

Office of the Auditor General
Performance Audit Report

**Workers' Compensation and
Long Term Disability Programs
for State of Michigan Employees**
Office of the State Employer
Department of Technology, Management, and Budget

November 2015

State of Michigan Auditor General
Doug A. Ringler, CPA, CIA

The auditor general shall conduct post audits of financial transactions and accounts of the state and of all branches, departments, offices, boards, commissions, agencies, authorities and institutions of the state established by this constitution or by law, and performance post audits thereof.

Article IV, Section 53 of the Michigan Constitution



OAG

Office of the Auditor General

Report Summary

Performance Audit

Workers' Compensation and Long Term Disability Programs for State of Michigan Employees
Office of the State Employer, Department of Technology, Management, and Budget

Report Number:
071-0141-14

Released:
November 2015

The Office of the State Employer (OSE) is responsible for managing and monitoring the workers' compensation and long term disability (LTD) benefit programs for State of Michigan employees. OSE has contracted the day-to-day management and claims processing for these programs to a third party administrator (TPA). Workers' compensation benefits include payments for loss of wages, medical care, vocational rehabilitation, scheduled awards for loss of body parts, and death benefits for surviving family members. LTD claimants are eligible for lost wage benefits equal to 66.67% of the employee's monthly earnings. For fiscal year 2014, the TPA invoiced OSE \$26.6 million in workers' compensation and \$36.6 million in LTD claims and fees.

Audit Objective			Conclusion
Objective #1: To assess OSE's efforts to monitor the TPA's processing and managing of workers' compensation and LTD claims for State of Michigan employees.			Moderately effective
Findings Related to This Audit Objective	Material Condition	Reportable Condition	Agency Preliminary Response
For OSE to gain assurance that its TPA processed claims in accordance with contractual provisions, OSE should obtain a service organization controls type 2 (SOC 2) report. The SOC 2 report would evaluate the design and operating effectiveness of the TPA's controls relevant to processing workers' compensation and LTD claims (Finding #1).		X	Agrees

Audit Objective			Conclusion
Objective #2: To assess OSE's efforts to ensure that calculated workers' compensation and LTD benefits accurately reflect income earned from other sources.			Moderately effective
Findings Related to This Audit Objective	Material Condition	Reportable Condition	Agency Preliminary Response
OSE did not obtain wage data from the Unemployment Insurance Agency to determine if employees receiving loss of wage benefits had unreported income from other Michigan employers or collected unemployment benefits. Income from other sources could impact the amount of lost wage benefits paid to an employee. For fiscal year 2014, the TPA invoiced OSE \$46.7 million for lost wages (Finding #2).		X	Agrees

A copy of the full report can be
obtained by calling 517.334.8050
or by visiting our Web site at:
www.audgen.michigan.gov

Office of the Auditor General
201 N. Washington Square, Sixth Floor
Lansing, Michigan 48913

Doug A. Ringler, CPA, CIA
Auditor General

Laura J. Hirst, CPA
Deputy Auditor General



OAG

Office of the Auditor General

201 N. Washington Square, Sixth Floor • Lansing, Michigan 48913 • Phone: (517) 334-8050 • www.audgen.michigan.gov

Doug A. Ringler, CPA, CIA
Auditor General

November 25, 2015

Mr. David B. Behen, Director
Department of Technology, Management, and Budget
Lewis Cass Building
Lansing, Michigan
and

Ms. Marie L. Waalkes, Director
Office of the State Employer
Department of Technology, Management, and Budget
Capitol Commons Center
Lansing, Michigan

Dear Mr. Behen and Ms. Waalkes:

I am pleased to provide this performance audit report on the Workers' Compensation and Long Term Disability Programs for State of Michigan Employees, Office of the State Employer, Department of Technology, Management, and Budget.

We organize our findings and observations by audit objective. Your agency provided preliminary responses to the recommendations at the end of our fieldwork. The *Michigan Compiled Laws* and administrative procedures require an audited agency to develop a plan to comply with the recommendations and submit it within 60 days of the date above to the Office of Internal Audit Services, State Budget Office. Within 30 days of receipt, the Office of Internal Audit Services is required to review the plan and either accept the plan as final or contact the agency to take additional steps to finalize the plan.

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

Sincerely,

Doug Ringler
Auditor General

TABLE OF CONTENTS

WORKERS' COMPENSATION AND LONG TERM DISABILITY PROGRAMS FOR STATE OF MICHIGAN EMPLOYEES

	<u>Page</u>
Report Summary	1
Report Letter	3
Audit Objectives, Conclusions, Findings, and Observations	
Monitoring the TPA's Processing and Managing of Workers' Compensation and LTD Claims	8
Findings:	
1. Enhanced review of TPA activities needed.	9
Ensuring That Calculated Disability Benefits Accurately Reflect Income Earned From Other Sources	10
Findings:	
2. Improvements needed to verify the existence of other income.	12
Supplemental Information	
Exhibit #1 - Workers' Compensation Claims Filed	14
Exhibit #2 - LTD Claims Filed	15
Exhibit #3 - Workers' Compensation Amounts Invoiced by the TPA	16
Exhibit #4 - LTD Amounts Invoiced by the TPA	17
Description	18
Audit Scope, Methodology, and Other Information	20
Glossary of Abbreviations and Terms	24

AUDIT OBJECTIVES, CONCLUSIONS, FINDINGS, AND OBSERVATIONS

MONITORING THE TPA'S PROCESSING AND MANAGING OF WORKERS' COMPENSATION AND LTD CLAIMS

BACKGROUND

The Office of the State Employer (OSE) is responsible for actively managing the State's workers' compensation* and long term disability* (LTD) benefit programs. OSE provides technical assistance and support to the State departments' goal* to reduce work-related injuries and illnesses. OSE has contracted the day-to-day management and claims processing for these programs to a third party administrator* (TPA). OSE provides support to State departments through periodic update meetings, consultation on individual issues, and assistance with implementing return-to-work and transitional employment programs.

AUDIT OBJECTIVE

To assess OSE's efforts to monitor the TPA's processing and managing of workers' compensation and LTD claims for State of Michigan employees.

CONCLUSION

Moderately effective.

FACTORS IMPACTING CONCLUSION

- Our analysis did not identify any material variances between information maintained within the TPA's system and supporting documentation.
- We did not identify delays in the TPA's claims processing or a large volume of complaints about the TPA's performance.
- Reportable condition* related to an independent review of the TPA's internal control* was not completed to ensure that it was functioning as designed.

* See glossary at end of report for definition.

FINDING #1

Enhanced review of TPA activities is needed to ensure that internal control functions as designed.

OSE's TPA invoiced \$63.2 million in workers' compensation and LTD claims and fees during fiscal year 2014 (see Exhibits #3 and #4).

OSE should obtain a service organization controls type 2 (SOC 2) report* of its TPA. Obtaining a SOC 2 report would provide OSE management with independent assurance that the TPA was processing claims in accordance with program rules and the terms of its contracts.

OSE contracted the operation of the State's workers' compensation program and LTD program to a TPA, which subjects OSE to additional risks because the programs are operated under the processes established by the TPA. To measure and mitigate these risks, OSE needs information about the TPA's processes. During our audit period, OSE's oversight of the TPA's internal control was based on information provided by the TPA.

An effective method to assess internal control and risks associated with contracted services is to obtain an independent analysis of the design and operating effectiveness* relevant to the processes that the TPA uses. This analysis, referred to as a SOC 2 report, is completed by an independent certified public accountant and provides a validation of the TPA's description of the processes' internal control and reports on the suitability of the design and operating effectiveness of those processes. The SOC 2 report should analyze the security, availability, integrity, confidentiality, and privacy of the TPA's system and claims processing. The current contracts do not require the TPA to obtain a SOC 2 report.

RECOMMENDATION

We recommend that OSE obtain a SOC 2 report of its TPA to help ensure that the TPA processes claims in accordance with program rules and the terms of its contracts.

AGENCY PRELIMINARY RESPONSE

OSE provided us with the following response:

OSE agrees with this recommendation and will research the options for obtaining the SOC 2 report.

* See glossary at end of report for definition.

ENSURING THAT CALCULATED DISABILITY BENEFITS ACCURATELY REFLECT INCOME EARNED FROM OTHER SOURCES

BACKGROUND

Benefits for injured employees on workers' compensation include payments for the loss of wages, medical care, vocational rehabilitation, scheduled awards for loss of body parts, and death benefits for surviving family members. Workers' compensation lost wage benefits are generally 80% of the employee's highest average 39 weeks of wages within the last 52 weeks. Injured State employees are also entitled to a supplemental payment from their department if their weekly workers' compensation benefit is less than two-thirds of their regular gross wages.

LTD lost wage benefits equate to 66.67% of the employee's monthly earnings. The first LTD benefit is payable the later of 14 days from the employee's disability or upon the employee exhausting his/her sick leave balance.

Workers' compensation law and the State of Michigan Long Term Disability Income Protection Plan require any income from sources other than the State of Michigan, including unemployment benefits, be considered when determining a claimant's level of workers' compensation and LTD benefits payments for loss of wages.

AUDIT OBJECTIVE

To assess OSE's efforts to ensure that calculated workers' compensation and LTD benefits accurately reflect income earned from other sources.

CONCLUSION

Moderately effective.

FACTORS IMPACTING CONCLUSION

- Income from other sources was self-reported by claimants with limited follow-up by the TPA.
- The TPA requested employees filing claims to report all income from other sources when the workers' compensation or LTD claim was opened and then annually thereafter.
- The TPA completed insurance claim searches to identify payments to claimants from other insurance providers.
- Reportable condition related to the TPA not completing an analysis to ensure that employees who received loss of wage payments accurately reported income from other sources and did not collect unemployment benefits.

- OSE did not pursue an agreement with the Unemployment Insurance Agency (UIA), Department of Licensing and Regulatory Affairs (LARA), to access wage and unemployment benefit information.
- Our sample of workers' compensation and LTD claims identified one employee who failed to report income earned from other sources while receiving loss of wage benefits for an LTD claim.

FINDING #2

Improvements are needed to determine if employees receiving loss of wage benefits accurately report income from other sources.

OSE paid employees \$46.7 million in loss of wage benefits during fiscal year 2014 with no independent verification of the accuracy of other income reporting to the TPA.

OSE did not obtain wage data from UIA to determine if employees receiving loss of wage benefits had unreported income from other Michigan employers or collected unemployment benefits. As a result, OSE could be overpaying employees for loss of wage benefits.

Workers' compensation law requires that any additional weekly claimant wages be considered when determining the level of workers' compensation benefits for loss of wages. Workers' compensation law also requires benefit reductions of 100% of the amount of unemployment benefits paid to the injured employee under the Michigan Employment Security Act. The State of Michigan Long Term Disability Income Protection Plan states that the amount of an LTD benefit otherwise payable under the Plan is reduced by the amount of other income. The Plan identified nine sources of income that should be considered other income when calculating loss of wage payments, including unemployment compensation. As part of the TPA's claims process to receive workers' compensation and LTD benefits, the employee must report income received from employment outside of State government (other income). Other income may impact the amount of the loss of wage payments. Although TPA staff annually ask individuals receiving workers' compensation or LTD loss of wage payments about the existence of other income, it is not independently verified.

For the period October 1, 2011 through September 30, 2014, we matched identifying information for the 7,598 individuals who received workers' compensation and 8,533 individuals who received LTD lost wage benefits to wage and unemployment data from UIA. We sorted the matched population to identify the 504 individuals who had income greater than \$20,000 in one fiscal year and received both loss of wage and unemployment benefits anytime during the period. We selected a random sample of 70 individuals and a judgmental selection of 5 individuals from the 504. Our review disclosed:

- None of the 40 individuals receiving workers' compensation claims had unreported other income or received unemployment benefits while receiving loss of wage benefits.
- One (2.9%) of the 35 individuals receiving LTD benefits had unreported other income while receiving loss of wage benefits. We noted that between October 1, 2011 and September 30, 2014, this individual had unreported other income of \$59,001. We expanded our review of this individual to include all unreported other income for the period January 1, 2002 through March 31, 2015. Unreported other income for that period was \$135,807. The TPA calculated overpayments for this individual at \$101,584 for the period January 1, 2002 through March 31, 2015.

During fiscal year 2014, OSE paid \$15.8 million of workers' compensation (see Exhibit #3) and \$30.9 million of LTD (see Exhibit #4) loss of wage payments.

RECOMMENDATION

We recommend that OSE obtain wage data from UIA to determine if employees receiving loss of wage benefits had unreported income from other Michigan employers or collected unemployment benefits.

**AGENCY
PRELIMINARY
RESPONSE**

OSE provided us with the following response:

OSE agrees with this recommendation and is in the process of entering into a data sharing agreement with UIA.

SUPPLEMENTAL INFORMATION

UNAUDITED
Exhibit #1

WORKERS' COMPENSATION AND LONG TERM DISABILITY PROGRAMS FOR STATE OF MICHIGAN EMPLOYEES

Office of the State Employer (OSE)
Department of Technology, Management, and Budget (DTMB)

Workers' Compensation Claims Filed Fiscal Years 2012 Through 2014

	Claims Filed by Fiscal Year			Total
	2012	2013	2014	
Michigan Department of Agriculture and Rural Development	12	16	15	43
Department of Attorney General	9	6	4	19
Department of Civil Rights	0	0	0	0
Michigan Civil Service Commission	8	13	12	33
Department of Community Health*	416	416	527	1,359
Department of Corrections	1,415	1,067	979	3,461
DTMB - Management and Budget	28	29	30	87
DTMB - Technology	14	11	13	38
Michigan Department of Education	7	9	12	28
Department of Environmental Quality	18	20	22	60
Executive Office of the Governor	0	0	1	1
Department of Insurance and Financial Services	2	6	3	11
Department of Human Services*	366	402	384	1,152
Judicial Branch	2	2	2	6
Department of Licensing and Regulatory Affairs	81	78	88	247
Mackinac Island State Park Commission	12	4	4	20
Department of Military and Veterans Affairs	77	73	93	243
Department of Natural Resources	282	228	250	760
Department of State	35	40	44	119
Michigan State Housing Development Authority	7	7	5	19
Michigan Department of State Police	394	480	505	1,379
Michigan Strategic Fund	2	5	5	12
Michigan Department of Transportation	223	203	153	579
Department of Treasury	46	30	33	109
Total	<u>3,456</u>	<u>3,145</u>	<u>3,184</u>	<u>9,785</u>

* In April 2015, after our performance audit, Executive Order No. 2015-4 created the Michigan Department of Health and Human Services by combining the Department of Community Health and the Department of Human Services.

Source: TPA report provided to OSE.

WORKERS' COMPENSATION AND LONG TERM DISABILITY PROGRAMS
FOR STATE OF MICHIGAN EMPLOYEES

Office of the State Employer (OSE)
Department of Technology, Management, and Budget (DTMB)

LTD Claims Filed
Fiscal Years 2012 Through 2014

	Claims Filed by Fiscal Year			Total
	2012	2013	2014	
Michigan Department of Agriculture and Rural Development	13	10	12	35
Department of Attorney General	17	27	13	57
Department of Civil Rights	6	8	10	24
Michigan Civil Service Commission	21	22	26	69
Department of Community Health*	315	332	345	992
Department of Corrections	1,098	1,049	1,028	3,175
DTMB - Management and Budget	52	49	22	123
DTMB - Technology	27	26	43	96
Michigan Department of Education	18	8	19	45
Department of Environmental Quality	28	34	24	86
Executive Office of the Governor	1	2	1	4
Department of Insurance and Financial Services	0	0	13	13
Department of Human Services*	889	1,010	1,128	3,027
Judicial Branch	7	10	10	27
Legislative Branch	8	3	3	14
Department of Licensing and Regulatory Affairs	248	205	177	630
Department of Military and Veterans Affairs	92	81	50	223
Department of Natural Resources	30	27	32	89
Department of State	78	100	79	257
Michigan State Housing Development Authority	11	13	12	36
Michigan Department of State Police	44	58	54	156
Michigan Department of Transportation	81	86	74	241
Department of Treasury	98	113	120	331
Total	<u>3,182</u>	<u>3,273</u>	<u>3,295</u>	<u>9,750</u>

* In April 2015, after our performance audit, Executive Order No. 2015-4 created the Michigan Department of Health and Human Services by combining the Department of Community Health and the Department of Human Services.

Source: TPA report provided to OSE.

WORKERS' COMPENSATION AND LONG TERM DISABILITY PROGRAMS
FOR STATE OF MICHIGAN EMPLOYEES

Office of the State Employer
Department of Technology, Management, and Budget

Workers' Compensation Amounts Invoiced by the TPA
Fiscal Year 2014

	October 1 Through December 31	January 1 Through March 31	April 1 Through June 30	July 1 Through September 30	Total
Indemnity wages	\$3,936,753	\$4,056,849	\$4,028,989	\$3,790,508	\$15,813,099
Medical expenses	2,127,457	1,690,548	2,117,343	2,146,205	8,081,553
Administrative fee	96,003	96,003	96,003	96,003	384,014
New claim fee	190,200	281,080	229,460	211,685	912,425
Maintenance fees	57,550	53,575	54,250	52,025	217,400
Cost containment expenses	24,635	22,590	28,624	31,051	106,900
PPO access fee (1)	29,600	24,518	24,583	31,796	110,497
Defense attorney fees	61,954	44,631	75,158	73,624	255,367
Defense attorney expenses	3,595	2,831	6,832	3,872	17,131
Court reporter transcripts	5,328	4,164	5,409	5,441	20,341
Settlement expenses	2,400	2,700	2,600	3,100	10,800
Vocational rehab	86,280	24,497	11,668	8,415	130,859
Private investigator	38,332	14,173	17,736	17,001	87,242
Medical report copies	3,857	1,972	3,601	2,055	11,485
Medical utilization review	8,722	6,486	10,887	11,912	38,007
Medical mgt. cost containment	15,078	14,758	13,040	17,802	60,678
IME causation (2)	13,200	9,388	0	0	22,587
IME litigated (2)	25,544	31,472	41,689	26,009	124,714
IME mileage (2)	4,881	2,995	5,202	5,967	19,045
Transportation mileage	3,418	2,272	2,861	1,852	10,403
Expert witness	26,671	33,995	24,824	16,975	102,465
Medicare settlement expense	16,250	4,700	2,750	7,150	30,850
Other expenses	2,103	0	3,150	379	5,631
Total	\$6,779,812	\$6,426,197	\$6,806,659	\$6,560,827	\$26,573,495

- (1) PPO = preferred provider organization
(2) IME = independent medical examination

Source: The TPA's monthly workers' compensation invoices and the TPA's monthly workers' compensation claims billed statements.

WORKERS' COMPENSATION AND LONG TERM DISABILITY PROGRAMS
FOR STATE OF MICHIGAN EMPLOYEES

Office of the State Employer
Department of Technology, Management, and Budget

LTD Amounts Invoiced by the TPA
Fiscal Year 2014

	<u>October 1 Through December 31</u>	<u>January 1 Through March 31</u>	<u>April 1 Through June 30</u>	<u>July 1 Through September 30</u>	<u>Total</u>
Claimant payment	\$7,496,652	\$7,071,252	\$7,783,099	\$8,506,091	\$30,857,094
Taxes	459,845	408,443	484,770	546,861	1,899,919
At risk fees	0	32,400	27,570	16,100	76,070
New claim fee	276,390	292,670	315,240	334,850	1,219,150
Maintenance fees	272,510	257,584	251,362	272,544	1,054,000
Check fees	113,805	106,980	114,750	120,540	456,075
Monthly flat fees	253,895	250,538	248,917	246,130	999,480
Total	<u>\$8,873,097</u>	<u>\$8,419,867</u>	<u>\$9,225,708</u>	<u>\$10,043,116</u>	<u>\$36,561,788</u>

Source: The TPA's weekly and monthly LTD invoices and the TPA's monthly check register.

DESCRIPTION

OSE's mission* is to promote the effectiveness and productivity of Michigan State government by developing and administering progressive State policies in employment relations and employee health management and service programs. To support this mission, OSE actively manages the State's workers' compensation and LTD benefit programs by providing technical assistance and supporting the State departments' goal to reduce work-related injuries and illnesses.

The Worker's Disability Compensation Act of 1969, as amended (Sections 418.101 - 418.941 of the *Michigan Compiled Laws*), established workers' compensation benefits for employees who suffer temporary or permanent disabilities from work-related injuries and disabilities. The State self-insures for workers' compensation benefits. OSE charges each department for claims incurred plus administrative fees. For fiscal year 2014, 3,184 workers' compensation claims were filed with the TPA (see Exhibit #1).

State employees may elect to participate in the State's LTD program. The costs of the program are shared by the State and LTD participants. Premium costs are calculated based on the four plan levels and the employee's gross wages. Enrollment in the plan levels is determined by the amount of sick leave hours that the employee has previously accumulated and the employee's plan level at the time of the injury. The plans were as follows for fiscal year 2014:

Plan Level	Employee Accumulated Sick Leave Hours	Employee Contributions per \$100 of Gross Wages	
		UAW*	Non-UAW
I	Never accumulated 184	\$2.13	\$2.08
IIA	More than 184 but less than 528	\$0.58	\$0.53
IIB	528 or more	\$0.00	\$0.00
IIC	Enrolled in Plan II but sick leave less than 184	\$1.79	\$1.74

The contributions made by the State and State employees are deposited into the State Sponsored Group Insurance Fund and are used to pay claims and TPA and State administrative fees.

A claimant requesting benefits must submit one or more written medical statements and medical release forms to the TPA within 90 calendar days following the date the claimant would be entitled to receive LTD payments. The medical statement must describe the nature and extent of any disability and

* See glossary at end of report for definition.

explain why the disabling condition prevents the claimant from performing the duties of the claimant's usual occupation or, after 24 months of total disability, any reasonable occupation. For fiscal year 2014, 3,295 LTD claims were filed with the TPA (see Exhibit #2).

OSE offers a transitional employment program to assist employees, with duty and non-duty injuries and illnesses, to successfully return to their regular job assignment. OSE's transitional employment program evaluates the various tasks that are identified by the department and agency supervisors that an injured employee may complete. These tasks are then grouped into a series of assignments that can be matched to an individual's particular temporary disabling condition. The employee is then assigned, for up to 6 months, to perform these alternative tasks until he/she is able to return to his/her regular position. During fiscal 2014, 32 employees participated in the program with an average duration of transitional employment assignments of 240 hours. OSE estimated that this resulted in an increase of nearly 7,500 hours of productivity.

AUDIT SCOPE, METHODOLOGY, AND OTHER INFORMATION

AUDIT SCOPE

To examine OSE's and its TPA's records related to workers' compensation and LTD activities. We conducted this performance audit* in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

PERIOD

Our audit procedures, which included a preliminary survey, audit fieldwork, report preparation, analysis of agency responses, and quality assurance, generally covered the period October 1, 2011 through September 30, 2014.

METHODOLOGY

We conducted a preliminary survey to obtain an understanding of how a workers' compensation or LTD claim is initiated, reviewed, monitored, reimbursed, and closed in order to establish our audit objectives and methodology. As part of our preliminary survey, we:

- Interviewed OSE staff to gain an understanding of how a claim is processed from its creation to its closure.
- Reviewed applicable laws, regulations, contracts, policies, and procedures to identify compliance standards for processing claims.
- Met with the TPA to obtain an understanding of how it processes and electronically stores disability claims.
- Interviewed OSE staff to identify the efforts they pursue to administer the TPA contracts.
- Interviewed four departmental case managers who are responsible for their departments' oversight of workers' compensation and LTD claims.
- Identified and analyzed the controls utilized to process workers' compensation and LTD claims.
- Analyzed OSE's appropriations and workers' compensation and LTD revenues and expenditures for the audit period.

* See glossary at end of report for definition.

OBJECTIVE #1

To assess OSE's efforts to monitor the TPA's processing and managing of workers' compensation and LTD claims for State of Michigan employees.

To accomplish our first objective, we:

- Identified compliance items presented in the workers' compensation and LTD TPA contracts and performed tests to ensure that OSE verified that the TPA met the terms of those contracts.
- Compared identifying information from the TPA claim management system with information from the State's payroll system to ensure that individuals receiving workers' compensation or LTD payments were State employees or authorized contractors.
- Compared the number and type of employees the TPA assigned to the State contract to ensure that they were in compliance with contract language.
- Calculated the number of open claims for fiscal year 2014 that each TPA adjuster was assigned to determine if the TPA maintained caseload levels consistent with the terms of the contracts.
- Reviewed a random sample of 21 individual employee claims of the 3,026 workers' compensation claims that were opened as of September 30, 2014 to ensure that the claim was initiated, reviewed, approved, paid, and monitored in compliance with the terms of the contracts, State statutes, and Michigan Civil Service Commission regulations.
- Reviewed a random sample of 15 individual employee claims of the 46,776 LTD claims that were opened as of June 30, 2014 to ensure that the claim was initiated, reviewed, approved, paid, and monitored in compliance with the terms of the contracts, State statutes, and Michigan Civil Service Commission regulations.
- Reviewed a random sample of 15 individual employee claims of the 8,838 LTD claims that were initiated between October 1, 2011 and June 30, 2014 to ensure that employees did not receive disability management payments before their sick leave was exhausted.
- Reviewed TPA administrative fees invoiced to ensure that the rates charged agreed to contract terms and the number of claims invoiced.
- Reviewed what OSE did with the reports provided by the TPA according to the terms of the workers' compensation and LTD contracts.

OBJECTIVE #2

To assess OSE's efforts to ensure that calculated workers' compensation and LTD benefits accurately reflect income earned from other sources.

To accomplish our second objective, we:

- Reviewed LARA rules and the State of Michigan Long Term Disability Income Protection Plan to determine how income from other sources impacts loss of wage payments.
- Interviewed OSE and TPA staff to determine how they identified income an individual earned from sources outside of State government.
- Compared identifying information from the TPA claim management system with information from the State's UIA for 40 of the 7,598 individuals who received workers' compensation and 35 of the 8,533 individuals who received LTD lost wage benefits between October 1, 2011 and September 30, 2014 to ensure that individuals receiving disability payments properly reported income earned from sources other than State employment to the TPA and were not collecting unemployment benefits.

CONCLUSIONS

We base our conclusions on our audit efforts and the resulting material conditions* and reportable conditions.

When selecting activities or programs for audit, we direct our efforts based on risk and opportunities to improve State government operations. Consequently, we prepare our performance audit reports on an exception basis.

AGENCY RESPONSES

Our audit report contains 2 findings and 2 corresponding recommendations. OSE's preliminary response indicates that it agrees with both recommendations.

The agency preliminary response that follows each recommendation in our report was taken from the agency's written comments and oral discussion at the end of our audit fieldwork. Section 18.1462 of the *Michigan Compiled Laws* and the State of Michigan Financial Management Guide (Part VII, Chapter 4, Section 100) require an audited agency to develop a plan to comply with the recommendations and submit it within 60 days after release of the audit report to the Office of Internal Audit Services, State Budget Office. Within 30 days of receipt, the Office of Internal Audit Services is required to review the plan and either accept the plan as final or contact the agency to take additional steps to finalize the plan.

* See glossary at end of report for definition.

**PRIOR AUDIT
FOLLOW-UP**

We released our prior performance audit of the Workers' Compensation and Long Term Disability Programs, Office of the State Employer, Department of Management and Budget (07-141-04), in October 2005. Within the scope of this audit, we followed up 3 of the 4 prior audit recommendations. OSE complied with all 3 of the prior audit recommendations.

**SUPPLEMENTAL
INFORMATION**

As part of our audit, we prepared supplemental information using unaudited data obtained from OSE (Exhibits #1 through #4). Our audit was not directed toward expressing an opinion on this information.

GLOSSARY OF ABBREVIATIONS AND TERMS

DTMB	Department of Technology, Management, and Budget.
effectiveness	Success in achieving mission and goals.
goal	An intended outcome of a program or an entity to accomplish its mission.
internal control	The plan, policies, methods, and procedures adopted by management to meet its mission, goals, and objectives. Internal control includes the processes for planning, organizing, directing, and controlling program operations. It also includes the systems for measuring, reporting, and monitoring program performance. Internal control services as a defense in safeguarding assets and in preventing and detecting errors; fraud; violations of laws, regulations, and provisions of contracts and grant agreements; or abuse.
LARA	Department of Licensing and Regulatory Affairs.
long term disability (LTD)	A plan that pays a monthly benefit during an employee's period of total disability which renders the employee unable to work at the employee's usual occupation for the first 24 months or at any reasonable occupation after the first 24 months.
material condition	A matter that, in the auditor's judgment, is more severe than a reportable condition and could impair the ability of management to operate a program in an effective and efficient manner and/or could adversely affect the judgment of an interested person concerning the effectiveness and efficiency of the program.
mission	The main purpose of a program or an entity or the reason that the program or the entity was established.
OSE	Office of the State Employer.
performance audit	An audit that provides findings or conclusions based on an evaluation of sufficient, appropriate evidence against criteria. Performance audits provide objective analysis to assist management and those charged with governance and oversight in using the information to improve program performance and operations, reduce costs, facilitate decision making by parties with responsibility to oversee or initiate corrective action, and contribute to public accountability.

reportable condition	A matter that, in the auditor's judgment, is less severe than a material condition and falls within any of the following categories: an opportunity for improvement within the context of the audit objectives; a deficiency in internal control that is significant within the context of the audit objectives; all instances of fraud; illegal acts unless they are inconsequential within the context of the audit objectives; significant violations of provisions of contracts or grant agreements; and significant abuse that has occurred or is likely to have occurred.
service organization controls type 2 (SOC 2) report	A report on controls at a service organization relevant to security, availability, processing integrity, confidentiality, or privacy.
third party administrator (TPA)	An insurance company or other entity separate from the State hired to administer workers' compensation and LTD claims and insurance expenses.
UAW	United Auto Workers.
UIA	Unemployment Insurance Agency.
workers' compensation	A statutorily required insurance to cover job-related accidental injury, disease, or death to covered employees. The insurance provides compensation for lost wages and for medical and legal expenses.

