

**The California Commission  
on Health and Safety  
and Workers' Compensation**



**DRAFT CHSWC Response to Community Concerns  
Regarding DWC Workers' Compensation Audits**

**CHSWC Members**

**John C. Wilson, 2007 Chair**

**Allen Davenport**

**Leonard C. McLeod**

**Alfonso Salazar**

**Kristen Schwenkmeyer**

**Robert B. Steinberg**

**Darrel "Shorty" Thacker**

**Angie Wei**

**Executive Officer**

**Christine Baker**

**State of California  
Labor and Workforce Development Agency  
Department of Industrial Relations**

**February 2007**

**DRAFT CHSWC Response to Community Concerns Regarding  
DWC Workers' Compensation Audits  
Table of Contents**

Introduction.....	1
Background .....	1
Establishment of the DWC Audit Function.....	1
Initial CHSWC Study of the DWC Audit Function.....	1
Recommendations for Changes to the DWC Audit Function.....	2
Concerns about the DWC Audit Process .....	3
A Preliminary Analysis of Audit Concerns.....	4
Recommendations .....	5
<i>Attachment A</i> – Brief Analysis of DWC Audit Reports by UC Berkeley.....	7
<i>Attachment B</i> – Response by DWC to Analysis of Audit Reports by UC Berkeley .....	11
<i>Attachment C</i> – 1993 Legislative Changes to DWC Audit Program.....	14
<i>Attachment D</i> – DWC Routine and Targeted Audits 2000-2005.....	15
<i>Attachment E</i> – Audits by Type of Audit Subject 2000-2005.....	16
<i>Attachment F</i> – Audits by Method of Audit Selection 2000-2005 .....	17
<i>Attachment G</i> – DWC Audit Unit – Administrative Penalties Assessed 2000-2005.....	18
<i>Attachment H</i> – Average Penalty Citations per Claim and Amount Per Citation 2000-2005 .....	19
<i>Attachment I</i> – Unpaid Compensation Due To Employees 2000-2005 .....	20
<i>Attachment J</i> – Type of Unpaid Compensation by % of Total 2000-2005 .....	21

# **DRAFT CHSWC Response to Community Concerns Regarding DWC Workers' Compensation Audits**

## **Introduction**

At the December 8, 2006, CHSWC meeting, concerns were raised about the effectiveness of the Division of Workers' Compensation (DWC) Audit and Enforcement process. CHSWC Chair Angie Wei requested that CHSWC staff review the recent audit process and comment on the concerns raised at the meeting.

This Issue Paper, prepared in response to Chair Wei's request, provides a background history of the DWC audit function and summarizes the findings from a brief, independent review by UC Berkeley, included as *Attachment A*. A response from the DWC Acting Administrative Director Carrie Nevans is included as *Attachment B*.

## **Background**

### ***Establishment of the DWC Audit Function***

The 1989 California workers' compensation reform legislation established an audit function within the Division of Workers' Compensation (DWC) to monitor the performance of insurers, self-insured employers, and third-party administrators to ensure that industrially injured workers were receiving proper benefits in a timely manner.

The purpose of the audit and enforcement function is to provide incentives for the prompt and accurate delivery of workers' compensation benefits to industrially injured workers and to identify and bring into compliance those insurers, third-party administrators, and self-insured employers who do not deliver benefits in a timely and accurate manner.

### ***Initial CHSWC Study of the DWC Audit Function<sup>1</sup>***

In April 1998, the Senate Industrial Relations Committee and the Assembly Insurance Committee jointly requested that CHSWC undertake an evaluation of the effectiveness of the DWC audit function.

The study determined that although much time and effort were being expended by the DWC Audit Unit in performing audits of workers' compensation insurers, a redirection of these activities could produce more effective outcomes. The research team found that the current audit procedure did not include all insurers within a reasonable period of time, did not focus on the worst performers and concentrated penalties on relatively inconsequential violations.

---

<sup>1</sup> CHSWC Report on the ?Division of Workers' Compensation Audit Function, 1998  
<http://www.dir.ca.gov/CHSWC/FinalAuditReport.html#2>

***Recommendations for Changes to the DWC Audit Function***

After research and thoughtful discussions with the Audit Advisory Committee and other community members, the study team recommended a new DWC Audit System. The focus of this new system would be

- To reward good performers by eliminating administrative penalties and resource requirements.
- To increase incentives to improve benefit delivery by raising administrative penalties substantially on poor performers.
- To focus administrative penalties on important violations.
- To provide balance to the audit process:
  - Bad business practices by claims administrators mean injured workers are not receiving proper indemnity payments and appropriate medical services in a timely manner.
  - Excessive audit penalties and regulation mean employers are paying higher costs to deliver the same benefits.

Under the original DWC audit procedures, locations were rarely subject to random audits and almost never subject to targeted audits. CHSWC recommended the replacement of the original audit procedures with the following:

- Simplified audit, focusing on key violations.
- Auditing of all locations on a five-year cycle.
- Electronic monitoring of key performance indicators where possible.
- Increased use of targeted audits to identify poor performers.

The results of the routine audits should be used to:

- Identify poor performers for an in-depth review.
- Verify data integrity.
- Benchmark performance on key indicators.
- Rank performance of adjusting locations.

***2003 Reforms to the DWC Audit Function***

Assembly Bill (AB) 749, effective January 1, 2003, resulted in major changes to California workers' compensation law and mandated significant changes to the methodologies for file selection and assessment of penalties in the audit program. Many of these changes reflected the CHSWC recommendations.

## **DRAFT CHSWC Response to Community Concerns Regarding DWC Workers' Compensation Audits**

- Labor Code Sections 129 and 129.5 were amended to assure that each audit unit will be audited at least once every five years and that good performers will be rewarded.
- A profile audit review (PAR) of every audit subject will be done at least every five years.
- Any audit subject that fails to meet a profile audit standard established by the AD will be given a full compliance audit (FCA).
- Any audit subject that fails to meet or exceed the FCA performance standard will be audited again within two years.
- Targeted PARs or FCAs may also be conducted at any time based on information indicating that an insurer, self-insured employer, or third-party administrator is failing to meet its obligations.
- To reward good performers, profile audit subjects that meet or exceed the PAR performance standard will not be liable for any penalties but will be required to pay any unpaid compensation. FCA subjects that meet or exceed standards will be required only to pay penalties for unpaid or late paid compensation and any unpaid compensation.
- Labor Code Section 129.5(e) is amended to provide for civil penalties up to \$100,000 if an employer, insurer, or third-party administrator has knowingly committed or (rather than “and”) has performed with sufficient frequency to indicate a general business-practice act discharging or administering its obligations in specified improper manners.
- Failure to meet the FCA performance standards in two consecutive FCAs would rebuttably be presumed to be engaging in a general business practice of discharging and administering compensation obligations in an improper manner.

*Attachment C* summarizes all the 2003 reform changes affecting the DWC audit program.

### **Concerns about the DWC Audit Process**

Mark Gerlach, a consultant for the California Applicants' Attorneys Association, raised several concerns about the current audit process based upon the 2005 Audit Report issued by the Division of Workers' Compensation.

- One of the advantages of the new audit process was that it was going to allow more audits to be done. It was felt that the DWC could no longer do full audits given limited resources, but by doing mini-audits more audits could be done. However, in 2003, DWC conducted 70 audits; in 2004, 48 audits and in 2005, 46 audits were done.
- The number of files that were audited has been reduced, but the number of violations has not been reduced.
- The new audit process was expected to create better results by possibly getting larger penalties against employers.
- The DWC audit process looks at several different issues, including unpaid compensation, first payment of temporary disability, and first payment of permanent disability. Concern was expressed that the performance in these areas has not improved. In 2005, \$623,000 in

## **DRAFT CHSWC Response to Community Concerns Regarding DWC Workers' Compensation Audits**

unpaid compensation was found in 480 claims out of the 3,000 indemnity files audited. If these numbers are extrapolated to the whole workers' compensation system, there could be \$68 million dollars unpaid.

- For first payment of temporary disability, the standard to pass the PAR exam in 2003 was that 24.7 percent were late but passed the exam; this year, it was 26 percent. For first payment of permanent disability, in 2003, it was 14.033 percent, and in 2006, it was 15.83 percent. These are statistics for those are firms making late payments but still passing the PAR and therefore not getting any penalties and not getting another audit, even though there were late payments.
- The problems evidenced in the audits have been continual since when they were first started in the early 1990s and moving to the mini-audit process has not improved the system. It is important to look into how to build in the proper incentives/disincentives against egregious behavior of claim administrators.

### **A Preliminary Analysis of Audit Concerns**

Frank Neuhauser of UC Berkeley performed a brief analysis of the DWC audit process, which is in *Attachment A*. Mr. Neuhauser's findings are based on the DWC Audit Reports from audit years 2001-2005 and CHSWC concludes that:

- The PAR audits appear to be accomplishing the objective of improving performance of claims adjusting locations.
- Performance does appear to be improving particularly among the most problematic claims administrators.
- The frequency of violations remains substantial and the amounts unpaid compensation are likely to be unacceptably high.
- Unpaid compensation appears to be declining as a fraction of all compensation due.
- Unpaid compensation is one of the serious violations that are heavily weighted in assessing whether a location passes the PAR audit. The trend in unpaid compensation cannot be accurately measured without additional data from the Audit Unit. That is because a large number of the indemnity files are selected at locations that failed the initial PAR audit level. These cannot be considered randomly selected files, even if the location was originally a randomly selected audit site.
- The number of locations audited appears low despite the streamlining of the audit process introduced by reform legislation.
- Similarly, the number of claim files reviewed is also low.
- Workload per audit should have decreased, due to fewer files required per audit (up to 59 files per audit, down from up to 138 per audit).
- Consequently, the number of audits should have increased.
- Workload per file should have decreased, due to fewer specific violations than the 22 categories in the pre-PAR process.

**DRAFT CHSWC Response to Community Concerns Regarding DWC Workers' Compensation Audits**

- There should also be fewer disputes over the audit findings, since penalties are not assessed for violations if the location meets PAR standards.
- The PAR review process requires no more work per file as the pre-PAR process.
- According to DWC, there have been reductions in Audit Unit staffing. The following chart is from the DWC response in *Attachment B*.

AUDIT UNIT	01/02	02/03	03/04	04/05	05/06	06/07
Total Authorized Positions	33.0	30.0	35.0	36.0	38.0	38.0
Authorized/(filled) Professional positions as of mid-year	27 (26)	22 (21)	18 (17)	33 (24)	35 (30)	36 (34)
Authorized/(filled) Clerical positions as of mid-year	2 (2)	2 (2)	1 (0)	2 (0)	3 (1)	3 (2)

- The PAR process was expected to reduce workload and increase productivity through simplification. However, the number of audits performed dropped from 70 in 2003 to 48 in 2004, 46 in 2005 and 77 in 2006 with no clear explanation for greater productivity in 2003 with so few staff and no clear explanation for low productivity with increased staff. The number of audits completed per auditor and the number of files audited per auditor should both have increased, but the opposite is observed. The following chart combines productivity numbers with the above staffing chart.

Year	Audits	Indemnity files audited	Denied claims	Complaint	Other	Total Auth. Positions	Auth. (Filled) Prof.	Auth. (filled) Clerical	Total (excluding Medical only)
2001	49	3,607	1,754	244	400	33	27 (26)	2 (2)	6,005
2002	55	3,638	1,992	363	169	30	22 (21)	2 (2)	6,162
2003	70	3,372	3	46	4	35	28 (17)	1 (0)	3,425
2004	48	3,182	6	72	22	36	33 (24)	2 (0)	3,282
2005	46	2,896	129	113	30	38	35 (30)	3 (2)	3,168
2006	77	--	--	--	--	38	38 (34)	3 (2)	

- The recent reforms to workers' compensation made auditing files more complex due to overlapping statutory rules.

**Recommendations**

- The DWC Audit and Enforcement Unit should track and report on the frequency and average underpayment of compensation for the randomly selected audits at randomly selected locations. This would allow policy makers the ability to evaluate trends and performance of the system.

**DRAFT CHSWC Response to Community Concerns Regarding DWC Workers' Compensation Audits**

- CHSWC in collaboration with the Audit Unit could determine if the indemnity trends are a result of the changes in the benefit levels or increases in the amount of payment due.
- The Division of Workers' Compensation should adjust staffing levels commensurate with performance requirements of the system.
- All locations should be audited at least once every 5 years. This would require the Division to audit approximately 100 per year.
- Conduct a more complete analysis of the audit process, which would require data similar to that obtained with the cooperation of the DWC/AU during the prior CHSWC study. Specifically, data on all randomly selected files at randomly selected locations would be needed. This would involve only the randomly selected locations and within those locations, only the results on the files randomly selected for the initial PAR audit.
- CHSWC should host an Audit Roundtable with the worker's compensation community to assess further what is working and what is not.

UNIVERSITY OF CALIFORNIA, BERKELEY

BERKELEY    DAVIS    IRVINE    LOS ANGELES    RIVERSIDE    SAN DIEGO    SAN FRANCISCO



SANTA BARBARA    SANTA CRUZ

**FRANK NEUHAUSER, Project Director**  
UC DATA/Survey Research Center  
2538 Channing Way, #5100  
Berkeley, California 94720-5100

Tel: (510) 643-0667  
Fax: (510) 643-8292  
E-mail: frankn@uclink4.berkeley.edu

**Memorandum**

**Date:**            **December 29, 2006**  
**To:**              **Christine Baker, Executive Officer, CHSWC**  
**From:**          **Frank Neuhauser**  
**Re:**              **Brief analysis of recent Audit Unit Reports**

---

**Summary**

At the December CHSWC meeting, Mark Gerlach, a consultant for the California Applicant Attorneys Association (CAAA) raised concerns about the effectiveness of the DWC Audit and Enforcement process. Of particular concern to Mr. Gerlach was the continuing high levels of unpaid compensation found in files audited by the DWC Audit Unit (DWC/AU) during the 2005 audit year. The then chairperson, Angie Wei, requested that the Commission review the recent audit process and comment on the concerns raised at the meeting. This memorandum summarizes the findings from a brief review of DWC/AU reports for audit years 2001 through the most recent audit year available, 2005.

The Audit Reports from audit years 2001-2005 reveal important concerns for the Commission.

- The number of locations audited appears surprisingly low despite the streamlining of the audit process introduced by reform legislation.
- Similarly, the number of claim files reviewed is also surprisingly low
- Performance does appear to be improving particularly among the most problematic claims administrators
- Unpaid compensation appears to be declining as a fraction of all compensation due, but the frequency of violations remains substantial and the amounts unpaid are likely to be unacceptably high.

One caveat—a more complete analysis of the audit process would require data similar to that obtained with the cooperation of the DWC/AU during the prior CHSWC study. That study resulted in substantial legislative and regulatory reform to the audit process. Specifically, data on all randomly selected files at randomly selected locations would be needed. This would involve only the randomly selected locations and within those locations, only the results on the files

randomly selected for the initial PAR audit. All other files are not randomly selected and can not be used in a statistical analysis to identify trends in claims administrators' performance.

**Findings**

The most serious concern that arises from a review of the audit reports is the limited number of audits that are being performed in any given annual cycle. One of the key objectives of the audit reform that adopted the abbreviated PAR audit for the majority of locations that perform well was to increase the number of locations audited each year. In turn, raising the likelihood of being audited was expected to increase the incentive of claims administering locations to improve their performance. At least this objective of the legislation has not been achieved.

Year	Audits	Indemnity files audited	Denied claims	Complaint	Other	Total (excluding Medical only)
2001	49	3,607	1,754	244	400	6,005
2002	55	3,638	1,992	363	169	6,162
2003	70	3,372	3	46	4	3,425
2004	48	3,182	6	72	22	3,282
2005	46	2,896	129	113	30	3,168

The table above shows the number of audits completed in each audit year. 2003 was the first year when the PAR audit process was fully implemented. While there was a brief increase in 2003, the number of audits has since declined to the pre-reform level, a level that was deemed unacceptable in the previous CHSWC study. There was also an immediate and substantial drop in the number of files audited after the introduction of the PAR audit process. Prior to 2003, the DWC/AU was reviewing approximately 6,000 files requiring significant audit resources and involving important issues (indemnity claims, denied claims, complaints and "other" files). In addition, audits were performed on 1500-2000 medical-only files which did not require the same level of audit resources.

After the adoption of the PAR audit process, the number of files involving significant resources to audit dropped by 50% to approximately 3200. This occurred despite efforts adopted as part of the PAR process to limit resources required for any single audit.

- Medical-only files were eliminated from audits
- At the initial level, the PAR audit involves only consideration of a limited set of violations instead of the full range of issues involved in all file reviews under the prior audit process
- Claims administering locations that met minimum requirements under the PAR process are not required to pay penalties for violations, being required only to pay unpaid compensation due. This reduced documentation requirements for violations and the often extensive administrative appeals by locations fighting penalties.

This streamlining of the audit process has apparently failed to broaden the number of locations audited during each year.

There can be several reasons for the failure of the reforms to achieve goals of increasing the number of locations audited and the related incentive to improve performance. Among those reasons could be the following:

- There may have been reductions in Audit Unit staffing.
- The PAR process may have failed to reduce work load despite simplification.
- The recent reforms to workers' compensation may have made auditing files more complex due to overlapping statutory rules.

The Audit Unit should be asked to comment on these issues.

**Trends in Claims Administrator performance**

At least from a first pass, the PAR audits appear to be accomplishing the objective of improving performance. The following table shows the PAR audit target levels for requiring higher levels of audit. Target standards are set at the 80<sup>th</sup> and 90<sup>th</sup> percentile of performance by locations over the previous several years. If performance is improving, the standard is progressively lowered, requiring even better performance in subsequent periods. Consistent with improving performance, the standards have declined substantially since the start of PAR audits suggesting that the 80% percentile of performance has been improving. The FCA Performance Standard has been declining even more rapidly suggesting that the 90<sup>th</sup> percentile performance has been significantly improved.

Year	PAR Performance Standard	FCA Performance Standard
2004	1.93	2.78
2005	1.76	2.48
2006	1.84	2.52
2007	1.83	2.22

This was one of the major objectives of the audit reform efforts. The focus was not on making performance perfect, which is impractical and inefficient. Rather, the focus was on reducing and even eliminating the poor performing locations through greater scrutiny and higher penalties.

**Unpaid compensation**

On the issue of unpaid compensation, the trend in performance is less clear. Unpaid compensation is one of the serious violations that are heavily weighted in assessing whether a location passes the PAR audit.

We cannot accurately measure the trend in unpaid compensation without additional data from the Audit Unit. That is because a large number of the indemnity files are selected at locations that failed the initial PAR audit level. These cannot be considered randomly selected files, even if the location was originally a randomly selected audit site.

**DRAFT CHSWC Response to Community Concerns Regarding DWC Workers' Compensation Audits**

Year	Indemnity files Audited	Files with unpaid compensation	% of Indemnity files	total	average
2001	3,607	731	20.3%	\$778,073	\$1,064
2002	3,638	579	15.9%	\$850,385	\$1,469
2003	3,372	490	14.5%	\$370,455	\$ 756
2004	3,182	559	17.6%	\$635,141	\$1,136
2005	2,896	498	17.2%	\$623,346	\$1,252

The figures in the above table for unpaid compensation probably overestimate the frequency and average amount of compensation that is unpaid across all claims locations. Also, we cannot directly compare the 2003-2005 levels with those from 2001-2002 because of the change in the way the claims are sampled. However, there is at least some indication that, overall, locations are improving. As a result of reforms, particularly AB-749, compensation levels were substantially increased. (Since 2005, there has been a significant reduction in permanent disability compensation, but this does not affect the figures above.) While compensation was substantially increased for many claims, often by as much as 60% or more, we do not observe that the average compensation unpaid on claims with unpaid compensation, has shown a similar increase. It is likely, that as a portion of compensation due, the unpaid amount has been declining.

However, some, if not most observers might consider these violations alarmingly frequent and the amounts surprisingly high. Several considerations are suggested. First, it would probably be useful as a regular practice for the DWC/AU to track the frequency and average underpayment of compensation for the sample of files that are randomly selected for audit at randomly selected locations. This would allow clear analysis of the trends by policymakers.

Second, some effort should be made to estimate the contribution to the level of indemnity that results from the recent series of reforms. This could fairly easily be estimated for the DWC/AU using tools developed for the Commission by UC Berkeley to analyze the impact of recent reforms. Removing the impact of reform on average indemnity would make analysis of the trends more accurate.

Finally, if the trends are considered unsatisfactory, the legislature or regulatory agency might consider increasing the penalties for violations related to unpaid compensation. This would increase the incentive for locations to more closely monitor this issue.

**State of California  
Department of Industrial Relations  
DIVISION OF WORKERS' COMPENSATION**

1515 Clay Street, 17<sup>th</sup> Fl.  
Oakland, CA 94612

## **Memorandum**

**DATE:** February 8, 2007

**TO:** Christine Baker  
Executive Officer



**FROM:** Carrie Nevans  
Acting Administrative Director

**SUBJECT:** Brief analysis of recent Audit Unit reports by Frank Neuhauser

This memorandum is in response to the December 29, 2006 draft report by Frank Neuhauser that analyzes basic data regarding Audit Unit activities from 2001 through 2005.

Mr. Neuhauser notes that the Audit Unit is reviewing a lesser number of locations and the number of claim files reviewed is lower than Mr. Neuhauser expected. He states that there can be several reasons for the failure of the reforms to achieve goals of increasing the number of locations audited and the related incentive to improve performance. Among those reasons could be the following:

- There may have been reductions in Audit Unit staffing.
- The PAR process may have failed to reduce work load despite simplification.
- The recent reforms to workers' compensation may have made auditing files more complex due to overlapping statutory rules.

The primary reason for a lesser number of claim files after the medical-only files are eliminated is due to a high percentage (about 80%) of audit subjects passing at the PAR level of an audit. The PAR phase of these audits is based on a short indemnity sample size of up to a maximum of 59 indemnity claim files. In the pre-2003 audit process only a very small number of audits (one or 2 per year) were short sample size audits. The vast majority of audits went to the large sample size of up to 138 indemnity claim files. This factor alone would result in a substantial reduction of claim files that come under review. Also, review of a lesser number of indemnity claim files

**DRAFT CHSWC Response to Community Concerns Regarding DWC Workers' Compensation Audits**

(up to 59 vs an average in pre-2003 of 110 per audit), would account for some if not all of the difference in the found unpaid indemnity.

Although AB 749 streamlined the audit process, there was little reduction in time needed to review a claim file. In the PAR and FCA-stage 1 audit process, the auditor still has to perform a comprehensive and thorough review of the claim file to identify the indemnity and notices requirements for the QME and NOPE along with what, if any, violations/penalties exist in a file, document and detail those violations/penalties and submit the auditor-recommended violations/penalties found on each file to the audit subject for review or comment.

If the audit subject needs explanation or disputes any violation/penalty, the auditor needs to take time for a discussion of issues. This process may require the auditor to perform a partial or complete re-review of the claim file. Additionally, it may require research and discussions with the Audit Unit's legal counsel.

Also, consideration must be given to the differences of claim files in today's audits as compared to pre-2003 audits. In the pre-2003 audits, a claim file classified as indemnity, if part of the random sample, would remain part of the sample and in the "numbers" even when the file had no actual indemnity payment. In current audits, each indemnity file within the total sample has multiple indemnity payments. Indemnity files with no exposure or only one lump-sum payment are replaced. This factor involves more audit time overall to the total sample. This also may be one of the reasons for the unpaid compensation issues discussed elsewhere in the report.

Mr. Neuhauser notes that the recent reforms to workers' compensation may have made auditing files more complex due to overlapping statutory rules and the PAR process may have failed to reduce workload despite simplification. This is true. The overlapping of the numerous reforms of 1/1/2003, 1/1/2004, 4/19/2004, along with associated changes in the Permanent Disability Rating Schedule (PDRS) on 1/1/2005, has contributed to audit complexity. Some changes are controlled by dates of injury while other changes are based on other, more complex, criteria. Within Title 8 regulations, the dollar values of some violations/penalties have changed with reforms and result in extra time for the audit process.

Mr. Neuhauser notes that claims administering locations that met minimum requirements under the PAR process are not required to pay penalties for violations, being required only to pay unpaid compensation due. This was expected to reduce documentation requirements for violations and the often extensive administrative appeals by locations fighting penalties. In actuality, there is no time savings for the PAR/FCA as it applies to appeals. There never have been extensive appeals, even in pre-2003 audits. The pre-2003 audits while in the first several years (1990 to 1993) had about three appeals annually. Since that time, numerous years have had no appeals. Since there was never significant workload associated with appeals, there was no time savings based on the changes in law.

Mr. Neuhauser is correct that the Audit Unit suffered from budgeting and staffing reductions prior to legislation that created a stable source of user funding. The Audit Unit experienced reductions in clerical and professional staff beginning in 2001 and continuing through late 2003. Additionally, 5 Audit Unit staffers retired, 4 in 2005 and one in 2006. Hiring of replacement and

**DRAFT CHSWC Response to Community Concerns Regarding DWC Workers' Compensation Audits**

additional qualified staff was restricted until fiscal year 2004/05 when user funding was approved by the Legislature. The table below details the Audit Unit's authorized and filled positions for the past 6 years.

AUDIT UNIT	01/02	02/03	03/04	04/05	05/06	06/07
Total Authorized Positions	33.0	30.0	35.0	36.0	38.0	38.0
Authorized/(filled) Professional positions as of mid-year	27 (26)	22 (21)	18 (17)	33 (24)	35 (30)	36 (34)
Authorized/(filled) Clerical positions as of mid-year	2 (2)	2 (2)	1 (0)	2 (0)	3 (1)	3 (2)

Subsequent to hiring, new staff require a 6 to 12-month training period before being fully productive. In order to provide this training of new staff, time is taken away from the audit activities of experienced staff. Because other departments were in a layoff mode while the Audit Unit was hiring, some of the new auditors who were hired had no previous experience in workers' compensation.

Productivity is increasing as Audit Unit staffing has improved and most new staff has been trained. There were 77 audits in 2006: 75 PAR/FCA and 2 target audits specific to prior stipulated agreements to a civil penalty. This shows that as with a progression of additional staffing numbers, the number of audits increased.

It is too soon to state that the changes in the audit process are not producing the intended results. The PAR/FCA process has not completed one 5-year cycle. There can be no determination of whether this process has improved compliance until:

- the results are known of the target PAR/FCA audits of the audit subjects failing the initial PAR/FCA; and
- the PAR/FCA goes into the second 5-year cycle.

It is not until the second cycle begins that audits of the same company/locations will determine whether improvement has resulted.

*Attachment C*

**1993 Legislative Changes to DWC Audit Program**

CHSWC Summary of DWC Audit Unit Information on Reforms to the Audit Program

Assembly Bill (AB) 749, effective January 1, 2003, resulted in major changes to California workers' compensation law and mandated significant changes to the methodologies for file selection and assessment of penalties in the audit program.

Labor Code Sections 129 and 129.5 were amended to assure that each audit unit will be audited at least once every five years and that good performers will be rewarded. A profile audit review (PAR) of every audit subject will be done at least every five years. Any audit subject that fails to meet a profile audit standard established by the DWC Administrative Director (AD) will be given a Full Compliance Audit (FCA). Any audit subject that fails to meet or exceed the FCA performance standard will be audited again within two years. Targeted PARs or FCAs may also be conducted at any time based on information indicating that an insurer, self-insured employer, or third-party administrator is failing to meet its obligations.

To reward good performers, profile audit subjects that meet or exceed the PAR performance standard will not be liable for any penalties but will be required to pay any unpaid compensation. FCA subjects that meet or exceed standards will only be required to pay penalties for unpaid or late paid compensation and any unpaid compensation.

Labor Code Section 129.5(e) is amended to provide for civil penalties up to \$100,000 if an employer, insurer, or third-party administrator has knowingly committed or (rather than "and") has performed with sufficient frequency to indicate a general business-practice act discharging or administering its obligations in specified improper manners. Failure to meet the FCA performance standards in two consecutive FCAs will be rebuttably presumed to be engaging in a general business practice of discharging and administering compensation obligations in an improper manner.

Review of the civil penalties assessed will be obtained by written request for a hearing before the WCAB rather than by application for a writ of mandate in the Superior Court. Judicial review of the Board's findings and order will be as provided in Sections 5950 et. seq.

Penalties collected under Section 129.5 and unclaimed assessments for unpaid compensation under Section 129 are credited to the Workers' Compensation Administration Revolving Fund (WCARF).

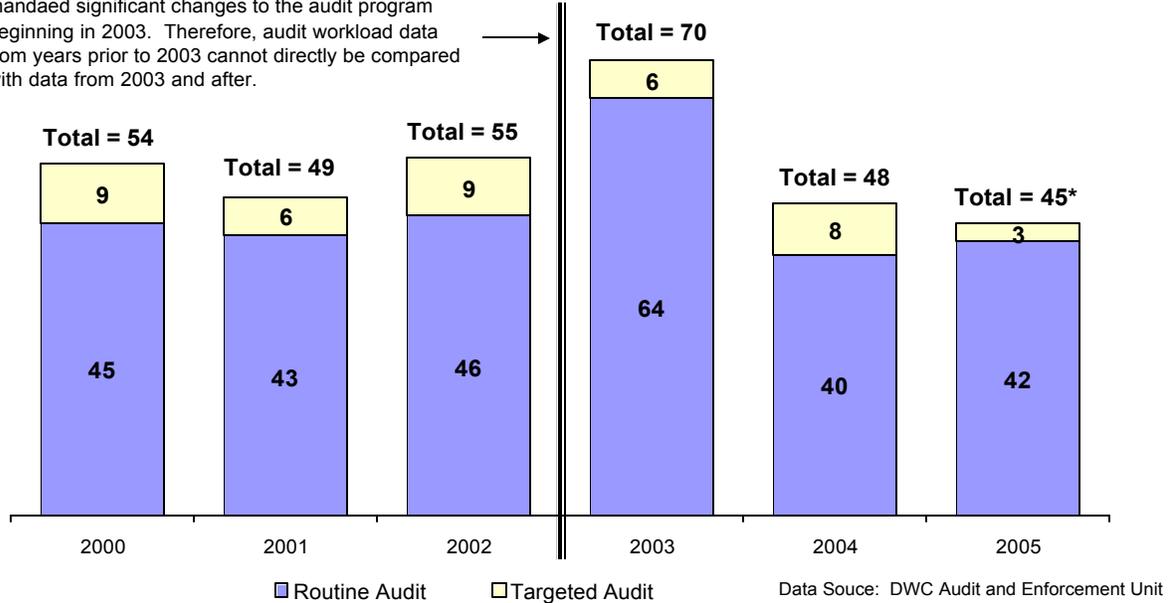
## DWC Routine and Targeted Audits 2000-2005

CHSWC Analysis of DWC Audit Unit Reported Data

The following chart shows the number of routine audits and target audits and the total number of audits conducted each year from 2000 through 2005.

### Routine and Targeted Audits

**Please Note:** Assembly Bill 749 resulted in major changes to California workers' compensation law and mandated significant changes to the audit program beginning in 2003. Therefore, audit workload data from years prior to 2003 cannot directly be compared with data from 2003 and after.



\* Note: An additional target audit was conducted based on a return agreement in a previous stipulation of civil penalty in year 2000

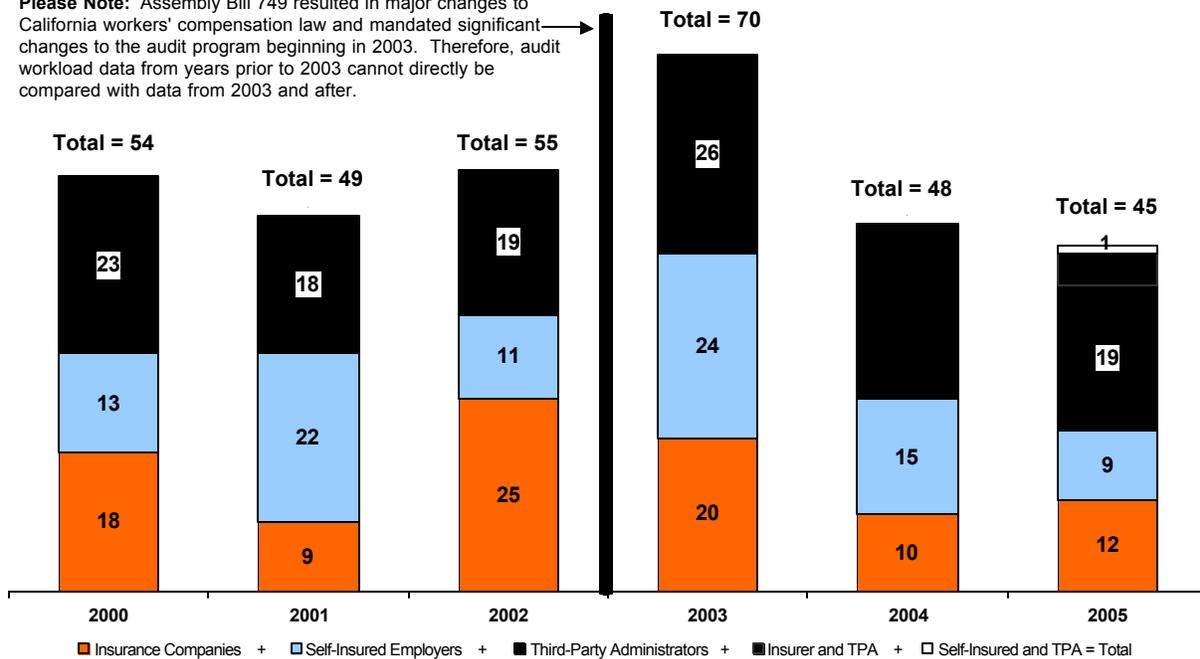
**Audits by Type of Audit Subject 2000-2005**

CHSWC Analysis of DWC Audit Unit Reported Data

The following graph depicts the total number of audit subjects each year with a breakdown by whether the subject is an insurer, a self-insured employer, or a third-party administrator.

**DWC Audits by Type of Audit Subject**

**Please Note:** Assembly Bill 749 resulted in major changes to California workers' compensation law and mandated significant changes to the audit program beginning in 2003. Therefore, audit workload data from years prior to 2003 cannot directly be compared with data from 2003 and after.



Data Source: DWC Audit and Enforcement

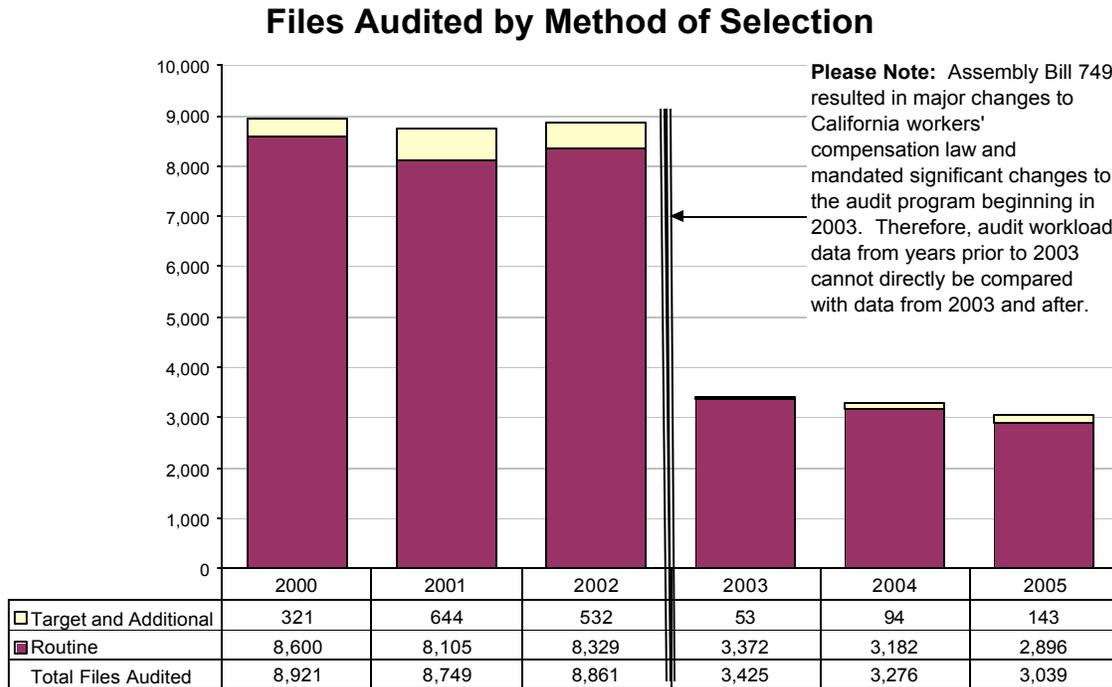
**Audits by Method of Audit Selection 2000-2005**

CHSWC Analysis of DWC Audit Unit Reported Data

The majority of claim files are selected for audit on a random basis, with the number of indemnity and denied cases being selected based on the numbers of claims in each of those populations of the audit subject:

- Targeted files are selected because they have attributes that the audits focus on.
- Additional files include claims chosen based on criteria relevant to a target audit but for which no specific complaints had been received.
- The number of claims audited is based upon the total number of claims at the adjusting location and the number of complaints received by the DWC related to claims-handling practices. Types of claims include indemnity, medical-only, denied, complaint and additional.

The following chart shows the total number of files audited each year and the method used to select them.



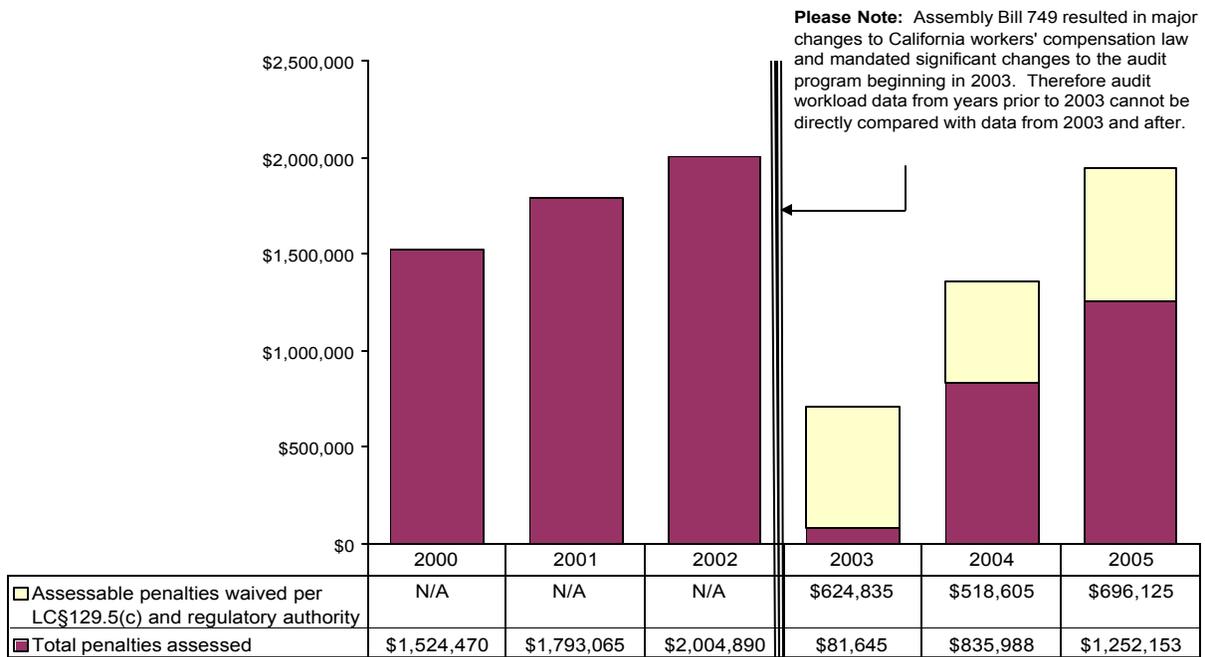
Data Source: DWC Audit and Enforcement Unit

**DWC Audit Unit – Administrative Penalties Assessed 2000-2005**

CHSWC Analysis of DWC Audit Unit Reported Data

As shown in the following chart, the administrative penalties assessed have changed significantly since the reform legislation changes to the Audit and Enforcement Program beginning in 2003.

**DWC Audit Unit - Administrative Penalties**



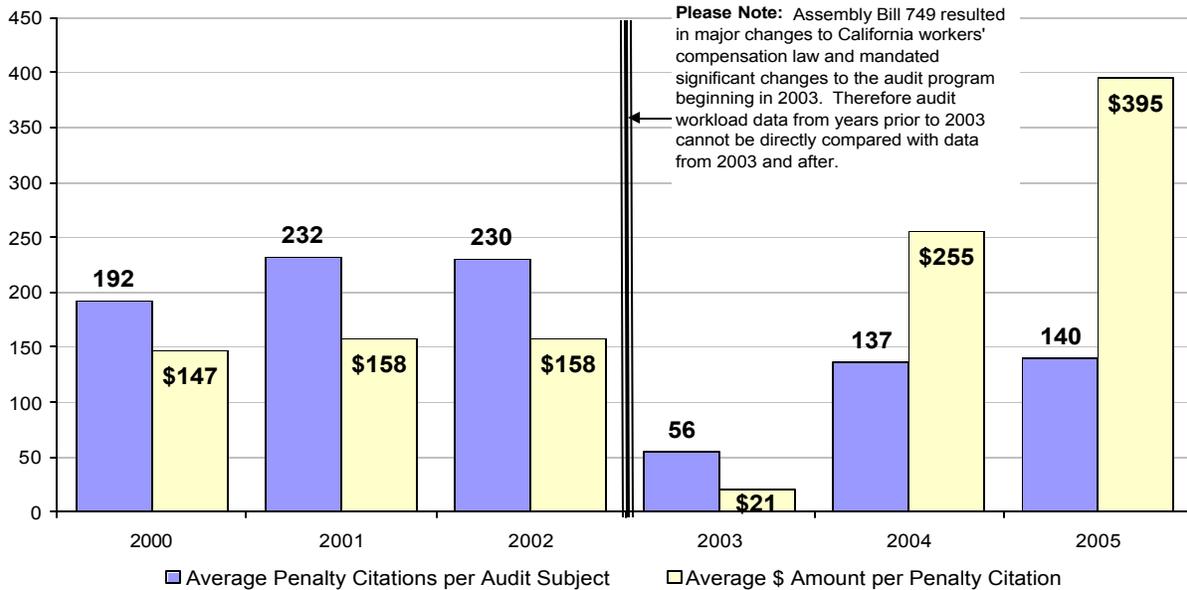
Source: DWC Audit and Enforcement Unit

**Average Penalty Citations per Claim and Amount Per Citation  
2000-2005**

CHSWC Analysis of DWC Audit Unit Reported Data

The following chart shows the average number of penalty citations per audit subject each year and the average dollar amount per penalty citation.

**Average Number of Penalty Citations per Audit Subject  
and Average Amount per Penalty Citation**



Source: DWC Audit and Enforcement Unit

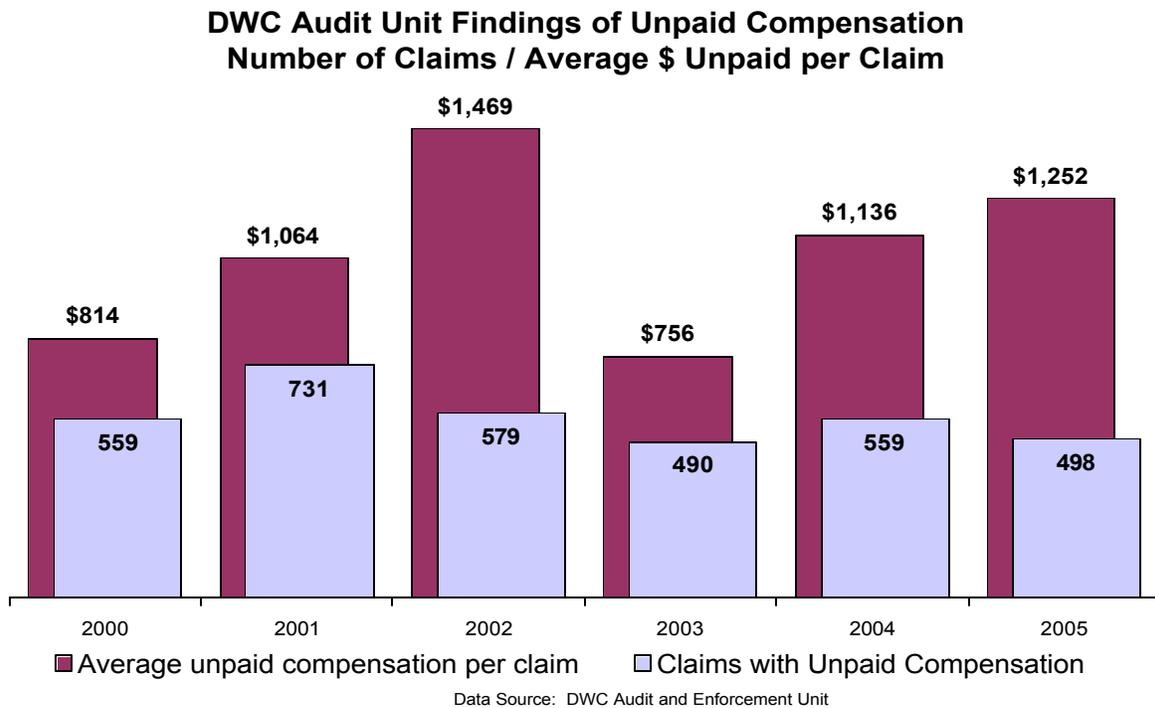
## **Unpaid Compensation Due To Employees 2000-2005**

CHSWC Analysis of DWC Audit Unit Reported Data

Audits identify claim files where injured workers were owed unpaid compensation.

The administrator is required to pay these employees within 15 days after receipt of a notice advising the administrator of the amount due, unless a written request for a conference is filed within 7 days of receipt of the audit report. When employees due unpaid compensation cannot be located, the unpaid compensation is payable by the administrator to the WCARF. In these instances, application by an employee can be made to the DWC for payment of monies deposited by administrators into this fund.

The following chart depicts the average number of claims per audit where unpaid compensation was found and the average dollar amount of compensation due per claim.

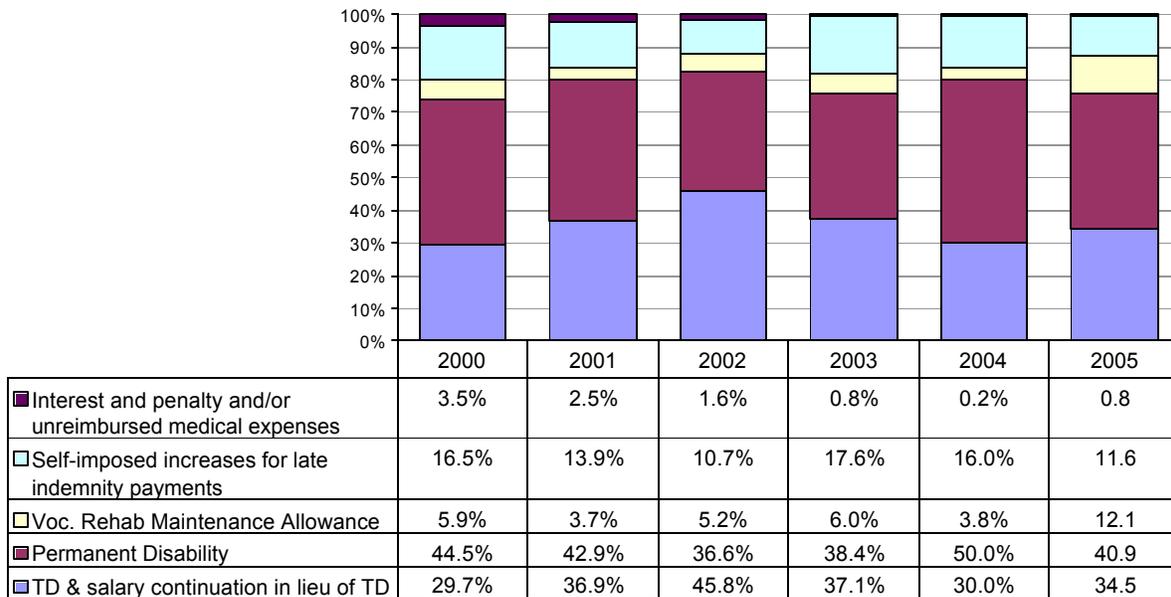


**Type of Unpaid Compensation by % of Total 2000-2005**

CHSWC Analysis of DWC Audit Unit Reported Data

This chart shows unpaid compensation each year, broken down by percentage of the specific type of compensation that was unpaid.

**Unpaid Compensation in Audited Files  
Type by Percentage of Total**



Data Source: DWC Audit and Enforcement Unit