

Risk Management and Safety Audit
October 2013

Patrice Randle, City Auditor
Craig Terrell, Assistant City Auditor

Risk Management and Safety Audit

Table of Contents

	<u>Page</u>
Executive Summary	1
Audit Scope and Methodology	3
Background	3
Detailed Audit Findings	8

Risk Management and Safety Audit



Office of the City Auditor
Patrice Randle, CPA
City Auditor

Project # 12-09

October 11, 2013

Executive Summary

The City has done an adequate job of mitigating risks

Opportunities for Improvement

Segregate and record medical, administrative and other expenses in the Lawson Financial System

Review reports of service organization controls and reconcile claims data to bank account data

Consider establishing or joining a Section 504 network

Verify potential subrogation recoveries

Establish and monitor workers' compensation contribution rates based on actual experience

As part of the Fiscal Year 2012 Annual Audit Plan, the City Auditor's Office conducted an audit of Risk Management and Safety. The audit was conducted in accordance with generally accepted government auditing standards, except for peer review. 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 objectives of the audit were to determine if the City:

- has effectively mitigated risks;
- has verified vendor compliance with existing contracts;
- can reduce costs by establishing its own workers' compensation network in accordance with Government Code section 504; and
- has maximized subrogation recoveries.

The City Auditor's Office noted that the Workforce Services Department (Workforce Services) has adequately mitigated risks through the purchase of catastrophic insurance coverage for City buildings, equipment and infrastructure. Workforce Services has also ensured vendor compliance with contractual requirements for outsourced risk management functions, which include subrogation recovery, property and casualty claims settlement and workers' compensation claims processing.

Internal Audit testing over workers' compensation claims processing indicated that sufficient controls existed to ensure that medical expenses were appropriately pre-authorized, that maximum medical improvement determinations were obtained as necessary and that the calculation of indemnity benefits was accurate.

Testing also indicated that Workforce Services provided sufficient oversight over property and casualty claims processing handled by the third party administrator (TPA).

The City Auditor's Office identified several opportunities for improvement. Currently, the City does not separately record medical, administrative and other expenses in the Lawson Financial System. Because the TPA is allowed to sweep administrative fees from the City's concentration account, the City does not specifically review and approve administrative fees prior to payment to the TPA.

Workforce Services staff has not performed a formal risk assessment of the contract with the TPA and did not request or review the TPA's latest Statement on Standards for Attestation Engagements No. 16 (SSAE 16) report. The City also does not verify that reviewed claims activity agrees to bank statement expenditures. Without performing these functions, the City may not establish adequate complementary controls to those established by the TPA.

By establishing or joining a Texas Labor Code Section 504 network, the City could reduce costs by contracting only with preferred providers. The City could also potentially decrease lost time due to injuries by eliminating unnecessary pre-authorization steps.

The City Auditor's Office found that the City does not independently verify the TPA's list of potential subrogation revenue. The risk exists that the TPA could potentially seek recovery and receive payment for claims that have not been reported to Workforce Services.

Although the City has established workers' compensation contribution rates by employee classification, the City does not monitor or track actual experience based on the employee classification. Allocating based on a department or fund experience rating would appear to simplify the current process and align contribution rates with expected expenditures. In addition, excess contributions resulting from the employee classification rates have been returned only to the City's General Fund. Federal grant guidelines suggest that the Federal government receive refunds for its share of any excess contributions.

These findings and related recommendations are discussed in the Detailed Audit Findings section of this report.

Audit Scope and Methodology

The audit was conducted in accordance with generally accepted government auditing standards, except for peer review. The following methodology was used in completing the audit.

- Interviewed Financial and Management Resources and Workforce Services personnel regarding current policies and procedures
- Reviewed applicable reports of service organization controls for vendors and subcontractors
- Documented and tested internal controls over Workers' Compensation claims, subrogation recoveries, the settlement of property and casualty claims and safety and accident reporting
- Reviewed selected workers' compensation claim and subrogation recovery files
- Reviewed the Lawson accounting system for proper recording of revenues and expenditures

Detailed information was not available to verify the calculation of estimated savings of outsourcing various risk management functions in FY2010. As such, the City Auditor's Office did not include an audit objective to determine whether the estimated savings were achieved. Detailed cost information (including the original signed contract) relating to an agreement with the previous provider of workers' compensation claims administration was not available.

Background

The Risk Management Division (Risk Management) of Workforce Services is responsible for placing and administering all City of Arlington property, casualty, liability, and excess insurance policies. Risk Management is also responsible for the verification of insurance certification for City contracts, property and liability claims administration, loss prevention, and Arlington Property Finance Authority Claims Board (discussed further on page 5 of this report) representation and support. One employee and one contracted staff provide support and assistance to all City departments and claimants. In FY2010, the City contracted with Alternative Service Concepts, LLC (ASC) for third party workers' compensation claims administration, property and casualty liability claims administration and other risk management services. Under the agreement, the City pays ASC an annual flat fee of \$239,000 plus additional negotiated fees for case management, subrogation recovery and preferred provider savings.

Workers' Compensation Fund

The City is self-insured for state-mandated workers' compensation claims, with purchased excess insurance for those claims exceeding \$500,000. Employer contributions are made to the Workers' Compensation Fund for each employee based on rates established for each of the 16 employment categories. Rates were initially based on state-wide experience rates that may or may not be comparable to actual City of Arlington experience. The rates vary by employment category – the City contributes a larger percentage of salary for employees in higher risk categories such as public safety and public works.

Various state laws outline employees' rights and obligations related to workplace injuries. Employees have the right to receive medical treatment for their workplace injuries and may be

entitled to additional benefits based on the severity of their injuries. Employees have the responsibility to notify the City within 30 days of when the employee first knew their injury or illness might be work related. The City provides a salary continuation benefit to regular full-time employees that are injured on the job. This benefit provides employees with 100% of their regular salary while off duty due to injury. The salary continuation benefit is available for 90 working days for each on-the-job injury within a 12-month period after the injury. This is greater than the state-mandated temporary income benefit, which is subject to a maximum \$818 per week for CY2013.

The following chart summarizes revenue, expenditures and other data for the Workers' Compensation Internal Service Fund.

Workers' Compensation Fund					
FY2008 to FY2012					
(000's)					
	2008	2009	2010	2011	2012
Operating Revenues	\$ 2,628	\$ 2,302	\$ 2,516	\$ 2,379	\$ 2,884
Operating Expenses	<u>1,968</u>	<u>3,037</u>	<u>1,882</u>	<u>2,965</u>	<u>368</u>
Operating Income (Loss)	660	(735)	634	(586)	2,516
Non-Operating Revenues (Expenses)	<u>394</u>	<u>224</u>	<u>67</u>	<u>51</u>	<u>32</u>
Income (Loss) Before Transfers	1,054	(511)	701	(535)	2,548
Transfers In	-	-	-	500	-
Transfers Out	<u>(2,000)</u>	<u>(2,000)</u>	<u>(1,000)</u>	-	<u>(1,500)</u>
Change in Net Assets	(946)	(2,511)	(299)	(35)	1,048
Cash	9,465	7,934	7,431	8,436	7,495
Liabilities	<u>4,480</u>	<u>5,460</u>	<u>5,256</u>	<u>6,296</u>	<u>4,307</u>
Net Assets, September 30	\$ 4,985	\$ 2,474	\$ 2,175	\$ 2,140	\$ 3,188

Source: City Comprehensive Annual Financial Reports (CAFRs)

In FY2012, a less conservative approach in establishing the reserve required for workers' compensation claims resulted in a significant reduction in the fund's outstanding liabilities and reported operating expense. As noted in the chart above, with the exception of FY2011, the City was able to transfer "excess" funds from the Workers' Compensation Fund to the General Fund.

The following chart summarizes the number of workers' compensation claims filed by fiscal year. Total incurred cost differs by fiscal year from the schedule above due to timing and changes in the approach used to reserve costs. The following schedule is a revised estimate of total incurred cost updated as of April 15, 2013. Higher costs were incurred in FY2010 due to a couple of large indemnity claims related to workplace deaths.

Workers' Compensation Cases				
FY2008 to FY2012				
Fiscal Year	# of Cases	Incurred Costs	Outstanding Reserve	Average Case Cost
2008	418	\$ 1,800,776	\$ 60,703	\$ 4,308
2009	447	1,243,089	85,969	2,781
2010	433	2,306,249	676,746	5,326
2011	495	1,893,250	384,535	3,825
2012	368	1,447,704	366,430	3,934
Grand Total	2,161	\$ 8,691,068	\$ 1,574,383	\$ 4,022

Source: ASC Claims Database

Arlington Property Finance Authority, Inc. (APFA) Fund

The APFA is a Texas nonprofit corporation that was created for the purpose of acting on the City's behalf in financing various governmental programs as prescribed by City Council ordinance or resolution. In October 1986, the City Council adopted an ordinance to establish the City's Self-Insurance and Risk Management Program (the "Program"). The purpose of the Program is to provide the City a defined and funded self-insurance program for general and automotive liability.

The City has contracted with ASC for general and automotive claims management. This includes claims for damage to City property, auto accidents, and any resulting bodily injury; claims for damage to citizen property or vehicles; as well as lawsuits filed against the City. Oversight of ASC is provided by Risk Management and the APFA Board. The following chart summarizes results of the APFA internal service fund over the past five fiscal years:

Arlington Property Finance Authority (APFA) Fund					
FY2008 to FY2012					
(000's)					
	2008	2009	2010	2011	2012
Operating Revenues	\$ 11	\$ 10	\$ 14	\$ 75	\$ 53
Operating Expenses	73	1,176	250	2,254	514
Operating Income (Loss)	<u>(62)</u>	<u>(1,166)</u>	<u>(236)</u>	<u>(2,179)</u>	<u>(461)</u>
Non-Operating Revenues (Expenses)	187	61	113	37	9
Income (Loss) Before Transfers	<u>125</u>	<u>(1,105)</u>	<u>(123)</u>	<u>(2,142)</u>	<u>(452)</u>
Transfers In	1,060	950	1,070	1,950	64
Transfers Out	-	-	-	-	(1,988)
Change in Net Assets	<u>1,166</u>	<u>(155)</u>	<u>947</u>	<u>(192)</u>	<u>(2,376)</u>
Cash	5,888	6,261	6,994	7,666	3,688
Liabilities	2,233	2,761	2,547	3,411	1,809
Net Assets, September 30	<u>\$ 3,655</u>	<u>\$ 3,500</u>	<u>\$ 4,447</u>	<u>\$ 4,255</u>	<u>\$ 1,879</u>

Source: City Comprehensive Annual Financial Reports (CAFRs)

The APFA internal service fund is funded by operating transfers from the City's General Fund and the Water Utilities Fund, as determined by the Financial and Management Resources Department. As with the Workers' Compensation Fund previously noted, a less conservative approach in booking the liability associated with outstanding claims against the City resulted in the ability to transfer "excess" funds back to the General Fund in FY2012.

Subrogation

ASC is also responsible for subrogating claims involving damage to City property. Prior to the agreement with ASC, this function was performed in-house. The City pays ASC a fee that equals 15% of subrogation revenues. The following chart summarizes recoveries over the past three calendar years.

Subrogation Recovery CY2010 to CY2012						
CY	Number of Claims	Billed	Recovered	Outstanding	Average Billed Amount	Collection %
2010	184	\$ 453,810	\$ 296,139	\$ 157,671	\$ 2,466	65.3%
2011	205	578,252	357,219	221,033	2,821	61.8%
2012	168	269,521	165,942	103,579	1,604	61.6%
Grand Total	557	\$ 1,301,583	\$ 819,300	\$ 482,283	2,337	62.9%

Source: ASC February 2013 Monthly Subrogation Report

Risk Management and Safety

In addition to claims processing, Risk Management ensures that the City obtains casualty, liability and excess insurance policies as needed and assists in verifying that City vendors maintain adequate insurance coverage per contractual requirements. Risk Management recently proposed a new policy that shifted much of the responsibility for insurance verification to the contract administrators throughout the City. Per the Workforce Services Director, the intent is to off-load some responsibility from the Risk Specialist position so that the position may provide additional attention to loss prevention and safety. The goal is to increase analysis of the claims reporting database and coordinate with departments to identify necessary loss prevention strategies.

Outsourcing

A staff report presented to City Council on November 17, 2009 recommended authorizing the City Manager to negotiate and execute a contract to outsource Workers' Compensation and General Liability Third Party Claim Administration services with ASC in the estimated amount of \$248,600. The staff report noted that the proposed contract represented \$168,987 in savings in the first year.

As noted in the Scope and Methodology section of this report, detailed information was not available to determine whether the estimated cost savings were obtained. However, the City Auditor's Office was able to review documentation supporting the calculation of the estimated savings, which included \$73,964 related to the elimination of the Safety Officer position. Because this function was eliminated from Workforce Services' responsibilities, the \$73,964 in savings would have been

obtained whether the City outsourced the functions of Risk Management or not. In addition, the calculated savings did not factor in the estimated payments (15%) for subrogation recovery. Although the City Auditor's Office did not perform a detailed analysis of the results of outsourcing, it appears that the presented savings of \$168,987 may have been overstated. However, based on review of available documentation, it appears likely that outsourcing achieved some level of savings and other expected benefits, such as access to an automated claims management system.

Detailed Audit Findings

1. The City's Lawson Financial System does not transparently reflect financial transactions between the City and its third party administrator.

According to the American Institute of Certified Public Accountants, a government is publically accountable for the services it provides taxpayers, and for the way it uses human and financial resources to provide those services. Government fiscal accountability is demonstrated through strong internal controls, budgetary and other legal compliance, accurate and timely financial reporting and a culture of strong moral and ethical behavior. As such, it follows that a City's financial system must provide transparent, reliable information that reflects the nature of transactions between the City and its vendors in a way that promotes accountability.

The City has established a financial arrangement with its third party claims administrator whereby the TPA "sweeps" funds from the City's concentration bank account into the TPA's bank accounts that are used for payment of workers' compensation and property and casualty claims. Expenditures made from the funds include settlement payments, medical expenses, legal expenses and administrative expenses payable to the TPA under the contract with the City. While this type of arrangement is not uncommon in the insurance industry, it does create significant internal control issues that must be addressed and monitored. In reviewing sample case files, the City Auditor's Office noted the following:

- City staff does not review or approve administrative fees paid to the TPA.

Under the agreement with the City, the TPA is entitled to service fees of \$8.50 per claim reviewed and 28% of Preferred Provider Organization (PPO) savings. These fees are "swept" from the City's concentration account and recorded as workers' compensation expenses in the City's financial system. As these fees are payments to the TPA under the contract, better transparency would result if the fees were segregated from medical and other expenditures. This would allow the contract administrator to review, approve and monitor contractual payments to the vendor. For FY2012, the TPA recorded approximately \$53K in fees earned. By not separately identifying and approving payment for administrative expenses, there is no assurance that the City has performed adequate oversight over the fees swept from the City's concentration account. The risk exists that the TPA could "sweep" an incorrect (or inflated) amount of fees from the City's concentration account and not be detected.

- City staff does not segregate and separately record administrative, medical, legal and other costs in the City's financial system.

When submitting monthly bank reconciliation data to support sweep amounts, the TPA provides the City with detailed transaction information including type of expenditure. Currently, the City records the total amount swept from its concentration bank account as "workers' compensation expense" in the City's financial system. Coding expenditures in this manner does not result in the ability to perform historical analyses and comparisons of contract costs using data in the City's financial system. Such information would be useful in establishing benchmarks for future contracts and identifying trends in administrative and medical costs that may need to be addressed.

- The City allows the TPA to draw funds from the City's concentration bank account as necessary (as opposed to a reimbursement basis) to maintain sufficient operating funds in the TPA's bank accounts.

Although the City's agreement with the TPA specifies the various fees to which the TPA is entitled, the agreement does not specify the manner in which the fees should be invoiced and paid. Under financial arrangements made with the City, the TPA has been verbally authorized to "sweep" funds from the City's concentration bank account to pay for checks issued under the workers' compensation and property and casualty claims programs. The TPA performs these "sweeps" periodically in increments of \$50,000 at a time. The total amount swept is recorded as an expenditure under the Workers' Compensation Fund in the City's financial system. This results in an overstatement of expenditures when the amount "swept" exceeds actual expenditures for a given period of time. For example, in September 2012, the TPA swept \$300,000 from the City's concentration account into the TPA workers' compensation bank account, but issued only \$226K in checks for the month.

Because the "sweep" is not performed on a reimbursement basis, a risk exists that the TPA could "sweep" an excessive amount of funds from the City's concentration account without being detected. If swept on a reimbursement basis, City staff could authorize payment based on a review of a specific set of transactions. Recorded expenditures by the City would equal expenditures reported by the TPA.

- Checks are issued to the City of Arlington as reimbursement for temporary income benefits not actually paid to employees.

Injured employees that are not able to work are entitled to temporary income benefits. At the City, most injured employees take advantage of the City's salary continuation program and therefore do not actually receive temporary income benefits from the TPA. However, the TPA calculates the statutorily required temporary income benefits that would have been paid to an employee and issues a check to the City for that amount. According to the City's Controller, the issuing of the check is necessary to record the amount of temporary income benefits that would have been paid to the employee for state reporting purposes. The City deposits the checks in the City concentration account and records the revenue in the Workers' Compensation Fund. The TPA then receives reimbursement for the check in the TPA's "sweep" transaction. Therefore, there is no net effect to the Workers' Compensation Fund. The result is an unnecessary processing of a check which includes the risk that the check can be stolen or recorded incorrectly. The City Auditor's Office was informed that no policy currently exists regarding how to record the check received from the TPA. In FY2012, the City received approximately \$160,000 in payments from the TPA for temporary income benefits.

Recommendation:

The Workforce Services 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.

Management's Response:

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, WFS will coordinate with FMR to discuss proper accounting of the amounts being swept from the checking account.

Target Date: 2nd Qtr FY14

Responsibility: Workforce Services Director

Recommendation:

The Workforce Services 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.

Management's Response:

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 FMR.

Target Date: 2nd Qtr FY14

Responsibility: Workforce Services Director

Recommendation:

In future third party contractual relationships, the Workforce Services Director should consider requiring that the third party administrator request reimbursement for actual expenditures instead of drawing down advance funds.

Management's Response:

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 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. FMR has established, based on historical amounts of claims processed, maximum cash draw-down amounts. FMR will codify the cash policies regarding the amount of advance funds to be deposited as part of the TPA agreement.

Target Date: 2nd Qtr FY 2014; FMR codification of cash policy for TPAs

Responsibility: Controller/Treasurer

Recommendation:

The Workforce Services 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.

Management's Response:

Concur. 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, WFS and FMR will work together to develop a solution for tracking the benefits.

Target Date: 2nd Qtr 2014

Responsibility: Risk Specialist

2. WFS staff has not implemented the recommended complementary controls for claims administration to those controls put in place by the TPA.

Sound business practices suggest that organizations periodically perform risk assessments related to their operations, including contracted services. Risk assessment is the identification and analysis of relevant risks to achievement of objectives, forming a basis for determining how the risks should be managed. Because operating conditions will continue to change, mechanisms are needed to identify and deal with risks associated with change.

The American Institute of Certified Public Accountants issued Statement on Standards of Attestation Engagements (SSAE) No. 16 in 2010. A SSAE 16 audit is a process in which an independent accounting firm assesses the internal controls of a service organization and issues both a service auditor's report and an opinion based on the assessment. A report, named a "Report on Controls Placed in Operation and Tests of Operating Effectiveness", provides user organizations (the City) and auditors information regarding the service organization's (the TPA) controls and assurance that the controls are operating as reported during the period of review. Although there are not standards mandating that service organizations have a SSAE 16 audit report, the reports may be requested by user organizations to gain an understanding of the controls at a service organization and the complementary controls needed within their own operations.

In reviewing controls in place at the City related to the contract with ASC, the City Auditor's Office noted the following:

- Workforce Services has not performed a formal risk assessment related to the City's contract with ASC for workers compensation claim administration.

The City Auditor's Office did not find documented evidence that WFS staff identified and analyzed risks associated with the outsourcing of claims administration to ASC. There was also no documentation of any determination as to how those risks would be managed. Without

conducting periodic risk assessments, the City will not be able to form a basis for determining how those risks will be managed.

- Workforce Services staff had not requested or reviewed ASC's latest SSAE 16 report, dated May 31, 2012.

The SSAE 16 report includes the identification of 10 complementary controls that should be implemented by user entities to provide additional assurance that the control objectives described within the report are met. The 10 controls include several related to data security and passwords, authority levels, monitoring payment and transaction activity and reviewing bank reconciliations and reports provided by ASC in a timely manner. Reviewing a service organization's SSAE-16 report enables a user organization to identify controls that should be in place at its organization to address risks associated with the contracted services.

- Workforce Services staff does not verify that reviewed claims activity agrees to bank statement expenditures.

ASC's SSAE 16 report indicates that user organizations (the City) are responsible for monitoring payment and transaction activity to ensure that transaction activity is accurate. Workforce Services staff reviews claims activity on a transaction basis but does not verify that expenditures for the claims reviewed agree to expenditures reflected on ASC bank statements. Therefore, there is no assurance that the City has reviewed or confirmed case files supporting the dollar amount provided to ASC for claims processing. While the City Controller reviews submitted bank reconciliations and verifies that reported claims expenditures (in aggregate) agree to bank account information, the Controller does not review detailed transactions and is not familiar with the reported claims information. To ensure that monitoring is complete, the City needs to ensure that reported claims activity agrees to bank account expenditures.

Recommendation:

The Workforce Services Director should ensure that staff periodically performs and documents risk assessments for contracted services.

Management's Response:

Concur. Formal assessments will be completed by the Risk Specialist.

Target Date: 2nd Qtr FY14

Responsibility: Risk Specialist

Recommendation:

The Workforce Services Director should ensure that Workforce Services' 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.

Management's Response:

Concur. SSAE 16 reports are provided for the external audit as well as to the actuaries. FMR will send a copy of the reports to WFS. A more formal review of the report will be completed by the Risk Specialist.

Target Date: 2nd Qtr FY14

Responsibility: Controller, Workforce Services Director and Risk Specialist

3. The City has not performed an analysis to determine whether potential cost savings could result from establishing or joining a Texas Labor Code Section 504.053 network.

Common business practice dictates that management routinely review operations and explore possible cost saving alternatives. Texas Labor Code Section 504.053 allows a political subdivision to enter into interlocal agreements with other political subdivisions to establish workers' compensation networks by directly contracting with health care providers. The potential exists for overall reduced costs due to better utilization statistics and better control over medical expenses. According to Workforce Services management, the City has not previously considered establishing or joining a Section 504 network.

If a political subdivision establishes a network under Section 504.053, they must meet certain standards. These standards require that the political subdivision:

- ensure that workers' compensation medical benefits are reasonably available to all injured workers;
- ensure that all necessary health care services are provided in a manner that will ensure the availability of and accessibility to adequate health care providers, specialty care and facilities;
- have an internal review process for resolving complaints relating to the manner of providing medical benefits;
- establish reasonable procedures for the transition of injured workers to contract providers and for the continuity of treatment; and,
- provide for emergency care if an injured worker cannot reasonably reach a contract provider.

The Texas Department of Insurance (TDI) publishes an annual report - "Workers' Compensation Network Report Card Results". The report summarizes the performance of approximately 30 certified networks compared to non-network performance. The report includes Alliance, a joint contracting partnership of five political subdivisions (authorized under Chapter 504, Texas Labor Code) that chose to directly contract with health care providers. While not required to be certified by TDI under Chapter 1305, Texas Insurance Code, the Alliance network must still meet TDI's workers' compensation reporting requirements.

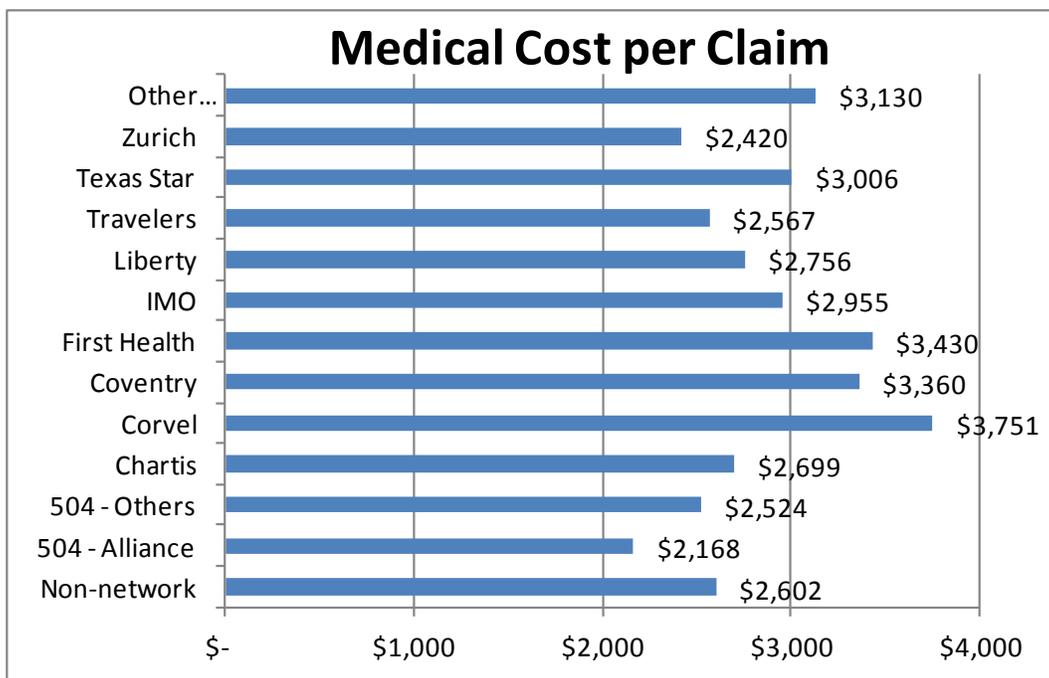
The Alliance intergovernmental pools are:

- Texas Association of Counties Risk Management Pool
- Texas Association of School Boards Risk Management Fund
- Texas Municipal League Intergovernmental Risk Pool

- Texas Council Risk Management Fund
- Texas Water Conservation Association Risk Management Fund

In addition to the Alliance, TDI’s report covers a separate group of networks authorized under Chapter 504, Texas Labor Code. This group is referred to in the report as 504-Others, and is comprised of Dallas County schools and the Trinity Occupational Program (Fort Worth Independent School District). While not required to be certified by the Department under Chapter 1305, Texas Insurance Code, these networks must still meet TDI’s workers’ compensation reporting requirements.

Generally, the Section 504 plans have one of the lowest overall average medical costs per claim, as shown in the chart below.



Source: Texas Department of Insurance

Dallas County Schools established a Section 504 workers’ compensation network that is utilized by four entities – Dallas Area Rapid Transit (DART), Dallas Independent School District (DISD), Dallas County and Dallas County Schools. Per network organizers, DISD has saved approximately \$11 million over the four years that they have participated in the network. According to network organizers, a Section 504 network allows the entities to recruit specific specialty providers while narrowing the field of vendors. According to the Dallas County Schools Director of Risk/Emergency Management, DISD noted an 18% reduction in medical services under the Section 504 program. According to the network organizer, the following benefits have been observed through participating in the Section 504 network.

- Providers feel more at ease since they are not competing with a lot of other eligible providers
- The number of pre-authorization steps has decreased from 18 to approximately six
- Employees return and stay at work quicker than under the old program

- The program eliminates the adversarial nature of dealing with claims adjustors

Although the City could create interlocal agreements with Arlington political subdivisions and establish its own Section 504 network, the City also has the option of joining the existing Dallas County Schools program. The City's current third party administrator (TPA) is familiar with Section 504 networks and believes that costs can generally be lowered when an entity joins a Section 504 network. The TPA representative also noted that the TPA could run reports that could be used to analyze COA medical expenses to determine whether a Section 504 network would be beneficial to the City.

Recommendation:

The Workforce Services 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.

Management's Response:

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.

Target Date: 2nd Qtr FY14

Responsibility: Workforce Services Director

4. The City does not independently verify the list of potential subrogation recoveries.

The City's agreement with ASC requires the vendor to "investigate the possibility of subrogation in each file and document in the claim system so that reports may be generated regarding the subrogation pursuit. Subrogation potential may not be waived, compromised or discounted without the express permission of Client (the City)." While ASC has been providing the City with quarterly subrogation status reports, the City does not perform any monitoring or review to determine whether the list of potential recoveries provided by ASC is complete.

ASC primarily receives reports of damage to City property from the Police Department. Police Officers are trained to notify Risk Management if City property is damaged in automobile accidents or other police incidents (vandalism, attempted theft, etc.). If a citizen caused the damage to City property, the police reports are sent to ASC, not Workforce Services. The Traffic Division forwards reports involving damage to City property to ASC but does not maintain a specific log indicating which reports were sent.

ASC is not responsible for verifying that the Police Department is capturing all incident reports involving damage to City property. Workforce Services also has not performed any review or analysis to verify whether all potential subrogation recoveries have been identified. The Police Traffic Division was able to provide the City Auditor's Office with a listing of all accidents but not a listing of accidents with damage to City property. Therefore, only limited testing was performed to

verify whether accidents were reported to ASC and whether ASC reported the potential subrogation recovery to the City.

In a sample of 60 accidents from calendar year 2012, 19 were found to include damage to City property. Of the 19 accident files, the City Auditor's Office noted that the Traffic Division had informed ASC of each accident and that ASC reported the potential subrogation recovery to Workforce Services. Therefore, no material exceptions were noted. However, the lack of independent review does not address the risk that ASC could seek subrogation recovery for cases that are not reported to Workforce Services. The risk is higher as citizens are asked by ASC to send payment to ASC, not the City.

The Police Department's Traffic Division maintains an accident reporting system, which was recently updated to a system called CRASH. The new CRASH accident reporting system may allow the Police Department to query the database to more quickly identify accidents with damage to City property. Such a report may also be used to identify/verify reports of City damage submitted to ASC and allow WFS to compare potential subrogation recoveries to those reported by ASC.

Recommendation:

The Workforce Services 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.

Management's Response:

Concur. A report is being requested from APD. Through a trial period, WFS will determine how often it will be needed.

Target Date: 1st Qtr FY14

Responsibility: Risk Specialist and Police Chief

5. Workers' Compensation individual contribution rates are not periodically reviewed for accuracy.

In order to fund the Workers' Compensation Fund, the City has established 16 separate employee classification rates. Each City employee is associated with one of the 16 classifications. The rates were established years ago based on TDI state-wide experience rates for various job classifications. Although separate rates were established for the different employee classifications (police, electrical installation, clerical, building operations, etc.), the City has not evaluated and adjusted those rates to actual City of Arlington experience by classification. In fact, the City does not monitor or obtain reports of claims segregated by employee classification.

In order to ensure that the rates result in sufficient reserves for workers' compensation expenses, contribution rates must be periodically compared to actual experience and adjusted to meet desired funding levels. When the City last modified the rates in 2012, the same percentage reduction was applied across the board to all 16 employee classifications. The rates were reduced to better align funding with expected expenditures. However, differences in claims experience among the various employee classifications were not considered in establishing the new rates. The Workforce Services

Director indicated a preference to move towards establishing contribution rates based on department experience, as opposed to individual employee classification rates.

A survey of other metroplex cities (Dallas, Garland, Irving, and Mesquite) indicated that it is common to allocate contributions based on fund or department experience, as opposed to individual employee classification rates. Because experience is not reported by job classification, it is difficult to determine whether changing to a department or fund-based allocation would result in a material difference to any specific department's allocation. However, allocating based on department or fund experience should simplify the process of aligning contribution rates with expected expenditures.

Recommendation:

The Workforce Services 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.

Management's Response:

Concur. WFS analyzed and reviewed current workers' compensation rates during June 2013. WFS compared workers' compensation rates to losses over the last three years. WFS advised the Assistant Director of Financial Management Resources of three different methodologies used to determine rates. Both the WFS Director and the Assistant Director of FMR 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 3rd quarter, and adjusted if appropriate.

Target Date: a) Completed [using State compensation rates]
 b) Annually, 3rd quarter each fiscal year [update compensation rates]

Responsibility: Workforce Services Director and Compensation Specialist

6. Excess funds in the Workers' Compensation Fund were not transferred back to the Community Oriented Policing Services (COPS) grant fund.

Attachment C of Circular No. A-87 issued by the Office of Management and Budget (OMB) defines the process whereby central service costs can be identified and assigned to benefitting activities on a reasonable and consistent basis. Only local governments designated as a "major local government" by the OMB are required to submit cost allocation plans to their cognizant agency annually. All other governments (including the City of Arlington) claiming central service costs must develop a plan in accordance with A-87 requirements and maintain supporting documentation for their single audit. The plan must include details on self-insurance funds, including a statement of revenue and expenses; a summary of billings and claims paid by agency; a listing of non-operating transfers into and out of the fund; a copy of the current actuarial report; and a description of the procedures used to charge or allocate fund contributions to benefitted activities.

Billing rates used to charge Federal awards shall be based on the estimated costs of providing the services. A-87 further states that a comparison of the revenue generated by each billed service to the actual allowable costs of the service will be made at least annually, and an adjustment will be made

for the difference between the revenue and the allowable costs. The circular provides that any required adjustment be made on one of the following methods:

- a. Cash refund to the Federal Government for the Federal share of the adjustment,
- b. Credits to the amounts charged to the individual programs,
- c. Adjustments to future billing rates, or
- d. Adjustments to allocated central service costs.

Adjustments to central services costs are not permitted where the total amount of the adjustment for a particular service (Federal and non-Federal share) exceeds \$500,000. As seen in the chart on page 4 of this report, the City has historically transferred excess funds from the Workers' Compensation Fund to the General Fund. Over the past five fiscal years, the City has transferred \$6.5 million out of the Workers' Compensation Fund. Only in FY2011 did the City have to transfer funds to the Workers' Compensation Fund, due to the higher than expected claims level in FY2010. According to A-87, whenever funds are transferred from a self-insurance reserve to other accounts (e.g. General Fund), refunds shall be made to the Federal Government for its share of the funds transferred, including earned or imputed interest from the date of transfer.

For FY2012, the total Federal share of the \$1.5 million that was transferred back to the General Fund could be considered immaterial. The \$1.5 million represented approximately 60% of the revenue initially collected. In FY2012, federal grants contributed approximately \$100,000 to the Workers' Compensation fund. Therefore, the Federal share of the excess adjustment would be \$60,000, plus earned or imputed interest. Although this amount may be considered immaterial, compliance is expected by the Federal government. Failure to comply with the requirements of Circular A-87 could jeopardize future grant awards. The \$1.5 million transfer to the General Fund was recorded in October, 2011. Subsequently, in January 2013, \$60,193 was transferred from the General Fund to three grant funds (Handitran, Arlington Housing Authority and Community Development Block Grant). Other grant programs, including the COPS grant, were not included in this transfer and did not receive a rebate in proportionate share of their contributions. In FY2012, the COPS grant fund contributed \$37,499 to the Workers' Compensation Fund.

Although there would be no legal requirement to refund excess contributions made by other funds such as Water and Sewer, Storm Water Utility, Parks Performance and Street Maintenance, it may be desirable to ensure that those funds are charged an equitable amount to avoid any appearance of diverting funds to the General Fund. While the amount of workers' compensation contributions is generally immaterial to these individual funds, in total the amount of excess contributions is material to the General Fund. If implemented, the recommendation related to the periodic evaluation of workers' compensation rates by employee classification may reduce the likelihood that excess contributions need to be refunded in the future.

Recommendation:

The Chief Financial Officer should ensure that transfers out of the Workers' Compensation Fund for excess reserves meet the requirements of Circular A-87.

Management's Response:

Concur. 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.

Target Date: Completed

Responsibility: Assistant Director Financial Operations

Recommendation:

The Workforce Services 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.

Management's Response:

Concur. The rates that will be set for FY2014 have been determined using actuarial expectations.

Target Date: Completed

Responsibility: Workforce Services Department