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# **Audit of the Special Compensation Fund of the Workers' Compensation System**

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A Report to the  
Governor  
and the  
Legislature of  
the State of  
Hawaii

Report No. 97-3  
January 1997



**THE AUDITOR**  
STATE OF HAWAII

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## The Office of the Auditor

The missions of the Office of the Auditor are assigned by the Hawaii State Constitution (Article VII, Section 10). The primary mission is to conduct post audits of the transactions, accounts, programs, and performance of public agencies. A supplemental mission is to conduct such other investigations and prepare such additional reports as may be directed by the Legislature.

Under its assigned missions, the office conducts the following types of examinations:

1. *Financial audits* attest to the fairness of the financial statements of agencies. They examine the adequacy of the financial records and accounting and internal controls, and they determine the legality and propriety of expenditures.
2. *Management audits*, which are also referred to as *performance audits*, examine the effectiveness of programs or the efficiency of agencies or both. These audits are also called *program audits*, when they focus on whether programs are attaining the objectives and results expected of them, and *operations audits*, when they examine how well agencies are organized and managed and how efficiently they acquire and utilize resources.
3. *Sunset evaluations* evaluate new professional and occupational licensing programs to determine whether the programs should be terminated, continued, or modified. These evaluations are conducted in accordance with criteria established by statute.
4. *Sunrise analyses* are similar to sunset evaluations, but they apply to proposed rather than existing regulatory programs. Before a new professional and occupational licensing program can be enacted, the statutes require that the measure be analyzed by the Office of the Auditor as to its probable effects.
5. *Health insurance analyses* examine bills that propose to mandate certain health insurance benefits. Such bills cannot be enacted unless they are referred to the Office of the Auditor for an assessment of the social and financial impact of the proposed measure.
6. *Analyses of proposed special funds* and existing *trust and revolving funds* determine if proposals to establish these funds and existing funds meet legislative criteria.
7. *Procurement compliance audits* and other *procurement-related monitoring* assist the Legislature in overseeing government procurement practices.
8. *Fiscal accountability reports* analyze expenditures by the state Department of Education in various areas.
9. *Special studies* respond to requests from both houses of the Legislature. The studies usually address specific problems for which the Legislature is seeking solutions.

Hawaii's laws provide the Auditor with broad powers to examine all books, records, files, papers, and documents and all financial affairs of every agency. The Auditor also has the authority to summon persons to produce records and to question persons under oath. However, the Office of the Auditor exercises no control function, and its authority is limited to reviewing, evaluating, and reporting on its findings and recommendations to the Legislature and the Governor.



## THE AUDITOR STATE OF HAWAII

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# OVERVIEW

THE AUDITOR  
STATE OF HAWAII

## Audit of the Special Compensation Fund of the Workers' Compensation System

### Summary

This audit was prepared in response to House Concurrent Resolution No. 284, Senate Draft 1 of the 1996 Regular Session which requested that the State Auditor conduct a management audit of the Special Compensation Fund of the workers' compensation system. Several state agencies are involved in the administration of the fund which provides workers' compensation benefits in special circumstances. The resolution expressed concern about the multiple jurisdictions involved, and asked the Auditor to determine whether the fund may function more effectively and efficiently as a separate entity with its own administrator and staff devoted solely to its specific purposes or placed in an administrative setting other than the Department of Labor and Industrial Relations.

The fund, established in Section 386-151, Hawaii Revised Statutes, is a revolving fund financed primarily by assessments against workers' compensation insurers or against employers who are self-insured. In certain circumstances, the fund pays workers' compensation benefits for injured employees instead of, or in addition to, payments by the employer or its insurer. For example, the fund may pay benefits when the employer defaults in paying. In calendar year 1995, the fund paid about \$15.5 million or 5 percent of all workers' compensation payments in Hawaii.

The Department of Budget and Finance is the custodian of fund moneys. The Department of Labor and Industrial Relations is the key administrative agency for the fund and is involved both in financing the fund and in adjusting claims against the fund. The Department of the Attorney General provides legal advice and representation to the fund. The Department of Commerce and Consumer Affairs collects certain assessments to support the fund, and the Department of Accounting and General Services issues checks for fund disbursements on orders from the director of labor and industrial relations.

We found that changing the fund's administrative structure is not warranted. The multi-agency approach is reasonable. Each department has an appropriate role, and interagency coordination appears good. We did find that the Department of Labor and Industrial Relations has an internal conflict of responsibilities because it acts both as administrator of the fund and adjudicator of workers' compensation claims against the fund. However, there is not enough justification to alter the fund's administrative structure to eliminate the conflict. A recent legislative decision to finance a workers' compensation facilitator unit through the fund should be reconsidered, though, in order to reduce conflicts within the labor department.

We also found that the fund has grown larger than necessary to meet its obligations. In FY1994-95, fund expenditures were about \$17.6 million, but revenues were about \$24 million. The Department of Labor and Industrial Relations needs to control the fund's balance more systematically.

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## **Recommendations and Response**

We recommend that the existing administrative structure of the Special Compensation Fund be left as is. However, the Legislature, if it continues to fund the new Workers' Compensation Benefits Facilitator Unit in the Department of Labor and Industrial Relations, should do so not from the Special Compensation Fund but from the general fund.

We also recommend that the Department of Labor and Industrial Relations improve the management of the fund's balance by establishing a formula that more closely matches revenues and expenditures.

The Department of Labor and Industrial Relations is in general agreement with all of our findings and recommendations, and the Department of Accounting and General Services is in general agreement with our findings. The Department of the Attorney General did not comment on our recommendations, but explained some of the circumstances surrounding its representation of the Special Compensation Fund.

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Submitted by

**THE AUDITOR**  
STATE OF HAWAII

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## Foreword

This audit was prepared in response to House Concurrent Resolution No. 284, Senate Draft 1 of the 1996 Regular Session which requested that the State Auditor conduct a management audit of the Special Compensation Fund of the workers' compensation system. Several state agencies are involved in the administration of the fund which provides workers' compensation benefits in special circumstances. The resolution expressed concern about the multiple jurisdictions and procedures associated with administering the fund and the effectiveness and efficiency of the fund's current structure.

We wish to acknowledge the cooperation and assistance extended to us by officials and staff of the Department of Labor and Industrial Relations, the Department of the Attorney General, the Department of Accounting and General Services, the Department of Commerce and Consumer Affairs, and the Department of Budget and Finance, and by other participants in the workers' compensation system who provided information during the course of the audit.

Marion M. Higa  
State Auditor



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# Chapter 1

## Introduction

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The workers' compensation law, Chapter 386, Hawaii Revised Statutes, requires employers and in some instances the state-run Special Compensation Fund to compensate employees or their dependents if the employee suffers personal injury by "accident arising out of and in the course of employment" or "disease proximately caused by or resulting from the nature of the employment." Workers' compensation includes payments for such items as employees' lost wages, medical treatment, vocational rehabilitation, and death benefits.

The Special Compensation Fund (the fund), now established in Section 386-151, HRS, is a revolving fund held for the benefit of injured employees and financed primarily by assessments against workers' compensation insurers or against employers who are self-insured. In certain situations, the fund pays for cash, medical, and rehabilitation benefits for the injured employee instead of, or in addition to, payments by the employer or its insurer.

Five state agencies play significant roles in the administration of the fund. The Department of Budget and Finance serves as fund custodian. The Department of Labor and Industrial Relations is the key administrative agency; staff from several units in the labor department allocate part of their time to fund activities, such as its financing and claims adjustment. The Department of the Attorney General provides legal advice and representation to the fund. The Department of Commerce and Consumer Affairs collects certain assessments to support the fund, and the Department of Accounting and General Services issues checks for fund disbursements on orders from the director of labor and industrial relations.

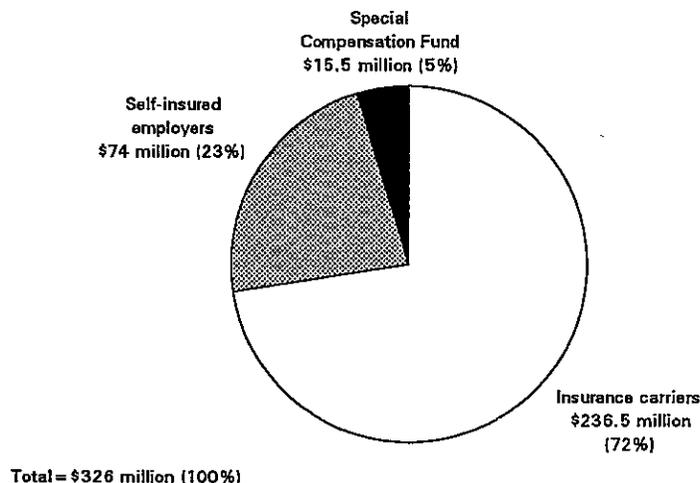
Concerns about multiple jurisdictions and procedures associated with administering the fund led to the passage of House Concurrent Resolution No. 284, Senate Draft 1 of the 1996 Regular Session. The resolution requested the State Auditor to conduct a management audit of the fund to determine whether it may function more effectively and efficiently as a separate entity with its own administrator and staff devoted solely to its specific purposes or placed in an administrative setting other than the Department of Labor and Industrial Relations.

## Background on the Special Compensation Fund

As in other states, the aim of Hawaii's Special Compensation Fund is to resolve inequities that may arise in the workers' compensation system. The fund's purposes include ensuring that persons who are entitled to benefits receive them, achieving orderliness and fairness to employers, and encouraging employers to hire employees with pre-existing conditions. To serve these purposes, the fund provides workers' compensation benefits in various circumstances. Examples include cases where the employer defaults in paying benefits and cases where it would be unfair to saddle the employer with the entire cost of an employee's condition that is attributable in part to a previous disability.

The Special Compensation Fund is *not* the principal source of workers' compensation payments in Hawaii; rather, it serves as a type of back-up fund in special circumstances. Most compensation—about \$236.7 million or 72 percent of the total in the state in calendar year 1995—is paid by companies that provide workers' compensation insurance to employers. A much smaller portion—about \$74 million or 23 percent—is paid by self-insured private and government organizations. An even smaller portion—about \$15.5 million or 5 percent—is paid by the Special Compensation Fund. (See Exhibit 1.1.)

**Exhibit 1.1**  
**Sources of Workers' Compensation Payments in Hawaii**  
**Calendar Year 1995**



***History of the fund***

In Act 66 of 1937, the Legislature created the Special Compensation Fund as a second-injury fund. The act required that the fund be used to pay workers' compensation benefits for permanently disabled workers whose disability was caused in part by a previous disability. The employer was responsible for paying only for the portion of the disability caused by the second injury; the fund bore the remaining responsibility.

To finance the fund, employers and workers' compensation insurance carriers were required to pay \$500 to the fund for each case of death from accidental injury in which no dependents were entitled to compensation.

Subsequent acts of the Legislature expanded both the scope of the fund's responsibilities and its financing mechanisms.

***Types of fund expenditures***

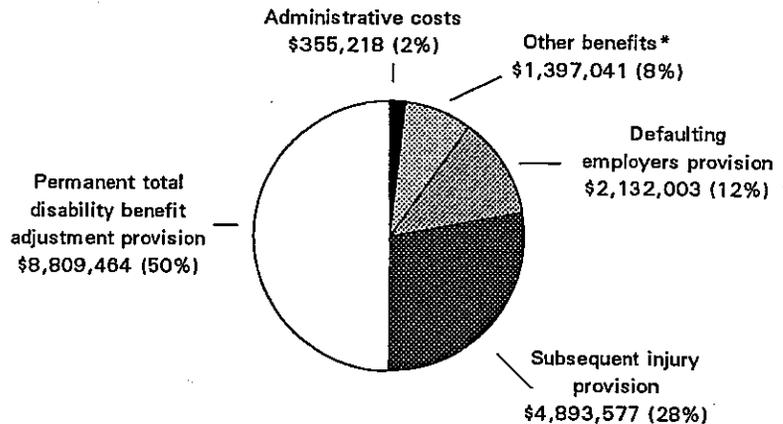
Chapter 386 now requires the Special Compensation Fund to provide workers' compensation benefits in certain circumstances involving the following: permanent total disability benefit adjustments; subsequent injuries and pre-existing conditions; defaulting employers; total disability under previous laws; concurrent employment; and benefit adjustments for services of attendants. Currently, the fund is making payments in about 900 open cases. In an average year, 500 new claims against the fund are approved; some are resolved with lump sum payments (settlements) and some are added to the list of ongoing cases. Other fund expenditures include certain administrative costs and, under a new law, expenses for workers' compensation facilitators.

In FY1994-95, the fund's expenditures totaled about \$17.6 million. Payments to workers' compensation claimants made up about \$17.2 million or 98 percent of this amount; various administrative costs accounted for the remaining 2 percent. Exhibit 1.2 shows an expenditure breakdown for the year.

**Benefit adjustments: permanent total disability**

Section 386-35, HRS, requires the fund to reimburse employers for "cost of living" adjustments. Employers are required to make these adjustments every ten years in workers' compensation benefits being paid to permanently and totally disabled employees. These benefit adjustments are provided because benefits formerly authorized by the law may no longer be adequate in a changing economy. The adjustments totaled about \$8.8 million in FY1994-95, accounting for half of the fund's total expenditures.

**Exhibit 1.2  
Special Compensation Fund Expenditures  
FY1994-95**



Total = \$17,587,303 (100%)

\*Includes total disability payments under previous laws, concurrent employment payments, and services-of-attendants adjustments.

**Subsequent injuries and pre-existing conditions**

Sometimes a person's subsequent work injury combines with a previously existing, permanent partial disability to result in greater permanent partial disability, permanent total disability, or death. When a claim is filed for the subsequent injury, Section 386-33, HRS, allocates the responsibility for paying workers' compensation benefits as follows:

- In cases involving a combined result of *greater permanent partial disability*, the employer compensates the employee for the actual permanent partial disability but not for more than 104 weeks; the fund pays for the balance of the compensation for the actual permanent partial disability.
- In cases involving a combined result of *permanent total disability*, the employer compensates the employee for 104 weeks, and the fund pays for permanent total disability thereafter.
- In cases involving a combined result of *death*, the employer pays weekly benefits governed by the death benefits sections of the workers' compensation law but not for more than 104 weeks; the fund pays the balance of compensation.

However, Section 386-33 has a threshold. If the previous permanent partial disability amounted to less than necessary to support at least 32 weeks of compensation for permanent partial disability, the fund does not

have to pay anything. In such a case, the employer pays the full compensation for actual permanent partial disability, total disability, or death, whichever applies.

In FY1994-95, payments under Section 386-33 totaled about \$4.9 million or 28 percent of the fund's expenditures.

### **Defaulting employers**

Section 386-56, HRS, requires the fund to provide workers' compensation benefits in cases where employers fail to provide prompt and proper benefits, if the default is not caused by the employee. The employer is then responsible for reimbursing the fund, and the fund is "subrogated to" (entitled to) the legal rights of the claimant. If the defaulting employer moves to another state without reimbursing the fund, the director of labor and industrial relations can hire a collection agency in that state to collect from the employer.

About \$2.1 million or 12 percent of the fund's expenditures for FY1994-95 were attributable to employer defaults.

### **Total disability under previous laws**

At one time, the law set a maximum lifetime ceiling on payments for total disability by an employer to a claimant. The fund had to pay amounts in excess of the ceiling. Subsequent amendments eliminated the ceiling, but not retroactively. As a result, the fund still makes total disability payments in excess of the prior ceiling to some claimants under the previous law.

These total disability payments accounted for about \$693,000 or 4 percent of the fund's FY1994-95 expenditures.

### **Concurrent employment**

The fund may also be used to compensate employees for lost wages from another job. An employee may be injured at one place of employment while holding other jobs with other employers. With some exceptions, Section 386-51.5, HRS, limits the workers' compensation liability of the first employer to the benefits that would be payable if the employee had no other employment, and requires the fund to pay the balance of the benefits. Payments involving concurrent employment made up about \$534,000 or 3 percent of the fund's expenditures in FY1994-95.

### **Benefits adjustments: services of attendants**

In some cases, the workers' compensation law makes the employer responsible for paying for the services of a constant attendant for an injured employee. Section 386-23.5, HRS, requires the fund to pay

supplemental allowances to reflect changes in the maximum allowed by the law for these services. These adjustments made up about \$169,000 or less than 1 percent of the fund's expenditures for FY1994-95.

### **Fees and other costs**

Generally, the costs of administering the fund are included in the general operating costs of the Department of Labor and Industrial Relations and the other involved agencies, and are not charged against the fund. However, the fund does pay fees for certain services provided to it. These include legal services of attorneys from the Department of the Attorney General and services of a certified public accountant who conducts an annual financial audit and forecast for the fund. Under Section 386-21(e), HRS, the fund may also pay for costs incurred by the Department of Labor and Industrial Relations in promulgating the medical fee schedule and related rules for workers' compensation.

In FY1994-95, the fund paid \$345,000 in attorney general's and other fees and \$10,000 for the financial audit and forecast. This made up about 2 percent of fund expenditures.

Act 260 of the 1996 legislative session established a Workers' Compensation Benefits Facilitator Unit within the Department of Labor and Industrial Relations. The act required the fund to pay for all expenses incurred by the department in establishing the unit. The act also appropriated \$150,000 from the fund to be spent for this purpose in FY1996-97 by the fund's custodian, the Department of Budget and Finance.

### ***Sources of fund revenues***

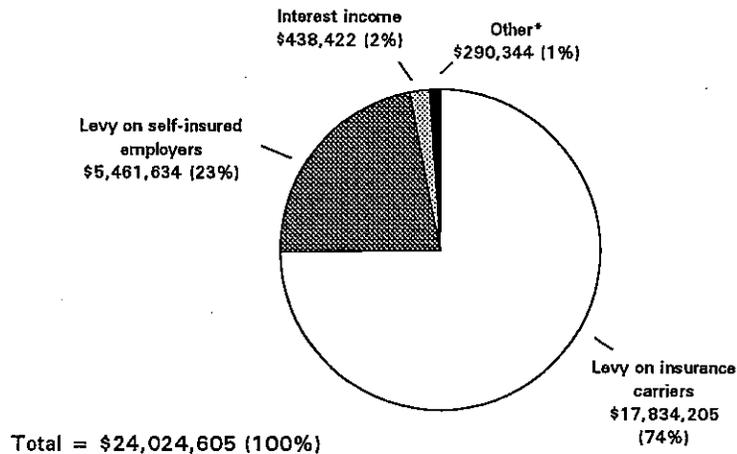
Under Chapter 386, the Special Compensation Fund has several sources of revenue: annual levies on about 125 workers' compensation insurance carriers and about 60 self-insured employers; interest income; reimbursement from defaulting employers; unpaid benefits in certain death cases; fines for noncompliance with the law; and additional sources.

In FY1994-95, the fund received about \$24 million in revenues. About \$23.3 million or 97 percent of this amount came from levies on insurance carriers (74 percent) and self-insured employers (23 percent). Exhibit 1.3 provides a revenue breakdown for the year.

### **Levies on insurance carriers and self-insured employers**

Chapter 386 allows employers to purchase workers' compensation insurance from authorized carriers; or to be self-insured, providing that certain conditions are met. Sections 386-152 through 386-154, HRS, authorize the fund to levy assessments on workers' compensation insurers and self-insured employers in amounts sufficient to meet the fund's current and projected obligations.

**Exhibit 1.3**  
**Special Compensation Fund Revenues**  
**FY1994-95**



\* Includes revenues from defaulting employers reimbursements, unpaid benefits in certain death cases, fines for non-compliance, and overpayment of benefits.

The law requires the director of labor and industrial relations to appoint annually a certified public accountant to audit the fund's books and records and advise the director on the fund's solvency. The audit includes recommendations as to levies and charges on insurers and the fund's required level of funding. Total fund requirements are prorated between carriers and self-insured employers based on certain formulas. After this proration, carriers pay their assessment in March and self-insured employers pay in September.

In FY1994-95, the levy on insurance carriers accounted for about \$17.8 million or 74 percent of the fund's revenues and the levy on self-insured employers accounted for about \$5.4 million or about 23 percent.

### **Interest income**

The fund also receives interest income as a source of revenue. The Department of Budget and Finance, the fund custodian, invests some of the fund's cash in certificates of deposit to earn interest. In FY1994-95, interest income was about \$438,000 or 2 percent of fund revenues.

### **Other sources**

As noted earlier in this report, Section 386-56, HRS, requires defaulting employers to reimburse the fund for payments it has made to claimants following the default. In addition, Sections 386-31(b) and 386-34(5), HRS, require that following a claimant's death the unpaid balances of

certain benefits be paid to the fund. The fund also receives payments of various fines imposed as penalties for noncompliance with the workers' compensation law.

Funds from these sources totaled about \$290,000 in FY1994-95, or 1 percent of fund revenues.

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## Objectives of the Audit

The objectives of this audit were to:

1. Determine the roles and responsibilities of state agencies in the administration of the Special Compensation Fund.
2. Assess the effectiveness and efficiency of the fund's existing organizational structure.
3. Describe and assess the process of financing the fund.
4. Make recommendations as appropriate.

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## Scope and Methodology

Our audit focused on the processes for administering claims against the fund and assessing and collecting moneys to finance the fund. We identified the roles of the Department of Budget and Finance, Department of Labor and Industrial Relations, Department of the Attorney General, Department of Commerce and Consumer Affairs, and Department of Accounting and General Services.

In particular, we examined fund practices during FY1994-95 and FY1995-96. We also collected and analyzed trend data from the past ten years. We studied independent audit reports on the fund for the past six years, and reviewed the size of its cash balances and fluctuations in the assessment rates from year to year.

We assessed the possibility of a fund administrative structure that maintains its own staff and a different organizational location. We also examined the method and standards used to determine the assessments on self-insured employers and workers' compensation insurance carriers. Our work included an examination of key management controls over the organization, implementation, and monitoring of the fund's collection and disbursement of moneys.

We reviewed the workers' compensation law (Chapter 386, HRS), pertinent administrative rules, administrative directives, and agency files. We also reviewed the U.S. Department of Labor's 1995 *State Workers'*

*Compensation Administration Profiles* and the Council of State Governments' 1994-95 *The Book of the States*. For additional information, we contacted directly the National Conference of State Legislatures, the Council of State Governments, the National Association of Insurance Commissioners, and other states with special funds for workers' compensation.

Our fieldwork included interviews with officials of the various departments; attorneys representing claimants, employers, and insurers; and the certified public accountants who have audited the fund for the past six years.

Our work was performed from July 1996 through December 1996 in accordance with generally accepted government auditing standards.



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# Chapter 2

## Adjustments Are Needed in the Use and Size of the Fund

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In requesting this audit, the Legislature voiced concern about the multiple jurisdictions and procedures associated with the administration of the Special Compensation Fund. We were asked to determine whether the fund might function more effectively and efficiently as a separate entity with its own administrator and staff devoted solely to its specific purposes or placed in an administrative setting other than the Department of Labor and Industrial Relations.

This chapter contains our assessment of the organizational structure and financing of the fund. Although we found a significant problem in the structure, we do not believe a different structure is warranted. However, the fund should not continue to pay for workers' compensation facilitators in the labor department. We also found that the fund has been allowed to grow too large.

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### Summary of Findings

1. One of the many state agencies involved in the administration of the Special Compensation Fund—the Department of Labor and Industrial Relations—has an internal conflict of responsibilities. However, there is not enough justification to alter the fund's administrative structure to eliminate the conflict. A recent legislative decision to finance a workers' compensation facilitator unit through the fund should be reconsidered, though, in order to reduce the conflict.
2. The fund has become too large. The Department of Labor and Industrial Relations needs to control the fund's balance more systematically.

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### Changing the Fund's Administrative Structure Is Not Warranted, but the Fund Should Not Pay for Facilitators

Changing the administrative structure of a government activity can be disruptive and costly. Assessing whether reorganization is justified involves examining the need for the change and determining whether the benefits of alternative structures outweigh the costs.

We identified two principal arguments for changing the administrative structure of the Special Compensation Fund (the fund). First, it can be argued that the number of agencies involved in administering the fund should be reduced. Second, it can be argued that the Department of Labor and Industrial Relations should not continue to serve both as fund

administrator and as adjudicator of claims involving the fund. Our analysis concluded that neither argument justifies changing the fund's organization.

***Multi-agency approach is reasonable***

The following departments of state government are directly involved in the administration of the Special Compensation Fund: the Department of Labor and Industrial Relations, Department of the Attorney General, Department of Accounting and General Services, Department of Commerce and Consumer Affairs, and Department of Budget and Finance. Exhibit 2.1 shows the fund responsibilities of these departments.

We found that this multi-agency approach has a sound basis. Each department has an appropriate role, and interagency coordination appears good.

**Responsibilities in processing and paying claims against the fund are appropriate**

The Department of Labor and Industrial Relations, Department of the Attorney General, and Department of Accounting and General Services are involved in the processing and payment of claims against the fund. These agencies' duties for the fund are consistent with their overall missions and special expertise.

The *Department of Labor and Industrial Relations* through its Disability Compensation Division is the lead agency in administering Hawaii's workers' compensation law and the Special Compensation Fund. The division acts both as "claims adjuster" for the fund and as adjudicator—on behalf of the director of labor and industrial relations—of all disputed workers' compensation claims, including those that involve the fund and those that do not. (We will examine the conflict between these responsibilities later in this report.) In addition, the division's Enforcement Branch investigates whether an employer against whom a claim is filed is "collectable" and seeks moneys on behalf of the fund from employers that are delinquent in paying benefits.

Benefits paid to claimants from the fund are determined by the workers' compensation law and the large majority of benefits are not disputed by the fund's administrator. Occasionally, the fund administrator does dispute a claim as an employer or insurance carrier might. These claims are resolved through an administrative hearings process.

Once benefits are determined by the administrator or the hearings process, the administrator notifies the labor department's Administrative Services Office, which then transmits claim vouchers to the Department of Accounting and General Services for payment.

**Exhibit 2.1**  
**State Agencies' Roles in the Administration of the Special Compensation Fund**

Department	Processing and Payment of Claims Against the Fund	Financing of the Fund
<p><b>Department of Labor &amp; Industrial Relations (DLIR)</b></p>	<p>* Disability Compensation Division (DCD) administers the Special Compensation Fund on behalf of the DLIR director</p> <p>* DCD adjudicates all disputed workers' compensation claims, including those involving the fund, on behalf of the DLIR director</p> <p>* Enforcement Branch collects and pursues delinquent employers</p> <p>* Administrative Services Office (ASO) manages payments of claims against the fund by recording, monitoring, and preparing claim vouchers sent to DAGS</p>	<p>* ASO manages annual fund audits that determine annual assessment rates for insurance carriers</p> <p>* Research and Statistics Office determines assessment amount on self-insured employers</p> <p>* Records and Claims Processing Branch manages collection of assessments from self-insured employers</p>
<p><b>Department of the Attorney General (AG)</b></p>	<p>* Labor Division represents the fund in hearings and appeals</p>	
<p><b>Department of Accounting and General Services (DAGS)</b></p>	<p>* Accounting Division pre-audits the vouchers received from DLIR's ASO and issues checks to claimants being paid from the fund</p>	
<p><b>Department of Commerce and Consumer Affairs (DCCA)</b></p>		<p>* Insurance Division collects fund assessments from insurance carriers based on a rate approved by DLIR's ASO</p>
<p><b>Department of Budget and Finance (B &amp; F)</b></p>		<p>* Financial Administration Division monitors deposits and holds the fund moneys in bank accounts and invests some cash in certificates of deposit to earn interest for the fund</p>

The *Department of the Attorney General*, through deputy attorneys general in its Labor Division, represents the fund in hearings and in appeals to the Labor and Industrial Relations Appeals Board or the state Supreme Court, just as other attorney general divisions provide legal representation to other state government entities. The attorneys of the Labor Division work with the Disability Compensation Division of the labor department to carry out this function. A potential for conflicts exists because the Employment Relations Division of the Department of the Attorney General represents the State as a workers' compensation employer, whose interests may be at odds with the interests of the Special Compensation Fund. However, conflicts are minimized because the two divisions are separate.

The final step in claims processing involves the *Department of Accounting and General Services*. The department pre-audits vouchers received from the labor department's Administrative Services Office and issues checks to claimants paid from the fund. This is similar to the functions that the Department of Accounting and General Services performs for other state agencies.

### **Responsibilities in financing the fund are appropriate**

The Department of Labor and Industrial Relations, Department of Commerce and Consumer Affairs, and Department of Budget and Finance are involved in financing the fund. Again, these agencies' roles in administering the fund are consistent with their missions and expertise.

The *Department of Labor and Industrial Relations* through its Administrative Services Office manages the annual audit and financial forecast of the fund conducted by an independent certified public accountant. The audit determines annual assessment rates that insurance carriers pay to the fund and forecasts the monthly fund balance for the next 20 months. The department's Research and Statistics Office determines the assessments on self-insured employers and sends them the appropriate notices. The employers send checks for their assessments to the department's Disability Compensation Division. The division's Records and Claims Processing Branch manages the collection of assessments from self-insured employers.

The *Department of Commerce and Consumer Affairs* through its Insurance Division collects fund assessments from insurance carriers once a year based on the approved rate. This work is similar to and easily integrated with other collections from insurers that the division performs for various state funds.

The division records and verifies the amounts of premiums collected by insurance carriers through the National Association of Insurance

Commissioners and its own tracking system. The division then sends an assessment form to insurance carriers that includes the annual assessment rate. Carriers are required to certify the amount of workers' compensation premiums that they collected during the previous calendar year, calculate their assessment based on the assessment rate, and return the form with their payment to the division.

The *Department of Budget and Finance* through its Financial Administration Division is the custodian of all state funds including the Special Compensation Fund. The fund's moneys are placed into a general account along with all other funds (general, revolving, trust, etc.). To earn interest, the division places some of the moneys in certificates of deposit. Although there is no separate bank account for the fund, the division monitors the fund's deposits, expenditures, and balance.

### **Interagency coordination is good**

We found that the present fund administrative structure involving all five agencies has been in place for many years. Its activities follow a well-established routine that all participants understand and support. We detected no unwarranted delays or bottlenecks.

We did, however, find an organizational conflict within the Department of Labor and Industrial Relations. This is discussed in the following section.

***No clear solution to conflict within labor department exists***

The principal weakness in the existing organizational structure of the Special Compensation Fund is the dual role of the Department of Labor and Industrial Relations as administrator of the fund and adjudicator of workers' compensation claims involving the fund. However, we found no actual harm from this conflict, and changing the organizational structure to resolve the conflict could create new problems.

### **“Wearing two hats” could undermine fairness**

In our 1991 *Study of Administrative Adjudication in Hawaii* (Report No. 91-12), we observed:

The combination of certain functions within a position, unit, or agency can...affect the fact and appearance of fairness. For example, the workers' compensation law requires the director of the Department of Labor and Industrial Relations to decide any claim for compensation. The law also charges the director to administer the Special Compensation Fund. Payments for a compensable injury must come either from the injured employee's employer or from the Special Compensation Fund. The director's dual role of administering the fund and deciding issues of compensability could conflict, for example, should compensation threaten the fund's solvency or reduce its value.

The dilemma persists in 1996. The conflict focuses on the labor department's Disability Compensation Division. The division chief, acting on behalf of the director of labor and industrial relations, wears two hats: one as overall administrator of the fund and the other as overall administrator of the workers' compensation adjudication process. The workers' compensation chief in the division, who reports to the division administrator, also wears two hats: one as day-to-day administrator of the fund and one as reviewer of draft decisions in workers' compensation hearings.

The conflict occurs as follows: In all disputed workers' compensation cases, including those involving the fund, an assigned hearing officer employed by the Hearings Branch of the Disability Compensation Division collects and reviews submittals of the parties and conducts an informal hearing. The hearing process is intended to be impartial, with the hearing officer acting as a neutral decision maker on behalf of the department director. After hearing all parties and considering the facts and the law, the hearing officer drafts a recommended case determination and submits it to the workers' compensation chief. The chief or the supervisor of the hearing officers reviews the file and may require the hearing officer to re-evaluate the case so that the recommended determination is consistent with the evidence in the file and the workers' compensation law.

Disputed cases involving the fund follow the same general procedures as in other workers' compensation cases, with the workers' compensation chief or the hearings supervisor reviewing draft decisions of the hearing officers. The problem is that this could provide an opportunity for the department as fund administrator to influence the ruling "behind the scenes" in order to protect the fund. For example, in the case of an allegedly defaulting employer, the department could try to shape the decision to reduce the benefit payments to protect the fund. For another example, in a subsequent-injury case, the department could try to orchestrate a ruling that the previous permanent partial disability amounted to less than necessary to support an award of at least 32 weeks of compensation for permanent partial disability. With such a decision, the fund would not have to pay anything. The criticism is that any attempt by the fund to gain a favorable decision should occur through its written submissions and open arguments to the hearing officer, not through possible back-door maneuverings.

Some participants who express concern about the conflict seem to hold a general belief that fund administrators are too tight with fund moneys and reluctant or slow to make payments. For example, they claim that payments from the fund were delayed when an insurer defaulted on workers' compensation claims.

Other participants note that the fund is not always represented in person by deputy attorneys general at neighbor island hearings. These participants believe that when this occurs, the hearing officer, having available only documents and not oral arguments by the fund representatives to assess the fund's position, steps out of his or her neutral role in an effort to protect the fund's interests. Another concern is that in this situation, the issues and positions of all parties are not fully brought out into the open, reducing the possibility of an appropriate settlement and increasing the possibility of behind-the-scenes maneuvering by the fund.

A further concern about possible bias is that the proceedings conducted by workers' compensation hearing officers are informal and not governed by the State's Administrative Procedures Act, Chapter 91. Thus, Chapter 91 protections that are designed to reduce bias and ensure fairness to all the parties—for example the prohibition against the decision maker consulting any person on issues of fact without giving all parties an opportunity to participate—do not apply.

#### **Appearance of unfairness clearer than fact of unfairness**

We believe that the appearance of impartiality is important to building participants' faith in administrative adjudication and that the situation described above contains the appearance of a lack of fairness.

It is less clear whether actual unfairness has occurred. In reviewing fund files and interviewing agency staff, we found no evidence of actual bias in favor of the fund or against claimants, employers, or insurers. Bias can be subtle and built into a system without overt prejudice and awareness by participants. It is also difficult to detect. The files contain large amounts of forms, letters, and other documents but do not record opinions or discussions of draft decisions or other matters that could indicate whether or not preferential treatment has occurred.

Interviews with staff who manage the fund and influence the outcome of decisions indicated that the workers' compensation law and the hearings process do not lend themselves to arbitrary decisions. Those from the Department of Labor and Industrial Relations whom we interviewed indicated that decisions are uniform and follow the law. They also indicated that the parameters and rules of the process limit the range of the decisions. We interviewed some hearing officers, who stated that cases are clear cut, decisions are uniform, and their recommended decisions were rarely changed by other officials.

Furthermore, during our audit no fund case came to light that demonstrated a bias. According to the department, few cases involving the fund have been appealed to the Labor and Industrial Relations Appeals Board and very few case determinations involving the fund have been reversed.

We chose not to analyze actual decisions of hearing officers to try to determine if bias exists. Participants who suggest bias did not point us to any decisions in which it occurred. Furthermore, analyzing case decisions involves second-guessing the hearing officers on specialized issues of fact and law. We also did not examine rulings of the Labor and Industrial Relations Appeals Board or the state Supreme Court on appeals from hearing officer decisions concerning the fund. We believe it would be difficult to determine whether any overruled decisions had been flawed by initial biases resulting from the conflict within the labor department. However, we do note that the appeals process provides an opportunity to correct or reverse decisions by the hearing officers in fund cases or other cases.

### **Problems raised by reorganization alternatives**

The conflict of fund responsibilities in the labor department is real. At a minimum, it causes the appearance of unfairness and, at worst, it could result in decisions unfairly biased in favor of the fund, although this has not been proven.

However, possible solutions involving reorganization would carry their own costs. The workers' compensation process would be disrupted during the transition, and other problems exist.

For example, claims adjustment responsibilities now performed by the staff of the Disability Compensation Division of the Department of Labor and Industrial Relations could be moved to one of the other agencies involved with the fund, such as the Department of Budget and Finance or the Department of Commerce and Consumer Affairs. But this move would saddle those agencies with duties not truly compatible with their mission and expertise. They would have to retrain staff or hire new staff or consultants to carry out duties now conducted by labor department staff with extensive workers' compensation experience. The challenge for these agencies would be even greater if reorganization required them to take over other fund responsibilities of the labor department, such as managing audits, revenues, and expenses for the fund.

As another possibility, the Labor Division of the Department of the Attorney General could act as claims adjuster for the fund. This division litigates fund cases presently and is familiar with managing and adjusting them. Again, however, taking over as the lead agency for fund administration is somewhat different from the attorney general's primary mission of providing legal assistance to state agencies.

Yet another possibility would be to move the fund administration functions currently performed by the Disability Compensation Division to the Administrative Services Office of the labor department. The office currently manages the audit, revenues, and expenses of the fund and has

some knowledge about the process of adjusting cases. However, the office is in close proximity to the Disability Compensation Division, which hears fund cases, and to the director of labor and industrial relations, who is ultimately responsible for adjudications involving the fund. Therefore, both the appearance of bias and the possibility of actual bias would still exist.

We also considered the option of creating a separate unit in the Department of Labor and Industrial Relations solely devoted to the fund. To help foster its independence, the unit could be attached to the department for administrative purposes only, as is the case with the Labor and Industrial Relations Appeals Board. While this option has considerable merit, we do not believe that it would ensure fairness, and it might set a precedent for a proliferation of administratively attached agencies within state government. Moreover, there would be costs in setting up such a unit and maintaining it with adequate staff.

Finally, we considered whether the Disability Compensation Division could make internal changes to better separate its claims adjustment and adjudicative functions concerning the fund. Realistically, however, internal reorganization would probably be insufficient to eliminate the conflict.

***Paying for facilitators  
could increase conflict***

Conflicts in the administration of the Special Compensation Fund may be increased by a recent law.

Section 1 of Act 260 of 1996 established a Workers' Compensation Benefits Facilitator Unit within the labor department. Facilitators and other staff will be appointed by the director of the department. The facilitators will be responsible for (1) assisting injured workers in filing their workers' compensation claims, (2) assisting insurers, employers, and providers, and (3) facilitating the workers' compensation process.

An early version of the proposed law would have financed the establishment of this unit from the state general fund. However, Section 12 of the final Act 260 appropriated \$150,000 from the Special Compensation Fund to establish the unit, apparently because only limited general funds were available.

This financing arrangement carries difficulties that did not previously exist. The salaries of key labor department officials involved in the administration of the Special Compensation Fund are currently paid not from the fund, but from the state general fund. This is appropriate, because paying their salaries from the Special Compensation Fund would give fund administrators a greater incentive to bend the rules to protect the fund's assets and could foster undue influence by fund administrators over the hearing process.

While Act 260 does not involve the salaries of the existing fund *administrators*, its approach of paying the new workers' compensation *facilitators* from the fund—especially if this occurs on an ongoing basis—could increase the pressure on the department to influence hearing decisions so as to protect the assets of the fund. Furthermore, the *facilitators* might be tempted to slant their advice to the parties, again to protect the fund's assets. Finally, labor department officials involved in establishing the levies on insurers and employers could be tempted to raise the rates to support the salaries.

We also believe that paying these salaries from the fund is inconsistent with the fund's original purpose of helping claimants and employers in special circumstances. Act 260 extends this purpose to *all* workers' compensation matters, not just special circumstances involving the fund.

### **Conclusion**

In light of the findings presented above, we believe that reducing the number of agencies involved in administering the Special Compensation Fund, or moving the claims adjustment or other functions of the fund out of the Department of Labor and Industrial Relations, are actions that are not warranted. To help reduce conflicts within the labor department and ensure that the fund carries out its purpose, we recommend that if the Legislature continues to fund the Workers' Compensation Benefits Facilitator Unit, it do so through the state general fund, not the Special Compensation Fund.

---

### **Control of the Fund Balance Needs Improvement**

Chapter 386 authorizes the Department of Labor and Industrial Relations to collect moneys from workers' compensation insurance carriers and self-insured employers to meet the obligations of the Special Compensation Fund. To determine required funding levels, the department contracts with an independent certified public accountant, who forecasts monthly expenditures for the next 20 months. The accountant's calculations are based on information provided by the department.

From this forecast and the insurance premiums to be collected from workers' compensation carriers—as estimated by the Insurance Division of the Department of Commerce and Consumer Affairs—an assessment rate on premiums is determined. Contributions from self-insured employers are based on a formula specified in Chapter 386, which uses the last two years of their workers' compensation payments in relationship to the workers' compensation payment amounts paid by insurance carriers.

We found that the Department of Labor and Industrial Relations needs to improve management of the fund balance. The safe minimum balance of

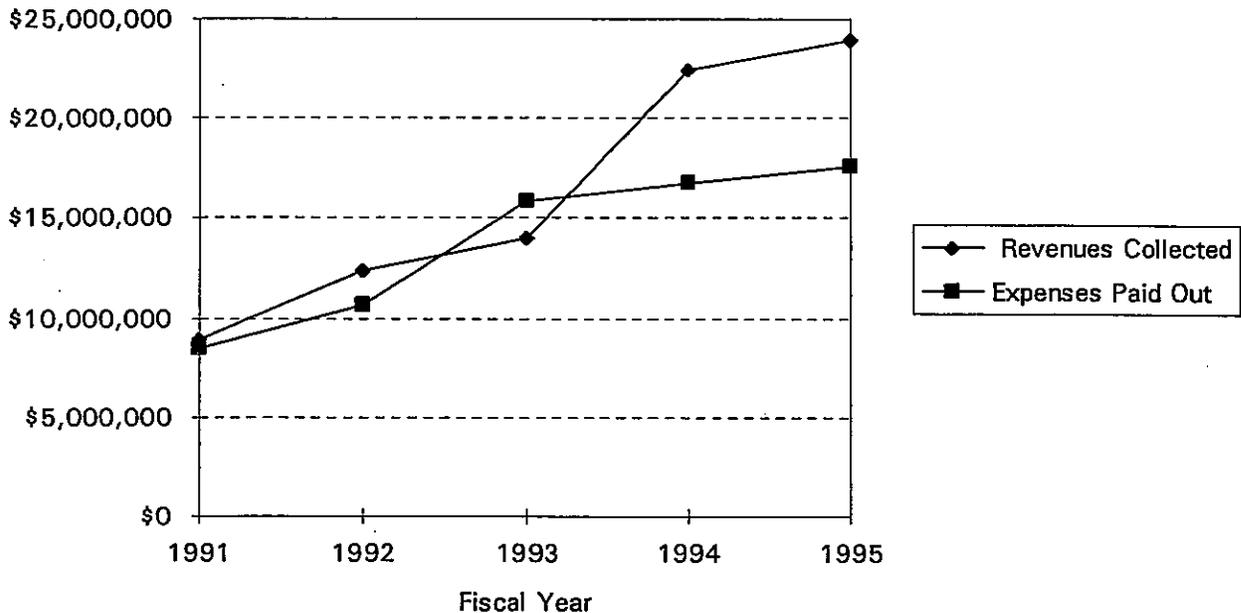
the fund should take into account expected liabilities and a reserve for unexpected liabilities. We found that the fund has grown larger than is necessary to meet its obligations, and assessments on insurers and self-insured employers may be too high as a result. The cause of this problem appears to be the audit information provided by the department to the certified public accountant.

***Fund is larger than necessary***

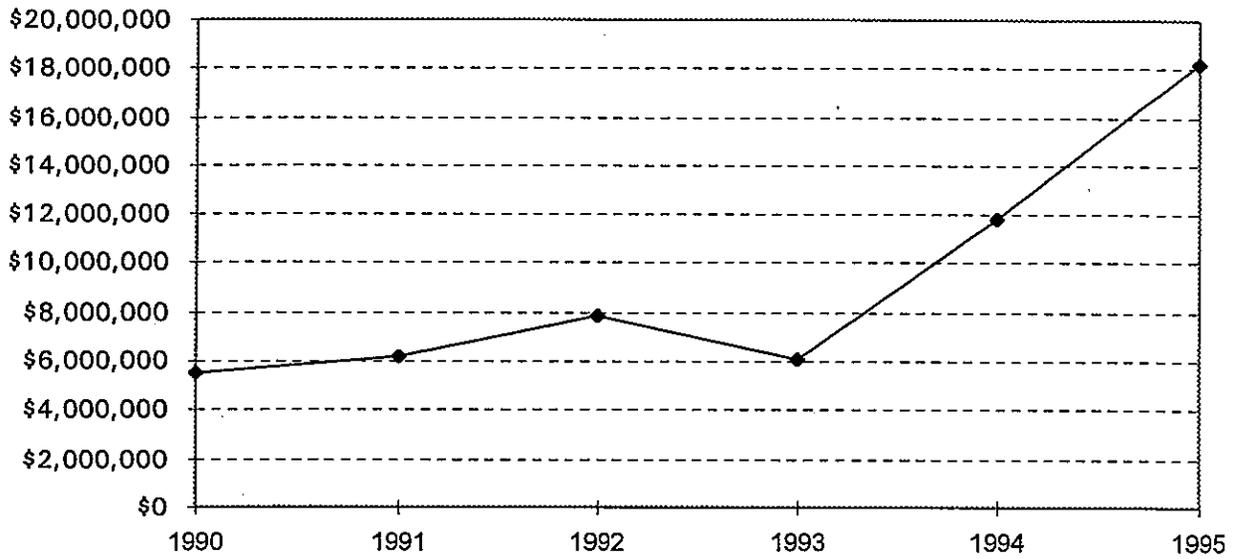
Exhibit 2.2 shows that moneys collected by the fund since 1991 have increased substantially more than fund expenditures. In FY1990-91, fund expenditures were about \$8.4 million and revenues \$9.0 million. In FY1994-95, fund expenditures were about \$17.6 million, an increase of 110 percent, but revenues were \$24 million, an increase of 167 percent.

Exhibit 2.3 shows a fund balance on June 30, 1991 of about \$6.2 million and on June 30, 1995 of \$18.2 million, an increase of 194 percent in four years. Exhibit 2.4 shows that the fund's assessment rate on insurance carriers has varied from a low of 2.30 percent of premiums in calendar year 1991 to a high of 5.55 percent in 1994.

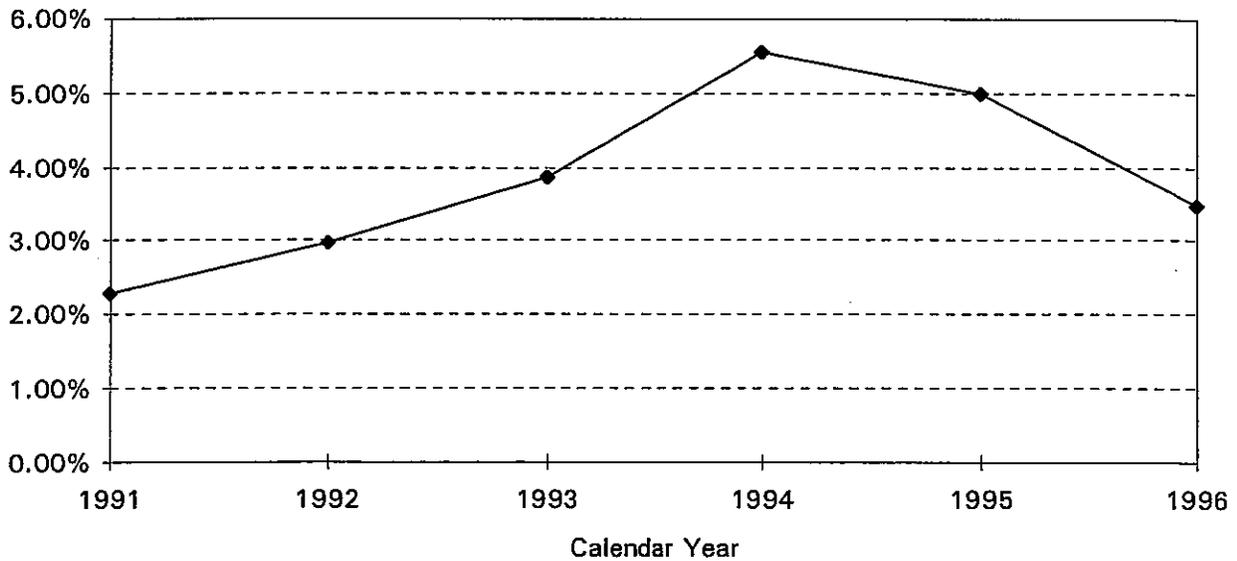
**Exhibit 2.2  
Special Compensation Fund Revenues Collected and Expenses Paid  
FY1990-91 through FY1994-95**



**Exhibit 2.3**  
**Special Compensation Fund Balance**  
**June 30, 1990 through June 30, 1995**



**Exhibit 2.4**  
**Rate Assessed on Insurance Carriers**  
**Calendar Years 1991 through 1996**



The most recent annual audit of the fund by the certified public accountant recommended a minimum cash reserve of \$1.9 million. The average monthly expenditure from the fund is projected to be \$1.6 million. Together these amounts suggest that the smallest monthly balance should be approximately \$3.5 million. But the recent annual audit projects the smallest balance in the next 20 months to be much higher at \$8.8 million. This balance is excessive.

***Lack of a systematic approach weakens forecasting***

In conducting our audit, we found that the department does not estimate costs for cases in progress or for cases that may result from bankruptcies of self-insured employers. There are usually several hundred cases involving the fund in the determination process at any time but their costs are not included in the annual audit until the final case determination is made and the payments due are recorded by the Fiscal Office. Also, the dearth of estimates for future liabilities apparently caused the department to overreact to the Hamakua Sugar bankruptcy, increasing assessments considerably beyond what was needed for a safe cash reserve.

Forecasting the fund's liabilities should reflect that assessments on insurers and employers are collected annually and that any large unexpected liability would take many months or years to process. The Hamakua Sugar Company bankruptcy in the summer of 1992 is the most recent unexpected liability. Approximately 40 open cases remain unresolved in which the fund may have to pay claimants because Hamakua could not pay. The final cost to the fund is expected to be about \$7 million.

Normal expenditures of the fund are not subject to unexpected short-term changes because the majority of disbursements are ongoing and the number of new cases does not vary significantly from year to year. When a major event such as the Hamakua Sugar Company bankruptcy occurs, the time frame to establish liability and pay beneficiaries is several years, while fund assessments and collections are done yearly.

In these circumstances, we would expect the growth of expenditures from the fund to be steady and expected, and this has been the case in recent years. Yet fund revenues recently have been rising dramatically. The Hamakua Sugar bankruptcy was followed by inappropriately high fund balances and assessment rates. It appears that the department sought a higher balance to be on the safe side.

To avoid such problems in the future, the department needs a formula to ensure that the fund balance is appropriate for the amount of risk involved. Such a formula should be flexible enough to allow not only for unusual events such as major bankruptcies that will increase fund liabilities, but for other events, such as premium reductions under new

laws, that could reduce fund revenues. In short, the department needs a more systematic approach to ensuring that fund revenues and expenditures are more in balance.

### ***Conclusion***

The process of financing the fund lacks adequate management controls by the Department of Labor and Industrial Relations, producing excessive fund balances and inappropriate responses to unusual economic events. A more systematic approach to managing the fund balance is needed, including an appropriate formula for better matching revenues and expenditures.

---

### **Recommendations**

1. The existing administrative structure of the Special Compensation Fund should be left as is. To help reduce the risk of unfairness and other problems posed by the conflict of fund responsibilities in the Department of Labor and Industrial Relations, the Legislature, if it continues to fund the department's new Workers' Compensation Benefits Facilitator Unit, should do so not from the Special Compensation Fund but from the state general fund.
2. The Department of Labor and Industrial Relations should improve the management of the fund's balance by establishing a formula that more appropriately matches revenues and expenditures.

---

## Responses of the Affected Agencies

### Comments on Agency Responses

We transmitted drafts of this report to the Department of Labor and Industrial Relations, Department of the Attorney General, Department of Accounting and General Services, Department of Commerce and Consumer Affairs, and Department of Budget and Finance on January 3, 1997. A copy of the transmittal letter to the Department of Labor and Industrial Relations is included as Attachment 1. Similar letters were sent to the other departments. The responses of the Department of Labor and Industrial Relations, the Department of the Attorney General, and the Department of Accounting and General Services are included as Attachments 2, 3, and 4 respectively. The Department of Commerce and Consumer Affairs and the Department of Budget and Finance did not respond to the draft report.

The Department of Labor and Industrial Relations is in general agreement with all of our findings and recommendations, and the Department of Accounting and General Services is in general agreement with our findings.

The Department of the Attorney General did not comment on our recommendations, but explained some of the circumstances surrounding its representation of the Special Compensation Fund.

We incorporated in our final report a minor change suggested by the Department of Accounting and General Services concerning its responsibility for pre-auditing vouchers and issuing checks. We also incorporated a change reflecting the Department of Labor and Industrial Relations' clarification of its responsibility with regard to an assessment rate. However, we did not make an additional change suggested by the Department of Labor and Industrial Relations concerning its responsibility over the annual audit of the fund. While acknowledging the department's view, we prefer our original wording.

We made another change to appropriately designate the House Concurrent Resolution requesting the audit, and we supplemented Exhibit 1.2 and Exhibit 1.3 with additional material. Finally, while preserving the essence of our draft recommendation concerning the funding of the new Workers' Compensation Benefits Facilitator Unit, we reworded the recommendation for purposes of clarification.

ATTACHMENT 1

STATE OF HAWAII  
OFFICE OF THE AUDITOR  
465 S. King Street, Room 500  
Honolulu, Hawaii 96813-2917



MARION M. HIGA  
State Auditor  
(808) 587-0800  
FAX: (808) 587-0830

January 3, 1997

*COPY*

The Honorable Lorraine H. Akiba, Director  
Department of Labor and Industrial Relations  
Keelikolani Building  
830 Punchbowl Street  
Honolulu, Hawaii 96813

Dear Ms. Akiba:

Enclosed for your information are three copies, numbered 9 to 11 of our draft report, *Audit of the Special Compensation Fund of the Workers' Compensation Fund*. We ask that you telephone us by Tuesday, January 7, 1997, on whether or not you intend to comment on our recommendations. If you wish your comments to be included in the report, please submit them no later than Tuesday, January 14, 1997.

The Departments of Accounting and General Services, Budget and Finance, Commerce and Consumer Affairs, and the Attorney General; Governor; and presiding officers of the two houses of the Legislature have also been provided copies of this draft report.

Since this report is not in final form and changes may be made to it, access to the report should be restricted to those assisting you in preparing your response. Public release of the report will be made solely by our office and only after the report is published in its final form.

Sincerely,

Marion M. Higa  
State Auditor

Enclosures

BENJAMIN J. CAYETANO  
GOVERNOR



LORRAINE H. AKIBA  
DIRECTOR

DAYTON M. NAKANELUA  
DEPUTY DIRECTOR

STATE OF HAWAII  
DEPARTMENT OF LABOR AND INDUSTRIAL RELATIONS  
830 PUNCHBOWL STREET  
HONOLULU, HAWAII 96813

January 13, 1996

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OFF. OF THE AUDITOR  
STATE OF HAWAII

Honorable Marion M. Higa  
State Auditor  
Office of the Auditor  
465 South King Street, Room 500  
Honolulu, HI 96813-2917

Dear Ms. Higa:

Thank you for the opportunity to review and comment on the draft Audit of the Workers' Compensation Special Compensation Fund.

We are in general agreement with all of your findings and recommendations. We offer the following additional comments:

(1) Ref. Pages 13 and 14, Responsibilities in Financing the Fund

As presently worded, the "...the Department of Labor and Industrial Relations through its Administrative Services Offices manages the annual audit and financial forecast of the fund....".

We believe the word "manage" does not accurately portray the role of ASO in the audit of the Special Compensation Fund that is conducted by an independent certified public accountant. Currently the DLIR ASO is responsible to:

- Coordinate procurement of the certified public accountant through the State's Auditor and oversee execution of the resultant audit contract.
- Provide information as requested by the independent auditor.
- Monitor progress of the audit to ensure timely completion.
- Transmit copies of the audit and management reports to the State Auditor.
- Process payment to the auditor for audit fees.

Honorable Marion M. Higa  
January 13, 1996  
Page 2

The DLIR ASO does not approve the assessment rate (ref. page 13 of draft audit report), but may comment, if appropriate, to the Director on the rate as recommended by the independent certified public accountant.

Given these responsibilities, and that, pursuant to Section 386-151, HRS, the certified public accountant provides recommendations (assumed independently) to the Director, the ASO does not "manage" the audit. Perhaps, wording that ASO "oversees and monitors" the independent audit is more appropriate.

- (2) Ref. Page 24, recommendation that DLIR should improve management of the fund's balance by establishing a formula that appropriately matches revenues and expenditures.

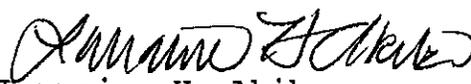
We acknowledge that fund balance has been high and we are making adjustments to reduce the balance. The DLIR, however, does use a formula to guide us in establishing levies and charges (to finance the special compensation) as recommended to us by the independent certified public accountant pursuant to Section 386-151(c). Our process in establishing the rate takes into consideration changing conditions and ensures that we carry out our statutory, fiduciary and fiscal responsibility to maintain an adequate balance to meet any financial obligations for injured workers.

We believe that it is difficult to include in the formula estimates for cases in progress or cases that may result from bankruptcies of self-insured employers, given the variability and uncertainty of this information.

If you have any questions regarding our comments, please call me or have your staff contact Gary Hamada, our Disability Compensation program administrator, at ext. (6)-9151, or Gordon Ing, our Business Management Officer, at ext. (6)-8888.

Thank you again for the opportunity to provide comments.

Sincerely,

  
Lorraine H. Akiba  
Director of Labor and  
Industrial Relations

BENJAMIN J. CAYETANO  
GOVERNOR



MARGERY S. BRONSTER  
ATTORNEY GENERAL

**STATE OF HAWAII**  
**DEPARTMENT OF THE ATTORNEY GENERAL**

425 QUEEN STREET  
HONOLULU, HAWAII 96813  
(808) 586-1500

JOHN W. ANDERSON  
FIRST DEPUTY ATTORNEY GENERAL

January 10, 1997

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OFC. OF THE AUDITOR  
STATE OF HAWAII

Ms. Marion Higa, State Auditor  
Office of the Legislative Auditor  
456 S. King Street, Room 500  
Honolulu, Hawaii 96813

Dear Ms. Higa:

Re: Audit of the Special Compensation Fund of the Workers'  
Compensation System

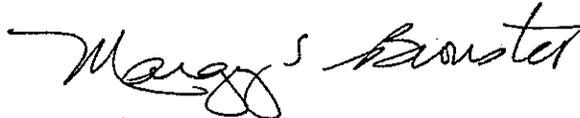
Thank you for allowing our office the opportunity to review and comment on the draft report prepared by your office regarding the Special Compensation Fund of the Workers' Compensation System. We submit for inclusion in the final report the following comments concerning the role of the Department of the Attorney General in the representation of the Special Compensation Fund.

You report a criticism raised by some system participants that the Special Compensation Fund is not always represented in person at neighbor island hearings. On that point, we wish to note that our client, the Special Compensation Fund, in recognition of the resources available to it, does not routinely refer cases to the Department of the Attorney General in which the Special Compensation Fund may be involved. In every case referred, however, the Department of the Attorney General has and will continue to provide the best possible representation of the Special Compensation Fund. If it becomes necessary for the Special Compensation Fund to be represented by a deputy at every neighbor island hearing, more personnel will be required and additional costs will be incurred.

Ms. Marion Higa, State Auditor  
January 10, 1997  
Page 2

We appreciate your consideration and inclusion of our comments to your final report. If you wish additional information or clarification, please call me.

Very truly yours,

A handwritten signature in cursive script that reads "Margery S. Bronster". The signature is written in dark ink and is positioned above the typed name.

Margery S. Bronster  
Attorney General

BENJAMIN J. CAYETANO  
GOVERNOR



SAM CALLEJO  
~~RUSSELL SOLOMON~~  
COMPTROLLER

MARY PATRICIA WATERHOUSE  
DEPUTY COMPTROLLER

**STATE OF HAWAII  
DEPARTMENT OF ACCOUNTING  
AND GENERAL SERVICES**

P. O. BOX 119  
HONOLULU, HAWAII 96810-0119

JAN 10 1997

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OFC. OF THE AUDITOR  
STATE OF HAWAII

The Honorable Marion M. Higa  
State Auditor  
Office of the Auditor  
465 S. King Street, Room 500  
Honolulu, Hawaii 96813-2917

Dear Ms. Higa:

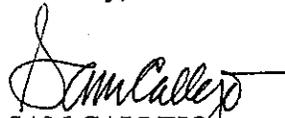
Thank you for providing us the opportunity to review and comment on the draft report on the "Audit of the Special Compensation Fund of the Workers' Compensation Fund."

With the exception of a minor change to Exhibit 2.1 on page 13, the Department of Accounting and General Services (DAGS) is in general agreement with the findings of the audit. The change to the process for DAGS should be made as follows:

\*Accounting Division pre-audits the vouchers received from DLIR's ASO and issues checks to claimants being paid from the fund

Thank you again for the opportunity to comment on this report.

Sincerely,

  
SAM CALLEJO  
State Comptroller

