



MONTANA LEGISLATIVE BRANCH

Legislative Fiscal Division

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Director
AMY CARLSON

DATE: May 18, 2010
TO: Economic Affairs Interim Committee
FROM: Kris Wilkinson, Fiscal Analyst II
RE: Costs Related to Regulation of Montana State Fund

As part of its review of the workers' compensation insurance system in Montana, the Economic Affairs Interim Committee (EAIC) requested information on the costs incurred by Montana State Fund (MSF) for audits and actuarial reviews. The following outlines the costs incurred by MSF and the Legislative Audit Division (LAD) for audits and actuarial reviews in the last four years.

Both MSF and LAD contracts for auditing and actuarial services for MSF. A summary of the various costs is provided in the following figures:

- Figure 1 provides the costs for auditing fees recorded on the state's accounting records for MSF over the last 4 years
- Figure 2 gives the additional costs paid from the general fund for LAD audits of MSF
- Figure 3 shows the MSF contracted actuarial costs
- Figure 4 provides LAD contracted actuarial cost of MSF

Audits

Figure 1 Montana State Fund Auditing Costs Recorded on SABHRS				
Description	FY 2007	FY 2008	FY 2009	FY 2010*
LAD Audit Costs	\$21,375	\$46,344	\$16,924	\$42,292
Statutory statement audit	33,000	25,855	22,300	34,480
Contracted Policyholder Premium/Payroll	892,802	876,097	909,508	596,808
Pharmacy Benefit Manager	0	58,000	0	0
Other Audits	<u>8,499</u>	<u>0</u>	<u>0</u>	<u>0</u>
	<u>\$955,676</u>	<u>\$1,006,296</u>	<u>\$948,732</u>	<u>\$673,580</u>

* Financial information as of May 17, 2010

MSF’s auditing costs have been approximately \$1.0 million a year. The majority of the costs are for MSF contracts with private firms to conduct policyholder premium and payroll audits. As shown, MSF has two financial statement audits conducted each year:

- LAD financial compliance audit – the statutorily required audit of MSF books as recorded on the state’s accounting system. The audit includes evaluations of the claims reservation process, the amounts reserved, and the current report of the MSF’s independent actuary
- Contracted statutory statement audit – an audit of MSF financial statements presented in a manner comparable to other workers’ compensation insurance companies

In addition to the statutorily required annual financial compliance audits, the Legislative Audit Division (LAD) also conducted:

- o Performance audit of MSF governance
- o Information system audit of MSF’s policyholder system

While financial and compliance audits are budgeted and appropriated costs to each agency, funding for performance audits and information system audits is funded from the general fund and, in most cases, not billed to an agency. According to LAD, the costs of the additional audits were:

Audit Number	Audit Title	Type of Audit	Date Issued	Audit Cost
07SP-14	Policy Holder System	Information Systems	Nov-07	\$20,974
08P-08	Corporate Governance Practices	Performance	Feb-09	71,720
Total				<u><u>\$92,694</u></u>

The costs of the additional audits were borne by the general fund appropriated to LAD.

Actuarial Services

Independent actuarial services are another significant cost for MSF. MSF contracts with a qualified independent actuary to:

- Provide analysis of loss and loss adjustment expense reserve indications
- Determine the reasonableness and actuarial fairness of MSF’s tier rating structure
- Provide an analysis of overall manual rate changes
- Provide analysis in selecting loss cost multipliers
- Review actuarial procedures and methods to develop class rates for MSF state special codes and for limited deviations from the National Council on Compensation Insurance loss costs

The costs of contracting for these services are shown in Figure 3.

Figure 3
MSF - Contacted Actuarial Costs

Fiscal Year	New Fund	Old Fund	Total
FY 2008	\$73,493	\$14,612	\$88,105
FY 2009	192,720	59,595	252,315
FY 2010*	<u>164,126</u>	<u>41,926</u>	<u>206,052</u>
Total	<u>\$430,339</u>	<u>\$116,133</u>	<u>\$546,472</u>

In addition, statute requires LAD to review workers' compensation rates set by the Montana State Fund Board of Directors to determine if they are excessive, inadequate, or unfairly discriminatory. The review of the rates is conducted by an independent actuary that reviews the work of the independent actuary contracted by MSF. The costs of the actuarial review contracted by LFD are presented in Figure 4.

Figure 4
LAD Contracted Actuarial Costs of Montana State Fund
November 2007 - November 2009

Contract Number	Actuarial Opinion Title	Type of Service	Date Issued	Actuary Cost
07C-04	MSF Actuarial Review FY07	Contract	Nov-07	\$9,500
08C-04	MSF Actuarial Review FY08	Contract	Nov-08	9,500
09C-03	MSF Actuarial Review FY09	Contract	Nov-09	8,500
	MSF Actuarial Review FY 10	Contract		<u>8,500</u>
Total				<u>\$36,000</u>

The review includes:

- Analysis of the rate setting process
- Analysis of the process for setting the overall rate level and rates by class
- The reasonableness of data, formulas, and methodology used in claims reservation process, the amounts of the estimated claims reserves and amounts carried on the financial statements using, to the extent possible, an analysis of MSF's contract actuary's work
- Review of the procedures to assess the validity of information obtained from MSF, determine the reliance placed on the information, and the procedures used to assess the validity of the information
- Review of the data elements used in the rate setting process and the estimation of claims liability