

**Schedule 13**

**1331 Emergency Change Request for FY 08-09 Budget Request Cycle**

Decision Item FY 08-09  Base Reduction Item FY 08-09  Supplemental FY 07-08  Budget Request Amendment FY 08-09

**Request Title:** 1331 Supplemental Request: Workers' Compensation Premiums

**Department:** Personnel and Administration

**Priority Number:** N/A

**Dept. Approval by:** *Nancy Brown*

**Date:** *6/6/08*

**OSPB Approval:** *DMZ*

**Date:** *6/5/08*

	Fund	1	2	3	4	5	6	7	8	9	10
		Prior-Year Actual FY 06-07	Appropriation FY 07-08	Emergency Supplemental Request FY 07-08	Total Revised Request FY 07-08	Base Request FY 08-09	Decision/ Base Reduction FY 08-09	November 1 Request FY 08-09	Budget Amendment FY 08-09	Total Revised Request FY 08-09	Change from Base (Column 5) FY 09-10
<b>Total of All Line Items</b>	<b>Total</b>	30,254,216	29,807,598	5,666,266	35,473,864	32,686,783	0	32,686,783	0	32,686,783	0
	FTE	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
	GF	0	0	0	0	0	0	0	0	0	0
	GFE	0	0	0	0	0	0	0	0	0	0
	CF	3,258,415	3,131,042	0	3,131,042	3,981,163	0	3,981,163	0	3,981,163	0
	CFE	26,995,801	26,676,556	5,666,266	32,342,822	28,705,620	0	28,705,620	0	28,705,620	0
	FF	0	0	0	0	0	0	0	0	0	0
<b>(2) Division of Human Resources</b>	<b>Total</b>	30,254,216	29,807,598	5,666,266	35,473,864	32,686,783	0	32,686,783	0	32,686,783	0
<b>(C) Risk Management Services, Workers' Compensation Premiums</b>	FTE	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
	GF	0	0	0	0	0	0	0	0	0	0
	GFE	0	0	0	0	0	0	0	0	0	0
	CF	3,258,415	3,131,042	0	3,131,042	3,981,163	0	3,981,163	0	3,981,163	0
	CFE	26,995,801	26,676,556	5,666,266	32,342,822	28,705,620	0	28,705,620	0	28,705,620	0
	FF	0	0	0	0	0	0	0	0	0	0

Letternote revised text:

Cash Fund name/number, Federal Fund Grant name: Workers' Compensation Account (COFRS 11W).

IT Request:  Yes  No

Request Affects Other Departments:  Yes  No

**CHANGE REQUEST for FY 08-09 BUDGET REQUEST CYCLE --- Emergency Supplemental**

Department:	Personnel and Administration
Priority Number:	N/A
Change Request Title:	1331 Supplemental Request: Workers' Compensation Premiums

**SELECT ONE (click on box):**

- Decision Item FY 08-09
- Base Reduction Item FY 08-09
- Supplemental Request FY 07-08
- Budget Request Amendment FY 08-09

**SELECT ONE (click on box):**

Supplemental or Budget Request Amendment Criterion:

- Not a Supplemental or Budget Request Amendment
- An emergency
- A technical error which has a substantial effect on the operation of the program
- New data resulting in substantial changes in funding needs
- Unforeseen contingency such as a significant workload change

Short Summary of Request:

This request is an emergency adjustment to the Risk Management Services (RMS) Workers' Compensation Premiums appropriation for FY 07-08 with *no impact* to statewide allocations for Workers' Compensation in customer agencies' operating budgets. The spending authority increase requested to finish out the fiscal year is \$5,666,266 cash funds exempt from reserves within the Workers' Compensation Account (COFRS Fund 11W) of the Risk Management Fund. At this time, the Department anticipates that appropriations for FY 08-09 will need to be adjusted, too, as a result of the annual allocation true-up among State agencies. This will be presented through the regular FY 08-09 supplemental process.

Background and Appropriation History:

This request represents a revised adjustment to the annual true-up of the State's Workers' Compensation Program for FY 07-08 required as a result of insufficient data early in the fiscal year when the actuarial projection of claims costs was first performed. The July 2007 actuarial analysis incorporated patterns and trends reflected in historic workers' compensation experience that did not reflect claim costs that emerged in the latter part of

the fiscal year. Claim costs are broken into two broad categories: medical and indemnity. Medical payments include such expenses as physician visits, ambulance transport, hospital stays, physical therapy, and pharmaceutical costs. Indemnity payments include reimbursement of lost wages, death benefits to surviving spouses, and settlement costs.

Data from the State's Third Party Administrator (TPA) for the current fiscal year reveal a dramatic 30.3% increase in indemnity payments paid to date in FY 07-08 versus FY 06-07, as presented in the "Calculations for Request" section. One reason for this is that the actuarial assessment did not adequately predict the Program's more aggressive experience regarding settlements made in FY 07-08. Decisions to settle claims are based on recommendations made by the TPA. This strategy, employed by the Program for several years, accomplishes cost avoidance in the future but is expensive in the short term, making up roughly a quarter of the current shortfall. Program officials are currently working with the actuary to help the Department make more realistic estimates for settlements in future years. Additionally, the Program found that benefits for lost wages increased substantially over the prior period, a pattern that is also very difficult to predict. Other cost drivers that the Program points to are the greater severity of some recent claims (such as workers struck by vehicles resulting in death or permanent disability) and the growing cost of statutorily-defined workers' compensation benefit payments beginning in FY 06-07. The picture that has emerged is that fiscal year-over-year payments for claims increased in both FY 06-07 and FY 07-08 by 15.0% and 16.1%, respectively.

The actuarial estimate is understood to include inherent uncertainties in its ultimate findings, as this caveat from the report itself claims (Colorado State Risk Management Office: Workers' Compensation and Liability Actuarial Report, July 13, 2007, p. 7):

*Projections of loss and ALAE [allocated loss adjustment expenses] are subject to large potential errors of estimation since the ultimate disposition of claims incurred prior to the financial statement date, whether reported or not, is subject to the outcome of events that have not yet occurred. Examples of these events include jury decisions, court interpretations, legislative changes, changes in the medical condition of claimants,*

*public attitudes, and social/economic conditions such as inflation. Any estimate of future costs is subject to the inherent limitation on one's ability to predict the aggregate course of future events. It should therefore be expected that the actual emergence of losses and ALAE will vary, perhaps materially, from any estimate. Thus, no assurance can be given that Colorado's actual loss and ALAE will not ultimately exceed the estimates contained herein.*

General Description of Request:

The Department's analysis indicates that an emergency adjustment to the Workers' Compensation Premiums appropriation for FY 07-08 is necessary, totaling \$5,666,266 cash funds exempt. For this FY 07-08 emergency supplemental request, the analysis reflects adjustments in three areas of the Program's funding: 1) extrapolations of the most current actual claims payments (April 2008, including both medical and indemnity costs), 2) a revised Colorado Department of Labor and Employment (CDLE) workers' compensation surcharge for self-funded programs, and 3) an updated excess premium billing due to late information from the Program's insurance broker. The request also attempts to capture the fact that settlement costs rose dramatically in FY 07-08 with payments to date exceeding the prior fiscal year by some 26% according to the Program's TPA.

Since sufficient operating cash reserves exist within the Program's fund, no adjustments are necessary for user agencies' appropriations; there is *no impact* (\$0) to statewide allocations for this spending authority increase. Currently, the Workers' Compensation Account is projected to have a fund balance of approximately \$18.4 million, which is sufficient to fund this emergency supplemental request. In addition, this payment does not jeopardize the solvency of the fund in the coming years.

The Workers' Compensation Account is unique to RMS in that the other two funds (Risk Management for liability claims and the Self-Insured Property Fund for physical property claims) are continuously appropriated for adjustments such as this one. Continuously appropriated funding for the Program by the Legislature allows the Department to make spending authority adjustments mid-year without a specific appropriation adjustment. This is beneficial to the Program and claimants because it enables payments to be made

with readily available funding reserves (operating cash) without risking an over-expenditure for the fiscal year. It is an especially useful funding mechanism for highly volatile appropriations, like the Workers' Compensation Premiums line item, that have expenditures during any given fiscal year that are extremely difficult to predict.

Consequences if Not Funded:

The State is legally obligated to pay Workers' Compensation benefits, but lack of spending authority prevents this. Settling claims early is strategically prudent so as not to prolong its financial burden for payments unnecessarily. If the emergency supplemental is not funded, claims cannot be paid to State employees and their families. This will create hardship for affected employees and puts the State in jeopardy of additional lawsuits and penalties with no reasonable defense, considering that operating cash is available and this request is simply for the authority to spend it.

Calculations for Request:

This section provides specific information related to calculations for this request.

a. The following table represents the appropriation adjustment for this request

Summary of Request FY 07-08	Total Funds	Cash Funds Exempt
<b>Total Request</b>	<b>\$5,666,266</b>	<b>\$5,666,266</b>
(2) Division of Human Resources, (C) Risk Management Services, Workers' Compensation Premiums	\$5,666,266	\$5,666,266

b. The following table represents three fiscal years of historic data for claims payments (medical and indemnity), including statistical calculations of growth over the years.

Year/Category	Period 1	2	3	4	5	6	7	8	9	10	11	12	Total	Average Monthly	\$ Increase	% Increase
FY06 Indemnity	\$715	\$785	\$866	\$1,147	\$673	\$864	\$885	\$709	\$1,060	\$1,033	\$1,060	\$1,187	\$10,985	\$915		
FY06 Medical	\$775	\$1,170	\$1,046	\$1,143	\$929	\$1,104	\$1,011	\$1,039	\$1,185	\$934	\$1,137	\$1,060	\$12,533	\$1,044		
Total	\$1,490	\$1,955	\$1,912	\$2,289	\$1,602	\$1,969	\$1,896	\$1,748	\$2,245	\$1,968	\$2,197	\$2,246	\$23,518	\$1,960		

STATE OF COLORADO FY 08-09 BUDGET REQUEST CYCLE: Personnel and Administration

Year/Category	Period 1	2	3	4	5	6	7	8	9	10	11	12	Total	Average Monthly	\$ Increase	% Increase
Year to Date	\$1,490	\$3,445	\$5,357	\$7,647	\$9,249	\$11,217	\$13,113	\$14,862	\$17,107	\$19,074	\$21,271	\$23,518				
FY06 Avg. Period %	6.3%	8.3%	8.1%	9.7%	6.8%	8.4%	8.1%	7.4%	9.5%	8.4%	9.3%	9.6%	100.0%			
FY06 Cumulative %	6.3%	14.6%	22.8%	32.5%	39.3%	47.7%	55.8%	63.2%	72.7%	81.1%	90.4%	100.0%				
FY07 Indemnity	\$1,069	\$1,088	\$1,101	\$967	\$1,002	\$1,207	\$974	\$910	\$628	\$1,066	\$1,122	\$980	\$12,113	\$1,009	94.0	10.3%
FY07 Medical	\$1,017	\$1,187	\$1,100	\$1,376	\$1,278	\$1,094	\$1,403	\$1,307	\$1,430	\$1,111	\$1,410	\$1,211	\$14,923	\$1,244	199.2	19.1%
Total	\$2,087	\$2,275	\$2,201	\$2,343	\$2,279	\$2,301	\$2,376	\$2,217	\$2,058	\$2,177	\$2,531	\$2,191	\$27,036	\$2,253	293.2	15.0%
Year to Date	\$2,087	\$4,362	\$6,563	\$8,906	\$11,185	\$13,486	\$15,863	\$18,080	\$20,137	\$22,314	\$24,846	\$27,036				
FY07 Avg. Period %	7.7%	8.4%	8.1%	8.7%	8.4%	8.5%	8.8%	8.2%	7.6%	8.1%	9.4%	8.1%	100.0%			
FY07 Cumulative %	7.7%	16.1%	24.3%	32.9%	41.4%	49.9%	58.7%	66.9%	74.5%	82.5%	91.9%	100.0%				
FY08 Indemnity	\$1,242	\$1,097	\$1,169	\$1,314	\$1,031	\$1,077	\$1,192	\$893	\$1,058	\$1,964	\$2,072	\$1,672	\$15,780	\$1,315	305.6	30.3%
FY08 Medical	\$1,213	\$1,251	\$1,228	\$1,323	\$1,293	\$1,228	\$1,087	\$1,218	\$1,244	\$1,517	\$1,499	\$1,499	\$15,599	\$1,300	56.3	4.5%
Total	\$2,456	\$2,348	\$2,397	\$2,637	\$2,324	\$2,305	\$2,278	\$2,110	\$2,302	\$3,481	\$3,571	\$3,171	\$31,380	\$2,615	362.0	16.1%
Year to Date	\$2,456	\$4,803	\$7,201	\$9,837	\$12,161	\$14,466	\$16,745	\$18,855	\$21,157	\$24,639	\$28,209	\$31,380				
FY08 Avg. Period %	7.8%	7.5%	7.6%	8.4%	7.4%	7.3%	7.3%	6.7%	7.3%	11.1%	11.4%	10.1%	100.0%			
FY08 Cumulative %	7.8%	15.3%	22.9%	31.3%	38.8%	46.1%	53.4%	60.1%	67.4%	78.5%	89.9%	100.0%				

Notes  
\$ x 1,000  
Estimated Values

c. The following table represents the calculation of the appropriation adjustment for this request, including the source(s) of the original regular supplemental request incorporated into the Program's funding through HB 08-1295.

Premium Line Expenses	Original Estimate	Original Basis	Revised Estimate*	Difference
Prospective Claim Payments (Medical and Indemnity)	\$26,106,363	Actuarial Report (7/13/2007) and Human Service Prior Year Actual as Estimate	31,379,687	(\$5,273,324)
Excess WC Policy	\$327,792	Actual (as of December, 2008)	390,897	(\$63,105)
CDLE Workers' Compensation Surcharge	\$890,000	Program Estimate	1,219,837	(\$329,837)
Balance of Appropriation	\$2,483,443	HB 08-1295	\$2,483,443	\$0
Total	\$29,807,598		\$35,473,864	(\$5,666,266)

d. The following are calculations made for the revised estimates.

- Prospective Claims Payments  
= Payments through April + Estimated May payments + Estimated June payments  
= \$24,638,505 + \$3,570,591 + \$3,170,591  
= \$31,379,687
  
- Excess WC Policy  
= Actual billed through December 2007 + Audited additional cost  
= \$327,792 + \$63,105  
= \$390,897
  
- CDLE Workers' Compensation Surcharge  
= Payments through April + Estimate of remaining FY 07-08 payments  
= \$609,837 + \$610,000  
= \$1,219,837

Assumptions for Calculations:

Following are assumptions used to develop revised estimates for this request.

- a. To calculate the remaining claims payments (medical and indemnity) for the fiscal year, the Department took actual payments for April (Period 10) and used this as the estimate for the two remaining months (May and June). In addition to this, \$400,000 was added in May for a known extraordinary settlement payment that has already been processed.
  
- b. The additional funding required for the excess worker's compensation policy is the amount actually billed to the Department for the year. It was determined through an audit by the broker (Marsh U.S.A.) that the State had not been billed properly, so this makes up for the vendor's initial understatement of cost.

- c. The CDLE assesses a surcharge to employers that self-fund their workers' compensation program based upon total payroll and a rate scale developed according to risks associated with occupational groups and job classifications. The Department was charged \$610,000 for the first half of FY 07-08 and anticipates that an equivalent amount will be billed for the latter half of the fiscal year (totaling just over \$1.2 million). This exceeds the Program's original estimate by nearly \$330,000 for the fiscal year and represents the basis for the revised estimate.

Impact on Other Government Agencies:

There is no impact in FY 07-08 to other agencies. The Department has determined that enough operating cash exists in the Workers' Compensation Account to sustain these payments without impacting appropriations within customer agencies, so no new appropriations outside DPA are contemplated for this request.

Cost Benefit Analysis:

Although spending authority is increased for the Program, allocations for State agencies are untouched because reserve funding will be utilized. Therefore, this \$0 impact to State agencies results in settled cases and timely payments to affected employees and their families under State and federal law. As for the advantage gained through settlements, payments made to date in FY 07-08 (76 of them) totaled \$3.7 million on claims that have already incurred \$6.1 million in benefits since initially being reported. By settling, the State will avoid approximately \$4.7 million in continued medical and indemnity payments (present value), for a benefit to cost ratio of 1.27 (\$4.7 million/\$3.7 million).

Statutory and Federal Authority:

24-30-1501 (3), C.R.S. (2007): *The general assembly also recognizes that the provision of workers' compensation insurance for state employees has become expensive. The general assembly hereby finds and declares that the administration of workers' compensation for state employees out of a separate account in the risk management fund as a self-insurance measure is an appropriate response to the high cost of workers' compensation insurance.*

Performance Measure(s):

Objective: Improve Business Processes/Align all Relevant Tools in Concert with Identified Business Needs					
Performance Measure	Outcome	FY 05-06 Actual	FY 06-07 Actual	FY 07-08 Approp.	FY 08-09 Request
Measure the impact of a tailored workers' compensation pilot loss control program on five agencies (Judicial, Transportation, Corrections, Human Services & Public Safety).	Benchmark	NA	NA	2.5% decrease in # of claims and claims payments	5% decrease in # of claims and claims payments
	Actual	2,542 claims, \$17,540,451 paid on claims	2,749 claims, \$18,773,701 paid on claims	---	---