# FINAL CLOSE-OUT FIRST FOLLOW-UP AUDIT

# INTERNAL CONTROL AUDIT: CEO/RISK MANAGEMENT WORKERS' COMPENSATION AND LIABILITY & PROPERTY CLAIM DISBURSEMENTS

# **ORIGINAL AUDIT NO. 2921**

## AS OF NOVEMBER 30, 2010

Our First Follow-Up Audit found that CEO/Risk Management fully implemented all seven (7) recommendations from our original audit where we audited internal controls to ensure claim disbursements were valid, supported, allowable, and processed completely, accurately and timely.

During the original audit, CEO/Risk Management and a third-party claims administrator disbursed approximately \$26 million for Workers' Compensation claims. CEO/Risk Management also disbursed \$8 million for Liability & Property claim settlements and expenses on behalf of the County.

## AUDIT NO: 1033-A REPORT DATE: DECEMBER 28, 2010

Director: Dr. Peter Hughes, MBA, CPA, CIA Deputy Director: Eli Littner, CPA, CIA Senior Audit Manager: Michael Goodwin, CPA, CIA Audit Manager: Winnie Keung, CPA, CIA Audit Manager: Michael Dean, CPA, CIA

#### **RISK BASED AUDITING**

GAO & IIA Peer Review Compliant - 2001, 2004, 2007, 2010

AICPA American Institute of Certified Public Accountants Award to Dr. Peter Hughes as 2010 Outstanding CPA of the Year for Local Government

> 2009 Association of Certified Fraud Examiners' Hubbard Award to Dr. Peter Hughes for the Most Outstanding Article of the Year – Ethics Pays

2008 Association of Local Government Auditors' Bronze Website Award



2005 Institute of Internal Auditors' Award to IAD for Recognition of Commitment to Professional Excellence, Quality, and Outreach

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## Corange county board of supervisors' Internal Audit Department

## GAO & IIA Peer Review Compliant - 2001, 2004, 2007, 2010

**Providing Facts and Perspectives Countywide** 

#### **RISK BASED AUDITING**

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To access and view audit reports or obtain additional information about the OC Internal Audit Department, visit our website: <u>www.ocgov.com/audit</u>



OC Fraud Hotline (714) 834-3608

## Letter from Dr. Peter Hughes, CPA





## **Transmittal Letter**

Audit No. 1033-A December 28, 2010

- TO: Thomas G. Mauk County Executive Officer
- **FROM:** Dr. Peter Hughes, CPA, Director Internal Audit Department
- SUBJECT: First and Final Close-Out Follow-Up Audit: Internal Control Audit of CEO/Risk Management Workers' Compensation and Liability & Property Claim Disbursements, Original Audit No. 2921, Issued June 3, 2010

We have completed a First Follow-Up Audit of internal controls over disbursements made by CEO/Risk Management for Workers' Compensation and Liability & Property claims. Our audit was limited to reviewing, as of November 30, 2010, actions taken to implement the **seven (7) recommendations** from our original audit. We conducted this First Follow-Up Audit in accordance with the *FY 10-11 Audit Plan and Risk Assessment* approved by the Audit Oversight Committee and Board of Supervisors (BOS).

The results of our First Follow-Up Audit are discussed in the **OC Internal Auditor's Report** following this transmittal letter. Our First Follow-Up Audit found that CEO/Risk Management fully implemented all seven (7) recommendations. **As such, this report represents the final close-out of the original audit.** We commend CEO/Risk Management on their responsiveness in taking corrective actions to implement the audit recommendations.

Each month I submit an **Audit Status Report** to the BOS where I detail any material and significant audit findings released in reports during the prior month and the implementation status of audit recommendations as disclosed by our Follow-Up Audits. Accordingly, the results of this audit will be included in a future status report to the BOS.

Other recipients of this report are listed on the **OC Internal Auditor's Report** on page 4.

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#### Audit No. 1033-A

December 28, 2010

TO:	Thomas G. Mauk
	County Executive Officer
FROM:	Dr. Peter Hughes, CPA, Director Augustus Internal Audit Department
SUBJECT:	First and Final Close-Out Follow-Up Audit: Internal Control Audit of CEO/Risk Management Workers' Compensation and Liability & Property Claim Disbursements, Original Audit No. 2921, Issued June 3, 2010

### Scope of Review

We have completed a First Follow-Up Audit of the Internal Control Audit for the CEO/Risk Management Workers' Compensation and Liability & Property Claim Disbursements. Our audit was limited to reviewing, as of November 30, 2010, actions taken to implement the **seven (7) recommendations** from our original audit report.

### Background

We conducted an Internal Control Audit of claim disbursements in CEO/Risk Management for the Workers' Compensation and Liability & Property programs, which included an evaluation of the adequacy and integrity of internal controls; compliance with department and County policy, and evidence of process efficiencies and effectiveness. The original audit identified **two (2) Significant Issues** and **five (5) Control Findings** resulting in seven (7) recommendations pertaining to reimbursements of negotiated discounts and penalty payments by the County's third-party claims administrator; contracted managed care services; audits of the third-party claims administrator; confidentiality and monetary authority limits over liability & property invoices; and differences in amounts reported between the third-party administrator and County payroll reports. During the original audit, approximately \$26 million was disbursed for Workers' Compensation claims, and \$8 million in Liability & Property claim settlements and expenses.

#### Results

Our First Follow-Up Audit indicated the CEO/Risk Management fully implemented all seven (7) recommendations. As such, this report represents the final close-out of the original audit. Based on our First Follow-Up Audit, the following is the implementation status of the seven original recommendations:

1. <u>Negotiated Discounts from Medical Savings and Interest Payment Billed to County</u>

(Control Finding) CEO/Risk Management evaluate requesting a reimbursement or refund from the provider for the \$16,769 negotiated discount charges paid by the County, and enhance the *Check Register* review process to include charge code reviews for timely identification and resolution of any questionable payments.



<u>Current Status:</u> **Implemented.** Our Follow-Up Audit found that CEO/Risk Management took appropriate corrective actions for requesting reimbursement from the third-party administrator (TPA) for negotiated discount charges, and enhancing the *Check Register* review process for timely identification and resolution of questionable claim payments.

We reviewed cash receipt supporting documents to verify that CEO/Risk Management received a reimbursement for negotiated discount charges. We also observed documentation showing CEO/Risk Management met with the TPA to define payment code types and under what circumstances each should be used, and that the TPA programmed its claims system to reject entries of unapproved payment codes. We verified that CEO/Risk Management reviews monthly *Check Registers* and quarterly summary and detailed reports submitted by the TPA to identify incorrectly coded payments, detect questionable payments, and evaluate cost drivers by tracking like expenditures from quarter to quarter and year to year. Because these corrective actions were taken, we consider this recommendation implemented.

### 2. <u>Timely Notification and Reimbursement of Penalty Payments (Control Finding)</u>

CEO/Risk Management enforce contract provisions for the reporting and reimbursement of penalty payments to the County by the contracted Claims Administrator.

<u>Current Status:</u> **Implemented**. CEO/Risk Management and the TPA revised their procedures to ensure timely reporting and reimbursement of penalties to the County. The TPA now completes and emails a *Penalty Explanation Form* to CEO/Risk Management for each penalty check payment within 10 days of issuance, and reimburses the County for the amount of penalty payments within 90 days after each quarter. Upon receipt of the email notification and the *Penalty Explanation Forms*, CEO/Risk Management prepares a *Penalty Payment Schedule* to track the penalty reimbursements due from the TPA. This schedule is reconciled to the TPA's *Payment Summary Report* to ensure all penalty charge reimbursements have been paid to the County.

During the period July 1, 2010 through September 30, 2010, six penalty payments were issued by the TPA totaling \$3,631. We reviewed and verified that all payments were reported to CEO/Risk Management within 10 days of the issuance, and were reimbursed to the County within 90 days after the quarter end. Because these corrective actions were taken, we consider this recommendation implemented.

## 3. <u>Contracted Managed Care Services</u> (Significant Issue)

CEO/Risk Management consult with County Procurement Office and County Counsel to determine if: 1) the current contract should be amended to include Managed Care Services and the related fees in the scope of work; 2) if the document dated December 29, 2009, can be used as the contract amendment; and 3) if Board of Supervisor approval is required for these contracted services.

<u>Current Status:</u> **Implemented.** On May 18, 2010, the Board of Supervisors approved a contract amendment and extension with the County's third-party claims administrator (York Risk Services Group, formerly SCRMA). Our review of the contract amendment noted it addressed managed care services in the Scope of Work, which were not included in the original contract.



Attachment B of the contract formalized the pricing structure of managed care cost containment fees incurred during claims processing. Because the contract amendment now clearly addresses and defines managed care services and related payments, we consider this recommendation implemented.

## 4. Claims Audit of Third Party Administrator (Significant Issue)

CEO/Risk Management ensure an audit is performed on the TPA responsible for claims processing, and establish procedures for conducting future claims audits on a regular basis.

<u>Current Status:</u> **Implemented.** CEO/Risk Management created an RFP to select a vendor to perform Workers' Compensation claim audits, and contracted with AON Global Risk Consulting to do an annual audit for a 3 year period, beginning January 26, 2010. The first year's audit was conducted between February 1 and February 10, 2010 and the first year's final report was received by the County on April 29, 2010. Our review of the audit report indicated that the TPA's claim handling process was good overall, although some areas of improvement were noted. According to CEO/Risk Management, they met with the TPA and discussed corrective actions to address the recommendations, and all recommendations have been addressed. Because actions were taken to ensure annual claims audits of the TPA are conducted, we consider this recommendation implemented.

## 5. <u>Confidential Invoice Procedures</u> (Control Finding)

CEO/Risk Management ensure invoices falling under the "attorney-client privilege" are marked as "confidential" to ensure restricted access.

<u>Current Status:</u> **Implemented.** CEO/Risk Management reiterated their existing policies and procedures with affected staff to ensure compliance. We obtained a listing from CEO/Risk Management of all liability and property claim payments made between September 1, 2010 and November 30, 2010. We selected 10 invoices and found all invoices for legal services (invoices falling under the attorney-client privilege) were properly marked by CEO/Risk Management as "confidential." Based on the corrective actions taken and results of our testing, we consider this recommendation implemented.

## 6. Monetary Authority Amounts (Control Finding)

CEO/Risk Management develop policies and procedures documenting monetary authority amounts and instances where exceeding those amounts are allowed.

<u>Current Status:</u> **Implemented.** CEO/Risk Management re-issued by email the monetary settlement authority documentation to its staff to ensure such documentation will remain readily available whenever requested.

We obtained a listing from CEO/Risk Management showing expense and claim payments made between September 1, 2010 and November 30, 2010. We tested 5 claim payments to determine if the payment amount was within the Claims Adjusters' respective monetary settlement authority amount, or if outside the respective monetary settlement authority amount, the payment was approved by the Liability and Property Claims Manager. No exceptions were noted. Based on the corrective actions taken and results our testing, we consider this recommendation implemented.



### 7. Differences Between County and SCRMA's Records (Control Finding)

CEO/Risk Management evaluate the need to adjust the differences found between SCRMA's *Voucher Register* and the County payroll system.

<u>Current Status:</u> **Implemented.** CEO/Risk Management and the TPA evaluated the immaterial differences (ranging from \$0.02 to \$0.09) in claim payments shown on the TPA's reports and in the County payroll system. Their evaluation found the State of California permits adjusters to use three different formulas to calculate average weekly wages. To ensure consistency, the TPA adopted one formula for calculating benefit rates. The formula calculates the average weekly wages using 4 decimal points (.6667%), and the TPA notifies the claimant of the weekly benefit based on that calculation. However, the County payroll system only calculates to 2 decimal points.

We selected ten items for testing and noted the immaterial differences have been greatly minimized; however some still exist due to the differences in decimal point calculations, which is beyond the control of CEO/Risk Management and the TPA. Since the claimant is entitled to the benefit as notified on the benefit notice, CEO/Risk Management is aware that the County remains responsible for any difference between the amount paid and the notice. Because CEO/Risk Management evaluated this issue and took appropriate corrective actions, we consider this recommendation implemented.

We appreciate the cooperation and assistance extended to us by the personnel of the CEO/Risk Management during our First Follow-Up Audit. If you have any questions, please contact me directly or Eli Littner, Deputy Director at 834-5899, or Michael Goodwin, Senior Audit Manager at 834-6066.

Distribution Pursuant to Audit Oversight Committee Procedure No. 1:

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