

STATE OF CALIFORNIA  
DEPARTMENT OF INDUSTRIAL RELATIONS  
DIVISION OF WORKERS' COMPENSATION

INITIAL STATEMENT OF REASONS

Subject Matter of Proposed Regulations:  
**Workers' Compensation – Audit Regulations**

**TITLE 8, CALIFORNIA CODE OF REGULATIONS**  
**SECTIONS 10104, 10107.1, 10111.2**

Amended section 10104	Annual Report of Inventory
Amended section 10107.1	Notice of Audit; Claim File Selection; Production of Claims Files; Auditing Procedure
Amended section 10111.2	Full Compliance Audit Penalty Schedule; Target Audit Penalty Schedule

BACKGROUND TO REGULATORY PROCEEDING:

Labor Code Sections 129 and 129.5 were amended, effective January 1, 2003. Labor Code sections 129 and 129.5 authorize the Administrative Director to audit and impose penalties against claims administrators who fail to meet their obligations to promptly and accurately provide injured workers with the compensation to which they are entitled. In order to comply with the legislative changes to Labor Code sections 129 and 129.5, the Division of Workers' Compensation adopted a number of new and amended regulations which also became effective January 1, 2003. Since that time, the Division has become aware of certain changes that are required in order to comply with the mandates of Labor Code Sections 129 and 129.5.

**Amended Section 10104                      Annual Report of Inventory**

**Specific Purpose of Amended Section 10104:**

The Annual Report of Inventory provides the Audit Unit with the name of each adjusting location, which will allow the Audit Unit to schedule an audit of each adjusting location once every five years. It also requires reports due on or after April 1, 2003 to report the numbers of indemnity, denied and medical only claims reported to the claims administrator. This information allows the audit unit to (1) determine the sample size of claims to be audited; (2) plan and schedule audits based on how many indemnity files will be audited; (3) create a target audit criteria; and (4) it provides the Audit Unit with the information necessary to determine the size of the adjusting locations. The regulation previously stated that the Self-Insurer's Annual Report could be substituted for the Annual Report

of Inventory. However, the Self-Insurer's Annual Report does not set forth the number of indemnity claims (as defined as claims in which indemnity has been paid), medical only files or denial files. Therefore, if a Self-Insurer substitutes the Self-Insurer Annual Report for the Annual Report of Inventory, the audit unit is unable to determine the sample size of files to be audited, is unable to plan and schedule the audits in advance, and is not provided with the information necessary to determine the size of the adjusting location. Proposed amended section 10104 deletes the sentence that allows the Self-Insurer's Annual Report to be substituted for the Annual Report of Inventory.

Necessity:

Labor Code section 129 (effective 1/1/03) requires that each audit subject be audited once every five years. Labor Code section 129.5 (effective 1/1/03) requires that penalty amounts be based on, among other factors, the size of the adjusting location. The changes in the amended regulation concerning the annual report of inventory will allow the Audit Unit to schedule an audit of each adjusting location every five years and will allow the Audit Unit to determine the size of the adjusting locations. The Self-Insurer Annual Report does not provide the number of indemnity files in which indemnity has been paid. This particular information is needed to determine the number of files that will be audited.

Technical, Theoretical, and/or Empirical Study, Reports or Documents:

The Division of Workers' Compensation posted a draft of the proposed section on its website to allow for pre-notice public comment. The division also relied upon the CHSWC report on the DWC Audit Function, and input from the auditors who schedule the audits.

Business Impact:

The proposed change to this section requires Self-Insurers, who previously had the option of filing the Self-Insurer Annual Report, to file the Annual Report of Inventory. This requirement to report the numbers of indemnity, denied and medical-only claims will not have a significant impact on businesses.

Specific Technologies or Equipment:

The regulation does not mandate the use of specific technologies or equipment.

Consideration of Alternatives:

No more effective alternative, nor equally effective and less burdensome alternative, has been identified by the Administrative Director at this time. The purpose of the present rulemaking is to solicit and consider alternatives.

## **Amended Section 10107.1**

## **Notice of Audit; Claim File Selection; Production of Claims Files; Auditing Procedure**

### Specific Purpose of Amended Section 10107.1:

This amended section describes the process for conducting audits on or after January 1, 2003, in order to comply with the legislative changes made to Labor Code sections 129 and 129.5 effective January 1, 2003. It sets forth the procedure for noticing an audit and the sampling methodology for selecting the claims that will be audited. The section sets forth the procedure for calculating the audit subject's profile audit review performance rating. Those who meet or exceed the performance standard will not be assessed any administrative penalties; however, they will be issued Notices of Compensation Due pursuant to section 10110. The section is also sets for the procedure for calculating the audit subject full compliance rating.

The proposed amendment is to subdivision (c)(3)(A)(v). This subdivision is the fifth factor in the procedure for calculating the audit subject's profile audit review performance rating and full compliance rating. The qualifying phrase "once the employees' injuries have been reached a permanent and stationary status" is being deleted as it is unnecessary and confusing. The claims administrator is required to issue the notice advising injured employees of the process for selecting Agreed Medical Examiners and/or Qualified Medical Examiners with the denial of permanent disability and indemnity.

### Necessity:

Labor Code Sections 129 and 129.5 (effective 1/1/03) require (1) that each audit subject be audited at least once every five years; (2) that the Administrative Director annually establish a profile audit review performance standard that will identify the poorest performing audit subjects; (3) that the Administrative Director annually establish a full compliance audit performance standard that will identify the audit subjects that are performing satisfactorily; (4) that any full compliance audit subject that fails to meet or exceed the full compliance audit performance standard shall be audited again within two years; (5) that the Administrative Director shall publish and make available to the public a list ranking all insurers, self-insurers, and third-party administrators audited during the period according to their performance measured by the profile audit review and full compliance audit performance standards; (6) that penalties will not be assessed against audit subjects that meet or exceed the profile audit review performance standards, but unpaid compensation must be paid; (7) that penalties will be assessed only for violations involving late-paid and unpaid compensation on those audit subjects that meet or exceed full compliance audit performance standards, and unpaid compensation must be paid; and (8) that penalties for all violations will be assessed against those audit subjects that do not meet or

exceed full compliance audit performance standards, and unpaid compensation must be paid.

This amended regulation is required to address the above mandates. The amendment is required to clarify the fifth factor in determining whether or not an audit subject meets or exceed the profile audit performance rating or the full compliance performance audit rating. The extraneous phrase “once the employees’ injuries have been reached a permanent and stationary status” is being deleted as it is unnecessary and confusing. The claims administrator is required to issue the notice advising injured employees of the process for selecting Agreed Medical Examiners and/or Qualified Medical Examiners with the denial of permanent disability and indemnity.

Technical, Theoretical, and/or Empirical Study, Reports or Documents:

The Division of Workers’ Compensation posted a draft of the proposed section on its website to allow for pre-notice public comment. The division also relied upon the CHSWC report on the DWC Audit Function, and input from the auditors who audit the claims administrators.

Business Impact:

The amendment to this regulation, which concerns one of the factors for calculating an audit subject’s profile audit review performance rating and full compliance performance rating, will not have a significant impact on businesses because the change merely clarifies the present meaning.

Specific Technologies or Equipment:

The regulation does not mandate the use of specific technologies or equipment.

Consideration of Alternatives:

No more effective alternative, nor equally effective and less burdensome alternative, has been identified by the Administrative Director at this time. The purpose of the present rulemaking is to solicit and consider alternatives.

**Amended Section 10111.2      Full Compliance Audit Penalty Schedules;  
Target Audit Penalty Schedule**

Specific Purpose of Amended Section 10111.2:

Section 10111.2 sets forth the audit penalty schedules in compliance with the new requirements of Labor Code section 129.5. This section applies to audits conducted on or after January 1, 2003. However, for violations in claims with dates of injury between January 1, 1990 and December 31, 1993, penalty

amounts may not exceed the amounts that would be assessed pursuant to section 10111. For violations in claims with dates of injuries between January 1, 1994 and December 31, 2002, penalty amounts may not exceed the amounts that would be assessed pursuant to section 10111.1. The penalty amounts in section 10111.2 are based on the type of violation, taking into consideration the lateness of an act or the monetary value of the failure to act. The section sets forth when and how mitigation of penalties will be determined and applied. The section also provides how consideration of penalty amounts based on the size of the audit subject will be determined.

Section 10111.2 will be amended to include a \$50 penalty for late paid self-imposed increased (which was due on the same date as the late paid indemnity payment); to delete the penalty reference to self-imposed increases from subsection (a)(8); to include a penalty for late subsequent indemnity payments; and to include a penalty for failure to comply with an award of the WCAB or Rehabilitation Unit which is not assessed pursuant to subdivision (a)(10).

#### Necessity:

Section 10111.2 sets forth the audit penalty schedules in compliance with Labor Code section 129.5. Section 10111.2 became effective on January 1, 2003. Since that time, it has been determined that several penalties that were in the previous regulations (Section 10111 and Section 10111.1) were inadvertently omitted from Section 10111.2. The penalties will be assessed when the claims administrator violates specific sections of the Labor Code or workers' compensation regulations. The penalties are necessary to ensure that claims administrators comply with the Labor Code and regulations so that injured workers' receive the benefits due to them. Specifically, Section 10111.2 will be amended to include a \$50 penalty for late paid self-imposed increased (which was due on the same date as the late paid indemnity payment); to delete the penalty reference to self-imposed increases from subsection (a)(8); to include a penalty for late subsequent indemnity payments; and to include a penalty for failure to comply with an award of the WCAB or Rehabilitation Unit which is not assessed pursuant to subdivision (a)(10).

#### Technical, Theoretical, and/or Empirical Study, Reports or Documents:

The Division of Workers' Compensation posted a draft of the proposed section on its website to allow for pre-notice public comment. The division also relied upon the CHSWC report on the DWC Audit Function, and input from the auditors who audit the claims administrators.

#### Business Impact:

Because of the legislative changes to Labor Code section 192 and 129.5 effective January 1, 2003, approximately 80% of claims administrators who are

audited will not be subject to any penalties. Approximately 10% of the claims administrators who are audited will have decreased penalties. The proposed changes to section 10111.2 will add three penalties that were inadvertently omitted, but were present in the previous penalty schedules (Section 10111 and Section 10111.1). In compliance with the Labor Code, Section 10111.2 provides for increase penalties, however, the increased penalties will apply only to the worst performers and largest audit subjects. Therefore, the amended regulation will not have a significant impact on business.

Specific Technologies or Equipment:

The regulation does not mandate the use of specific technologies or equipment.

Consideration of Alternatives:

No more effective alternative, nor equally effective and less burdensome alternative, has been identified by the Administrative Director at this time. The purpose of the present rulemaking is to solicit and consider alternatives.