



Washington State Department of
Labor & Industries

Tier 1 Audit Pilot: A Comprehensive Report

May 2017

Executive Summary

Background

In June 2013, the Self-Insurance Audit Reform Advisory Committee was formed to develop a new audit process. The committee is led by The Department of Labor and Industries (L&I) and is comprised of representatives from both business and labor.

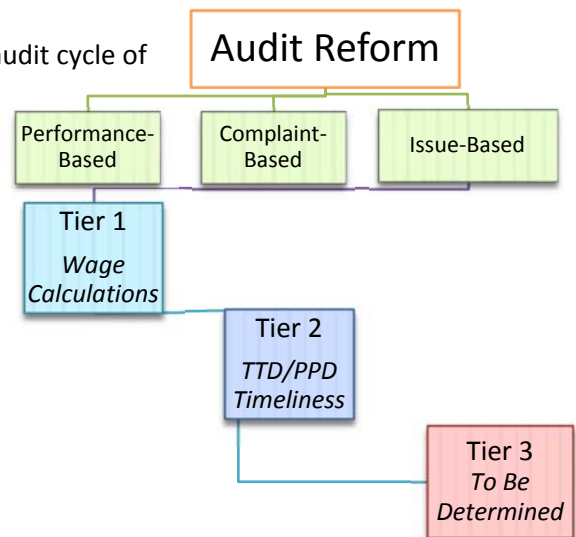
L&I in collaboration with this Committee has developed a new audit model. The new audit model focuses on areas of priority as recommended by business and labor, and is aimed to educate and promote compliance with Washington State Industrial Insurance Laws.

The new model is also designed to shorten the existing audit cycle of approximately 5 to 6 years, which was lengthy due to a broad review. The focused Tier 1 wage review took just under two years to complete. Although this was longer than first anticipated, it's still substantially shortened the length of the audit cycle.

The new model consists of three distinct types of audits:

- Performance-based.
- Issue-based.
- Complaint-based.

In addition, the performance-based audit includes three levels of review: Tier 1, Tier 2, and Tier 3. The level of review is determined by the performance in the preceding tier.



Summary of Activities and Findings

Tier 1 focused on the calculation of the injured worker's monthly wage which forms the basis for the rate of compensation. The wages are calculated as specified in RCW 51.08.178, WACs, applicable case laws, and department policies.

Tier 1 Wage Audits were conducted over a period of two years, between January 2015 and December 2016. Out of 358 self-insured employers:

- 162 employers passed Tier 1 with an accuracy rate of 70% or greater.
- 135 employers did not pass Tier 1 and will qualify for a Tier 2 Audit.
- 61 employers were not eligible for the audit pilot due to new or inactive status and no eligible claims.

Another key measurement was customer satisfaction. After each audit walkthrough an electronic survey was sent to the self-insured employer and their third party claims administrator.

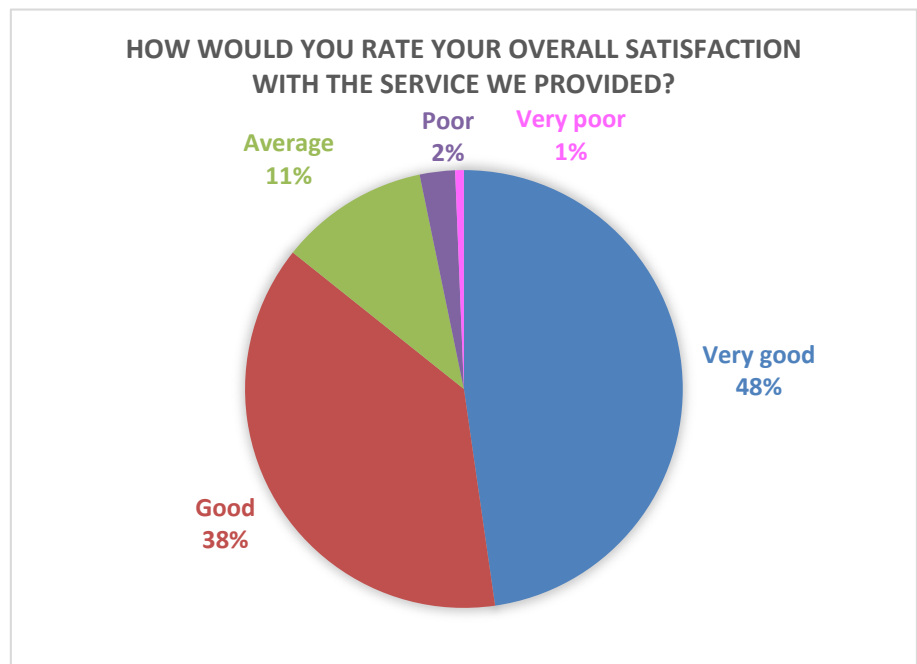
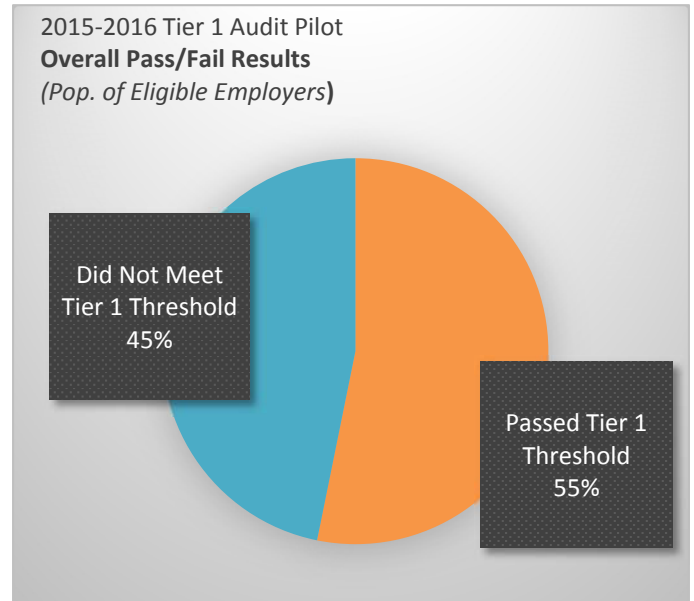
In response to the survey question "How would you rate your overall satisfaction with the service we provided?" the response was overwhelmingly positive, with 86% of our customers rating "Good" or "Very Good."

Conclusion

The new audit model is responsive, rewards compliance, and addresses program deficiencies. We believe overall customer satisfaction is high due to a focus on education before sanction.

Tier 1 focused on a highly complex calculation of the monthly wage that forms the basis of time-loss compensation for injured workers.

The pilot took 1 year longer to complete than estimated due to factors, such as, developing the new remote auditing process, lack of a standard audit management system, and the selection



for review of complex wages. Lessons were learned and best practices were discovered by the audit team.

We observed, both with employers that passed and did not pass, a strong initiative to make changes as a result of the audits. The walkthrough process helped facilitate this and, overall, promoted self-correction of areas identified to improve wage calculation.

Looking forward, the success of the performance-based audit pilot will be evaluated based on the overall results of all tiers.

“It has been an honor and pleasure to serve on the audit reform committee the past two years. The collaboration of all parties has allowed for ongoing progress and development of positive solutions based on lessons learned. I am confident the new performance based tier audit approach will effectively provide for continued education, and identify non-compliance issues and opportunities for process improvement.” Donna Egeland Ombuds for Self Insured Injured Workers.

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The Audit Process

Background

The Audit Reform project started as a collaborative effort between the Self-Insured Community and The Department of Labor and Industries. The Audit Reform Advisory Committee was born as a result of this initiative. During the Tier 1 Pilot, the Advisory Committee was comprised of:

- Labor representatives,
- Self-insured employers' representatives (i.e., third party claims administrators (TPAs), self-administered employers, etc.),
- L&I Insurance Services Assistant Director,
- L&I Insurance Services Deputy Assistant Director,
- L&I Self-Insurance Ombuds, and,
- L&I Self-Insurance Program Manager, Compliance Operations Manager, Claims Operation Manager and administrative support staff.

The Committee generally meets on a monthly basis to discuss the progress of Audit Reform and make recommendations to L&I leadership based on the perspective of their community. These recommendations are then discussed with the Program Compliance (audit) Team before final decisions are made by L&I Executive Leadership.

The focus of Tier 1 is the calculation of the injured worker's monthly wage which forms the basis for the rate of compensation. This calculation is highly complex, which is a primary reason it was selected as the focus of Tier 1. Newly self-insured employers and employers without audit eligible claims and claims beyond 3 years were excluded from employer selection. Claims with disputes, final wage orders and closed claims were excluded from claim selection.

Audit Timelines

Each audit was initiated with a letter to the employer. The letter advised of the claims selected for audit and requested payroll records, union contracts and other payroll documentation within 14 working days. Once complete documentation was received the final audit report was due within 90 days.

Since the old audit process was performed onsite, this was a new process for both the audit team and the employers. Once the process becomes familiar the time-cycle is expected to shorten. An aim of the new model is to be less intrusive and more effective.



Phases of a Tier 1 Audit

The Tier 1 Audit was divided up into three phases:

- 1) Planning,
- 2) Field Work,
- 3) Reporting and Finalization.

During the **Planning** phase the auditor selected the most recent audit eligible claims, then sent the list through a two-level quality assurance review (QAR).

During **Field Work** the Program Compliance Representative sent the initial audit letter to the employer. Once complete documentation was received the auditor calculated wages for each claim and compared it to the employer's calculations. Field Work was the lengthiest phase of the Tier 1 process because employers often needed extensions granted for return of documentation, or they unintentionally submitted incomplete documentation.

The wage calculations also added a great deal of time to the process. Wage complexity is variable depending on the wage type. Each wage calculation passed through two levels of Quality Assurance Review (QAR) before the audit proceeded to Reporting and Finalization.



Reporting and Finalization is

the third and last phase of a Tier 1 audit. During this phase the auditor prepares the preliminary report, then sends it through QAR before it is delivered. The auditor schedules and conducts a walkthrough with the employer and their TPA.

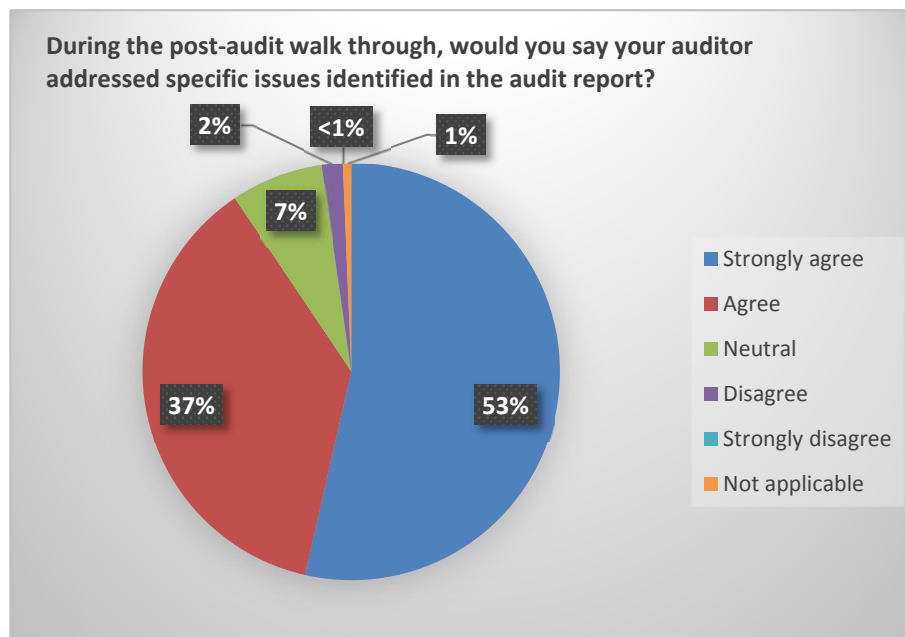
The best part – the walkthrough! The audit walkthrough, typically conducted by conference call, is for the purpose of ensuring the employer and TPA understand the preliminary report and audit findings. Customer feedback suggests it was the most beneficial part of the audit process because rich discussions were happening between the employers and their TPAs regarding ways they could improve their partnership to ensure injured workers' wages are calculated correctly. This was a key component to our education before sanction strategy. After the walkthrough a customer satisfaction survey was sent to all the participants.

If wages were determined to be under-calculated, the employer was required to correct the wage and benefit rate within 14 days. Some injured workers' received payment of underpaid benefits due to the Tier 1 Audit. Other workers were overpaid. If a worker was found to be overpaid, the employer was made aware and then could decide whether to pursue an overpayment assessment or not.

Customer Feedback and Survey Results

Employers and third party administrators were appreciative of the instruction and willing to correct any under-calculations found during the audit. Collaboration occurred between the employer, TPA and Program Compliance staff. This was reflected in the customer satisfaction surveys.

Employers and TPAs were able to focus on the educational benefits of Tier 1 resulting from the instruction and the customer support provided throughout the process.

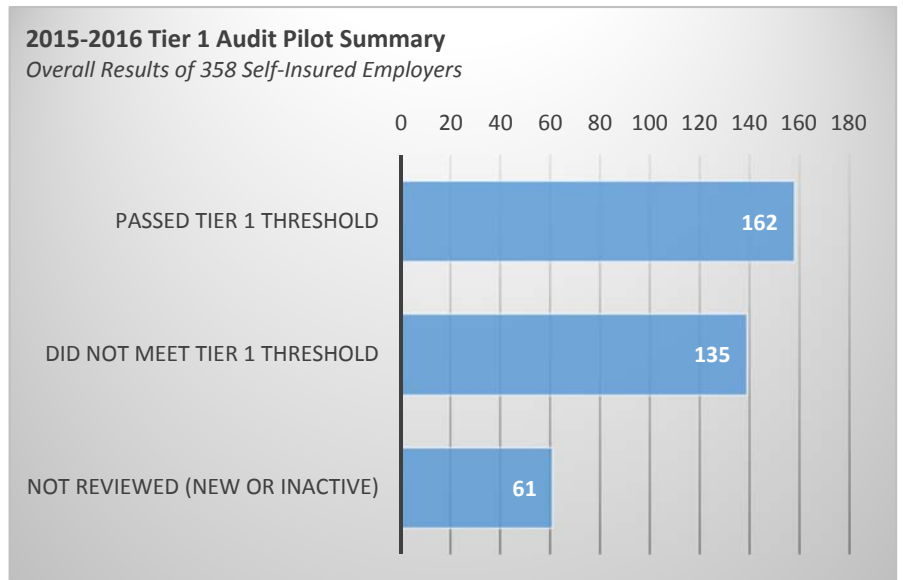


"Our auditor was very receptive to hearing our response to the audit and listened to our opinions. She worked with us and took back questions and responded to our needs immediately." Anonymous

The Audit Results

Passing a Tier 1 Audit

The Tier 1 Audit Pilot is designed for active self-insured employers. Employers who are new to self-insurance were excluded from the audit pilot since the scope of Tier 1 is limited to wages and a newly certified employer would benefit from a broader audit consultation. Likewise, if an employer became inactive they were excluded from the audit pilot.



The threshold for passing Tier 1 is 70% accuracy (i.e., 7 of 10 claims within variance) or *The Spirit of 70*. Claims within 5% of the auditor's wage calculation were considered within variance. If the employer over-calculated wages the claim was considered within variance as well, since an over-calculation would not adversely affect the worker.

Out of 297 employers audited, the 162 employers who passed the Tier 1 threshold will not require another performance-based audit until the next audit cycle. The 135 employers that did not meet the threshold will undergo a Tier 2 Audit.

Audit Findings

Methodology errors significantly outnumbered calculation errors due to the complexity of determining the monthly wage.

- *Method Error:* An error in the application of rules, policies, or guidelines.
- *Calculation Error:* A mathematical error or transposition.

The *SIF-5A* is a spreadsheet Self-Insurers are required to use when submitting wage calculations to L&I. The department attributes the low math errors to use of the new *SIF-5A*.

Table 1 (below) displays the detailed ranking of all audit findings.

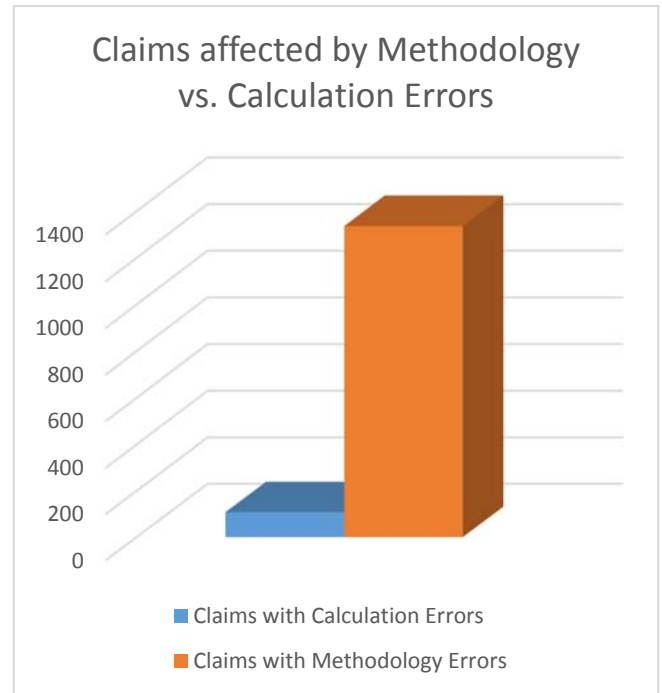


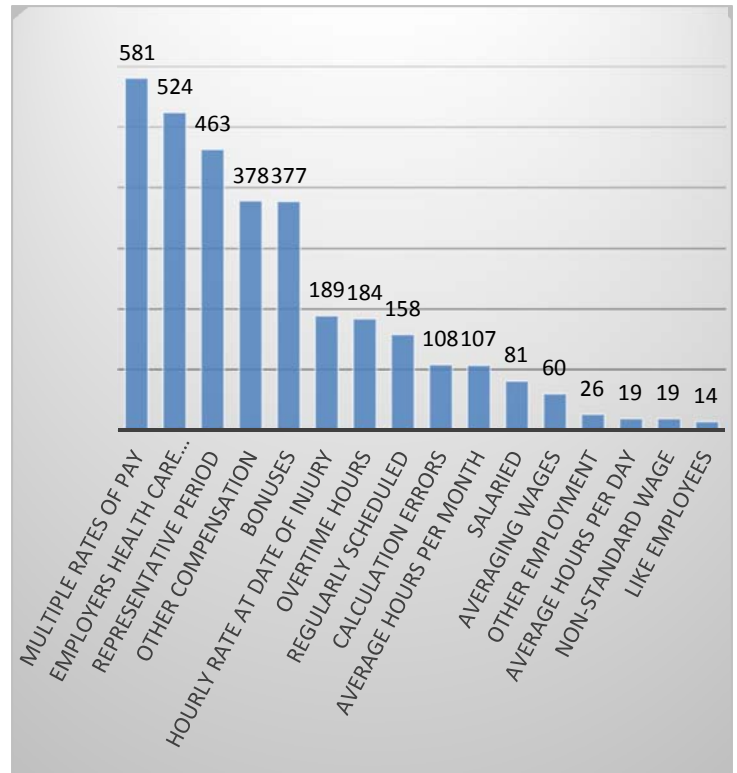
Table 1: Tier 1 Audit Findings Ranked

Rank	Error	Errors Found
1	Multiple Rates of Pay	581
2	Employers Health Care Contribution	524
3	Representative Period	463
4	Other Compensation	378
5	Bonuses	377
6	Hourly Rate at Date of Injury	189
7	Overtime Hours	184
8	Regularly Scheduled	158
9	Calculation Errors	108
10	Average Hours Per Month	107
11	Salaried	81
12	Averaging Wages	60
13	Other Employment	26
14	Average Hours per Day	19
14	Non-Standard Wage	19
15	Like Employees	14

The majority of audit findings are due to 5 common methodology errors.

- 1) **Multiple Rates of Pay:** Including all hourly rates (i.e., shift differential, weekend premiums, working out-of-class).
- 2) **Employers Health Care Contribution:** Including employer paid contribution and correct amount for medical, dental and vision.
- 3) **Representative Period:** Establishing a period that fairly represents the worker's wage on the date of injury (i.e., 3 months prior to the injury).
- 4) **Other Compensation:** Including lump sum payments that do not meet the definition of a "bonus" but still qualify as part of the worker's wage per RCW.
- 5) **Bonuses:** Including all bonuses (i.e., income based on work performance) paid in the 12 months preceding the injury.

Figure 1: Comparison of Tier 1 Audit Findings



Key Grouping of Methodology Errors

Reviewing the employment pattern is a key step in determining how to report and calculate the gross monthly wage. Seven of the methodology errors in Table 1 can be grouped together as employment pattern errors.

Table 2: Audit Findings Grouped

Rank	Methodology Error	Errors Found	Percentage
1	Employment Pattern:	1025	32%
	Multiple Rates of Pay	581	
	Regularly Scheduled	158	
	Average Hours Per Month	107	
	Salaried	81	
	Averaging Wages	60	
	Average Hours per Day	19	
	Non-Standard Wage	19	
2	Employers Health Care Contributions	524	16%
3	Representative Period	463	15%
4	Other Compensation	378	12%
5	Bonuses	377	12%
6	Hourly Rate at Date of Injury	189	6%
7	Overtime Hours	184	6%
9	Other Employment	26	1%
10	Like Employees	14	<1%
Total		3180	100%

Employment Pattern Scenarios:

Scenario 1: The Wages were calculated using *Average Hours Per Month* when the injured worker has an hourly shift differential. Wages should be calculated using multiple rates (i.e., regular hourly rate and shift differential rate). The methodology error is *Multiple Rates of Pay*.

Scenario 2: The wages were calculated using *Multiple Rates of Pay* when an injured worker has one hourly rate plus overtime. Per RCW the worker's wage should be calculated using a standard formula. In this scenario the methodology error is *Regularly Scheduled*.

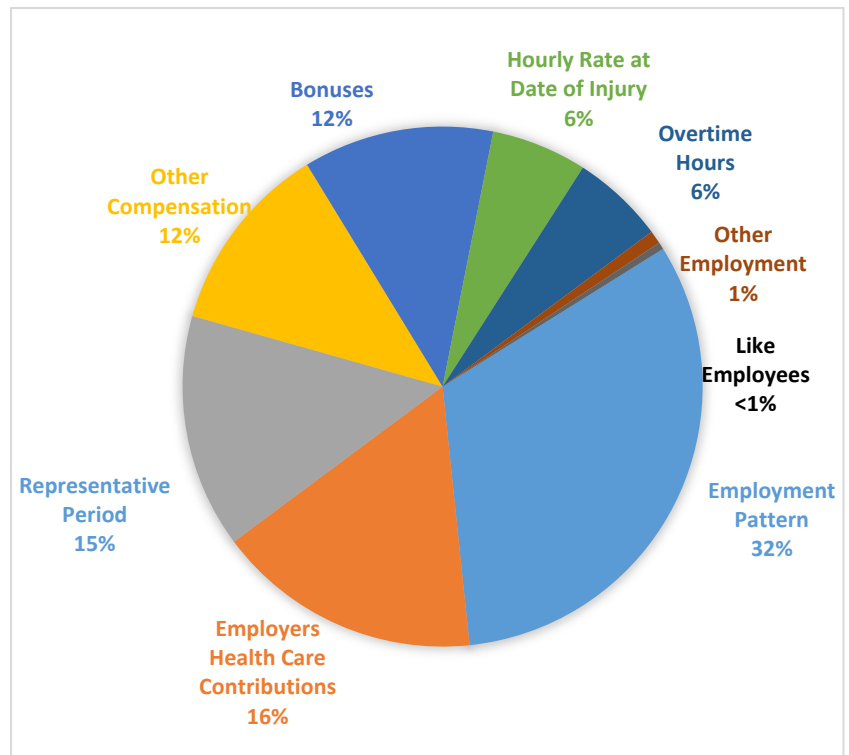


Figure 2: Audit Findings Grouped

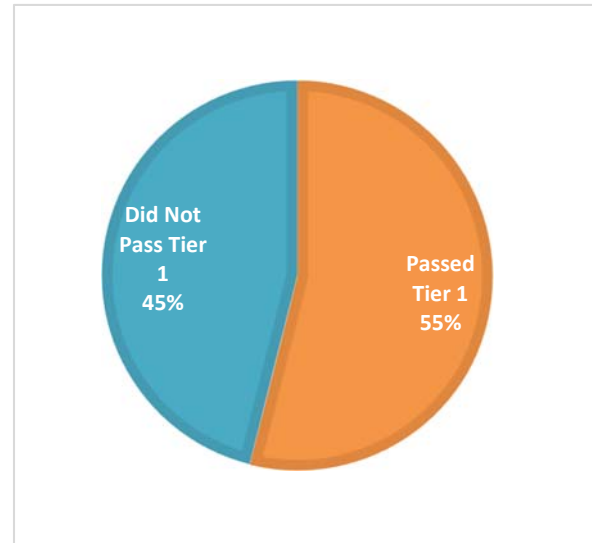
Audit Outcomes

During the Tier 1 Pilot, a total of 1752 claims were reviewed, of which 1127 were within variance (Figure 3). This indicates that the claim accuracy rate of 64% is higher than the employer passing rate of 54% (Figure 4).

Figure 3: Claims within 5% Audit Variance



Figure 4: Employer Pass/Fail Rate



The Tier 1 Pilot started with an audit selection goal of 35 claims per employer. Using a judgmental sample i.e., always with higher complexity of wage calculations. Because the selection of claims was often smaller than 35, and the experience showed that a smaller sampling had similar findings, the audit selection was changed to a goal of 10 claims per employer. However, many employers still had less than 10 audit eligible claims. This resulted in a range of claim selections per employer.

Figure 5 shows that 114 self-insured employers had less than 3 audit eligible claims.

An employer with less than 3 eligible claims must have 100% accuracy to pass (i.e., if 1 of 2 claims were out of variance they would not achieve 70% accuracy).

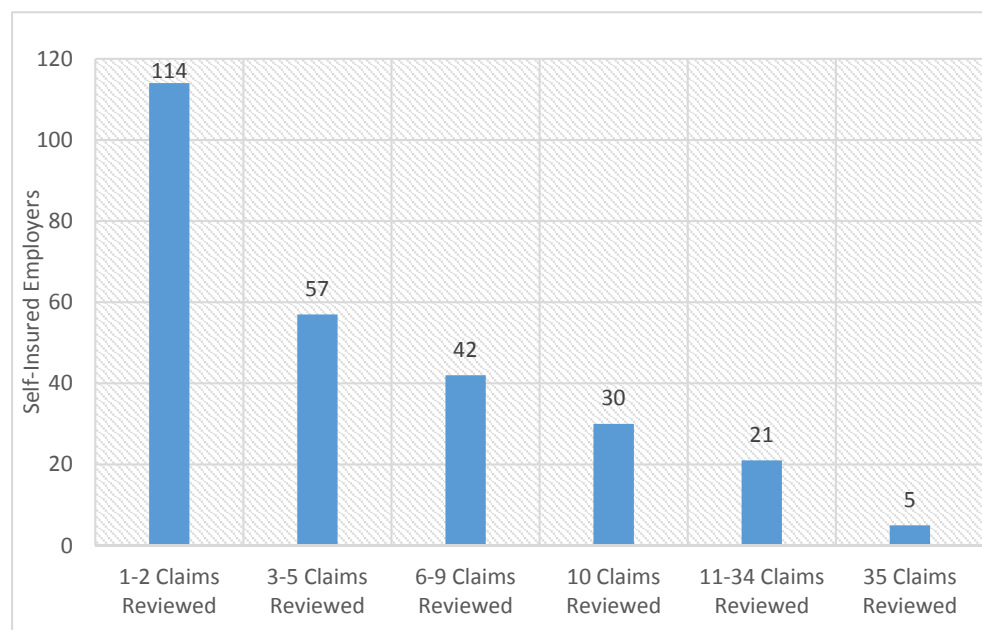


Figure 5: Claims Reviewed per Employer

Figure 6 shows how many wage determinations were found to be under-calculated, over-calculated and how many calculations matched the auditors (to the penny). Of the 899 claims that were under-calculated 625 were below the 5% variance.

If the wage was under-calculated, the employer was required to correct the wage calculation and pay any additional benefits owed. The auditor issued wage orders on all under-calculated claims.

If a claim was over-calculated the employer had the choice of requesting a wage order and/or pursuing an overpayment from the injured worker.

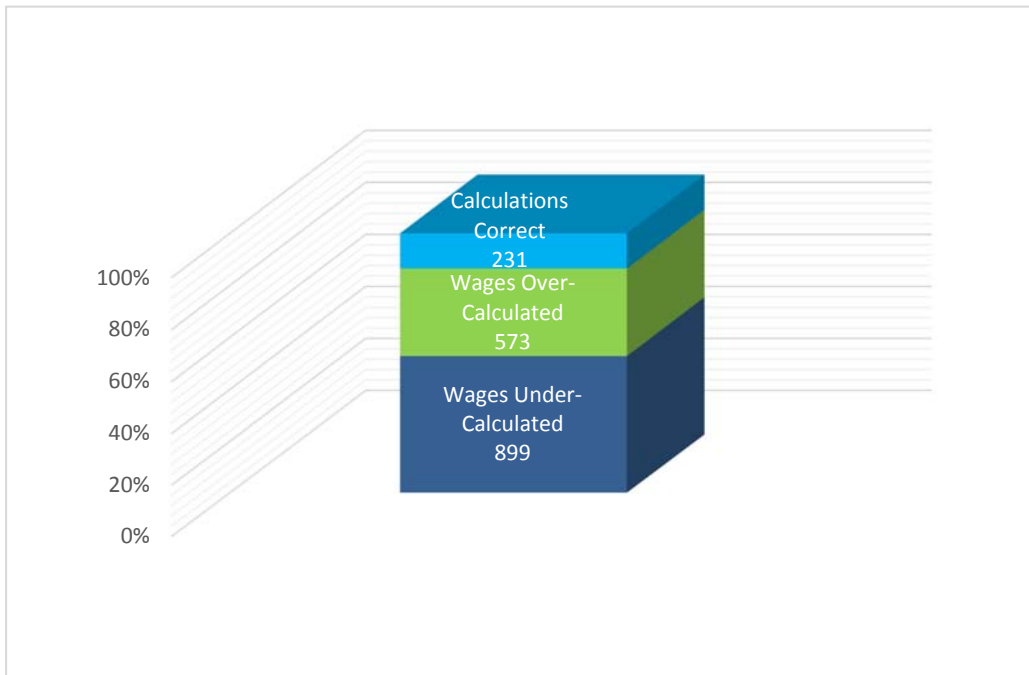


Figure 6: Wage Calculation Comparison Results

While the focus of Tier 1 was on wage calculation, and not rate of compensation, we did become aware of instances during walk-thru's where the wage calculation did not affect the benefit rate of the injured worker. For example, if an injured worker was paid at the maximum time-loss rate due to high wages, a correction that increased the wage calculation to a higher wage would not change the benefit amount.

Customer Feedback and Survey Results

A valuable part of the audit results were the corrections made to under-calculated wages, and in some cases, adjustment payments issued to injured workers.

As measured by the Customer Satisfaction Survey Results (Figure 7) approximately 90% of employers and TPAs agreed or strongly agreed that the walkthrough provided information needed to complete the required actions on the Preliminary Audit Report.

The survey also allows for free text. Below is a quote from a self-insured employer who had a positive outcome from the Tier 1 Audit Pilot.

Did the post-audit walk-through provide the information you needed to complete the required actions?

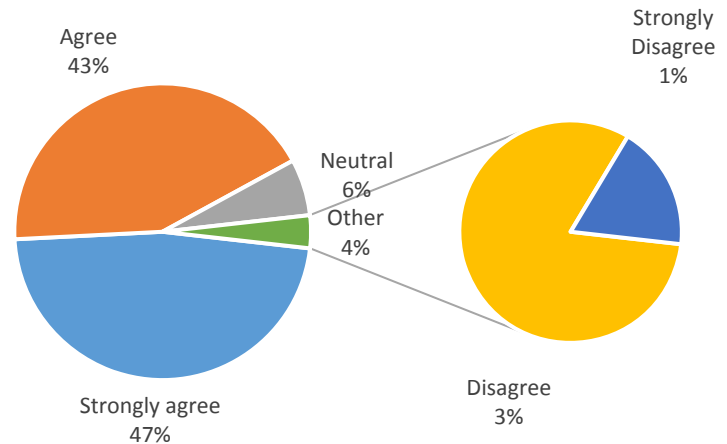


Figure 7: Customer Satisfaction Survey Results

“The narrow scope, on one specific issue, was efficient, allowed us to focus intently and learn what we were missing so we could make specific improvements to our program. [The Auditor] was AMAZING & was focused on HELPING us succeed by discovering our deficiencies and using them as opportunities to help us improve! Although it's hard to hear when you've made a mistake and these audits are extremely serious, this didn't feel punitive at all!! [The Auditor's] positive attitude and desire to work with us (not against us) was the catalyst that truly made... a team in this. Working together was not only a lot of fun but a wonderful experience. The walk-through was fantastic!! It was extremely detailed & collaborative, everyone's voices were heard and great ideas were implemented. We sincerely appreciate the time allocated for [The Auditor] to meet with us in person!! The face-to-face meetings alone, were the single most valuable aspect in this process. It was really nice having our own personal tutor!! Believe it or not, I am actually looking forward to future audits!! I know our program isn't perfect but I am 100% confident that this audit format facilitates allows L&I to help me get there, which ultimately benefits the most important customer in the process; the injured worker!” Terri Nienkirk Workers Compensation Program Manager Seattle Children's.

Lessons Learned

Lessons learned are experiences, both positive and negative, from a project that should be actively taken into account in future projects.

A debrief of the Lessons Learned from Tier 1 pilot was conducted with both the L&I Self-Insurance Program Compliance Unit (auditors) and the Audit Reform Advisory Committee.

Labor and Industries Program Compliance Auditors

What Went Well

The Walkthrough was educational for all parties. The employers and TPAs were receptive. There was also opportunity for the auditor to advise the employer on the best type of payroll documentation they could provide. This was appreciated by the TPAs because it makes it easier for them to calculate wages correctly when they have complete and relevant payroll documentation.

Communication by [Secure] email was convenient, as well as using Outlook to send audit walkthrough meeting requests to employers and TPAs. The ability to conduct the walkthrough by phone was beneficial, although an in-person walkthrough was still available at the employer's request. Additionally, having the contact information for the payroll department made it easier to get complex payroll information or questions answered during field work.

Future Opportunities

Timely and complete response to the initiation letter was challenging for employers. Many times this was due to the sheer size of documentation being requested and/or the structure of the company being audited.

Contact information was not updated with L&I when employer or TPA contacts changed. There were many occurrences where the auditor did not have the correct contact information. Other times, the contact information requested in the initial letter was not provided.

"The Tier 1 audit process allowed us to collaborate with the employer and third party administrator to obtain clarification of individual payroll systems and documentation necessary to accurately calculate a worker's wage. In addition, the preliminary report walkthrough meetings also provided an opportunity for all parties to participate in a discussion to hear the same message simultaneously." Susan Kauffman SI Compliance Auditor

Audit Reform Advisory Committee

What Went Well

Increased **awareness** regarding the complexity and inconsistency of wage calculations in the workers' compensation system.

More **consistency** between auditors due to a narrower focus. The Wage Classification Matrix helped standardize the review process. And, the findings will be provided to the state fund's Claims Administration leadership to inform their efforts to improve consistency throughout the workers' compensation system.

Collaboration throughout the life of the audit. The focus on education in the walkthrough allowed all participants to share tools and tips with each other.

Future Opportunities

Rigid review process in certain scenarios. For example, documenting a 1 penny difference or performing an in-depth review of the wages when the injured worker is already at the maximum time-loss rate.

The pass/fail threshold (70%) may not accurately reflect the performance of the self-insured business community, especially for all the employers who failed with a small number of claims. This impact is greater when a pass/fail threshold is set before data is available to support the threshold.

Scope of tiers needs to be agile and flexible.

Conclusion of Findings

Self-Insurance Audit Reform consists of three types of audits: performance-based, issue-based and complaint-based. The performance based audit model has three tiers.

Tier 1 focused on wage calculations. The reason this is so important is that the monthly wage is the basis of an injured worker's compensation rate.

The pilot ran from January 2015 to December 2016, during which time 297 of 358 self-insured employers were reviewed for 70% accuracy in their wage calculations. 61 employers were inactive, new to self-insurance, or did not have audit eligible claims.

Of 297 employers audited, 162 employers passed and 135 employers did not pass. The employer who didn't pass Tier 1 will move to Tier 2 – with a focus on the timeliness of benefit payments.

The Tier 1 pilot ran one year longer than anticipated. This may be due in part to challenges in the new process of performing the audits remotely, rather than on-site, need of new audit management technology, and overall complexity of scope of audit.

Tier 2 is under way and is anticipated to conclude in the summer of 2017. A passing threshold will be determined based on the reviews. The Audit Reform Advisory Committee will review and discuss the threshold once we have completed half of the audits in Tier2. Employers that do not meet the Tier 2 passing threshold will then move to Tier 3.

The Audit Reform Advisory Committee is continuing work on the scope of Tier 3 in partnership with L&I. The long term plan is to move from an advisory committee that assists with development of process to a governance role who receives information and advises on where best to allocate resources based on risk and community interest, or trends, in accordance with the International Professional Practices of Internal Auditors.

I have worked in the public sector for over twenty years. It was a privilege to work with forward thinking professionals both internally and externally that continue to change the way we do business and care about how workers compensation is administered to our injured workers in Washington State. This is just the beginning to a successful and evolving relationship with our community and Labor and Industries." Brian Schmidlkofer Self-Insurance Compliance Operations Manager