



August 27, 2015

MEMORANDUM FOR: LEONARD J. HOWIE III
Director
Office of Workers' Compensation Programs

Elliot P. Lewis

FROM: ELLIOT P. LEWIS
Assistant Inspector General
for Audit

SUBJECT: Longshore and Harbor Workers'
Compensation Act Special Fund Audit
Management Letter No. 22-15-013-04-432

In planning and performing our audit of the financial statements of the Longshore and Harbor Workers' Compensation Act Special Fund (Fund) for the years ended September 30, 2013 and 2012, in accordance with auditing standards generally accepted in the United States of America, we considered internal controls in order to determine our auditing procedures for the purpose of expressing an opinion on the financial statements and not to provide assurance on internal controls.

However, during our audit we became aware of matters that presented an opportunity for strengthening internal controls and operating efficiency. These matters did not rise to the level of a significant deficiency or material weakness and had no effect on our report on the financial statements dated March 26, 2015. The deficiencies needing improvement involved internal controls over the assessment process.

We have already met with Office of Workers' Compensation Programs (OWCP) management to discuss the deficiencies, and they have taken corrective actions. The purpose of this memorandum is to communicate to you the observations we made during our audit. Details of the deficiencies and the corrective actions OWCP took to resolve them are attached, as is OWCP's response to our management letter. We appreciate the cooperation of all OWCP staff involved in this audit. If you or your staff has any questions, please call Joseph Donovan, Audit Director, at (202) 693-5248.

Attachments

cc: Gary Steinberg, Deputy Director, OWCP
Antonio Rios, Director, Longshore Harbor Workers' Compensation, OWCP
Sam Shellenberger, Director, Financial Administration, OWCP
Jatin Wahi, Accounting Officer, Financial Administration, OWCP
Jennifer Valdivieso, Acting Branch Chief of Financial Mgmt., OWCP
Kenneth Ossman, Accountant, Financial Administration, OWCP
Roxanna Perry, Audit Liaison, OWCP

Internal Controls Over Assessments Need Improvement

Condition

As part of our review of assessments, we found that the Lumbermens' Group of insurance carriers went into receivership on May 10, 2013. Lumbermens' Group could no longer meet obligations, pay defense costs, or pay Fund settlements entered into on behalf of the insured. The Division of Longshore and Harbor Workers' Compensation (DLHWC) management did not sufficiently review the operating status of the three insurance carriers that were part of Lumbermens' Group prior to making the following assessments in July 2013:

Lumbermens' Group	
Liquidated Insurance Carriers	Carriers Improperly Assessed Amounts by the Fund on July 31, 2013
Eagle Pacific Ins. Company	\$873,048
Lumbermens' Mutual Casualty Co.	257,236
American Motorists Ins. Co.	88,376
Total	\$1,218,660

The total assessment of \$1,218,660 was included in the Assessment Receivable and Program Revenue/Deferred Revenue accounts of the Fund at September 30, 2013. However, there was no overall impact on the accounts receivable balance in the financial statements, since the assessment owed by Lumbermens' Group would have been re-assessed to the remaining carriers and self-insured employers.

Criteria

Office of Management and Budget Circular No. A-123, Management's Responsibility for Internal Control, states:

The agency head must establish controls that reasonably ensure that...revenues and expenditures applicable to agency operations are properly recorded and accounted for to permit the preparation of accounts and reliable financial and statistical reports. Further, management should identify external risks that may prevent the organization from meeting objectives, take into account relevant interactions with outside organizations, and analyze identified risks for their potential effect on the agency. In addition, information should be communicated to relevant personnel at all levels within an organization. The information should be relevant, reliable, and timely...It is also crucial that an agency communicate with outside organizations as well, whether providing information or receiving it.

Per the Government Accountability Office's Standards for Internal Control in the Federal Government:

Internal controls should generally be designed to assure that ongoing monitoring occurs in the course of normal operations. It is performed continually and is ingrained in the agency's operations. It includes regular management and supervisory activities, comparisons, reconciliations, and other actions people take in performing their duties.

Cause

DLHWC management did not sufficiently review the operating status of the Lumbermens' Group prior to making the July 2013 assessments. As a result, DLHWC staff identified the Lumbermens' Group as solvent in the Security Information System,¹ and invoices were generated and included in the assessment calculation. DLHWC staff was unaware that Special Fund cases associated with the Lumbermens' Group should have been coded as United States Code, Title 33 (33 U.S.C.), Section 918(b), to indicate insolvency, instead of as 33 U.S.C., Section 932(a), which indicated solvency.

When DLHWC staff became aware of the insolvency, they did not make any adjustment to the assessments receivable because they thought it could be satisfied with funds from the security deposit. Prior to March 2013, the standard operating procedure had been to use funds seized from carriers' and self-insured employers' security deposits to pay the delinquent assessments of insolvent carriers. DLHWC staff was unaware these funds can only be used for payment of compensation and medical benefits and that this past standard operating procedure was no longer permitted.

Title 20, Code of Federal Regulations (CFR), Section 703.201, Deposits of Security by Insurance Carriers, states, in part:

Security deposits secure the payment of compensation and medical benefits when an insurance carrier defaults on any of its obligations under the Longshore and Harbor Workers' Compensation Act, regardless of the date such obligations arose. They also secure the payment of compensation and medical benefits when a carrier becomes insolvent and such obligations are not otherwise fully secured by a State guaranty fund.

DLHWC management implemented a change in standard operating procedure based on this CFR, but did not document the change in the Fund Assessment Role Systems Manual and the Fund Security System Role System Manual, or disseminate it to

¹ The Security Information System supports delivery of services in compliance with the Longshore and Harbor Workers' Compensation Act. It provides claims processing, periodic roll maintenance, generation of DLHWC compensation benefits, and attorney fee payments. Additionally, it provides claims processing and tracking capabilities and generates DLHWC-approved payments for medical and vocational rehabilitation expenses program beneficiaries incurred. It records and calculates all insurance carrier and self-insured employer assessments due annually for the Fund and generates assessment notices in paper format to these groups on an annual basis.

DLHWC staff. The current standard operating procedure is for DLHWC staff to file a claim with the bankruptcy estate, and then to offset the uncollected assessments, raise assessments to the remaining insurance carriers and self-insured employers in the next assessment cycle.

Effect

The \$1,218,660 overstatement of Assessment Receivable and Program Revenue/Deferred Revenue accounts went undetected by DLHWC staff. We notified DLHWC management of the misstatement of the accounts and they made the following adjustments:

Dr. 5400004600	Program Revenue	913,995
Dr. 2320002300	Deferred Revenue	304,665
Cr. 1310000600	Assessments Receivables	1,218,660

Two liabilities are associated with Lumbermens' Group: (1) a liability to DLHWC for assessments and (2) a liability for the payment of indemnity and medical claims for policy holders.

- (1) To cover the \$1,218,660 assessment liability, DLHWC increased assessments receivables to the remaining carriers and self-insured employers in the next assessment cycle. This resulted in the Lumbermens' Group insolvency having no net effect on the assessments receivables account and financial statements.
- (2) Lumbermens' Group owed a larger liability of approximately \$5 million for indemnity and medical claims for policy holders. It had deposited \$2,598,292 with DLHWC to secure benefit liabilities in case of insolvency. On May 21, 2014, DLHWC management seized these funds from the Federal Reserve Bank of Philadelphia and placed them in an escrow account to pay benefits. When the seized funds are depleted, the remaining balance is payable from the fund by the remaining insurance carriers and self-insured employers who pay into the fund through assessments and penalties.

Resolution of the Matters

We have discussed our concerns and observations with DLHWC management and they have already taken corrective action. DLHWC management took the following steps to ensure this situation will not reoccur.

1. In July 2014, the Financial Branch Chief personally reviewed all assessment bills prior to mailing them to ensure none of the assessments were being sent to any insolvent carriers/self-insured employers. Management established procedures to ensure these reviews will continue to be performed.

2. In August 2013, staff were trained to ensure they used seized funds of carriers and self-insured employers to pay compensation and medical benefits only, and not to pay the assessments of insolvent carriers.
3. In July 2014, all liquidated carriers were terminated in the Security Information System so those carriers would no longer be included in the assessment calculation and future invoices would no longer be generated.
4. In September 2014, staff were instructed to immediately terminate liquated carriers/self-insured employers from all Fund systems and transfer the coding of any pending cases from 33 U.S.C., Section 932(a), to 33 U.S.C., Section 918(b).
5. In January 2015, the Fund Assessment Role Systems Manual and the Fund Security System Role Systems Manual were updated by management to reflect the new insolvency procedures.

U.S. Department of Labor

Office of Workers' Compensation Programs
Washington, D.C. 20210



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Assistant Inspector General
for Audit

FROM: **LEONARD J. HOWIE III** 
Director
Office of Workers' Compensation Programs

SUBJECT: Longshore and Harbor Workers' Compensation Act
Special Fund Audit
Management Letter No. 22-15-013-04-432

This memorandum responds to the above referenced management letter. We concur with the matters noted by the Office of Inspector General's and have already taken corrective action. Division of Longshore and Harbor Workers' Compensation management took the following steps to ensure these matters will not reoccur:

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Working for America's Workforce

We believe these additional compensating controls will ensure the integrity of the assessment process. As always, we appreciate the opportunity to provide input and look forward to continued collaboration with your office.

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