statutory interpretation that a violation of AS 21.36.125 involves repeated unfair acts in claims settlement.

The DOI developed regulations on unfair claims practices between 1984 and 1989. To interpret AS 21.36.125, the DOI proposed the following statement of purpose and definition:

> **3 AAC 26.010. PURPOSE**. The purpose of 3 AAC 26.010- 3 AAC 26.900 is to define minimum standards for the fair settlement of claims. Violation of the established standards with such frequency as to indicate a general business practice constitutes an unfair claims settlement practice or act under AS 21.36.125.
>
> **3 AAC 26.300. DEFINITIONS**. In this chapter, . . .
> (6) "frequency as to indicate a general business practice" means at least three violations of the established standards within a calendar year.

During the regulation adoption process, conducted in full compliance with the Administrative Procedures Act, there was extensive comment from the public, especially from the insurance industry. As a result, the proposed statement of purpose and definition was revised. The revised versions adopted then and remaining in effect today are the following:

3 AAC 26.010. PURPOSE. (a) The purpose of 3 AAC 26.010 - 3 AAC 26.300 is to

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[2] AS 21.36.125 is based on a section added in 1972 to the model Unfair Trade Practices Act developed by the National Association of Insurance Commissioners (NAIC). In 1990, the NAIC amended this section and moved it to a separate model, the Unfair Claims Settlement Practices Act. The procedural history of the model indicates that the original version defined an unfair claims settlement practice as one which was committed or performed with such frequency as to indicate a general business practice. The current version also makes an act an improper claims practice if "if is committed flagrantly and in conscious disregard of this Act or any rules promulgated hereunder." See NAIC Model Regulation Service, p. 900-2, 900-10.

[3] See, for example, Mean v. Burns, 509 A. 2d 11 (Connecticut 1986) (claims under the state Unfair Insurance Practices Act require a showing of more than a single act of insurance misconduct); United States Liability Insurance Company v Johnson and Lindberg, 617 F. Supp. 968 (D.C.Minn 1985) (party asserting the violation must show that the insurer's violation was a general business practice as opposed to an inadvertent occurrence); Klaudt v. Flink, 658 P.2d 1065 (Montana 1983) (The court held (contrary to Alaska caselaw) that statute similar to AS 21.36.125 created third party cause of action, but required a showing that lack of good faith or unfair trade practice was company's general business practice).

[4] David R. Andersen, *State Unfair Insurance Trade Practices and Claim Laws: the NAIC Model,* ___ Journal of Insurance Regulation 64, at 69-70 (adapted from a 1987 presentation to the American Bar Association).

define minimum standards for claim settlement acts and practices.

(b) Violation of a standard is an unfair or deceptive act and is prohibited.

(c) Violation of a standard with such frequency as to indicate a general business practice is an unfair or deceptive practice and is prohibited.

(d) Violation of a standard by a person who knew or should have known an act or practice violated the standard is subject to an additional penalty under AS 21.36.320 (e).

3 AAC 26.300. DEFINITIONS. . . . .

(6) "frequency as to indicate a general business practice" means violation of any one standard committed on one or more percent of claims handled within a 12-month period, or the repeated violation of a single standard without reasonable explanation;

Under existing law[5] and regulations, the above interpretation is the standard the DOI must use in investigating unfair controversions as possible violations of the unfair claims settlement practices statute. The regulation answers some, but not nearly all, of the questions about the proper interpretation of AS 21.36.125. Therefore, whether any particular frivolous controversion referral will result in a finding of an unfair claims settlement practice is a decision that must be made on the basis of the individual facts presented.

The report impliedly rejects the DOI interpretation that AS 21.36.125 means repeated acts. Citing AS 21.36.320, the report says, "Authority to impose significant sanctions for a single unfair or deceptive practice rests with the Director." (page 48 and footnote 48). AS 21.36.320(d) does authorize the director to impose a penalty up to $2500 for a single violation, but this section applies to violations of many statutes besides AS 21.36.125. AS 21.36.320 establishes the penalties for all the practices forbidden in the Alaska Insurance Code's Unfair Trade Practices chapter, AS 21.36. Some of the statutes in this chapter, such as AS 21.36.030. Misrepresentation and false advertising of insurance policies, or AS 21.36.060. False financial statements, clearly do prohibit single acts. It follows that a statute authorizing penalties for the entire chapter must provide a penalty available for a single act violation. It does not follow from the availability of a single act penalty, that the "such frequency as to establish a general business practice" language of AS 21.36.125 can be ignored.

The legislature may wish to consider declaring a finding of unfair or frivolous controversion by the AWCB to be direct grounds for sanctions under the insurance code by linking directly to AS 21.36.320(d), thus bypassing AS 21.36.125 entirely. This could be accomplished by amending AS 21.36.320(d) to read:

> (d) In addition to an order issued under (c) of this section, the director may, after a hearing, order restitution, assess a penalty of not more than $2,500 for each violation of this chapter <u>or each unfair or frivolous controversion determined by the Workers' Compensation Board,</u> or $25,000 for engaging in a general business practice in violation of this chapter.

It would also be necessary to drop the reference to AS 21.36.125 in AS 23.30.155(o).

III. Cooperating With The Division Of Worker's Compensation To Enforce The

[5] A currently pending bill, SB 177, would amend AS 21.36.125 to provide a single act as the standard for this statute.

Statutes.

As suggested in Recommendation No. 6 of the report (page 48), the director and staff of the DOI met with Paul Grossi, director of DWC, to discuss the coordination of efforts between these agencies, and each agency's responsibilities for enforcement of Worker's Compensation Act provisions. DOI is developing a draft memorandum of agreement to specify its responsibilities for enforcement of AS 23.30 provisions. This will cover unfair or frivolous controversion, adjuster residency requirement, and coordination of investigative resources on fraud issues, among other topics.

This discussion also identified some areas in which statutory clarifications would assist enforcement. AS 23.30.030(4) contains a requirement that each insurer provide claims facilities located in the state or by independent licensed resident adjusters with power to effect settlement in the state. This statute appears in a section entitled "Required Policy Provisions," and there is no indication how it is to be enforced if the insurer does not comply. In the past, the DOI has assumed jurisdiction and rendered a decision under this statute, but interpreted it to mean that, if a company did any resident adjusting, it could also use out-of-state adjusters. Please see In the Matter of the Petition of Firemen's Fund Insurance Co., SC 86-3, Decision and Order (August 8, 1986). The director at the time of this decision believed that there was a risk of pushing an insurer out of the Alaska market, and therefore chose not to strictly enforce the resident adjuster requirement. The DOI recommends that the legislature consider possible revision of AS 23.30.030(4) to take account of this, but at this time will enforce the statute as written.

The DOI notes that AS 23.30 contains three statutes which specifically identify duties that the division of insurance is to perform. One of these is AS 23.30.155(o), discussed above. The others are AS 23.30.025[6] and AS 23.30.030.[7] The DOI does carry out these assigned responsibilities and no issues have been raised regarding its handling of them. In addition, under the Alaska Insurance Code, the DOI is responsible for oversight of the rates and rating practices employed by insurers for use with workers' compensation insurance. The division is proud of its

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[6] Sec. 23.30.025. Approval and coverage of insurance policies.

(a) An insurer may not enter into or issue a policy of insurance under this chapter until its policy form has been submitted to and approved by the director of the division of insurance. The director of the division of insurance may not approve the policy form of an insurance company until the company files with it the certificate of the director of the division of insurance showing that the company is authorized to transact the business of workers' compensation insurance in the state. The filing of a policy form by an insurance company with the board for approval constitutes, on the part of the company, a conclusive and unqualified acceptance of the provisions of this chapter, and an agreement by it to be bound by them.

[7] Sec 23.30.030. Required Policy Provisions

. . . .

(7) If the insurer fails or refuses to pay a final award or judgment (except during the pendency of an appeal) made against it, or its insured, or if it fails or refuses to comply with a provision of this chapter, the director of the division of insurance shall revoke the approval of the policy form, and may not accept further proofs of insurance from it until it has paid the award or judgment or has complied with the violated provision of this chapter, and has resubmitted its policy form and received the approval of the form by the director of the division of insurance.

role in helping to achieve the Legislature's goal of reducing workers' compensation insurance rates, and ensuring a robust, competitive insurance marketplace in Alaska.

Conclusion

I appreciate the attention that the Division of Legislative Audit has focused on the question of strict enforcement of unfair or frivolous controversion. The DOI has significantly overhauled its processing of these referrals in recent months, and has set a goal of resolving or initiating administrative action on all AWCB referrals of frivolous controversion decisions within six months with the benefit of experience gained by concluding cases already referred to the DOI, the director will establish additional guidelines for processing these referrals.

Sincerely,

Robert A. Lohr
Director

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cc: Deborah B. Sedwick, Commissioner
Department of Community and Economic Development

ADOI Reply to Exhibit B to Preliminary Legislative Audit

This report summarizes the current status of the four frivolous controversion investigations discussed in Exhibit B to the Preliminary Legislative Audit Report. DOI has also taken action in two recent frivolous controversion referrals not mentioned in the audit report.

AWCB Decision 97-0212. The Division of Insurance (DOI) reopened complaint number **97-00659MJ** on December 22, 1999 and required the company to produce all claims handling records for the past four years, including the reasons for each grievance submitted, not only those involving worker compensation matters. The insurer is also required to provide, for the twelve month period before the AWCB order, the records of each worker compensation claim for which a benefit was controverted, to explain the reason for each controversion or delay in payment, and to identify the ultimate resolution or disposition including the amount of interest or penalty paid. Also the insurer must submit a detailed outline of any actions taken by the insurer in the past twelve months for the purpose of avoiding unfair or frivolous controversions and/or assuring that all claims are handled in accord with Alaska's claim settlement standards. On January 19 the insurer delivered a preliminary response of over 1000 pages, but requested an extension to February 18 to produce the grievance, controversion and remaining statistical data.

AWCB Decision 98-0092. The DOI has reviewed complaint number **98-00543DB** for possible administrative action. When the complaint was opened, DOI directed the insurer to provide copies of the claim file and to respond to the DOI with an explanation for the actions which resulted in the AWCB finding. The DOI has now required the insurer, the claim adjustment company, and the local adjuster agency in Alaska to provide additional records and information regarding each company's complaint, controversion and corrective settlements standards. The required information is to be supplied to the DOI by January 31, 2000. The insurer requested and received an extension to February 21 to produce requested records. The local resident adjuster's office provided records on January 31. The DOI is following up with the claim adjustment (management) company for not meeting the January 31 deadline for producing records.

AWCB Decision 98-0095. The DOI has reviewed complaint number **98-00542GC** for possible administrative action. The DOI has required the insurer to produce the detailed complaint, controversion and corrective settlement standards information to the DOI by January 31, 2000. Three representatives of the insurer met with DOI staff on January 19 to present a preliminary report showing the number of claims and controversions in the four year period. The DOI is working on developing a sampling approach because of the extensive records involved.

AWCB Decision 99-0108. Complaint number **99-00439DB** arrived at the DOI on 11/12/99 as a second copy of the DWC notice of final determination issued on 5/12/99. The DOI sent the complaint to the insurer and directed it to provide a copy of the claim file with an explanation for the action that resulted in the AWCB finding. While the time for reply was pending another notice has been sent to the insurer requiring that it provide the detailed complaint, controversion and corrective settlements standards information to the DOI by the end of January, 2000. Documents were received on January 19 and are now being reviewed by DOI staff.

AWCB Decision 99-0210. The AWCB forwarded its decision on Pool-v-City of Wrangell on October 15, 1999. Based on advice of counsel, on December 22, 1999 the DOI director found lack of jurisdiction over the Alaska Municipal League/Joint Insurance Association (AML/JIA) under AS 21.76.020. However, when the AML/JIA was formed, its Board of Trustees agreed to comply with AS 21.36.125. The DOI director therefore requested the AML/JIA to explain its procedures for determining whether its own claims practices comply with AS 21.36.125.

AWCB Decision 99-0249. The DOI opened complaint number **99-00469DB** on December 10, 1999, based on the referral by the AWCB on December 8, 1999. The DOI directed the insurer to provide a copy of the claim file with explanation for its action and the detailed complaint, controversion and corrective settlements standards information to the DOI by the end of January 2000.

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ALASKA STATE LEGISLATURE

LEGISLATIVE BUDGET AND AUDIT COMMITTEE

Division of Legislative Audit

P.O. Box 113300
Juneau, AK 99811-3300
(907) 465-3830
FAX (907) 465-2347
Internet e-mail address:
legaudit@legis.state.ak.us

February 17, 2000

Members of the Legislative Budget
and Audit Committee:

We have reviewed the Department of Labor and Workforce Development's (DLWD) response to our audit report. A central theme of DLWD's response involves the inadequacy of agency funding to perform the many statutory mandates imposed by the 1988 law changes. We acknowledge that past budgetary cuts contributed to the operating problems discussed in our report. Budget constraints and funding issues were enumerated in the response to 7 of the 12 recommendations. Following are a few examples:

> Page 59: *The current backlog . . . is not likely to improve given current staffing shortages and budgetary constraints.*
>
> Page 59 and 60: *If the only certainty is further cuts to general funds . . . the strategic plan becomes an exercise in futility.*
>
> Page 61: *We believe DWC meets this intent, within the constraints of process complexity and funding limitations, ...*
>
> Page 68: *Again, this would require funds for staff and computer programming to capture this information in a fully quantifiable way.*

The perspective evidenced by such comments is counter productive. By focusing entirely on budgetary constraints at almost every turn, the Division of Workers' Compensation (DWC) is dismissing out of hand opportunities that may exist to make agency operations more efficient and effective. We recommend that DLWD evaluate the recommendations and determine which would have the highest return in the shortest amount of time. We acknowledge DLWD is most familiar with agency internal resources and capabilities, and employs individuals with intimate knowledge of Alaska's workers' compensation program. We are confident that this expertise can be tapped to take action on the issues discussed in the report.

In addition to our perspective on the tenor of the agency's response, we also offer comments on specific agency responses to the following recommendations:

Recommendation No. 4

DWC's director should take proactive measures to identify and monitor uninsured employers.

DLWD response at page 62 asserts the report claims 31,000 employers were identified as potentially uninsured. DLWD objects to such a statement. However, an attentive review of the report reveals the 31,000 is a reference to potential employers, not uninsured employers. Furthermore, the 450 employer responses DLWD refers to were reviewed before the conclusion of the audit, and the insured status of over 900 employers remained unresolved.

In the report, we conclude DWC does not maintain adequate documentation related to uninsured employers. DLWD argues that the source of uninsured employer information was not official DWC records. When specifically asked about other official records, DLWD did not produce any alternative sources of data and declined to state exactly what, if anything, the agency considered to be official records related to monitoring uninsured employers.

DLWD contends the report makes an *"erroneous and misleading"* statement that DWC has not sought prosecution against uninsured employers in recent years. As identified in footnote 17 of the report, the successful prosecution referred to in the agency's response was a result of the Division of Labor Standards and Safety's contractor licensing program. Other than coordination with DWC, such as confirming the employer had not filed proof of insurance, the allegations were investigated and charges were filed independently of DWC monitoring efforts.

Recommendation No. 7

DWC's director should improve controls over review of insurers' annual reports.

Functioning as the administrative arm of the Alaska Workers' Compensation Board (AWCB), the division receives, and should implement policy and procedure directives issued by the board. AWCB has issued bulletins directing the implementation of some effective internal control procedures. However, DWC has not followed or implemented these directives.

On page 64, the DLWD response states *"DWC requires annual report data to be submitted in the board-prescribed format."* Although annual report data is submitted either electronically or on paper, DWC has not enforced AWCB directives that require reports to be filed on the annual report **form** prescribed by the board. In essence, such a practice has resulted, in at least one instance, shifting the burden and cost of preparing annual reports to the State.

On page 64, the DLWD response states *"DWC does acknowledge that* [ongoing] *improvement in data systems and procedures will contribute to improving the efficiency of the annual report submission process."* In our view, adopting procedures consistent with the previously issued AWCB directives would significantly contribute to improving the efficiency of the annual reporting process.

DLWD attributes the lack of independent verification of annual report data to reasons such as insurers or adjusters not reporting the data. However, compensation reports request this data. DWC has the authority to require insurers and adjusters to complete all sections of a report. Furthermore, DWC should consider designing forms that only captures relevant and utilized information.

The DLWD response asserts there was insufficient information to address the recommendation that annual report summary amounts be reconciled to the workers' compensation data system. DWC's annual report summary data indicated insurer code "093," which is assigned to uninsured employers, reported $14,763 in total claim-related expenditures for 1997. However, when requested to provide the annual reports supporting the figures, DWC said no reports were filed by uninsured employers for the year. DWC could not provide any documentation, nor a reasonable explanation as to why the annual report summary contained the erroneous data.

Furthermore, our review concluded a reconciliation of summary schedule compensation types to the workers' compensation system was not performed. DWC could not demonstrate that all compensation types were properly accounted for, that timeliness calculations for waiving penalties were accurate, or that potential resulting penalties were ultimately assessed and collected. In the absence of such controls, there is insufficient assurance that all penalties required by statute are assessed.

In DLWD's response, on page 64, the agency asserts *"reasonable exception report variances are established and used."* We acknowledge that a 10% variance between the suspense file and the extract file is permissible under state regulations. However, given the accuracy of computer processing, a 10% variance seems to us to be excessive. As discussed on page 32 of the report, the potential magnitude of this variance level is underscored. Specifically, DWC would be unaware of significant underpayments statutorily payable to the Second Injury Fund (SIF), even if insurers were to remit only 90% of total assessments due.

The DLWD response, on page 65, states *"DWC acknowledges that the use of codes resulted in some duplications and errors in the old system."* We understand the annual report component of the new workers' compensation system is still not complete. However, the inherent potential for human error will continue even in the new system. As an example, just as DWC inadvertently assigned the same insurer code to multiple insurers, and multiple insurers the same insurer code, a potential exists to make similar mistakes. DWC should establish internal controls to minimize the potential frequency and magnitude of such errors.

Recommendation No. 8

The DWC's director should adopt a methodology for assessing compensation report penalties that is consistent with statute.

DLWD's response at page 65 states with regard to interpretation of AS 23.30.155(m) that *"The auditors ... raise a valid question of interpretation for which DWC will seek clarification."* We are encouraged that DWC will seek clarification on this issue.

However, with regard to the second part of this recommendation, DWC states *"the audit may be correct in its interpretation of what constitutes a compensation report."* We are not questioning DWC's definition of a compensation report, but rather the methodology DWC uses to calculate the percentage of reports considered late.

Each discrete compensation report may contain several compensation types. DWC is using inherently different units of measure in the equation used to determine the percentage of late reports. This calculation is critical in determining if penalties should be waived.

To determine the percentage of late reports, DWC is dividing the number of late discrete reports by the total number of compensation types listed on the discrete reports. Simply stated, once DWC has defined what the agency considers to be a "report" (that is, discrete reports or compensation types listed on each discrete report), the same unit of measure should be used to calculate the percentage. See inset at right.

Methodologies to Determine the Percentage of Late Compensation Reports

For each insurer, DWC should use:

$$\frac{\text{Late } \textbf{discrete reports}}{\text{Total } \textbf{discrete reports}}$$

Or

$$\frac{\text{Late } \textbf{compensation types} \text{ reported}}{\text{Total } \textbf{compensation types} \text{ reported}}$$

However, DWC inappropriately uses a different basis for the numerator than for the denominator as follows:

$$\frac{\text{Late } \textbf{discrete reports}}{\text{Total } \textbf{compensation types} \text{ reported}}$$

As stated in the report on page 50, use of the inflated count of compensation types per discrete report as the percentage base instead of the count of discrete reports results in a smaller calculated amount of late compensation report penalties being assessed on insurers. Accordingly, we disagree with DWC's assertion that *"this would effect the same count result as our current interpretation, but would require additional staff time to enter data because of the increase in forms filed."* DWC's current methodology precludes an accurate computation.

Recommendation No. 9

The director of the Division of Workers' Compensation should correct inappropriate administrative and accounting practices.

The DLWD response on page 66 asserts the audit report fails to cite AS 23.30.040(h), which requires administration expenses related to the SIF to be expended from the fund. Contrary to DLWD's assertion, the report cites the requirement in footnote 30, on page 34.

Although administering the SIF requires the workers' compensation database and information system, DLWD has not produced any supporting evidence to reasonably conclude data entry attributable to the SIF represents a workload equivalent to one full time position.

To avoid the appearance that DWC is in violation of AS 23.30.040(a), we reiterate the recommendation and assert that charges to the SIF should be supported by adequate documentation.

Recommendation No. 10

The director of DWC should resolve the legality of "supplemental" benefits and rectify internal control weaknesses over such expenditures.

We have reviewed DLWD's response and reaffirm our position concerning this recommendation. In the response, on page 67, DLWD portrays the likelihood of obtaining documentation to support the expenditures as remote. We are concerned over the lack of documentation DWC maintains to support continued expenditures, which over the years represents millions of dollars. In short, DWC has repeatedly submitted budget requests and has obtained legislative appropriations without adequate support.

The legislature intended these funds strictly for issuing supplemental benefits under AS 23.30.172, and has allocated the appropriations accordingly. However, DLWD has transferred funds earmarked for issuing supplemental benefits to augment DWC operations. Specifically, during the last three years, DLWD shifted $96,500 of these appropriations for other purposes including travel, capital outlay, supplies, and other services or charges. At a minimum, the FY 01 budget request should be reduced by $48,000 below what was appropriated in FY 00.

Recommendation No. 12

DWC's director should seek legal clarification with regard to methodology for assessing annual report penalties.

On page 54 of our audit report, we recommended DWC's director seek legal clarification with regard to the methodology for assessing annual report penalties. The recommendation

arises from differing interpretations of statute. Alaska statutes reads, in part *"the **insurer or adjuster** shall file a verified annual report on a **form prescribed by the board.**"* [Emphasis added.]

In our opinion, there is ambiguity in that the statute allows annual reports to be filed by insurer or adjuster on a form prescribed by the board. However, the form prescribed by the board in AWCB bulletins requires a discrete annual report to be submitted for each insurer code.

DLWD's response states that the agency does not concur with this recommendation. DLWD states that the AWCB bulletins are advisory in nature and therefore DWC assesses penalties on the party that submits the annual report, whether it is the insurer or the adjuster. DWC states the agency has interpreted this within the latitude allowed by statute to avoid litigation on the issue.

In our view, lack of guidelines allows adjusters or insurers to manipulate the amount of penalties assessed. As such, well-informed adjusters may choose to submit an annual report on behalf of multiple insurers to significantly reduce exposure to penalties. As discussed in the Background Information section of this report, Chapter 79, SLA 1988, section 1(e) states that it was the intent of the legislature in amending AS 23.30.155 that DWC **strictly enforce** the reporting requirements and penalties for noncompliance. DWC's current practice and accompanying rationale is not consistent with this intent. If indeed the AWCB bulletins are only advisory in nature, we suggest DLWD clarify this statute in regulation.

Pat Davidson

Pat Davidson, CPA
Legislative Auditor

ALASKA STATE LEGISLATURE

LEGISLATIVE BUDGET AND AUDIT COMMITTEE

Division of Legislative Audit

P.O. Box 113300
Juneau, AK 99811-3300
(907) 465-3830
FAX (907) 465-2347
Internet e-mail address:
legaudit@legis.state.ak.us

SUMMARY OF: A Special Report on the Department of Labor and Workforce Development, Division of Workers' Compensation, October 31, 1999.

PURPOSE OF THE REPORT

In accordance with Title 24 of the Alaska Statutes and a special request by the Legislative Budget and Audit Committee, we conducted a performance audit of the workers' compensation program administered by the Department of Labor and Workforce Development. Alaska Statute 23.30 requires employers to maintain insurance coverage for the purpose of compensating workers injured in the course and scope of their employment. The Division of Workers' Compensation (DWC) administers the program with oversight by the Alaska Workers' Compensation Board. Our review also considered workers' compensation insurance issues administered by the Department of Community and Economic Development, Division of Insurance.

REPORT CONCLUSIONS

Our analysis of the workers' compensation program considered laws, legislative intent accompanying the amended statute, and regulations related to state operations. As discussed in the Background Information section, extensive legislative intent accompanied the comprehensive revision to the Workers' Compensation Act (WCA) in 1988. We focused on key aspects of this intent, which provided a context for our evaluation of the State's workers' compensation program. These key concepts were as follows:

- quick, efficient, fair, and predictable delivery of indemnity and medical benefits;
- reasonable costs to employers;
- laws not being construed by the courts in favor of any party;
- compensation cases decided on merits;
- strict enforcement of reporting requirements; and
- strict enforcement of punishment for uninsured employers.

Our analysis of 1988 changes in the workers' compensation program identified the primary objective of the legislature in changing the law was to lower workers' compensation costs to Alaskan employers. It was widely reported that the pre-1988 law favored injured workers, at the expense of state businesses and economic development.

In our view, the 1988 revisions were not made with the specific intent of disadvantaging injured workers. Rather, the statute was to be balanced between the interests of injured workers and the insurance companies who provided protection to employers. Workers' compensation premiums paid by employers were on the rise primarily due to rising medical costs, extended disability payments made to workers thought capable of returning to work, and the costs of retraining individuals for alternative work.

The legislature achieved its policy objective of lower workers' compensation insurance costs. However, in achieving this goal, a situation has developed due to a variety of circumstances that has left injured workers disadvantaged by the statute. As set out in this report, circumstances have developed that limit the protections the legislature meant to be in place, and strictly enforced, to the benefit of workers. Specifically, as discussed in this section:

1. The policing of uninsured employers is largely ineffective due to administrative shortcomings in the Division of Workers' Compensation and the prosecutorial philosophy of the Department of Law.

2. Sanctions against frivolous controversions have been rendered ineffective by the policies and practice of the Division of Insurance.

3. In addition to these administrative and interagency coordination problems, in places where the statutes may lack clarity, they have been interpreted and applied to the benefit of the insurance companies. Specifically, when calculating penalties and penalty "forgiveness" provisions of the statutes, DWC does it in a manner that benefits insurance companies the most.

Meanwhile, provisions put in the 1988 statutes as part of a legislative desire to control, if not lower workers' compensation insurance rates have, over time, become increasingly contrary to the interests of injured workers. Specifically:

1. The caps on injury awards and burial costs set out in statute in 1988, have eroded over time by inflation.

2. The complexity of the disputed claims process has generally, in our view, worked to the disadvantage of injured workers who often cannot obtain appropriate representation, or who are inordinately affected by delays in the quasi-judicial process more so than are insurance companies.

3. Constraints on the eligibility requirements for injured workers to qualify for retraining and reemployment benefits have proven to be overly restrictive.

The Findings and Recommendations section of the report addresses this unbalanced situation. We make 12 recommendations we believe would result in administration of the statute as intended by the legislature. We also identify where the statutes could possibly be amended to add clarity or additional enforcement authority in order to provide a better, overall, even-handed mechanism for implementing the workers' compensation law.