

**Risk Management & Safety Follow-Up Audit  
December 2014**

Lori Brooks, City Auditor  
Lee Hagelstein, Internal Auditor



City Auditor's Office

December 12, 2014

Honorable Mayor and Members of the City Council:

I am pleased to present the Risk Management and Safety Follow-Up Audit. The audit objective was to determine the implementation status of prior audit recommendations.

Audit follow-up results indicate that management fully implemented nine prior audit recommendations, partially implemented one and did not implement one.

We would like to thank the Risk Management personnel for their cooperation during the audit and their implementation of our prior audit recommendations.

*Lori Brooks*

Lori Brooks, CPA, CIA, CGAP, CRMA  
City Auditor

c: Trey Yelverton, City Manager  
Theron Bowman, Deputy City Manager  
Don Jakeway, Deputy City Manager  
Gilbert Perales, Deputy City Manager  
Mike Finley, Chief Financial Officer  
Will Johnson, Police Chief  
Kari Zika, Human Resources Director

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# Risk Management & Safety Follow-Up Audit

Office of the City Auditor  
Lori Brooks, CPA  
City Auditor

December 2014

## **Executive Summary**

*Nine of eleven prior audit  
recommendations were  
fully implemented*

### **Fully Implemented**

*Verification of fees prior to  
payment to ASC*

*Revised process for  
temporary income benefits*

*Risk assessment for  
contracted services*

*Reviewed the current SSAE  
16 Report for ASC*

*Analysis of Section 504  
Network*

*APD report for identifying  
potential subrogation cases*

*Established new WC rates*

*No transfers from the WC  
Fund*

### **Partially Implemented**

*Reimburse expenses vs.  
drawdown of funds*

### **Not Implemented**

*Segregation of expenses  
in Lawson*

The City Auditor's Office has completed a follow-up audit of the Risk Management and Safety Audit released in October 2013. The audit was conducted in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives. The audit objective was to determine the implementation status of prior audit recommendations.

Management concurred with ten recommendations in the initial audit report and partially concurred with the remaining recommendation. Audit follow-up indicates that Risk Management fully implemented nine recommendations, partially implemented one and did not implement one.

Risk Management has fully implemented the following:

- Verification of checks issued by Alternative Service Concepts, LLC (ASC) for payment of claims and verification of administrative fees to be paid to ASC
- Coordinated with the Third Party Administrator (TPA) to change the process of issuing a check for temporary income benefits to employees
- Risk assessment for contracted services is an ongoing process performed by Risk Management personnel
- Reviewed ASC's SSAE 16 Report for the period June 1, 2013 to May 31, 2014
- Obtained an analysis from a Risk Management Consultant stating whether the City would benefit from joining an established Section 504 Network or from creating its own 504 Network
- Coordinated with the Arlington Police Department (APD) to obtain reports of potential subrogation recoveries relating to damage to City property and/or vehicles

- Updated the Workers' Compensation rates as of June 1, 2014
- Ensured that contributions to the Workers' Compensation Fund did not result in excess reserves, resulting in transfers out of the Fund

Management has partially implemented the recommendation to require the TPA to request reimbursement for actual expenditures rather than drawing down advanced funds. To mitigate the risks associated with drawing down funds, the Finance Department has established a limit to the amount of funds that may be drawn down in a single transaction.

Management did not implement the recommendations to segregate expenditures within the Lawson accounting system.

According to Risk Management, a new TPA contract will be effective as of January 1, 2015. The new contract is currently being reviewed by the City Attorney's Office.

For additional details, please see the recommendation matrix beginning on page 4 of this report.

## *Audit Scope and Methodology*

The following methodology was used in completing the audit.

- Reviewed preliminary check registers provided by ASC for verification of claims and fees
- Discussed the possible changes that could be included in the new TPA agreement
- Reviewed the ASC voucher process for tracking temporary income benefits
- Reviewed the current SSAE 16 report for ASC covering the period 6/1/13 to 5/31/14
- Reviewed a summary memo from the Risk Management Consultant relating to the possibility of joining or creating a Section 504 Network
- Reviewed reports provided by the APD to identify possible subrogation claims for damage to City property and/or vehicles
- Reviewed the updated Workers' Compensation rates which were effective 6/1/14
- Reviewed the Lawson accounting system for transfers out of the Workers' Compensation Fund
- Discussed with management other issues identified in the previous audit recommendations, including segregation of expenditures within the Lawson accounting system, and on-going assessment of risk related to contracted services.

### Status of Prior Audit Recommendations

AUDIT RECOMMENDATION	CONCUR / DO NOT CONCUR	MANAGEMENT'S RESPONSE	RESPONSIBLE PARTY	DUE DATE	IMPLEMENTATION STATUS
1. The Human Resources Director should coordinate with the Chief Financial Officer to ensure that signature approval is provided to document the authorization of administrative and other fees paid to the third party administrator.	Concur	Contract Renewal with ASC will provide the opportunity to change from having fees swept from the checking accounts to having all fees invoiced to the City as a first choice. If the cost of making that change is prohibitive, Human Resources will coordinate with Finance to discuss proper accounting of the amounts being swept from the checking account.	Human Resources Director	2 <sup>nd</sup> Qtr FY14	Implemented.  ASC currently provides the City with two Preliminary Check Registers for approval prior to processing of payment to ASC. One register is for payment of claims and the other is for fees to be paid to ASC. The first Preliminary Check Registers were generated in June 2014.
2. The Human Resources Director should coordinate with the Chief Financial Officer to ensure that expenditures are segregated and reported in the Lawson Financial System in a manner that will allow historical analysis of administrative, medical, legal and other costs.	Concur	Please see response above related to the fees currently being swept from accounts – if changed to invoicing this will be rectified. The ASC reporting system does segregate expenditures; however, this information is not included in the Lawson system. Reports can be provided to Finance.	Human Resources Director	2 <sup>nd</sup> Qtr FY14	<b>Not Implemented.</b>  According to management, historical analysis of claim reserve and payment data is available through the Risk Management Information System (RMIS) maintained by the TPA. Reports are generated at the City's request. Per management, segregation of expenditures in the manner stated in the recommendation is not possible with the Lawson Accounting System.
3. In future third party contractual relationships, the Human Resources Director should consider requiring that the third party administrator request reimbursement for actual expenditures instead of drawing down advance funds.	Partially Concur	With the exception of fees which can be established as invoices, the payment of other expenses by a third party administrator will always be through a City account that is jointly managed and not by reimbursement. As an administrator, a TPA does not provide operating funds for the City program they	Controller/ Treasurer	2 <sup>nd</sup> Qtr FY 2014; Finance codification of cash policy for TPAs	<b>Partially Implemented.</b>  Finance maintains documentation with the City's bank which reflects the maximum amount that ASC may draw from the City's account. Administrative fees are invoiced separately and

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		<p>administer. They are hired not to provide operating capital and request reimbursement from the City for services, but rather to administer a City program using City funds; acting, in effect, like a contract employee. The administrative fees the City pays are comparable to salary and wages, and as such are the only part of the transaction that can be billed after the fact. Finance has established, based on historical amounts of claims processed, maximum cash draw-down amounts. Finance will codify the cash policies regarding the amount of advance funds to be deposited as part of the TPA agreement.</p>			<p>paid through Catalyst. HR is contracting with a new TPA effective 1/1/15, and written procedures will be in place to codify policies for the drawing of funds by the TPA, including frequency and maximum amounts.</p>
<p>4. The Human Resources Director should either coordinate with the Chief Financial Officer to determine how temporary income benefit checks will be recorded or coordinate with the third party administrator to identify alternatives that would eliminate the need to issue the City checks for temporary income benefits that are not actually paid to City employees.</p>	<p>Concur</p>	<p>The processing of temporary income benefits through the TPA and back to the City requires follow up. The TPA has agreed that a transaction report could be used to reconcile the amounts of claims without a draw-down and subsequent check. A report will be developed for claims tracking and cash reconciliation. Because the amount of draw-down and the amount of temporary income benefit paid is not the same, HR and Finance will work together to develop a solution for tracking the benefits.</p>	<p>Risk Specialist</p>	<p>2<sup>nd</sup> Qtr 2014</p>	<p>Implemented.  Effective 07/14/14, ASC began processing a “voucher” rather than a check, to record all temporary income benefits without issuing a check. This allows for recordkeeping within the claim, and eliminates the draw-down and subsequent check. Reports will be provided monthly to allow tracking and reconciliation.</p>

AUDIT RECOMMENDATION	CONCUR / DO NOT CONCUR	MANAGEMENT'S RESPONSE	RESPONSIBLE PARTY	DUE DATE	IMPLEMENTATION STATUS
5. The Human Resources Director should ensure that staff periodically performs and documents risk assessments for contracted services.	Concur	Formal assessments will be completed by the Risk Specialist.	Risk Specialist	2 <sup>nd</sup> Qtr FY14	<p>Implemented.</p> <p>According to management, assessments are ongoing. Deficiencies hindering recovery were identified in subrogation. Processes were modified to ensure identification and pursuit of subrogation. Claims were also identified with potential recovery from the City's excess WC insurance, and ASC's progress is being monitored.</p>
6. The Human Resources Director should ensure that Human Resources' staff annually requests service operators' SSAE 16 reports to identify and implement any controls necessary to manage identified risks, including ensuring that transaction activity is accurate.	Concur	SSAE 16 reports are provided for the external audit as well as to the actuaries. Finance will send a copy of the reports to HR. A more formal review of the report will be completed by the Risk Specialist.	Controller, Human Resources Director and Risk Specialist	2 <sup>nd</sup> Qtr FY14	<p>Implemented.</p> <p>The City Auditor's Office noted that the Risk Specialist has received and reviewed the most recent SSAE 16 report. The report was reviewed by the Audit Office – no deficiencies noted.</p>
7. The Human Resources Director should conduct an analysis to determine whether the City would benefit from either joining an established Section 504 network or from creating its own Section 504 network.	Concur	Currently cost containment is provided through the TPA by using a PPO network. We are consulting our broker and TPA to investigate costs involved and benefits to evaluate. We have yet to determine if this is within the current broker agreement as a risk consulting service, or if additional costs will be involved.	Human Resources Director	2 <sup>nd</sup> Qtr FY14	<p>Implemented.</p> <p>A Risk Management Consultant has reviewed this possibility. Current 504 Networks either do not apply to self-funded programs or they are not large enough to meet the needs of the City. In addition, the creation of a Section 504 Network would not be advantageous for the City as it would require a significant increase in staffing to administer.</p>

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<p>8. The Human Resources Director should ensure that City staff coordinates with the Police Chief (or his designee) to maintain an independent listing of potential subrogation recoveries for comparison to ASC reports.</p>	<p>Concur</p>	<p>A report is being requested from APD. Through a trial period, HR will determine how often it will be needed.</p>	<p>Risk Specialist and Police Chief</p>	<p>1st Qtr FY14</p>	<p>Implemented.  The City Auditor's Office noted that the APD now provides the Risk Specialist with a report of potential subrogation recoveries due to damage to City property and/or vehicles.</p>
<p>9. The Human Resources Director should coordinate with the Chief Financial Officer, to either establish workers' compensation rates, based on fund or department experience, or update and periodically evaluate the employee classification rates.</p>	<p>Concur</p>	<p>HR analyzed and reviewed current workers' compensation rates during June 2013. HR compared workers' compensation rates to losses over the last three years. HR advised the Assistant Director of Finance of three different methodologies used to determine rates. Both the HR Director and the Assistant Director of Finance agreed with using the rates set by the Texas Department of Insurance, also known as the Texas Loss Control Formula Rates (LCF). This project is complete and the new rates have been uploaded into Lawson for FY2014. To avoid excess funds in the account, rates will be reviewed annually, in the 3<sup>rd</sup> quarter, and adjusted if appropriate.</p>	<p>Human Resources Director and Compensation Specialist</p>	<p>a. Completed [using State compensation rates]  b. Annually, 3<sup>rd</sup> quarter each fiscal year [update compensation rates]</p>	<p>Implemented.  The City Auditor's Office noted that the Risk Specialist and Compensation Specialist annually update rates in June. The new rates have been posted and matched to the City's class codes.</p>
<p>10. The Chief Financial Officer should ensure that transfers out of the Workers' Compensation Fund for excess reserves meet the requirements of Circular A-87.</p>	<p>Concur</p>	<p>Any future transfers out of the Workers Compensation Fund for excess reserves will meet the requirements of the Federal Office of Management and Budget grant recipient compliance requirements as outlined in the Circular A-87 and A-133.</p>	<p>Assistant Director, Finance</p>	<p>Completed</p>	<p>Implemented.  No transfers out have been recorded in the Workers' Compensation Fund for excess reserves.</p>

AUDIT RECOMMENDATION	CONCUR / DO NOT CONCUR	MANAGEMENT'S RESPONSE	RESPONSIBLE PARTY	DUE DATE	IMPLEMENTATION STATUS
11. The Human Resources Director should coordinate with the Chief Financial Officer to ensure contributions to the Workers' Compensation Fund match actuarially calculated expectations so that large transfers into or out of the Fund are not necessary.	Concur	The rates that will be set for FY2014 have been determined using actuarial expectations.	Human Resources Department	Completed	Implemented.  The City Auditor's Office noted that no transfers have been necessary due to excess contributions.