PERFORMANCE AND FINANCIAL AUDIT
OF THE
BUREAU OF WORKERS' DISABILITY COMPENSATION
DEPARTMENT OF CONSUMER AND INDUSTRY SERVICES

October 1, 1998 through September 30, 2000
EXECUTIVE DIGEST

BUREAU OF WORKERS' DISABILITY COMPENSATION

INTRODUCTION

This report contains the results of our performance* and financial* audit of the Bureau of Workers' Disability Compensation, Department of Consumer and Industry Services. The financial portion of our audit covered the period October 1, 1998 through September 30, 2000.

AUDIT PURPOSE

This performance and financial audit was conducted as part of the constitutional responsibility of the Office of the Auditor General. Performance audits are conducted on a priority basis related to the potential for improving effectiveness* and efficiency*. Financial audits are conducted at various intervals to provide for enhanced financial reporting of significant State programs and/or activities and to complement the annual audit of the State's financial statements. Also, this audit complements the departmentwide financial audit.

BACKGROUND

The Workers' Disability Compensation Act of 1969, being Sections 418.101 - 418.941 of the Michigan Compiled Laws, requires employers to compensate workers for injuries suffered on the job, including certain wage loss benefits, the cost of medical treatment, and certain rehabilitation services. The Bureau of Workers' Disability Compensation's mission* is to administer the Act in order

* See glossary at end of report for definition.
to facilitate timely benefit payments to injured employees at a reasonable cost to employers.

In fiscal year 1999-2000, the Bureau expended approximately $12.3 million for general operations. As of September 30, 2000, the Bureau had 147 classified and 1 unclassified full-time employees.

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<th>AUDIT OBJECTIVES, CONCLUSIONS, AND NOTEWORTHY ACCOMPLISHMENTS</th>
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<td><strong>Audit Objective:</strong> To assess the effectiveness and efficiency of the Bureau's administration of the Workers' Disability Compensation Act of 1969.</td>
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**Conclusion:** We concluded that the Bureau was generally effective and efficient in its administration of the Act. However, our assessment disclosed reportable conditions* in the areas of the continuous quality improvement* (CQI) process, insurance coverage, automated data collection, allocation of annual fund assessments, and the penalty process (Findings 1 through 5).

**Noteworthy Accomplishments:** The Bureau's web site was rated as one of the three best workers' disability compensation web sites in the nation, as reported in the March/April 2001 issue of the *Workers' Compensation Policy Review*. The web sites of all 50 states and the District of Columbia were rated on 15 criteria, such as the workers' compensation law, publications, and statistics and other important features, including the availability of forms and contact information. The Bureau's web site also provides users with helpful interactive features, including a benefit calculation program that enables users to calculate weekly workers' disability compensation payments payable on general disability claims and a search function to determine current insurance coverage information for

* See glossary at end of report for definition.
employers in Michigan. This recognition is consistent with the Governor’s efforts to provide information to consumers on a 24-hour basis and to promote the use of web technology.

In 1999, the Bureau made available to all system participants a toll-free telephone number to address any questions and provide information relating to workers' disability compensation in the State. The Bureau has published the toll-free number in various pamphlets and mailings, in its annual reports, and on its web site.

**Audit Objective:** To assess and report on the Bureau’s compliance with certain provisions of laws and regulations, noncompliance with which could have a direct and material effect on the financial statements, and on its internal control* over financial reporting, based on our audit of the financial statements.

**Conclusion:** Our assessment of compliance did not disclose any instances of noncompliance that could have a direct and material effect on the financial statements. Also, our assessment of internal control over financial reporting did not disclose any material weaknesses. However, we identified reportable conditions related to cash receipts and revenue processing and information systems security (Findings 6 and 7).

**Audit Objective:** To audit the financial statements of the Second Injury Fund; the Silicosis, Dust Disease, and Logging Industry Compensation Fund; the Self-Insurers' Security Fund; the Uninsured Employers' Security Fund; and the Workers' Disability Compensation - Multiple Trust Funds as of and for the fiscal years ended September 30, 2000 and September 30, 1999.

* See glossary at end of report for definition.
Conclusion: We expressed an unqualified opinion* on the Bureau's financial statements.

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<th>AUDIT SCOPE AND METHODOLOGY</th>
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| Our audit scope was to examine the program and other records of the Bureau of Workers’ Disability Compensation. Also, our audit scope was to examine the financial records for the period October 1, 1998 through September 30, 2000. Our audit was conducted in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States and, accordingly, included such tests of the records and such other auditing procedures as we considered necessary in the circumstances.

Our methodology included examination of the Bureau's records and activities primarily for the period January 1, 1999 through May 31, 2001. We conducted a preliminary review of the Bureau's operations to formulate a basis for defining the audit objectives and scope.

We assessed whether the Bureau appropriately evaluated its program effectiveness and efficiency through the establishment of a continuous quality improvement process. We also assessed whether the Bureau had established effective methods to educate those involved in the workers' disability compensation process and whether the Bureau had established efficient methods to obtain required information from those parties.

We examined the Bureau's methods for ensuring that workers' disability compensation payments to injured employees were timely and accurate and in accordance with the Workers' Disability Compensation Act of 1969.
Also, we reviewed the maintenance of the Bureau's current and historical claims/case and employer records system.

We analyzed the effectiveness of the Bureau's procedures for ensuring that all eligible employers had complied with the requirements of the Act by maintaining the required workers’ disability compensation insurance coverage. Also, we evaluated the Bureau's process for approving employers for self-insurance.

We reviewed the Bureau's handling of contested cases, through either the informal mediation process or through the formal hearings process, and its management of the related caseloads. Also, we evaluated whether the Bureau was effective and efficient in informing employers and employees of the Act's provisions regarding vocational rehabilitation.

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<tr>
<td>Our audit report contains 7 findings and 8 corresponding recommendations. The Bureau’s preliminary response indicated that it agreed with 7 recommendations and agreed in part with 1 recommendation.</td>
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The Bureau complied with 5 of the 8 prior audit recommendations included within the scope of our current audit. Two of the prior audit recommendations were repeated and one was rewritten for inclusion in this report.
February 20, 2002

Ms. Kathleen M. Wilbur, Director
Department of Consumer and Industry Services
G. Mennen Williams Building
Lansing, Michigan

Dear Ms. Wilbur:

This is our report on the performance and financial audit of the Bureau of Workers’ Disability Compensation, Department of Consumer and Industry Services. The financial portion of our audit covered the period October 1, 1998 through September 30, 2000.

This report contains our executive digest; description of agency; audit objectives, scope, and methodology and agency responses and prior audit follow-up; comments, findings, recommendations, and agency preliminary responses; and independent auditor’s reports on compliance and on internal control over financial reporting and on the financial statements of the Second Injury Fund; the Silicosis, Dust Disease, and Logging Industry Compensation Fund; the Self-Insurers’ Security Fund; the Uninsured Employers’ Security Fund; and the Workers’ Disability Compensation - Multiple Trust Funds. This report also contains the Bureau of Workers’ Disability Compensation’s financial statements and notes to the financial statements and a glossary of acronyms and terms.

Our comments, findings, and recommendations are organized by audit objective. The agency preliminary responses were taken from the agency’s responses subsequent to our audit fieldwork. The Michigan Compiled Laws and administrative procedures require that the audited agency develop a formal response within 60 days after release of the audit report.

We appreciate the courtesy and cooperation extended to us during this audit.

Auditor General
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Description of Agency

The Workers' Disability Compensation Act of 1969, being Sections 418.101 - 418.941 of the *Michigan Compiled Laws*, requires employers to compensate workers for injuries suffered on the job, including certain wage loss benefits, the cost of medical treatment, and certain rehabilitation services. Nearly all employers in Michigan are subject to the Act, including both private and public employers. Generally, if a private employer has three or more employees at any one time or employs one or more workers for 35 or more hours per week for 13 or more weeks, during the preceding 52 weeks, the employer is subject to the Act. All public employers are subject to the Act, irrespective of the number of persons employed.

The following graphs illustrate the number of workers' disability compensation claims and the amount of benefits paid in workers' disability compensation, as reported to the Bureau, during the last five years:

![Workers' Disability Compensation Claims](chart)
The Bureau of Workers' Disability Compensation's mission is to administer the Workers' Disability Compensation Act of 1969, as amended, in order to facilitate timely benefit payments to injured employees at a reasonable cost to employers. The director of the Bureau is appointed by the Governor, with the advice and consent of the Senate, and serves a three-year term. The Bureau consists of eight divisions:

1. The Claims Processing Division maintains a current and historical claims/case records system. It is responsible for ensuring that employees who have suffered work-related injuries are provided correct wage loss replacement and that both voluntary claims and litigated cases are processed in a timely manner.

2. The Compliance and Employer Records Division maintains a current and historical records system for over 200,000 employers. It is responsible for ensuring that all employers subject to the Act have complied with the requirements by securing workers' disability compensation coverage either through a policy of insurance or through approved self-insurance authority.

3. The Self-Insured Programs Division administers the Act's provisions relating to employers who request authority to self-insure and assume responsibility for direct
payment of benefits to injured workers. The Division reviews initial applications and renewals for self-insurance, including the formation of group self-insured programs.

4. The Health Care Services Division is responsible for ensuring that injured workers receive appropriate and necessary health care services provided by licensed health care providers and that the health care providers are paid a reasonable amount for services in a timely manner.

5. The Vocational Rehabilitation Division is responsible for ensuring that employers provide rehabilitation services according to the provisions of the Act and that the injured employees accept such services.

6. The Mediation Division attempts to resolve disputed cases between employers and employees in an informal setting, thereby avoiding the formal litigation process. The Division has nine field offices established throughout the State where 11 mediators provide services to employers and employees.

7. The Board of Magistrates Division consists of 30 members who are appointed by the Governor, with the advice and consent of the Senate, for four-year terms, with a maximum of three terms. The magistrates, located in nine hearing sites throughout the State, hear disputed cases at the trial level and issue formal written orders or opinions with findings of fact and conclusions of law for each resolution.

8. The Funds Administration Division administers special funds* provided for in the Act. The funds consist of the Second Injury Fund; the Silicosis, Dust Disease, and Logging Industry Compensation Fund; the Self-Insurers’ Security Fund; the Uninsured Employers’ Security Fund (ended on the sunset date, June 1, 2000); and the Workers’ Compensation Fund - Multiple Trust Funds. The funds are managed by a Board of Trustees, which is composed of the director of the Bureau (who is a permanent trustee), an insurance industry representative, and a self-insured employer representative appointed by the Governor, with the advice and consent of the Senate, for four-year terms.

* See glossary at end of report for definition.
In fiscal year 1999-2000, the Bureau expended approximately $12.3 million for general operations. As of September 30, 2000, the Bureau had 147 classified and 1 unclassified full-time employees.
Audit Objectives, Scope, and Methodology
and Agency Responses and Prior Follow-Up

Audit Objectives
Our performance and financial audit of the Bureau of Workers' Disability Compensation, Department of Consumer and Industry Services, had the following objectives:

1. To assess the effectiveness and efficiency of the Bureau's administration of the Workers' Disability Compensation Act of 1969.

2. To assess and report on the Bureau’s compliance with certain provisions of laws and regulations, noncompliance with which could have a direct and material effect on the financial statements, and on its internal control over financial reporting, based on our audit of the financial statements.

3. To audit the financial statements of the Second Injury Fund; the Silicosis, Dust Disease, and Logging Industry Compensation Fund; the Self-Insurers' Security Fund; the Uninsured Employers' Security Fund; and the Workers' Disability Compensation - Multiple Trust Funds as of and for the fiscal years ended September 30, 2000 and September 30, 1999.

Audit Scope
Our audit scope was to examine the program and other records of the Bureau of Workers' Disability Compensation. Also, our audit scope was to examine the financial records for the period October 1, 1998 through September 30, 2000. Our audit was conducted in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in Government Auditing Standards issued by the Comptroller General of the United States and, accordingly, included such tests of the records and such other auditing procedures as we considered necessary in the circumstances.

Audit Methodology
Our audit procedures, conducted from November 2000 through May 2001, included examination of the Bureau's records and activities primarily for the period January 1, 1999 through May 31, 2001.
We conducted a preliminary review of the Bureau's operations to formulate a basis for defining the audit objectives and scope. Our review included interviewing Bureau personnel, analyzing available data and statistics, reviewing reference materials, and obtaining an understanding of the Bureau's internal control and operational activities.

We assessed whether the Bureau appropriately evaluated its program effectiveness and efficiency through the establishment of a continuous quality improvement process. We also assessed whether the Bureau had established effective methods to educate those involved in the workers' disability compensation process, such as employers, employees, and insurance carriers, and whether the Bureau had established efficient methods to obtain required information from those parties.

We examined the Bureau's methods for ensuring that workers' disability compensation payments to injured employees were timely and accurate and in accordance with the Act. Also, we reviewed the maintenance of the Bureau's current and historical claims/case and employer records system.

We analyzed the effectiveness of the Bureau's procedures for ensuring that all eligible employers had complied with the requirements of the Act by maintaining the required workers' disability compensation insurance coverage, either through a policy of insurance or through approved self-insurance authority. Also, we evaluated the Bureau's process for approving employers for self-insurance to determine if the Bureau ensured that the employers had the financial ability to meet future payment of benefits in a timely manner.

We reviewed the Bureau's handling of contested cases, through either the informal mediation process or the formal hearings process, and its management of the related caseloads. Also, we evaluated whether the Bureau was effective and efficient in informing employers and employees of the Act's provisions regarding vocational rehabilitation to determine if employees who could benefit from such services were receiving them in a timely manner.

Agency Responses and Prior Audit Follow-Up
Our audit report contains 7 findings and 8 corresponding recommendations. The Bureau's preliminary response indicated that it agreed with 7 recommendations and agreed in part with 1 recommendation.
The agency preliminary response that follows each recommendation in our report was taken from the agency's written comments and oral discussion subsequent to our audit fieldwork. Section 18.1462 of the *Michigan Compiled Laws* and Department of Management and Budget Administrative Guide procedure 1280.02 require the Department of Consumer and Industry Services to develop a formal response to our audit findings and recommendations within 60 days after release of the audit report.

The Bureau complied with 5 of the 8 prior audit recommendations included within the scope of our current audit. Two of the prior audit recommendations were repeated and one was rewritten for inclusion in this report.
COMMENTS, FINDINGS, RECOMMENDATIONS,
AND AGENCY PRELIMINARY RESPONSES

EFFECTIVENESS AND EFFICIENCY

COMMENT
Audit Objective: To assess the effectiveness and efficiency of the Bureau of Workers' Disability Compensation's administration of the Workers' Disability Compensation Act of 1969.

Conclusion: We concluded that the Bureau was generally effective and efficient in its administration of the Act. However, our assessment disclosed reportable conditions in the areas of the continuous quality improvement (CQI) process, insurance coverage, automated data collection, allocation of annual fund assessments, and the penalty process.

Noteworthy Accomplishments: The Bureau's web site was rated as one of the three best workers' disability compensation web sites in the nation, as reported in the March/April 2001 issue of the Workers' Compensation Policy Review. The web sites of all 50 states and the District of Columbia were rated on 15 criteria, such as the workers' compensation law, publications, and statistics and other important features, including the availability of forms and contact information. The Bureau's web site also provides users with helpful interactive features, including a benefit calculation program that enables users to calculate weekly workers' disability compensation payments payable on general disability claims and a search function to determine current insurance coverage information for employers in Michigan. This recognition is consistent with the Governor's efforts to provide information to consumers on a 24-hour basis and to promote the use of web technology.

In 1999, the Bureau made available to all system participants a toll-free telephone number to address any questions and provide information relating to workers' disability compensation in the State. The Bureau has published the toll-free number in various pamphlets and mailings, in its annual reports, and on its web site.
**FINDING**

1. **CQI Process**

   The Bureau could improve its CQI process by regularly obtaining customer feedback for use in evaluating its effectiveness in administering the Workers' Disability Compensation Act of 1969.

   A CQI process can be useful in monitoring and enhancing program performance. A CQI process should include: performance indicators* for measuring outputs* and outcomes*; performance standards* that describe the desired level of outputs and outcomes; a management information system to accurately gather output and outcome data; a comparison of the data with desired outputs and outcomes; a reporting of the comparison results to management; and proposals of program modifications to improve effectiveness.

   We reviewed the Bureau's CQI process and determined that it included most of the components of an effective CQI process, including performance indicators, performance standards, and a management information system. However, the Bureau's CQI process did not include obtaining performance data in the form of customer feedback and using the data to consider changes to further improve its effectiveness. The Bureau serves an extensive number of customers, including employees, employers, insurance carriers, and health care providers. Also, considering the complexity of the Act, the Bureau's process of evaluating and improving its effectiveness is critical.

   We determined that only one of the Bureau's eight divisions performed a formal customer survey. However, this survey, which was conducted in 1998, was somewhat limited because it focused on only one aspect of the division's responsibilities. The results of the survey, which indicated that the division was effective in providing the specified service, provided good information for the division, including some suggestions for improvement.

   During fiscal year 1999-2000, the Bureau considered customer surveys in two other divisions; however, the surveys were never developed or performed. An internal program performance measures report indicated that the Bureau's Board of Magistrates Division was to develop a customer survey by January 1, 2001 and survey customers of its operations monthly through July 1, 2001. Also, the

* See glossary at end of report for definition.
Bureau's Mediation Task Force suggested that surveys of users of the mediation process be performed for use in obtaining customer feedback to measure mediator performance.

The Bureau could obtain customer information or feedback through formal written surveys or informal methods. The Bureau's web site is quite extensive and could be utilized to solicit customer information or feedback. The Bureau could obtain information on its general operations or could focus the solicitation for feedback on specified areas of its operations.

**Recommendation**

We recommend that the Bureau improve its CQI process by regularly obtaining customer feedback for use in evaluating its effectiveness in administering the Act.

**Agency Preliminary Response**

The Bureau agreed in part and responded that its position is that it is adequately assessing the needs of its customers on an ongoing basis. The Bureau also indicated that while individual customer feedback may be the norm in other areas of the Department of Consumer and Industry Services, the Bureau receives sufficient information from the various groups that are a part of the workers' disability compensation community and evaluates this information for possible improvement in the Bureau's overall effectiveness for its customers. These sources include, but are not limited to, the Director's Advisory Committee, Health Care Services Advisory Committee, Workers' Compensation Section Council of the State Bar of Michigan, Michigan Self-Insurers' Association, Mediation Task Force, Vocational Rehabilitation Blue Ribbon Committee, and Funds Administration Review Committee, along with various contacts with special interest groups involved in the Bureau's automated Workers' Compensation System (WORCS).

The Bureau informed us that, under the direction of its director, it has also formed committees to address specific concerns within the Workers' Compensation System. Committees have met and issued reports regarding mediation, funds administration, and vocational rehabilitation. The Bureau is currently reviewing this information for possible changes toward improving its effectiveness in each of these areas.
FINDING

2. Insurance Coverage

The Bureau should expand its efforts to ensure that employers have the required workers’ disability compensation insurance coverage.

The Act (Section 418.611 of the Michigan Compiled Laws) requires all employers that are not excluded by the workers’ compensation laws to either be self-insured or be covered by an insurance carrier for workers’ disability compensation.

Bureau efforts to ensure that employers had the required insurance coverage were limited to following up:

a. Complaints made against employers.

b. Claims filed with the Bureau when there was no record of insurance coverage.

c. Insurance termination notices received from insurance carriers to determine if new coverage had been obtained.

The Bureau did not use records of other State agencies to help detect employers who did not have the required workers’ disability compensation insurance coverage.

We reported on this condition in our prior two audit reports. In the prior audit report (issued in November 1995), the Bureau responded that it would evaluate the feasibility of matching information via electronic exchange with other agencies to identify employers that may be operating in Michigan without the required workers' disability compensation insurance coverage. Since that time, the Bureau had determined that an electronic exchange of employer records would be most feasible and effective with the State’s Unemployment Agency. The two agencies have been coordinating their efforts but have not yet developed a program that would allow for the electronic exchange.

Bureau staff informed us that from June 1, 1997 to June 1, 2000 there had been 1,869 employee claims filed against the Uninsured Employers’ Security Fund that was maintained by the Funds Administration Division. Benefit payments totaling over $5.1 million were paid to approximately 300 of the claimants. The Fund paid
benefits to employees who were unable to receive benefits from their employer because the employer failed to secure the payment of compensation as required under the Act.

Without identifying all employers required to carry workers' disability compensation insurance, the Bureau cannot fully enforce Section 418.611 of the *Michigan Compiled Laws* and ensure that employees will be compensated in the event of a job-related injury.

**RECOMMENDATION**

WE AGAIN RECOMMEND THAT THE BUREAU EXPAND ITS EFFORTS TO ENSURE THAT EMPLOYERS HAVE THE REQUIRED WORKERS' DISABILITY COMPENSATION INSURANCE COVERAGE.

**AGENCY PRELIMINARY RESPONSE**

The Bureau agreed and responded that it has been working with the Unemployment Agency to develop a process to obtain data and match it against the Bureau's system. A preliminary meeting was held with Bureau staff and Unemployment Agency staff where a decision was made regarding the feasibility of this project. Data elements have been identified that are needed to perform the match and have been communicated to the Unemployment Agency. The Bureau is proceeding forward to develop the necessary computer programming to achieve this goal.

The Bureau informed us that it has also met with the Michigan Liquor Control Commission (MLCC) to develop a process to match MLCC's data against the Bureau's system. Bureau and MLCC staff have met and are in the process of reconciling information and are considering developing a comparison system.

**FINDING**

3. **Automated Data Collection**

The Bureau could more efficiently process insurance and claims data by fully utilizing available computer technology.

During 2000, the Bureau received over 597,000 completed forms from insurance carriers, self-insured employers, third party administrators, employers, injured
workers, attorneys, and health care providers containing information related to insurance coverage, injuries, and benefit payments. Bureau employees manually keyed this information into the Bureau's computer system. Wages of the employees performing these key entry duties were in excess of $425,000 annually.

Bureau management informed us that, during the last five years, it has been working toward the implementation of an electronic data interchange (EDI). EDI would allow insurance and claims data from insurance carriers, self-insured employers, and third party administrators to be transmitted electronically to the Bureau. EDI would improve the accuracy of information, as the risk of mistakes during the key entry of this information would be eliminated. EDI would also be more efficient because the Bureau has estimated that it could eliminate approximately 86% of the current manual processing of forms.

Current legislation requires insurance carriers, self-insured employers, and third party administrators to submit insurance data to both the Compensation Advisory Organization of Michigan (CAOM) and the Bureau. The Bureau is seeking amendatory legislation that would allow it to submit the data only to CAOM, which would then submit the data to the Bureau in electronic format.

We reported a similar finding in our prior audit report. In its response, the Bureau agreed with our recommendation and stated that it would assess the computer resources and related time frames needed to implement the electronic collection of insurance data.

**RECOMMENDATION**

WE AGAIN RECOMMEND THAT THE BUREAU MORE EFFICIENTLY PROCESS INSURANCE AND CLAIMS DATA BY FULLY UTILIZING AVAILABLE COMPUTER TECHNOLOGY.

**AGENCY PRELIMINARY RESPONSE**

The Bureau agreed and responded that it has begun implementation of a three-phase approach toward automating insurance and claims data.

**Phase I** will focus on cleaning up the Bureau’s current computer database. The Bureau of Technology Services, Department of Consumer and Industry Services, is currently working with Bureau staff to develop a program to clean up the carrier file.
Once completed, the Bureau will send each carrier a listing of workers’ disability compensation insurance policy records for the purpose of verifying status. Policies determined not to be open will be sent a closing termination notice.

**Phase II** of the project will be to work toward the passage of (currently pending) legislation designed to legalize EDI of the Bureau's insurance and claims records. The legislation would also allow for a designated outside agency to be the collector of workers' disability compensation policy information. The designated agency would be required to provide the Bureau with data in a manner fully compliant with the Act.

**Phase III** will be enhancing the Bureau's system to accept EDI and to coordinate information exchange between the agency collecting insurance data and the Bureau.

**FINDING**

4. **Allocation of Annual Fund Assessments**
   The Bureau had not established adequate procedures to ensure the reliability of workers' disability compensation benefit payments recorded on WORCS. As a result, the Bureau could not ensure that annual fund assessments were accurately allocated to insurance companies and self-insured employers.

   The Act (Section 418.551 of the *Michigan Compiled Laws*) requires the Bureau director, as trustee of the special funds, to levy annual assessments against each individual insurance company and self-insured employer to fund the Second Injury Fund (SIF); the Silicosis, Dust Disease, and Logging Industry Compensation Fund (SDDLICF); and the Self-Insurers’ Security Fund (SISF). The Bureau's Funds Administration Division calculates the total assessment needed for each fund based on the fund's previous year's disbursements and its year-end balance. The Act then requires the Bureau to allocate these assessments to each insurance company and self-insured employer based on the proportionate amount of workers' disability compensation benefit payments made by each individual insurance company and self-insured employer in the prior year.

   The Bureau established WORCS to serve as its database for information related to workers' disability compensation in the State, including employer records,
insurance coverage information, claims filed, and the related workers’ disability compensation benefits paid by each individual insurance company and self-insured employer. *Michigan Administrative Code* R 408.31(6) requires insurance companies and self-insured employers to notify the Bureau when employees begin receiving workers’ disability compensation benefits and also when those benefits are terminated. The Bureau updates the WORCS database by processing a series of forms submitted by the insurance companies and self-insured employers.

The Bureau informed us that the insurance companies and self-insured employers generally report when workers’ disability compensation benefit payments are initiated but often do not report when these payments are terminated. As a result, the Bureau believes that the total employee workers’ disability compensation benefit payments recorded on WORCS is inaccurate. In order to have a more accurate basis for allocating the annual assessments, the Funds Administration Division developed a separate process of gathering this information directly from insurance companies and self-insured employers. However, the Division could not document or demonstrate that this separate process resulted in an accurate allocation basis.

We compared workers’ disability compensation benefit payment amounts as recorded in WORCS to the amounts reported to the Funds Administration Division for calendar year 2000 and noted a difference of approximately $95.4 million. However, it should be noted that the usefulness of this comparison is limited because the Division was unable to document the accuracy of any of the amounts:

| Workers' Disability Compensation Benefit Payments | | |
|-----------------------------------------------|-----------------------------------------------|
| WORCS                                         | Funds Administration                          | Difference |
| Insurance Companies                           | $566,912,298                                  | $495,979,623            |
| Self-Insured Employers                        | $502,448,548                                  | $477,973,664            |
| Totals                                        | $1,069,360,846                                 | $973,953,287            |

To illustrate how an insurance company’s or a self-insured employer’s proportionate share of the total assessment could differ, depending on whether the calculation was based on workers’ disability compensation benefit payments as recorded in WORCS or the amount reported separately to the Funds Administration Division, we judgmentally selected four of the larger insurance
companies and self-insured employers and compared the amounts of the annual assessment using both sources of payment information:

<table>
<thead>
<tr>
<th>Fund</th>
<th>WORCS</th>
<th>Funds Administration</th>
<th>Difference</th>
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<tbody>
<tr>
<td>Insurance Company 1</td>
<td>$1,593,661</td>
<td>$1,382,015</td>
<td>$211,646</td>
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<tr>
<td>Insurance Company 2</td>
<td>$1,710,954</td>
<td>$1,530,961</td>
<td>$179,993</td>
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<tr>
<td>Self-Insured Employer 1</td>
<td>$54,374</td>
<td>$43,758</td>
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<tr>
<td>Self-Insured Employer 2</td>
<td>$538,522</td>
<td>$599,754</td>
<td>$(61,232)</td>
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</table>

During calendar year 2000, the Bureau performed a limited reconciliation process for 18 of the larger insurance companies and self-insured employers. The Bureau's objective was to obtain the necessary documentation to update the WORCS database and help ensure that workers' disability compensation benefit payment amounts were accurate. The Bureau determined that its limited reconciliation process was beneficial and that it resulted in the processing of over 3,400 forms that updated the information recorded in WORCS.

As of March 31, 2001, there were 303 insurance companies writing workers' disability compensation insurance for 210,891 employers in the State and 8,325 employers with workers' disability compensation coverage through self-insurance.

**RECOMMENDATION**

We recommend that the Bureau establish adequate procedures to ensure the reliability of workers' disability compensation benefit payments recorded on WORCS.

**AGENCY PRELIMINARY RESPONSE**

The Bureau agreed and responded that it plans to allocate staff to modify existing procedures for the purpose of ensuring adequate reconciliation of benefit payment data received from insurance companies and self-insured employers.

**FINDING**

5. **Penalty Process**

The Bureau should establish a formal process for assessing penalties against employers with lapses in insurance coverage to help ensure that penalties are assessed in accordance with the Act and that the process is properly documented.
The Act (Section 418.611 of the *Michigan Compiled Laws*) requires all employers subject to the Act to secure workers’ disability compensation coverage either through a policy of insurance or through approved self-insurance. The Act authorizes the Bureau to penalize an employer up to $1,000 per day for each day the employer fails to secure the required workers’ disability compensation insurance.

Prior to November 1999, if the Bureau determined that an employer was not in compliance with Section 418.611, it would require the employer to obtain insurance coverage and did not assess any penalties against the employer. However, the Bureau determined that this practice was not effective in ensuring employer compliance with the Act. As a result, in November 1999, the Bureau initiated an informal process of assessing penalties against employers that were determined to have lapses in their workers’ disability compensation coverage. The Bureau informed us that since implementing this informal process, it has improved its effectiveness.

In its informal penalty process, the Bureau will pursue a penalty if the employer has at least a 30-day lapse in coverage, five or more employees, and a payroll of greater than $100,000. The penalty pursued by the Bureau will range from two times the amount the employer saved in insurance premiums during the lapse period, if the employer cooperates with the Bureau, to four times, if the employer is uncooperative, resulting in the need for the Bureau to pursue court action against the employer. During calendar year 2000, the Bureau collected penalties in 105 cases totaling $220,500.

We randomly selected 33 employer files from May 1999 through December 2000 and noted 5 cases in which the Bureau determined that the employer had a lapse in insurance coverage and the employer met the Bureau’s criteria for follow-up. Our review of these 5 cases disclosed:

a. In 1 file (20%), the Bureau did not penalize the employer for the lapsed insurance coverage and did not document the reasons why a penalty was not assessed.

b. In 2 files (40%), the Bureau penalized the employer for the lapsed insurance coverage but did not retain complete documentation of the penalty process,
including all correspondence between the Bureau and the employer, and the calculation and collection of penalty amounts.

A formal process could further improve the Bureau's effectiveness in ensuring employer compliance with the Act. Also, it would help ensure that the Bureau is consistent in assessing penalties and documenting the penalty process.

**Recommendation**

We recommend that the Bureau establish a formal process for assessing penalties against employers with lapses in insurance coverage to help ensure that penalties are assessed in accordance with the Act and that the process is properly documented.

**Agency Preliminary Response**

The Bureau agreed and responded that it has revised its administrative procedure to negotiate penalty fees with employers who have had a lapse in insurance coverage. This procedure was created to simplify the statutory process that was extremely burdensome and time-consuming for both the employer and the Bureau. The current administrative procedure was developed to expedite the resolution with the employer. It penalizes the employer for lapses in insurance coverage and also ensures that the employer understands the necessity of maintaining a workers' disability compensation policy.

The Bureau also responded that over the past two years, it has been working to develop a procedure and formula to issue and calculate fines against employers. The (informal) procedure and formula have undergone several changes, but have been utilized and applied consistently by every staff member involved in the process. They have now been refined to the point where they will be documented as a formal procedure.

The Bureau also agreed that as part of the process, all files should be consistently documented. Each file should clearly indicate if a penalty is due, how the penalty is computed, and when the penalty is paid. If a determination is made that a penalty is not due, then the file should also be documented with the rationale for no penalty being levied.
COMMENT
Audit Objective: To assess and report on the Bureau's compliance with certain provisions of laws and regulations, noncompliance with which could have a direct and material effect on the financial statements, and on its internal control over financial reporting, based on our audit of the financial statements.

Conclusion: Our assessment of compliance did not disclose any instances of noncompliance that could have a direct and material effect on the financial statements. Also, our assessment of internal control over financial reporting did not disclose any material weaknesses. However, we identified reportable conditions related to cash receipts and revenue processing and information systems security.

FINDING
6. Cash Receipts and Revenue Processing

The Bureau needs to improve its controls over cash receipts. Also, the Bureau should establish procedures to ensure that the approval of revenue transactions is properly documented.

The Bureau's Funds Administration Division is responsible for the administration of the special funds provided for in the Act. The Division processed cash received by mail totaling approximately $18.9 million and $28.8 million during fiscal years 1999-2000 and 1998-99, respectively. The majority of cash receipts processed by the Division are the special funds' assessments, which are levied against insurance carriers and self-insured employers.

Our review of the Funds Administration Division's controls over cash receipts and processing of revenue disclosed:

a. The Division had only one employee open the mail and did not record cash received on a cash receipts log. The Division informed us that the individual check amounts received through the mail for the 2001 assessments ranged from under $100 to as much as $8 million.
Department of Management and Budget Administrative Guide procedure 1270.02 requires that mail be opened by a minimum of two employees and that cash received by mail be recorded on a cash log prepared by the mail openers. A log should include the date each cash receipt is received, the type received (cash, check, warrant, etc.), the amount received, the mail openers' initials, and the initials of the employee who received the cash for deposit.

b. The Division did not require the documentation of supervisory approval of cash receipt (revenue) transactions entered into the State's accounting system. The Division informed us that the supervisor should compare the revenue transactions to the amounts received after the transactions have been entered by an employee into the system, but the supervisor was not required to document approval of the transactions.

We reviewed a random sample of 86 revenue transactions, totaling approximately $13.7 million, processed by the Division during fiscal years 1998-99 and 1999-2000. The Division had not documented its supervisory approval for any of the 86 transactions.

**Recommendations**

We recommend that the Bureau improve its controls over cash receipts.

We also recommend that the Bureau establish procedures to ensure that the approval of revenue transactions is properly documented.

**Agency Preliminary Response**

The Bureau agreed and responded that procedures are being established and the following measures have been taken.

A cash receipts log has been developed. Also, a tape will now be run on both the cash receipts (check/warrant) for the day and the sums entered on the log for reconciliation.

Due to the decline in the number of claims filed against the Bureau’s Funds Administration Division, staff have been significantly reduced. This has made it difficult for management to assign two individuals to mail opening duties on a year-round basis. However, the Bureau agrees to assign two individuals to these duties.
during the peak receipting period (the date assessments are called to 90 days thereafter, when the assessments are due).

A bookkeeper batch report is being added to the functionality of the Cash Receipt System. This report will be generated by the bookkeepers upon closure of a batch and will be presented to the accountant or backup for deposit. The report will detail all transactions for a specific batch and will include the payee, account coding block, and amount of revenue received. The report will be used as documentation to support the deposit and will be signed off by the person performing the deposit function on the Cash Receipt System.

**FINDING**

7. **Information Systems Security**

   The Bureau had not established control procedures to prevent unauthorized access and use of data processed through automated information systems.

The Bureau's Funds Administration Division maintains the Funds Administration Information System (FAIS), which is used by the Division to process all workers' disability compensation payments for the funds administered by the Division. The Division is also responsible for processing all accounting transactions relating to the funds through the Michigan Administrative Information Network (MAIN).

Effective information systems access controls establish accountability and include granting access to data files only to the extent necessary for individuals to perform their assigned duties.

Our review of the Funds Administration Division's information systems security disclosed:

a. The Division did not disable the system access capabilities of employees who had terminated employment or individuals who had completed their consulting work with the Division.

Of the 35 individuals who had active FAIS access capabilities as of February 2001, 4 were no longer working for the Division, including 1 individual who had not worked for the Division since October 1998.
Allowing departed individuals to access the Division's information system could result in unauthorized access to and use of system resources, such as confidential information or payment processes.

b. The Division did not ensure that employees were assigned the appropriate system access and user capabilities.

Our review of the 13 MAIN users disclosed that 2 had user capabilities beyond what was necessary for their job functions. In addition, 1 FAIS user was assigned administrator capabilities, even though her job responsibilities did not require such extensive capabilities.

Limiting access would help reduce the risk of processing unauthorized transactions and prevent unauthorized access to and use of the information systems.

Department of Management and Budget Administrative Guide procedure 1310.02 requires that procedures be established relating to information processing security, including the deletion of system access of departed employees. Also, section 3 - 3 of the MAIN FACS (Financial Administration and Control Systems) Security Manual (replaced in June 2000 by the ADPICS/R*STARS [Advanced Purchasing and Inventory Control System/Relational Standard Accounting and Reporting System] Security Manual) required that employees' job functions correspond with their assigned system access and user capabilities and that agencies continually monitor their users' security status.

**RECOMMENDATION**

We recommend that the Bureau establish control procedures to prevent unauthorized access and use of data processed through automated information systems.

**AGENCY PRELIMINARY RESPONSE**

The Bureau agreed and responded that it has adopted formal procedures addressing this issue.

Access rights to FAIS have been terminated for all individuals who have left the employ of the Funds Administration Division, as well as outside consultants who no
longer require access to the system. Eligible users on the production version of FAIS will be limited to current employees and consultants actively engaged in the development or upgrade of FAIS.

The Bureau also responded that modifications have been made to user access rights under MAIN and FAIS to ensure compatibility with employee job functions.

FINANCIAL ACCOUNTING AND REPORTING

COMMENT

Background: The scope of our audit included four expendable trust funds and one special revenue fund. The expendable trust funds were:

a. Second Injury Fund
Act 317, P.A. 1969, created the Second Injury Fund (SIF) to reimburse insurance carriers and self-insured employers for certain workers' compensation losses. SIF also pays benefits to permanently and totally disabled employees and employees working for more than one employer. SIF also provides benefits for injuries to certain types of handicapped persons. SIF's revenue consists of assessments, calculated under provisions of the Act, which are assessed against insurance carriers and self-insured employers.

b. Silicosis, Dust Disease, and Logging Industry Compensation Fund
Act 317, P.A. 1969, created the Silicosis, Dust Disease, and Logging Industry Compensation Fund (SDDLIC) to reimburse insurance companies and self-insured employers. SDDLIC reimburses payments made for disability or death from silicosis or other dust disease and also reimburses payments made for employees disabled through employment in the logging industry. SDDLIC's revenue includes third party reimbursements and assessments, calculated under provisions of the Act, which are assessed against insurance carriers and self-insured employers.

c. Self-Insurers' Security Fund
Act 317, P.A. 1969, created the Self-Insurers' Security Fund (SISF) to pay benefits to employees of insolvent private self-insured employers. SISF pays employees of a private self-insured employer when the employer is insolvent, the employees have requested payments from SISF's administrator or filed a petition against SISF.
with the Bureau, and the employer is unable to make such payments. SISF's revenue sources include recoveries from bankrupt employers and "excess insurance" carriers and assessments, calculated under provisions of the Act, which are assessed against private self-insured employers.

d. Workers' Disability Compensation - Multiple Trust Funds

The Workers' Disability Compensation - Multiple Trust Funds are court-ordered funds that pay workers' disability compensation benefits on behalf of insolvent private self-insured employers. These benefit payments are due to the employees under the provisions of Act 317, P.A. 1969. If the trust funds are insufficient to pay compensation benefits due under the Act, SISF pays benefits to employees of the insolvent private self-insured employers. The Workers' Disability Compensation - Multiple Trust Funds were composed of 15 entities during the period October 1, 1998 through September 30, 2000.

The special revenue fund included in our scope of audit was the Uninsured Employers' Security Fund (UESF). Act 198, P.A. 1993, created UESF. UESF paid benefits to employees injured on or after June 29, 1990 who were unable to receive benefits from their employer because the employer failed to secure the payment of compensation as required under Section 418.611 of the Michigan Compiled Laws. UESF was funded through receipt of one half of the proceeds of the sale of the Accident Fund by the State of Michigan. UESF ended on the sunset date, June 1, 2000, but retained sufficient equity in common cash at September 30, 2000 to cover the remaining UESF liabilities.

**Audit Objective:** To audit the financial statements of the Second Injury Fund; the Silicosis, Dust Disease, and Logging Industry Compensation Fund; the Self-Insurers' Security Fund; the Uninsured Employers' Security Fund; and the Workers' Disability Compensation - Multiple Trust Funds as of and for the fiscal years ended September 30, 2000 and September 30, 1999.

**Conclusion:** We expressed an unqualified opinion on the Bureau's financial statements.
Independent Auditor's Report on Compliance and on Internal Control Over Financial Reporting

May 31, 2001

Ms. Kathleen M. Wilbur, Director
Department of Consumer and Industry Services
G. Mennen Williams Building
Lansing, Michigan

Dear Ms. Wilbur:

We have audited the financial statements of the Second Injury Fund; the Silicosis, Dust Disease, and Logging Industry Compensation Fund; the Self-Insurers' Security Fund; the Uninsured Employers' Security Fund; and the Workers' Disability Compensation - Multiple Trust Funds, Department of Consumer and Industry Services, as of and for the fiscal years ended September 30, 2000 and September 30, 1999 and have issued our report thereon dated May 31, 2001. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in Government Auditing Standards issued by the Comptroller General of the United States.

Compliance
As part of obtaining reasonable assurance about whether the Funds' financial statements are free of material misstatement, we performed tests of their compliance with certain provisions of laws, regulations, contracts, and grants, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance that are required to be reported under Government Auditing Standards.

Internal Control Over Financial Reporting
In planning and performing our audit, we considered the Funds' internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. However, we noted certain matters involving the internal control over financial reporting and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention
relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect the Funds' ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial statements. Reportable conditions are described in Findings 6 and 7.

A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, we believe that neither of the reportable conditions identified in the previous paragraph is a material weakness.

This report is intended solely for the information and use of the State's management and the Legislature and is not intended to be and should not be used by anyone other than these specified parties. However, this report is a matter of public record and its distribution is not limited.

AUDITOR GENERAL
Independent Auditor's Report on
the Financial Statements

May 31, 2001

Ms. Kathleen M. Wilbur, Director
Department of Consumer and Industry Services
G. Mennen Williams Building
Lansing, Michigan

Dear Ms. Wilbur:

We have audited the accompanying balance sheets of the Second Injury Fund; the Silicosis, Dust Disease, and Logging Industry Compensation Fund; the Self-Insurers' Security Fund; the Uninsured Employers' Security Fund; and the Workers' Disability Compensation - Multiple Trust Funds, Department of Consumer and Industry Services, as of September 30, 2000 and September 30, 1999 and the related statements of revenues, expenditures, and changes in fund balance for the fiscal years then ended. These financial statements are the responsibility of the Bureau of Workers' Disability Compensation's management and the Department's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in Government Auditing Standards issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and the significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

As described in Note 1b, the accompanying financial statements present only the Second Injury Fund; the Silicosis, Dust Disease, and Logging Industry Compensation Fund; the Self-Insurers' Security Fund; the Uninsured Employers' Security Fund; and the Workers' Disability Compensation - Multiple Trust Funds and are not intended to present fairly the financial position and results of operations of the State of Michigan or its expendable trust or special revenue funds.
In our opinion, the financial statements referred to in the first paragraph present fairly, in all material respects, the financial position of the Second Injury Fund; the Silicosis, Dust Disease, and Logging Industry Compensation Fund; the Self-Insurers' Security Fund; the Uninsured Employers' Security Fund; and the Workers' Disability Compensation - Multiple Trust Funds as of September 30, 2000 and September 30, 1999 and the results of their operations for the fiscal years then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with Government Auditing Standards, we have also issued a report dated May 31, 2001 on our tests of the Second Injury Fund's; the Silicosis, Dust Disease, and Logging Industry Compensation Fund's; the Self-Insurers' Security Fund's; the Uninsured Employers' Security Fund's; and the Workers' Disability Compensation - Multiple Trust Funds' compliance with certain provisions of laws, regulations, contracts and grants and on our consideration of their internal control over financial reporting. That report is an integral part of an audit performed in accordance with Government Auditing Standards and should be read in conjunction with this report in considering the results of our audit.

Auditor General
### ASSETS

**Current Assets:**
- Equity in Common Cash (Note 2)  
  - 2000: $16,218,783
  - 1999: $28,254,514
- Accounts receivable from assessments  
  - 2000: $5,825,106
  - 1999: $8,857,449
- Prepaid expenditures  
  - 2000: 25,117
  - 1999: 32,334
  - 2000: 2,698
  - 1999: 1,213

**Total Assets**  
- 2000: $16,243,899
- 1999: $28,395,301
- 2000: $5,827,805
- 1999: $8,906,419

### LIABILITIES AND FUND BALANCES

**Current Liabilities:**
- Warrants outstanding  
  - 2000: $963,992
  - 1999: $463,953
  - 2000: $180,516
  - 1999: $154,251
- Accounts payable and other liabilities  
  - 2000: 2,786,679
  - 1999: 2,858,187
  - 2000: 1,173,303
  - 1999: 1,436,348
- Amounts due to other funds  
  - 2000: 7,282
  - 1999: 3,077
  - 2000: 2,037
  - 1999: 4,791
- Deferred revenue  
  - 2000: 3,466,544
  - 1999: 4,602,843
  - 2000: 1,991,544

**Total Liabilities**  
- 2000: $7,224,496
- 1999: $7,928,060
- 2000: $1,355,856
- 1999: $3,586,934

**Fund Balances**  
- 2000: $9,019,403
- 1999: $20,467,241
- 2000: $4,471,949
- 1999: $5,319,485

**Total Liabilities and Fund Balances**  
- 2000: $16,243,899
- 1999: $28,395,301
- 2000: $5,827,805
- 1999: $8,906,419

The accompanying notes are an integral part of the financial statements.
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<th>Workers' Disability Compensation - Multiple Trust Funds</th>
<th>Self-Insurers' Security Fund</th>
<th>Uninsured Employers' Security Fund</th>
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<td>$ 1,289,158 $ 98 $</td>
<td>$ 112,838 209,003</td>
<td>944,371 1,197,743</td>
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<tr>
<td>2,002,677 1,280,481</td>
<td>130,067 5,996</td>
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<td>$ 3,534,740 $ 1,495,577</td>
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<td>$ 944,371 1,197,743</td>
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<td>$ 1,544,406 $ 685,407</td>
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<tr>
<td>$ 882,048 $ 786,549 $</td>
<td>$ 375,376 161,248</td>
<td>2002,677 1,280,481</td>
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<tr>
<td>1,835,132 1,598,276</td>
<td>24,410 112,370 (849)</td>
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<td>576,804 441,288</td>
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<td>21,605 4,607</td>
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<td>$ 3,693,770 $ 3,098,883</td>
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<td>$ 2,600,046 $ 678,749</td>
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<td>$ 887,075 $ 330,200</td>
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<tr>
<td>$ (159,030) $ (1,603,306)</td>
<td>$ 1,518,079</td>
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<tr>
<td>$ (3,979) $ (5,129) $</td>
<td>$ (6,515) (7,884) $ (1,300)</td>
<td>$ (1,300) (1,300)</td>
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<tr>
<td>$ (163,009) $ (1,608,435)</td>
<td>$ (1,662,190) $ 511,109</td>
<td>$ 656,031 $ 353,907</td>
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<tr>
<td>1,518,079 2,361,620</td>
<td>219,333 764,894</td>
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</tr>
<tr>
<td></td>
<td>(21,654,854)</td>
<td>(219,333) (764,894)</td>
</tr>
<tr>
<td></td>
<td>$ 1,574,404 $ 1,518,079 $ 0</td>
<td>$ 23,317,044 $ 2,158,444 $ 1,721,747</td>
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</table>
Note 1 Significant Accounting Policies

a. Reporting Entity
The accompanying financial statements report the financial position and results of operations of the Second Injury Fund (SIF); the Silicosis, Dust Disease, and Logging Industry Compensation Fund (SDDLICF); the Self-Insurers' Security Fund (SISF); the Uninsured Employers' Security Fund (UESF); and the Workers' Disability Compensation - Multiple Trust Funds (WDC-MTF), Department of Consumer and Industry Services, as of and for the fiscal years ended September 30, 2000 and September 30, 1999. These funds are a part of the State of Michigan's reporting entity. SIF, SDDLICF, SISF, and WDC-MTF are reported as expendable trust funds and UESF is reported as a special revenue fund in the State of Michigan Comprehensive Annual Financial Report (SOMCAFR).

The notes accompanying these financial statements relate directly to SIF, SDDLICF, SISF, UESF, and WDC-MTF. The SOMCAFR provides more extensive general disclosures regarding the State’s Summary of Significant Accounting Policies, Budgeting and Budgetary Control, Treasurer's Common Cash, and Pension Benefits and Other Postemployment Benefits.

b. Basis of Accounting and Presentation
The financial statements contained in this report are prepared on the modified accrual basis of accounting. The modified accrual basis of accounting, which emphasizes the measurement of current financial resource flows, is explained in more detail in the SOMCAFR.

The accompanying financial statements present only SIF, SDDLICF, SISF, UESF, and WDC-MTF. Accordingly, they are not intended to present fairly the financial position and results of operations of the State of Michigan or its expendable trust or special revenue funds.

Under Act 198, P.A. 1993, UESF succeeded the former Workplace Health and Safety Fund. UESF provided workers' compensation benefits to
employees injured on or after June 29, 1990 through June 30, 1996 (and for related claims administration), in cases in which their employers failed to provide coverage for them. UESF managed and provided payment on these claims until UESF’s sunset date, June 1, 2000. Except for managing a few remaining claims, all oversight of UESF, by the Funds Administration Division, ended on the sunset date. UESF recorded an equity transfer of $21.7 million to the General Fund in December 2000, applicable to fiscal year 1999-2000. This transfer was made to close UESF in accordance with Act 357, P.A. 1996. Sufficient equity in common cash was retained to cover the remaining liabilities.

c. Future Changes in Accounting Standards
The Governmental Accounting Standards Board has issued Statement No. 34, Basic Financial Statements - and Management’s Discussion and Analysis - for State and Local Governments.

This new accounting and reporting standard will affect primarily the Workers' Disability Compensation - Multiple Trust Funds, which will be reclassified from expendable trust funds to private purpose fiduciary funds. The financial statements for fiduciary funds under this new standard will be a statement of fiduciary net assets and a statement of net changes in fiduciary net assets. The basis of accounting for these funds will also change under this new standard from the modified accrual basis to the accrual basis. These changes are explained in more detail in the SOMCAFR.

This new accounting and reporting standard will also result in the reclassification of the Second Injury Fund; the Silicosis, Dust Disease, and Logging Industry Compensation Fund; and the Self-Insurer's Security Fund from expendable trust funds to special revenue funds. However, these funds will continue to be accounted for on the modified accrual basis of accounting.

The State plans to implement this new standard for the fiscal year ending September 30, 2001.
Note 2  Investments
All available funds are invested in the State Treasurer's Common Cash. Interest is paid quarterly on the average amount invested in the previous quarter. There are no withdrawal restrictions on funds invested in the State Treasurer's Common Cash.

Note 3  Differences From the State's General Accounting System
Certain differences exist between these financial statements and the State's general accounting system. These differences result from the need to reclassify certain items to provide additional detail and to make corrections to certain items determined to be misstated. The corrections were generally limited to the individual revenue and expenditure line items of SIF, SDDLICF, SISF, UESF, and WDC-MTF and did not result in any changes in total revenues and total expenditures reported in the SOMCAFR.

Note 4  Contingencies and Commitments - Second Injury Fund
Synopsis of events: During June 1985, the Funds Administration Division's Board of Trustees reduced the benefit rates of all claimants injured before July 1, 1968 to reflect application of Section 357, the "age 65 reduction," of the Workers' Disability Compensation Act. The Trustees acted after the Court of Appeals held Section 357 applicable. Some affected claimants filed both individual and class action lawsuits, challenging SIF's right to apply Section 357 reductions. On February 2, 1993, the Court of Appeals departed from its earlier decision, held that SIF could not apply Section 357 reductions, and further ruled that minimum weekly rates apply in cases with injury dates before July 1, 1968. In applying the Court's 1993 opinion, SIF distinguished between claimants who filed an application for hearing and those who had not filed, with respect to the retroactivity of payment. Some claimants, as individuals and as a class, challenged SIF's decision not to adjust all payments retroactively. The individual lawsuits culminated in a Supreme Court ruling on March 8, 2000 holding the Court of Appeals 1993 opinion to be retroactively applicable to all individuals who did not file applications. The class action lawsuit, in which SIF contests the trial court's certification of the case as a class action, is pending before the Court of Appeals. SIF's total estimated liability as of March 8, 2000, including interest, exceeded $15 million. A more detailed history of events follows.
During June 1985, the "total and permanent disability" provision of SIF reduced the differential benefits then being paid to totally and permanently disabled claimants who had been injured prior to July 1, 1968. SIF based the reduction on Section 418.357(1) of the *Michigan Compiled Laws*, also known as the "age 65 reduction," as construed by the Court of Appeals' final order in *Lopez v Flower Basket Nursery* 122 Mich App 680 (1982), lv den 422 Mich 911 (1985). Prior to *Lopez*, the courts had held that the age 65 reduction did not apply in cases with dates of injury before July 1, 1968.

Section 418.357(1) of the *Michigan Compiled Laws* mandates an annual 5% reduction of the weekly workers' compensation benefits payable to claimants for each year after age 65, but not to less than 50% of the weekly benefit payable. After the *Lopez* decision became final, the Trustees directed SIF to apply the age 65 reduction to differential benefits on all eligible claims, regardless of the date of injury and established a process to recover benefits overpaid during the prior year ("one-year back" rule, Section 418.833(2) of the *Michigan Compiled Laws*).

Some claimants filed individual petitions with the Bureau of Workers' Disability Compensation contesting the reduction of their differential benefits. Also, the first of three class action suits was filed on behalf of the affected claimants during December 1985. The Supreme Court dismissed this case during February 1988.

The Court of Appeals reviewed the assertion of one claimant in *Florence Wozniak v GMC, Fisher Body Division (Wozniak I)*, 198 Mich App 172 (1993). In *Wozniak I*, the Court of Appeals (1) ruled that the *Lopez* decision had been decided erroneously; (2) held that the "age 65 reduction" was inapplicable to employees injured prior to September 1, 1965; (3) held that Section 418.351(2) of the *Michigan Compiled Laws* establishes the minimum weekly benefit payable to totally and permanently disabled employees injured prior to July 1, 1968; and, (4) remanded the case to the Workers' Compensation Appellate Commission for further proceedings.

Following *Wozniak I*, SIF paid the accrued benefits due the claimant in that case from April 18, 1987, one year prior to the date she filed her petition (application of Section 418.833(1) of the *Michigan Compiled Laws*, the "one-year back" rule). Also, SIF retroactively paid benefits due, with application of
the one-year back rule, to the other claimants who had filed individual petitions with the Bureau of Workers’ Disability Compensation contesting SIF’s reduction of their differential benefits.

The Trustees directed SIF to increase differential benefit payments, effective February 2, 1993, the date of the Wozniak I decision, to those claimants who had not filed petitions challenging SIF’s reduction of their differential benefits pursuant to the age 65 reduction. SIF paid those benefits without any retroactive adjustment. Some individual claimants who had not disputed SIF’s original benefit reductions filed petitions with the Bureau of Workers’ Disability Compensation contesting SIF’s decision to pay the additional benefits mandated by Wozniak I on a prospective basis.

In Wozniak I, on remand by the Court of Appeals, the Workers’ Compensation Appellate Commission held that the one-year back rule limited SIF’s retroactive adjustment of payments. Wozniak appealed to the Court of Appeals, seeking full retroactive application of increases in her differential benefits. In Wozniak v General Motors Corp (aft rem), 212 Mich App 40 (1995) (Wozniak II), the Court of Appeals reversed and held that the one-year back rule did not apply. The Court of Appeals specifically declined to address the retroactivity issue as to those claimants who had not objected to SIF’s reduction of their differential benefits.

Following Wozniak II, SIF retroactively adjusted the differential benefit payments of all claimants who filed petitions prior to Wozniak I. Those claimants were paid in full. SIF did not change its benefit payments to those who had not challenged the benefit reduction.

The second class action suit, Gonek, et al v Wheatley, et al, was filed in Wayne County Circuit Court on behalf of the affected claimants during January 1994. Plaintiffs sought a writ of mandamus against SIF, requesting full retroactive application of the Court of Appeals’ opinion in Wozniak I. The Wayne County Circuit Court transferred this case to the Court of Claims, which later dismissed the suit for lack of jurisdiction. The appellate courts subsequently denied leave to appeal.
The third class action suit, *Gonek, et al v Wheatley, et al*, was filed in Wayne County Circuit Court during October 1995. The plaintiffs in that case sought relief identical to that which had been requested in the second class action suit.

The first case heard by the Court of Appeals involving a claimant who filed a petition challenging the age 65 reduction after *Wozniak I* was *Lincoln v General Motors Corp* 231 Mich App 268 (1998). In *Lincoln*, the Court of Appeals held that the rule of *Wozniak II* was fully retroactive as to all individuals who had not previously filed applications. SIF appealed to the Supreme Court.

After the Court of Appeals issued its opinion in *Lincoln*, the Wayne County Circuit Court granted class action certification and a writ of mandamus in *Gonek*. Also, the Wayne County Circuit Court entered an interim order indicating, after notice and hearing, that the Court would determine what portion, if any, of the attorney fee SIF shall pay. SIF appealed the Wayne County Circuit Court's orders to the Court of Appeals, where the case is pending. In light of the Supreme Court's opinion in *Lincoln*, the issue before the Court of Appeals in *Gonek* is whether the Wayne County Circuit Court erred in certifying the case as a class action.

As of September 30, 1999, the Supreme Court had granted leave to appeal in *Lincoln*. There was also the appeal pending before the Court of Appeals in *Gonek*.

On March 8, 2000, the Supreme Court affirmed the Court of Appeals' decision in *Lincoln*. When the Supreme Court decided *Lincoln*, approximately $15 million was due from SIF. Since this decision became final, SIF has worked with plaintiffs' counsel in an effort to pay the benefits not in dispute to the claimants or to their estates as quickly as possible.

As of September 30, 2000, *Gonek* continued to pend before the Court of Appeals. Between the date of the *Lincoln* decision, March 8, 2000, and September 30, 2000, SIF paid claims totaling approximately $7 million. There were a significant number of claims in which payment had not been made because supporting documentation had not been provided. As of September 30, 2000, SIF estimated that the remaining liability for unpaid claims, which has not been recorded in SIF's financial statements, totaled approximately $8 million to $9 million. It is doubtful that *Gonek* will become
final during fiscal year 2000-01. SIF's policy is not to process payments until supporting documentation has been provided. From October 1, 2000 through May 31, 2001, SIF expended an additional $2.8 million on remaining claims and there are 27 claims totaling approximately $1.2 million still awaiting payment.
<table>
<thead>
<tr>
<th><strong>Glossary of Acronyms and Terms</strong></th>
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<tbody>
<tr>
<td><strong>Act</strong></td>
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<tr>
<td><strong>CAOM</strong></td>
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<td><strong>continuous quality improvement (CQI)</strong></td>
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<td>Term</td>
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<td>internal control</td>
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<td>performance indicators</td>
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<td>performance standards</td>
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reportable condition  A matter coming to the auditor's attention that should be communicated because, in the auditor's judgment, it represents (1) either an opportunity for improvement or a significant deficiency in management's ability to operate a program in an effective and efficient manner or (2) a significant deficiency in the design or operation of internal control that could adversely affect the entity's ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial schedules and/or financial statements.

SDDLICF  Silicosis, Dust Disease, and Logging Industry Compensation Fund.

SIF  Second Injury Fund.

SISF  Self-Insurers' Security Fund.


special funds  The funds administered by the Funds Administration Division, as provided for in the Act. The funds consist of the Second Injury Fund; the Silicosis, Dust Disease, and Logging Industry Compensation Fund; the Self-Insurers' Security Fund; the Uninsured Employers' Security Fund (sunsetted June 1, 2000); and the Workers' Compensation Fund - Multiple Trust Funds.

UESF  Uninsured Employers' Security Fund.

unqualified opinion  An auditor’s opinion in which the auditor states, without reservation, that the financial schedules and/or financial statements are fairly presented in conformity with the disclosed basis of accounting or are fairly presented in relation to the primary financial schedules and/or statements.
<table>
<thead>
<tr>
<th>Abbreviation</th>
<th>Description</th>
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<tr>
<td>WDC-MTF</td>
<td>Workers' Disability Compensation - Multiple Trust Funds.</td>
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<tr>
<td>WORCS</td>
<td>The Bureau's automated Workers' Compensation System.</td>
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