

July 10, 2007

Presentation to the Joint Legislative Task Force on the Underground Economy in the Construction Industry

Labor & Industries

Fraud Prevention & Compliance

Our Mission: To prevent abuse of the workers' compensation system and protect the economic vitality of Washington State

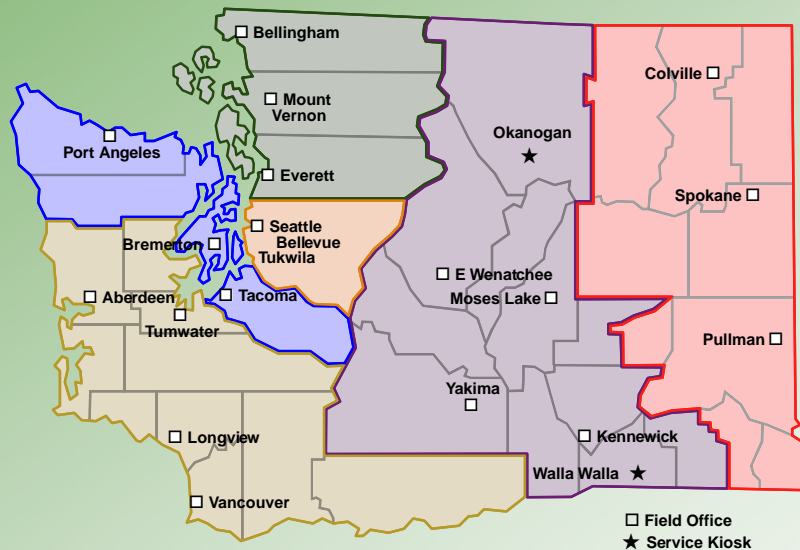
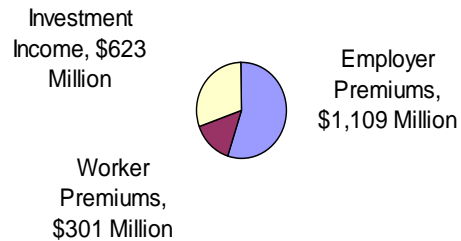
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Washington State Workers' Compensation State Fund

2005 State Fund Revenue Sources



Background

- L&I provides insurance coverage for about 2.3 million employees working for 161,000+ employers.
- L&I provides more than \$1.2 billion in insurance benefits for about 139,000 claims each year.
- Only four states have higher benefit levels while 34 states have higher premium rates.
- Money for these benefits come from three sources:
 - Quarterly premiums paid by employers (54.5%)
 - Payroll deductions from workers (14.8%)
 - Investment income (30.7%)
- L&I uses a voluntary reporting system of risk classifications by type of work and the claims experience of each individual employer to determine and assess premiums.
- About 90% of premiums are paid voluntarily, with the rest collected through department compliance actions.
- L&I employs 57 auditors in 18 service locations to ensure reporting compliance.

Fraud prevention and detection is important to Washington's economic vitality

- Cheating the workers' compensation system is **NOT** a victimless crime.
- Fraud takes its toll on honest people and businesses:
 - Businesses and workers pay more if some employers underpay or don't pay at all.
 - Construction companies who play by the rules are underbid and lose jobs to employers who do not pay their fair share.
 - Several recent national studies have pointed out the high costs associated with misclassifying workers as independent contractors (The "Gray Economy")
- We must stop fraud and abuse to keep our workers' compensation system healthy and to protect the honest employers and workers who rely on it.

Recent studies show insurance fraud accepted, independent contractor abuse on the rise

Coalition Against Insurance Fraud

- Dec 2006 white paper – insurance fraud noted as “acceptable” by 3 of 10 Americans surveyed in two studies
 - National anti-fraud “branding” campaign is needed
- Illinois study – employee misclassification – Feb 2006
- Misclassification as independent contractors is a key issue, and increasing in rate. Nearly 32% of employers by 2004

- Workers’ comp losses alone estimated at \$104.8 m

New York study – workers’ comp shortfall – Jan 2007

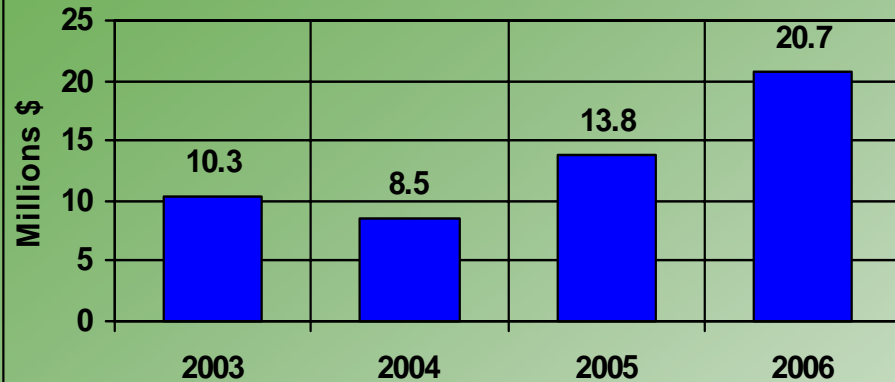
- Underreporting workers’ comp vs. unemployment insurance – (65-80%)
- Independent contractor abuse – total shortfall \$500+ m

Recent Fraud and Abuse Program Changes:

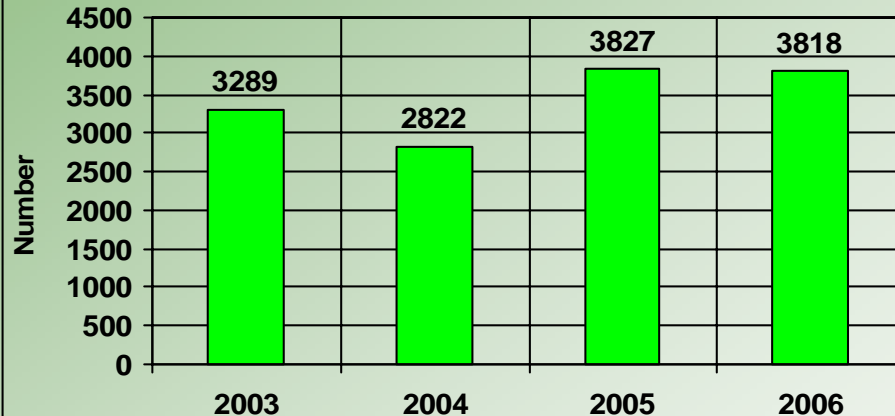
- Reorganized Fraud Prevention & Compliance efforts under one manager and added a fraud detection unit and a unit to handle the most egregious civil and criminal cases
- Implemented a new Fraud team who work nights and weekends specifically in construction
- Improved coordination and data sharing between programs and agencies
- Implemented new desk auditing procedures allowing us to audit a higher percent of firms and make the process faster for employers
- Implemented automated collection dialer system – Software that assists in early contact and collection of outstanding debts.
- Improved ease in use of online fraud reporting system.
 - WWW.Fraud.LNI.wa.gov
- Expanded and improved online premium status tracking system
 - <https://fortress.wa.gov/lni/crpsi>

What We Have Accomplished

Audit Dollars Assessed



Audits Completed

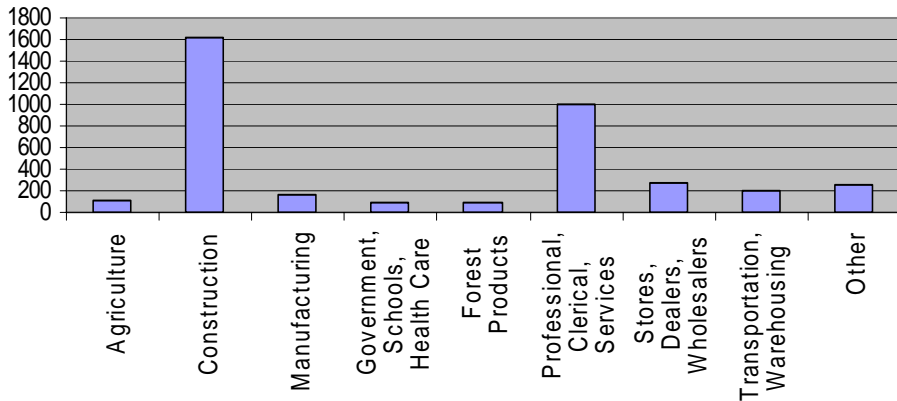


Results in 2006:

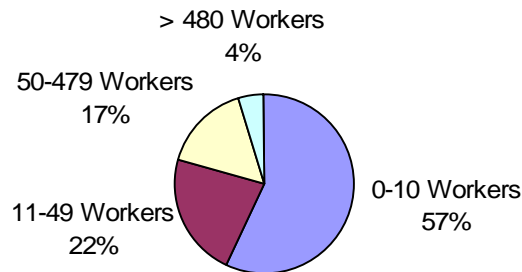
- Overall collections increased from \$104.9 M to \$135.4 M up 29%
- We pursued successors and prime contractors over 290 times which enabled us to collect \$2.1 M
- Improved audit targeting process and directed audits towards cheaters
- Audits Assessments up by 52% from 2004 to \$20.7 Mil.
- Increased audit debit percentage from a historical level of <50% to 56% in 2006 (and over 60% for the past 6 months)

Who does L&I audit?

FY 2006 Completed Audits by Industry



FY 2006 Completed Audits by Size of Employer



Analysis

- In FY2006 43% of L&I audits were in construction, 26% in professional, clerical and service occupations, and the remaining 20% in other industries
- In FY2006 612 (16%) of the completed audits were for unregistered businesses
 - Most unregistered businesses tend to have few workers
- Proportionately, L&I audits in FY2006 roughly equaled the overall percentage of employers by size category in the system
 - About half of all businesses insured by L&I have 10 or fewer workers although they only represent about 2.25% of total hours reported
 - Very large employers with over 480 workers represent about 2.25% of employers insured by L&I but over half of the hours reported
- The very largest companies self-insure and therefore are not audited by L&I

Where We're Going

- **Expand and refine computer cross match and computer identification of fraud and abuse by Workers, Employers, and Providers**
- **New tools include Nationwide New Hire Register, improved fraud detection and data mining technology, and cross-match with IRS information**
- **Design and implement new computerized employer audit system**
- **Expand coordination and prosecution of fraud
(New Assistant Attorney General – Susan DanPullo)**
- **Solidify and improve on gains in collections from new collection tools
(Successorship, Corporate officer Liability, Prime Contractor liability and automated phone collection system)**
- **First draft of a Joint study with DOR/ESD/L&I on employment tax implications of the underground economy due in August**

2006 Activities Specific to the Underground Economy and/or the Construction Industry

- Assessed \$20,732,592 through employer audits of which \$3,835,603 was assessed on unregistered employers
- Added 6 new L&I compliance employees in the construction industry who work nights and weekends
- Collected \$1,575,000 through Prime Contractor Liability
- Suspended 113 Contractor Registrations for failing to pay workers' compensation

1996 Task Force On Nonpayment of Employer Obligations Study Recommendations

Recommendations Adopted

- #2: Require Checking of Unified Business Identifier Numbers
- #4: Use Targeted Auditing for Particular Industrial Insurance Classifications
- #5: Implement a Joint Auditing Program (Cross-Training, Improved Information Sharing, and Interagency Referral Process)

1996 Task Force On Nonpayment of Employer Obligations Study Recommendations

Recommendations Not Adopted

- #1: Implement Unified Tax Reporting
- #3: Expand Capacity to Prosecute for Failure to File

Other Underground Economy Issues In Construction

- **Need a clear definition of Underground Economy**
 - Large number of employers register but do not pay or intentionally underreport
- **No legal definition of Independent Contractor**
 - Existing worker definition (RCW 51.08.180) with contractor exemption / alternate exception (RCW 51.08.195) with the six part test confusing for many employers
 - Recent studies in other states show large costs of intentionally classifying workers as independent contractors