

# State of North Dakota Workforce Safety & Insurance

## 2008 Performance Evaluation Report

October 8, 2008

BERRY.DUNN.MCNEIL & PARKER

**BID|MP**

Report prepared by:

**Berry, Dunn, McNeil & Parker**

Certified Public Accountants ■ Management Consultants

©2008 Berry, Dunn, McNeil & Parker. All rights reserved. No part of this document may be copied without the express written consent of Berry, Dunn, McNeil & Parker.



October 8, 2008

Governor of North Dakota  
The Legislative Assembly  
Chairman of the Board of Directors, Workforce Safety & Insurance  
Executive Director, Workforce Safety & Insurance

We are pleased to submit this report summarizing the results of the 2008 Performance Evaluation of North Dakota's Workforce Safety & Insurance (WSI) which covers Calendar Years 2006 and 2007. The purpose of this evaluation was to assess certain aspects of the functions and operations of WSI as directed by the Office of the State Auditor and in accordance with North Dakota Century Code Section 65-02-30

This 2008 Performance Evaluation addresses the following nine elements:

- **Element 1:** Evaluation of Safety Grants;
- **Element 2:** Board of Directors Evaluation;
- **Element 3:** Evaluation of Performance Measures;
- **Element 4:** Evaluation of Fraud Expenditures;
- **Element 5:** Evaluation of Prior Performance Evaluation Recommendations;
- **Element 6:** Claims;
- **Element 7:** Evaluation of the Change in Financial Condition from FY 1997 - FY 2007;
- **Element 8:** Policy Holder Services; and,
- **Element 9:** Legal.

Where applicable, BDMP has provided recommendations pertaining to each of the elements.

This evaluation includes the executive summary, detailed sections for each element including relevant recommendations, WSI responses to BDMP's recommendations, and supporting appendices as warranted. In some instances, we have added follow-up comments to WSI responses.

We wish to thank all those at WSI who assisted us in the performance evaluation process.

*Berry, Dunn, McNeil & Parker*

Berry, Dunn, McNeil & Parker



**State of North Dakota**  
**Workforce Safety & Insurance**  
2008 Performance Evaluation Report

**Table of Contents**

<b>Executive Summary .....</b>	<b>2</b>
<b>Element 1: Safety Grants .....</b>	<b>10</b>
<b>Element 2: Board of Directors Evaluation .....</b>	<b>25</b>
Board Adherence to Governance Principles .....	26
Benchmark Governance Principles against Other Organizations .....	32
<b>Element 3: Performance Measures .....</b>	<b>40</b>
<b>Element 4: Evaluation of Fraud Expenditures .....</b>	<b>66</b>
<b>Element 5: Review of Previous Performance Evaluation Recommendations .....</b>	<b>75</b>
<b>Element 6: Claims .....</b>	<b>80</b>
Evaluation of Denied Claims .....	80
Evaluation of Independent Medical Exam (IME) Program .....	91
Evaluation of Disability Guideline Integration .....	95
Evaluation of "Routine" Claims Processes & Permanent Partial Impairments (PPI) .....	96
Evaluation of Claims with Degenerative Conditions .....	102
Evaluation of WSI Claim Philosophy .....	108
<b>Element 7: Evaluation of the Change in Financial Condition from FY 1997 through FY 2007 .....</b>	<b>113</b>
<b>Element 8: Policyholder Services .....</b>	<b>123</b>
Evaluation of Employer Rates and Employee Classifications .....	123
Policyholder Services Division Audit Plan .....	125
Consideration of Overall Rate Structure .....	128
Premium Rebates to Employers .....	135
Premium Rebate Comparison to Monopolistic States and Insurance Companies .....	139
<b>Element 9: Legal .....</b>	<b>147</b>
<b>Appendix A: HELP and STEP Grant Selection Criteria</b>	
<b>Appendix B: IAIABC Recommended System Performance Metrics</b>	
<b>Appendix C: Detailed Analysis on Prior Performance Evaluation Recommendations</b>	

## Executive Summary

### Introduction

In the spring of 2008, the State of North Dakota engaged Berry Dunn McNeil & Parker (BDMP) to conduct a performance evaluation of certain components of the North Dakota Workforce Safety & Insurance organization (WSI). The overall objective of this evaluation was to determine whether WSI is providing quality service in an efficient and cost-effective manner, and to provide recommendations for improvement.

BDMP's performance evaluation considered the following elements as specified by the Office of the State Auditor:

- Safety Grants
- Board of Directors
- Performance Measures maintained by WSI
- Effectiveness of Fraud Expenditures
- Prior Performance Evaluation Recommendations
- Claims
- Change in Financial Condition of WSI
- Policyholder Services
- Legal and the Administrative Hearing Process

Our evaluation team included specialists in workers compensation, actuarial practices, accounting, board governance, and business operations. Each element was evaluated by one or more members of our team who led the fact finding portion for their assigned elements. At the conclusion of these evaluations, our entire team collaborated to analyze the element data and to develop recommendations.

We identified 46 recommendations for improvement as a result of our work. Our conclusions and recommendations are described at a high level in the following paragraphs of this Executive Summary. Because this is only a summary, we caution readers that they should read and understand the full report before drawing conclusions or taking any actions.

## **Results**

The following paragraphs are organized by review element and present highlights of our findings, conclusions, and recommendations:

### ***Element 1 - Safety Grants***

BDMP's evaluation of WSI and of benchmark systems in other states shows that safety Grant programs serve a useful purpose. WSI has an opportunity to improve the current safety grant program by creating a process that is more open and interactive with the employer and the worker community it supports; by improving the consistency and credibility of the award and intervention verification process; and by designing and staffing the outcome measurement function appropriately.

Inconsistencies were identified in the safety grant review and those are described in the observations and findings of this report. In order to improve public confidence and the effectiveness of the safety grant award program, WSI should:

- Create an advisory committee to assist in the design and implementation of needed safety grant programs
- Engage employer and employee constituencies in the development of grant eligibility, applications, and decision making processes
- More actively market the STEP grant program
- Implement a redesigned HELP safety grant program
- Determine how grant programs will be measured prior to the awarding of funds

### ***Element 2 - Board of Directors***

BDMP evaluated the WSI board governance model in place at WSI during the evaluation period and found that the WSI Board complied with its governance policies. Additionally, we considered WSI's current governance model and policies and determined they are appropriate for WSI.

In this report we have identified recommendations that will strengthen the makeup, operation, and functioning of the board and will also clarify the roles and responsibilities of board members. These recommendations include:

- Modifying criteria used to appoint board members to include specific skills and experience relevant to a state workers' compensation fund specifically, in the area of accounting and actuarial disciplines
- Reviewing and clarifying the process with respect to board member qualifications so as to serve the State statute
- Filling the Internal Audit Manager position and giving this person appropriate board support to effectively perform the function

### ***Element 3 - Performance Measures***

BDMP's evaluation of the performance measures maintained by WSI revealed no significant issues with the accuracy of the metrics currently used in Operating Reports with respect to claims and financial data. We did observe, however, unreconciled differences in information reported with respect to Legal/SIU data. We also observed that WSI tracks many more measures than other peer organizations. While the metrics in the WSI Operating Report are valid, many of them are more appropriate for use at a department level rather than for overall governance and decision-making at the board level.

The effectiveness of WSI's use of performance metrics could be improved by:

- Focusing the Board's attention on a smaller number (15 to 25) of strategic measurements
- Providing more training and support for board members
- Periodically benchmarking WSI performance against national standards
- Strengthening the transparency of changes to reports
- Making better use of automation in generating reports
- Having the internal audit department review information provided by the SIU department

### ***Element 4 - Effectiveness of Fraud Expenditures***

BDMP evaluated WSI's fraud expenditures and concluded that WSI's Special Investigative Unit (SIU) appears inadequately resourced and positioned to fulfill its fraud prevention and investigation function. WSI does not have a comprehensive employer and provider fraud program in place to protect the best interests of legitimate employers and workers. We also noted a history of inter-departmental conflict and role confusion between former directors of



SIU and Policyholder Services that has made it difficult to support a comprehensive fraud program.

Fraud identification, investigation, and prevention are critical responsibilities of WSI management when protecting the interests of stakeholders. We have made recommendations that will help WSI management to:

- Clearly define fraud prevention roles and responsibilities
- Increase focus on conducting provider and employer fraud investigations
- Strengthen collaboration between internal and external organizations to more proactively identify and investigate fraud
- Strengthen training for fraud investigators and timely follow-up with respect to complaints received
- Track the costs and benefits of fraud activities in order to demonstrate long-term value

#### ***Element 5 – Previous Performance Evaluation Recommendations***

WSI tracked the implementation status of 109 prior recommendations from the 2006 Performance Evaluation. In our work, BDMP identified that 61 (56%) of these recommendations have been fully implemented. The remainder are either partially implemented or, as the result of WSI management decision, not implemented. The Element 5 section of this report and Appendix C provide detailed information on our findings.

Going forward, WSI should improve their tracking of prior recommendations by requiring that recommendations be classified as “100% complete” only after Internal Audit has completed an independent validation of actions and assessed final disposition of the recommendations

#### ***Element 6 - Claims***

BDMP independently evaluated a random and objective sample of 250 claims, including denied claims, claims referred to Independent Medical Exams (IME's), and claims for people with degenerative conditions. In our work we found no evidence of inappropriate claims handling processes or of decisions inconsistent with State law or WSI claim policies. The claims handling displayed in the files we evaluated was appropriate.

We identified impacts on claims processing related to a change in philosophy that occurred during 2006-2007 in which adjusters were encouraged to investigate all new claims for prior injuries or pre-existing conditions more thoroughly. Multiple factors, including the change in philosophy and practices to incentivize prompt claim submission did result in increased rates of

denied claims. However, none of the claims evaluated were denied inappropriately based on state law, administrative code, and WSI claim policies.

Our recommendations with respect to claims include:

- Revising the WSI Claim Procedure Manual to standardize "best practices" and train claims adjusters on new practices
- Implementing the Injury Management pilot program across all 7 claim units
- Enhancing WSI's knowledge of industry best practices through attendance at appropriate industry conferences
- Reviewing the North Dakota Statute in relation to other jurisdictions

In our work, BDMP observed that the North Dakota Statute is more conservative than most other jurisdictions with respect to treatment for specific conditions. Bringing together North Dakota stakeholder groups to study and consider how other states handle such conditions and choosing what is appropriate for the State of North Dakota, will be beneficial to the employers, injured workers, and WSI.

#### ***Element 7 - Change in Financial Condition, FY 1997-FY2007***

BDMP evaluated the change in WSI's financial condition from FY1997 through FY2007. Our analysis identified that the greatest impact on increasing the financial reserves has been WSI conservative approach to investment assumptions. We identified the following factors that impacted WSI's financial condition, ranked in order of descending impact from greatest to least:

- Investment return in excess of assumed rate of return
- Reduction in the discount rate used for employer rate setting
- Discount rates for unpaid loss liability
- Additional revenue from other sources
- Changes in the undiscounted estimated claims expenses
- Change in economic conditions in the State of North Dakota

WSI Board members and stakeholders should understand the nature of these factors and consider their impact in making decisions for WSI.

In our work, BDMP considered the change in structure from reporting to the Governor to reporting to a Board of Directors. We did not identify a direct or indirect correlation between the change in reporting structure and the change in financial condition.



### ***Element 8 - Policyholder Services***

BDMP evaluated employer rates, employee classifications, and the Policyholder Services Division audit plan for the evaluation period. From this analysis, we did not identify any employer rates or employee classifications that were inconsistently applied or inappropriate. We noted that WSI is appropriately focusing its premium audit efforts on the significant policyholders where potential audit adjustments could yield a more significant result.

Our recommendations for WSI with respect to policyholder services include:

- Reviewing the premium audit function and determining whether additional staffing is necessary in order to comply with the stated audit plan
- Adopting a process that allocates policyholder dividends to active policyholders based on historical information
- Seeking to modify the appropriate section of North Dakota statute to reduce the lower end of the required fund surplus range to 115% of the discounted loss reserves plus surplus

### ***Element 9 - Legal***

BDMP's evaluation of North Dakota's workers' compensation administrative hearing process revealed that the process is efficient, however, it is not effective for the workers of North Dakota. We found no indication of impropriety or inappropriate influence on decisions.

The perception of fairness and overall effectiveness of the system relates to the situation where North Dakota is the only jurisdiction in the United States where the payer (WSI) makes the final administrative decision in disputes between payers and injured workers. This situation would be improved by separating independent fact finder responsibilities from WSI.

Our recommendations with respect to this element are:

- WSI and the State of North Dakota should seek legislative changes such that administrative decisions are made by an independent, impartial hearing authority from a government agency separate from WSI.
- WSI should train administrative law judges or hearing officers using national practices and external experts in North Dakota-specific workers compensation and administrative law.

## Organization and Structure of this Report

This report is structured into nine sections, one for each element for our review. Within each element, our report is organized as follows:

- **Objective** – States the focal points of each element in the performance evaluation. In some cases an element has multiple components, and these are presented in bulleted lists.
- **Key Activities** – Describes the approaches and work on which our findings, conclusions, and recommendations are based.
- **Observations and Findings** – Presents key information on which our analyses and conclusions are based.
- **Conclusions** – Presents the determinations we drew from our fact-finding and analysis.
- **Recommendations** – Presents and describes the recommendations for improvement which we developed as a result of our evaluations.

In some instances, sections have been combined for readability and flow of information. Also, some sections include “background” information to provide historical context of that element for the reader.

For each element, we have presented and described recommendations at the end of the appropriate element section. This is done for purposes of consistency and because, in some instances, multiple observations and findings led to the same recommendation. To facilitate the reader’s review of this report, we have provided references within each element’s observations and findings to relevant recommendations.

We have prioritized each of our recommendations with respect to High, Medium, or Low priority. The priority rankings are assigned based on our professional experience, objective assessment as to the risk or benefit at the time of our evaluation, and relative comparison between our recommendations. These are described as follows:

- **High** – Issue presents an immediate significant risk or benefit to the organization and immediate action should be taken to resolve the issue or realize the benefit. Risk is broadly defined to include but not be limited to: financial, political or legal.
- **Medium** – Issue presents a lower level of risk that may not pose an immediate threat or a benefit that will be achieved right away, but should be addressed by WSI in the near term.

- Low – Comments that are more administrative in nature that represent a less significant level of risk or benefit. Implementation of these comments would enhance the current systems in place at WSI.

## **Our Performance Evaluation**

The period of evaluation for this performance evaluation was January 1, 2006 through December 31, 2007. Our work was conducted from April through June of 2008.

Our work was conducted in accordance with the instructions and parameters set forth in the Request for Proposal #117-08-01 issued by the State of North Dakota Office of the State Auditor. The work performed by us in conducting this performance evaluation does not constitute an audit as defined by the American Institute of Certified Public Accountants, nor does it in any way constitute a legal review.

In several components of our work we have relied upon audits and other reports prepared for WSI or the State of North Dakota. Where we have done so, this is presented in the Key Activities section of each element of our report.

## **Closing Remarks**

Readers should note that reports of this type, by their very nature, focus on areas for improvement and typically do not comment to the same extent on areas of strength that we observed.

We wish to acknowledge and thank the staff of WSI for the cooperation and courtesy exhibited while conducting our evaluation.

*©2008 Berry, Dunn, McNeil & Parker. All rights reserved. No part of this document may be copied without the express written consent of Berry, Dunn, McNeil & Parker.*