

HOUSE BILL REPORT

HB 1856

As Reported by House Committee On:
Commerce & Labor

Title: An act relating to industrial insurance fund audits.

Brief Description: Requiring industrial insurance fund audits.

Sponsors: Representatives Conway, Condotta, Wood, McCoy, Kessler, Campbell and Chase.

Brief History:

Committee Activity:

Commerce & Labor: 2/14/05, 2/21/05 [DPS].

Brief Summary of Substitute Bill

- Requires the Department of Labor and Industries to prepare financial statements and financial information on the industrial insurance funds using specified standards.
- Requires the State Auditor to conduct annual audits of the state fund with regard to specified issues and make a report to the Governor, the Legislature, the Office of Financial Management, and the Director of the Department of Labor and Industries (Director).
- Requires the Director to respond to the State Auditor report within 90 days.

HOUSE COMMITTEE ON COMMERCE & LABOR

Majority Report: The substitute bill be substituted therefor and the substitute bill do pass. Signed by 6 members: Representatives Conway, Chair; Wood, Vice Chair; Condotta, Ranking Minority Member; Sump, Assistant Ranking Minority Member; Hudgins and McCoy.

Staff: Chris Cordes (786-7103).

Background:

The Department of Labor and Industries (Department) administers the Washington industrial insurance system. The Department's responsibilities include operating the state fund from which employers who are not self-insured purchase industrial insurance coverage.

The industrial insurance trust fund administered by the Department includes three basic funds: the accident fund, the medical aid fund, and the supplemental pension fund. The *Accident*

Fund is used to pay time-loss benefits, permanent partial disability awards, and pensions. The *Medical Aid Fund* is used to pay medical and vocational rehabilitation benefits. The *Supplemental Pension Fund* is used to pay cost-of-living adjustments to workers receiving time-loss or pension payments.

All state fund employers pay premiums to the Department for these three funds. These employers deduct one-half of the premium for the medical aid fund and the supplemental pension fund from their employees' wages.

The State Auditor is required to audit state agencies at intervals determined by the State Auditor. Audits of financial statements must include determinations regarding the validity and accuracy of accounting methods and standards used in the statement's preparation, as well as the accuracy of the statement.

Summary of Substitute Bill:

The Department of Labor and Industries (Department) is required to prepare financial statements on various industrial insurance funds using generally accepted accounting principles (GAAP) and financial information based on statutory accounting principles.

Beginning in 2006, the State Auditor must conduct annual audits of the state fund, which must be coordinated with other Department audits that the State Auditor conducts. As part of the audit, the State Auditor may contract with firms qualified to perform a financial audit. The firms doing reviews must be familiar with accounting standards applicable to these accounts and have experience in workers' compensation reserving, discounting, and ratemaking.

The financial audit must include at least:

- an opinion on whether the financial statements were prepared in accordance with GAAP;
- an assessment of the financial impact of proposed rates on the funds' actuarial solvency, taking into consideration various factors, including insurance risks, actuarial assumptions, discount rates, reserving, retrospective rating programs, refunds, individual employer rate classes, as well as standard accounting principles used for insurance underwriting; and
- an actuarial opinion on whether the loss and loss adjustment expense reserves for the Accident Fund, Medical Aid Fund, and Pension Reserve Fund were prepared under generally accepted actuarial principles.

The State Auditor must issue an annual report on the results of the audits and reviews within six months of the end of the fiscal year. The report is made to the Governor, majority and minority caucus leadership in both chambers of the Legislature, the Office of Financial Management, and the Department. The Department, within 90 days of delivery of the report, must notify the State Auditor about measures it has taken in response to the report, if any.

Substitute Bill Compared to Original Bill:

The substitute bill specifies that (1) financial information for the Accident Fund, the Medical Aid Fund, and the Pension Reserve Fund must be prepared based on statutory accounting principles and (2) the scope of the financial audit includes an actuarial opinion on whether specified reserves were prepared in accordance with generally accepted actuarial principles.

Appropriation: None.

Fiscal Note: Available.

Effective Date of Substitute Bill: The bill takes effect 90 days after adjournment of session in which bill is passed.

Testimony For: (In support) There have been many questions over the years about the state of the industrial insurance funds. These kinds of audits have been done in other parts of state government. It will help everyone know what is happening to the funds and bring transparency to, and confidence in, the process. Everyone wants to understand what happens with industrial insurance rates. It may be helpful to include specific provisions about using standard accounting principles. The bill could be strengthened by requiring all funds to be covered, and specifying authority to use an outside source for estimating claims reserves.

(Neutral) Standard accounting principles are used in insurance accounting to amortize the value of assets for the long term. This approach allows for a better comparison with the insurance industry than GAAP valuations of assets.

Testimony Against: None.

Persons Testifying: (In support) Carolyn Logue, National Federation of Independent Business; Owen Linch, Joint Council of Teamsters; and Rick Slunaker, Associated General Contractors of Washington.

(Neutral) Bob Malooly, Department of Labor and Industries.

Persons Signed In To Testify But Not Testifying: None.