

Workers' Comp Insurance and False Claims

Written by Nick Sanders
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The Workers' Compensation insurance program varies by state, so if you want to understand the detailed requirements associated with it, you first need to understand the requirements of the state you're working in. Workers' Comp insurance premiums are expensive, especially in states such as California, where premiums can reach up to ten percent of each hundred dollars of labor costs (in some circumstances).

One problem with discussing the insurance premium amounts is that the rates shown by insurance companies are not always what companies actually pay. There are "manual base rates" which can be modified by "rating plans" to reflect individual account characteristics, and there are "experience modification factors" which are used to further modify premiums based on recent loss history. In addition, rating plans may include surcharges for new businesses or employers with an adverse loss history, as well as credits for those with favorable safety records or procedures.

Moreover, often the insurance premium is retrospectively adjusted (after the fact), based on a payroll audit. The audit determines the actual payroll (as opposed to the expected payroll) and, once again, the premiums are adjusted accordingly.

So there's what the insurer and the company *expect* to pay in premiums, and then there's what is *actually* paid. The values can differ significantly. This is especially true in industries where there is a lot of payroll volatility and a lot of accident-inducing manual labor—such as in construction. There, a good safety program can easily pay for itself, in terms of both favorable rating plans and favorable experience modification factors.

Defense contractors have an advantage in this area, as they may be able to access the National Defense Projects Rating Plan—which can provide the same coverage at lower premium costs than a state or commercial insurance carrier would charge. (See DFARS 228.304 for more details.)

There are some questions that spring to mind when thinking about this issue in a context of government contracting and government contract cost accounting. The first question is, does the company estimate its costs based on expected premium costs, or does it estimate its adjusted premium costs based on what it thinks it will pay after the rating plans and experience

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modification factors and payroll audits have been included? For companies with a long and stable history—such as defense contractors—any significant variation has probably smoothed-out long ago, and they are safe in bidding last year's adjusted actuals as the best guess of next year's adjusted actuals. But other, smaller or newer, companies may have more difficulty in this area.

Regardless of estimating approach used, the inescapable fact of the matter is that if a contractor included its premium costs in its estimated direct or indirect costs—or if a contractor included its premium costs in its reimbursement vouchers on cost-type contracts—then the government gets a fair share of any subsequent premium adjustment.

For example if, in 2013, the 2011 Workers' Comp insurance premium costs are adjusted downwards, then the government gets to share in that credit. This is a basic requirement found in FAR 31.201-5 ("Credits"). Similarly, if the premiums are adjusted upwards, then there's an extra charge to be expensed.

If your contract is firm, fixed-price, then the government's "share" of the adjustment is zero, because the price doesn't change as a result of the contractor's cost experience. But if your contract is cost-type, then the government's share of the adjustment should be relatively equal to its share of the original premium cost.

Again, this is not such a tremendously big deal in the aerospace/defense industry, with its mega-contractors that have been in business for 75 or 100 years. But in the construction industry (for example) this is a big deal.

Many construction contractors have developed a practice of bidding their manual base rates, unadjusted, and then taking the downstream adjustment at the corporate home office level. That way, their FFP and commercial contracts become a source of additional margin. (Never mind TINA. Let's assume all government bids are competitive and TINA was not applicable.) To the extent those construction companies have cost-type government contracts, then the government does share in any credits, but it does so as a reduction in otherwise allowable and allocable G&A expense.

The reduction in G&A expense is entirely dependent on the sensitivity of the expense

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pool—i.e., the size the allocation base. If the company is large enough, then the premium credits are lost in the noise and the claimed rate doesn't change, even though the credit was properly accounted for.

So you can see that some companies in some industries—notably construction—are gaming the Workers' Comp system, bidding the supported manual base rates while knowing that any retrospective adjustments will be largely hidden in the noise. There's big money to be made there, if you're a savvy construction contractor.

Unless you're Granite Construction Company, a California-based construction company with Department of Transportation and U.S. Army Corps of Engineers contracts. If you're Granite Construction, you've recently been caught playing your Workers' Comp insurance premium games and you've been forced to negotiate a \$367,500 settlement to resolve allegations of violations of the False Claims Act.

Oops.

Allegedly, Granite Construction inflated its contract-related Requests for Equitable Adjustment (REAs) because it used "cushions" in its insurance premium cost estimates, instead of premium costs it had actually incurred. This had nothing to do with invoicing and nothing to do with competitive bids, and everything to do with estimating sole source contract modifications. You might want to think about that for a while.

It should be noted that Granite Construction itself disclosed the "potential overcharges" directly to the Government. There was no relator involved. Which is likely why the company was able to negotiate such a favorable settlement with the DOJ.

If you are a construction contractor, you might want to think about Granite Construction Company and its estimating and billing practices. Consider it to be a cautionary tale. We do.