STATE OF MAINE
121st LEGISLATURE
FIRST REGULAR SESSION

Final Report of the COMMISSION TO REVIEW THE BUDGET PROCESS OF THE WORKERS' COMPENSATION BOARD

February 2004

Members:
Sen. Betheda G. Edmonds, Chair
Rep. William J. Smith, Chair
Sen. Kenneth Blais
Rep. Russell P. Treadwell
John Cooney
Anthony Monfiletto

Staff:
Deborah C. Friedman, Legislative Analyst
Office of Policy & Legal Analysis
Maine Legislature
(207) 287-1670

Table of Contents

Page

Executive Summary i

I. Introduction 1

II. Background 2

III. Commission Conclusions 10

Appendices

A. Authorizing Legislation: Public Law 2003, chapter 425
B. List of Commission Members
C. Budget Process Recommendations from the Berry Dunn McNeil and Parker Report; Workers' Compensation Board Report on Implementation of Recommendations
D. Outline of the Process for Developing the Workers' Compensation Board Budget
E. Example of Cost Center Accounting
F. History of Board Assessments and Expenditures
G. Funding and Assessment Methods in Other States
H. Proposal to Change Assessment Process, submitted by Department of Professional and Financial Regulation Commissioner Robert E. Murray, Jr.
I. Description of the Assessment Calculation for FY 04

Executive Summary

The Commission to Review the Budget Process of the Workers' Compensation Board was created by Public Law 2003, chapter 425, section 3. The Commission, composed of 4 legislators and 2 members of the Workers' Compensation Board, was directed to review the process used by the Board to establish, approve and monitor its budget. The Commission was also specifically directed to review the Board's progress in making changes recommended in recent reports on the siness processes.

Commission members met 4 times between August, 2003 and December 2003, and received informational briefings on how the Board develops its budget, how it assesses insurers and employers to fund Board activities, and how the Legislature and the Bureau of the Budget (Department of Administrative and Financial Services) play roles in reviewing and approving the Board's budget. Workers' Compensation Board staff also described steps taken by the Board in response to recommendations of the 2001 Berry Dunn McNeil and Parker study of Workers' Compensation Board governance.

The Commission did not make any formal findings or recommendations. However, members reached consensus on the following issues.

A. Budget Development within the Workers' Compensation Board

Commission members agree that the Board has taken steps to improve internal and external accountability for its budget by (1) allocating expenses to specific activities, or "cost centers" and (2) by creating performance standards or benchmarks. The Commission urged the Board to continue monitoring costs and developing benchmarks, especially through its revision of the Board's business plan.

Oversight of the budget process and budgeting results by the Legislature is an important part of accountability to the public. The Joint Standing Committee on Labor is directed by statute to review the Board's budget, but has not always done so at the time of the biennial budget request. The Commission urges the Labor Committee to meet that responsibility more rigorously, and urges the Board and its Executive Director to develop a more understandable way to present budget information to the Legislature as well as a way to seek input in development of the budget.

B. Revenue Stream

Although the current method of collecting revenue for Board operations (an assessment of insurers and self-insuring employers and groups) is somewhat unpredictable and generally results in collection of more revenue than anticipated, it appears to members of the Commission that the current law is adequate for the needs of the Board, especially with the availability of the reserve fund to cover cash flow problems.

Other methods of collecting revenue have advantages and disadvantages over the current system. However, no consensus emerged from commission discussion that the current system needed to be changed. The Commissioner of Professional and Financial Regulation urged the Commission to change the assessment process. He submitted proposed legislation to alter the method of assessment, but the proposal was not provided in time for the Commission members to discuss it. That proposal is included in Appendix H without a recommendation from the Commission.

I. Introduction

The Commission to Review the Budget Process of the Workers' Compensation Board was created by Public Law 2003, chapter 425, section 3. The Commission was composed of 6 members – 2 Senators, 2 members of the House of Representatives and 2 members of the Workers' Compensation Board, one representing the Board's labor members and one representing its management members.

The Commission was directed to review the process used by the Workers' Compensation Board to establish, approve and monitor its budget and to determine whether improvements are needed. The Commission was also directed to review the Board's progress on implementing budget-related recommendations resulting from 2 recent studies of Board administration and governance: the 1997 Coopers and Lybrand study[1] and the 2001 Berry, Dunn, McNeil and Parker (BDMP) study.[2]

The Commission met 4 times during the interim between the 1st and 2nd Regular Sessions of the 121st Legislature – August 20, October 6, November 3 and November 17, 2003.

At its first meeting, the Commission received information on the role of the Workers' Compensation Board, the Bureau of the Budget and the Legislature in developing and reviewing the Board's budget. The Commission also heard a presentation from the Workers' Compensation Board staff regarding the progress of the Board in implementing recommendations of the BDMP report.

At its 2nd meeting, Commission members focused on the process used within the Board to predict future expenditures and future revenue from the Board's assessment on insurers and self-insurers, and the process for bringing expenditures in line with projected revenues. The Commission also discussed the Board's use of "performance measures" to increase accountability.

At its 3rd meeting, the Commission looked at how other states fund their workers' compensation administrative agencies, especially at their processes for collecting revenue through assessments. The Commission reviewed the Board's Long Term Business Plan and the Board's progress in meeting the goals of that plan. Commission members discussed the level of Board expenditures and the allocation of Board resources among its various programs.

At their final meeting, Commission members discussed the concept of applying additional benchmarks in the audit program, e.g., examining the frequency with which insurers or employers contest the payment of benefits to an employee. The members also had additional discussions on the allocation of Board resources. Finally, members reviewed a list of issues and summed up their

---

[1] Workers' Compensation Board Business Assessment, prepared by Coopers and Lybrand Consulting (December 1997)

[2] Report of the Workers' Compensation Board Governance Study, performed by Berry Dunn McNeil and Parker under contract to the Department of Administrative and Financial Services pursuant to PL 2001 chapter 49 (December 2001)

conclusions. No formal recommendations or findings were voted upon by the Commission, but a summary of consensus items as well as areas of disagreement is included as Part III of the report.

II. Background

A. Budget Development, Review And Approval -- The Process

The Workers' Compensation Board is an independent board within State Government, funded by a dedicated account known as the "Workers' Compensation Board
3 The Administrative Fund is composed primarily of money collected
through an assessment on workers' compensation insurers and self-insured employers and employer groups. In order to spend money from that dedicated account, the Board must submit a budget and receive permission from the Legislature and the Governor to make expenditures. That permission comes in the form of an "allocation" that is generally included in legislation enacted in the Legislature and signed by the Governor.[3]

The Workers' Compensation Board budget goes through several steps before an allocation request to fund the budget is submitted to the Legislature.

1. Workers' Compensation Board Develops Budget

First, the Board must estimate the amount of funds needed to cover the current level of services and any new programs for the next 2 fiscal years. Approximately 80% of the Board's budget is spent on salaries and benefits for staff. The rest is spent on capital expenses and all other expenses, such as rent, equipment and supplies. Once the total need is calculated, the Board must ensure that it will have sufficient revenue to cover the costs. If anticipated expenditures are likely to exceed anticipated revenue, the Board must review and reduce its budget so that revenues and expenditures match.[4]

2. Bureau of the Budget Reviews; Governor Decision

The Board then submits its proposed budget to the Bureau of the Budget, within the Department of Administrative and Financial Services. As it does with other self-funded agencies (e.g., the Public Utilities Commission), the Bureau of the Budget reviews the Board's proposal primarily for the purpose of ensuring that the expenditure plan can be supported by sufficient revenue. If the Bureau of the Budget concludes that sufficient revenues will be available to meet the budget, the budget is then submitted to the Governor, for review and inclusion in the Governor's biennial budget legislation presented to the Legislature in the beginning of each biennium. Although the Governor has authority to revise the Board's

---

[3] The other way for the Board to obtain an allocation is through the Financial Order process described later in this report.

[4] Appendix D contains a more detailed description of the budget development process for the 2004-05 fiscal biennium, which required moving some of the expenses into a separate bill that contained an increased assessment cap.

budget before including it in his bill[6], the Governor generally submits the proposal as he receives it from the Bureau of the Budget

3. Legislature Reviews and Approves Allocation

The Governor's biennial budget bill is referred to the Joint Standing Committee on Appropriations and Financial Affairs for review. However, since the Board does not receive General Fund dollars, that committee does not generally conduct a public hearing on the proposed allocation to the Board. The Joint Standing Committee on Labor is directed by Title 3, section 522-B to review the Board's budget and make a written recommendation to the Appropriations Committee. In recent years, the Labor Committee has heard budget presentations from the Board on various occasions, but the presentations are not always a regular part of the biennial budget review process.

Once the Legislature approves the Board's allocation, the Board has authority to spend up to the amount of the allocation. Without an allocation, the Board may not spend funds even if the funds are in the Board's hands. Unlike most state agencie legislative allocation is not broken down into specific programs, such as worker advocate, general office administration, etc. It is simply broken down into 3 categories – Personal Services, Capital and All Other. This form of allocation gives the Board flexibility to move staff and funds among programs as needed without having to seek legislative approval. The Board does, however, need approval to move funds among the 3 categories of expenditures.

B. Budget Development, Approval and Monitoring – Issues

Commission members raised a number of concerns about the budgeting process during this interim study, some of which were highlighted in the 2001 Berry Dunn McNeil and Parker (BDMP) report. Those issues included:

- The insufficiency of budget information provided to Board members
- The lack of accountability for expenditures
- The sufficiency of Legislative review of the budget
- The relationship between the Board and the Bureau of the Budget

The BDMP report found that the "fiscal reports reviewed by the Board are not sufficient to enable the Board members to evaluate management or overall fiscal performance[7]." Among other things, the report recommended that Board members increase the level of financial detail they evaluate and that members conduct more frequent reviews of Board finances.

[6] Title 5, section 1666.
[7] BDMP Report, page 16

1. Cost Center Reporting

The Workers Compensation Board staff reported to the Commission that the Board has recently made 2 significant changes in its accounting and financial management, partly in response to the BDMP report. First, the Board now tracks and reviews spending on the basis of 5 "cost centers" (1) Board Central Office and Administration; (2) The Worker Advocate program; (3) Monitoring, Auditing and Enforcement; (4) Dispute Resolution (including costs of the regional offices); and (5) Computer Services. Allocation of staff positions and funding to the various cost centers will improve the Board's understanding of program expenses, trends in spending, and needs within and among programs. The Board allows the Executive Director to move funds around within each cost center, but a shift of funds from one cost center to another would require approval of the Board.

The Board provided examples of cost center reporting to Commission members, and members agreed that the cost center approach improves communication and understanding about expenditures. Appendix E provides an example of cost center budgeting.

2. Performance Measures

The second significant change adopted by the Board was development of "performance measures," to help the Board evaluate the effectiveness and efficiency of programs. Paul Dionne, Executive Director of the Board, explained that he is in the process of developing a new business plan for the Board that will include performance measures or standard operating procedures for each cost center. Commission members expressed approval of the Board's use of performance measures, and some urged the Board to expand the use of objective criteria in evaluating performance of staff and management. Executive Director Dionne provided the Commission with a draft of the 2004 Long-Term Business Plan, which the Board will address at future meetings. Executive Director Dionne was asked to provide legislators with a copy of the final plan.

3. Legislative Review

Legislative review of the Board's budget may be easier in the future. Some members felt that Commission meetings had helped them gain a better understanding of the Board's budgeting and revenue processes. In addition, the use of cost center reporting will provide information in a clearer format and performance measures will provide additional information.

The Commission urged the Board to involve the Legislature's Labor Committee early in the process of developing a budget, and to ensure that Board members representing labor and management are available to answer committee questions. Executive Director Dionne suggested that one way to inform the Labor Committee early in the process might be for the Board to brief the committee in January,

which is the middle of a fiscal year, on Board expenditures to date and to get committee input for future fiscal year spending.

C. Current Law on Funding the Board

The Workers' Compensation Board is a self-funded agency; it is not supported by the state's General Fund. Instead, it is primarily funded by an assessment on workers' compensation insurers and self-insured employers and employer groups. Other sources of revenue consist of investment income,[8] fines,[9] and sales of publications.

1. Calculation of the Assessment[10]

To begin the assessment process for a fiscal year, the Workers' Compensation Board first determines the total amount to be collected by assessment. That number is governed by two factors.

First, the assessment target may not exceed the statutory "cap" set forth in Title 39-A, section 154, subsection 6.[11] This is not quite as straightforward as taking the dollar amount from the statute. The law requires the Board to assess an amount lower than the statutory figure if, in the prior year, assessment collections exceeded the prior year's statutory dollar amount. In some years, the maximum target assessment calculated under the statutory formula is significantly less than the dollar amount set forth in statute.[12] Second, the Board looks at its planned budget, and determines what amount must be collected by assessment after subtracting anticipated revenue from other sources.

Once the aggregate assessment is determined, the Board divides the total between insurers and self-insurers, based on the proportion of disabling cases attributable to each group in the most recently completed calendar year.[13]

The total to be collected from self-insured employers and employer groups is divided among the employers and groups, based on the proportion of aggregate

---

[8] Investment income to the Board has dropped from $339,893 in FY 99 and $352,742 in FY 00 to $155,959 in FY '02

[9] Not all fines go to the Administrative Fund. Most are deposited in the General Fund pursuant to Title 39-A, section 360 (penalties for violation of reporting requirements, willful violations of the Act, fraud or intentional misrepresentation). Most fines for late payment of incapacity benefits go to the injured employee pursuant to section 205 and 324. Fines for employers operating without mandatory workers' compensation insurance go to the Employment Rehabilitation Fund under section 324.

[10] Further detail about the calculation of the assessment for FY 2004 can be found in the Appendix

[11] That cap was set at $6 million for FY96, and was increased to $6.6 million by Public Law 1997, c. 486; to $6.735 by PL 1999, c. 359; to $6.860 million by PL 2001, c. 692; and to $8.39 in FY 04, $8.565m in FY 05, and $8.525m after FY05 by PL 2003, c. 425. The cap was increased temporarily by $300,000 by PL 2001, c. 393. Some of the increases were attributable to additional programs. For example, PL 1997, c. 486 created the Worker Advocate and MAE programs and increased the cap by $600,000.

[12] For example, for fiscal year '01, the statutory dollar limit was $6.735 million, but after reduction for the prior year's excess collection, the assessment was limited to $5 million

[13] Title 39-A, section 154, subsection 5

benefits paid by each employer or group. Self-insurer assessments must be sent to the Board by June 1 to fund the fiscal year beginning July 1.

Insurers are not given a specific dollar amount to remit to the Board.[14] They are directed to add to each premium bill sent to insureds a specific percentage of premium for payment to the Board. The surcharge is separately stated on the premium invoice. The Board must estimate what percentage, when applied to premiums, will result in the dollar amount targeted to be collected from insurers. The Bureau of Insurance assists the Board is estimating premium levels. The Board estimates the percentage by May 1st and insurers begin collecting them from insureds on July 1.[15] The percentage to be collected is determined on the basis of anticipated premiums, so it is impossible to determine precisely.

2. Problems with the Assessment Process -- Lack of Predictability

The assessment process is not precise, especially with respect to assessments of insurers. Because the assessment rate is applied to premiums collected from employers on an ongoing basis during the fiscal year, the amount of total assessments collected is not known until the end of the fiscal year. In each year since FY98, the amount collected exceeds the target assessment amount (from $350,000 to $1.4 million)[16]. Another reason for assessment totals to exceed the amount anticipated is that audits of insurers or employers in later years may turn up additional amounts due to the Board, and those amounts are credited to the year in which they should have been paid, rather than the year in which they are collected.

The unpredictability causes 2 problems. First, in order to avoid a revenue shortfall, the Board may estimate the premium percentage high and end up collecting too much from insured employers. The use of the excess collections is limited in 2 ways. First, the Board may not spend money in excess of its allocation, even if it has excess funds on hand.[17]

Second, Title 39-A provides a formula for use of the excess collections. Amounts collected that exceed the statutory dollar cap for that fiscal year by more than 10% must be "returned to employers." Amounts collected that exceed that cap, within

---

[14] In the Maine Law Court decision, Hanover Ins. Co. v. Workers' Compensation Board, 1997 ME 104, 695 A.2d 556 (1997), the assessment law was interpreted to require that the assessment for insurers be stated as a percentage of premium, rather than a dollar amount.

[15] Insurers remit collections quarterly, unless the total due is less than $50,000. Those smaller sums must be paid by June 1.

[16] See Appendix F for information on expenditures and assessments

[17] The primary allocation, or permission to spend, comes from the biennial budget bill. However, allocations may be increased in 2 ways. Legislation can be enacted to specifically authorize an additional allocation. (See, e.g., PL 2001, chapter 393) If the Legislature is not in session, the Governor, through the Bureau of the Budget, can issue a "Financial Order" authorizing the Board to spend additional money, as long as money is on hand and can legally be spent for the intended purpose. Financial Orders are reported to the Joint Standing Committee on Appropriations and Financial Affairs during the interim, but generally review occurs after the Order takes effect.

the first 10%, must first be used to fund the Board's allocation, then deposited in a reserve account until the maximum reserve is achieved,[18] then used to reduce the next year's assessment. Because of this formula, the Board has in recent years been forced to appear before the Legislature seeking access to reserve funds to cover its budget, even though its assessment for the year is well below the statutory dollar limit. This has created confusion on the part of those trying to understand the Board's finances.

3. Alternative Methods of Funding

The Commission examined other possible funding methods to determine whether there is a more predictable revenue source. Appendix G summarizes the methods used in other states to fund their workers' compensation administrative agencies. A few are funded by General Fund dollars or by fees.

Most state workers' compensation agencies, like Maine's Workers' Compensation Board, are funded by assessments. Many other states, however, allocate the assessment among insurers on the basis of prior year premiums, rather than trying to predict premiums for the upcoming year. This makes the assessment collection more predictable. However, insurer representatives told the Commission that such a system shifts the unpredictability to the insurer since, without a specific rate to apply to premiums, the insurer has to estimate the likely premium and somehow account to employers for overcollections or turn over more to the Board than they collected as a pass-through to employers. Also, since premium levels change from year to year, insurers with little market share in the current fiscal year, may owe a sizeable assessment, but have no premium base from which to collect it.

Given that each potential funding method has advantages and disadvantages, and that the disadvantages of the current system did not appear critical, Commission members did not conclude that a change in the assessment process was necessary. Commissioner Murray, of the Department of Professional and Financial Regulation, told the commission that he believes the assessment process needs to be made more predictable. With more predictable assessment collections, he believes that the Board would not need a reserve account. Executive Director Dionne commented that the reserve account would still be needed to cover unexpected expenses, such as salary increases, unless the assessment cap was indexed to take those increases into account. Without an increase in the assessment cap, or the ability to access the State's salary plan, the Board will bump up against limits again within the next few years.

Commissioner Murray's proposal, to base insurer assessments on prior year premiums, is included as Appendix H. The proposal was submitted after the Commission's final meeting, so the Commission did not take a position on the specific proposal.

[18] The maximum reserve amount is ¼ of the board's annual budget. Title 39-A, section 154, subsection 6.

4. Complexity of Relationship between the Assessment, the Cap and the Budget

A second problem with the assessment process is the complicated relationship between the assessment cap and the Board's budget. This has caused misunderstanding. For example, the BDMP report concluded that the Workers Compensation Board was not operating with a balanced budget and recommended that the Board's budget not exceed its assessment cap. The assessment cap, however, is not an expenditure limit as currently provided in statute.

The total amount that the Board may spend is determined through the Legislative process; without an "allocation" contained in legislation and approved by the Legislature and the Governor, the Board may not spend money even if it has it on hand. The allocation is permission to spend money. The assessment, on the other hand, is just one of the sources of revenue that the Board may use. The statutory assessment cap is a limit on the amount that the Board can send out assessment bills to collect. The assessment cap, as many appear to believe, is not an expenditure limit. So, for example, in FY99, the Board could legally budget for $6.855 million even though the assessment cap was set as $6.6 million. The additional funding is provided by investment income, certain fines collected by the Board, and sales of publications. As long as the expenditure does not exceed the allocation, the Board operates within legal limits.

As a result of the thorough discussion of this issue, Commission members expressed the belief that they have improved their level of understanding of the relationship between the assessment cap, the allocation, and the budget.

5. Reserve Account

A second confusing element of the Board's funding is the reserve account created by Title 39-A, section 154, subsection 6. When assessment collections exceed the Board's budget, the excess goes into a reserve account[19] until the reserve account reaches ¼ of the budget. The Board has always believed that it could use the Reserve Fund to cover costs that were not budgeted for, such as increases in salary and benefits costs, especially health insurance costs. Without access to a salary plan[20], or to increases in its assessment, the Board had difficulty covering staff cost increases. The Bureau of the Budget, which determines whether the Board has available resources to fund a particular cost, believed that the statute did not authorize the use of the reserve fund for ongoing basic costs. This disagreement over interpretation of the law led to tension between the Board and the Bureau of

[19] Account is not a separate pot of money, but is accounted for in records

[20] Most state agencies have access to a State Salary Plan, which provides funds to cover salary and benefit increases during a biennium. The Workers' Compensation Board does not have a salary plan.

the Budget, as well as several appeals directly to the Legislature for permission to use the reserve fund to cover budget deficits or special projects.[21]

In 2003, the Board sought and won approval of legislation that amends Title 39-A to allow the Board to use the reserve account as a source of revenue to cover any legitimate costs related to its administration of the workers' compensation system.[22]Therefore, the Board could potentially count the reserve fund as available revenue, in addition to its assessment, investment income and other sources, in determining how much they can request for an allocation. This could occur in the initial budgeting process or in an off-session request for a financial order from the Governor. For this reason, the Board was required by the new law to report to the Joint Standing Committee on Labor whenever they sought permission from the Bureau of the Budget for a Financial Order to use reserve funds to increase their allocation.

D. Expenditures – Amount and Allocation

Although the study focus was directed to the budgeting process, not the budget itself, commission members also discussed the level of Board expenditures and the allocation of funds within the Board.

The Board's total budget has risen from $6.06 million in FY98 to $6.99 million in FY01 and $8.69 million in FY03. Some of the increases are attributable to added programs or staff. For example, 10 positions were added and the budget was increased by $600,000 when the Worker Advocate and the Monitoring Auditing and Enforcement (MAE) program were created in FY98. Those programs have both been expanded since their creation to include additional staff and resources.

With regard to the level of funding for the MAE program, some members argued that additional funding is needed. They argued that expanded auditing of insurers would allow the program to audit for additional matters, e.g., unwarranted refusal to pay benefits. Reducing unnecessary disputes would, in turn, reduce costs of the system. Other Commission members argued that the program is sufficiently funded, but could probably be made more efficient.

No specific recommendations were made relating to expenditure amounts or allocation among programs.

[21] PL 2001, c. 393 (request for $40,000 to fund technology for the Monitoring, Auditing and Enforcement (MAE) program), Res. 2001, c. 49 ($700,000 for FY '02 expenses), Res. 2001, c. 126 ($1,341,750 to balance the FY 03 budget)
[22] PL 2003, c. 93

III. Commission Conclusions

A. Budget Development within the Workers' Compensation Board

Commission members agree that the Board has taken steps to improve internal and external accountability for its budget by (1) allocating expenses to specific activities, or "cost centers" and (2) by creating performance standards or benchmarks. The Commission urged the Board to continue monitoring costs and developing benchmarks, especially through its revision of the Board's business plan.

Oversight of the budget process and budgeting results by the Legislature is an important part of accountability to the public. The Joint Standing Committee on Labor is directed by statute[23] to review the Board's budget, but has not always done so at the time of the biennial budget request. The Commission urges the Labor Committee to meet that responsibility more rigorously, and urges the Board and its Executive Director to develop a more understandable way to present budget information to the Legislature as well as a way to seek input in development of the budget.

B. Revenue Stream

Although the current revenue collection method is somewhat unpredictable and generally results in overcollection, it appears to members of the Commission that the current law is adequate for the needs of the Board, especially with the availability of the reserve fund to cover cash flow problems. Other methods of collecting revenue have advantages and disadvantages over the current system. However, no consensus emerged from commission discussion that the current system needed to be changed. The Commissioner of Professional and Financial Regulation urged the Commission to change the assessment process. He submitted proposed legislation to alter the method of assessment, but the proposal was not provided in time for the Commission members to discuss it. That proposal is included in Appendix H without a recommendation from the Commission.

C. Allocation of Board Resources

Commission members agreed that reducing the number of unreasonable disputes would benefit participants in the system as well as reducing costs. Some members felt that allocating more resources to the MAE program would enhance efforts to reduce unreasonable disputes. Others felt that the program could accomplish its goals by focusing its efforts and becoming more efficient, and did not need additional funds.

[23] Title 3, section 522-B