

Internal Audit Department

O R A N G E C O U N T Y
 5th Largest County in the USA

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

Critical
 Impact
 Audit

For the Year Ending
 June 30, 2009

During FY 2008/2009, 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. We audited internal controls to ensure these disbursements are valid, supported, allowable, and are processed completely, accurately and timely.

Overall, we found controls and processes are in place in CEO/Risk Management over Workers' Compensation and Liability & Property claim disbursements to ensure the payments are valid, supported, allowable and are processed completely, accurately and timely. There are **two (2) Significant Issues** we identified that, when implemented, will greatly improve oversight of the third-party claims administrator, and **five (5) Control Findings** to enhance existing controls and processes in CEO/Risk Management.

AUDIT No: 2921
 REPORT DATE: JUNE 3, 2010

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RISK BASED AUDITING

GAO & IIA Peer Review Compliant – 2001, 2004, 2007

2009 Association of Certified Fraud Examiners' Hubbard Award to Dr. Peter Hughes For the Most Outstanding Article of the Year



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

Providing Facts and Perspectives Countywide

RISK BASED AUDITING

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Letter from Dr. Peter Hughes, CPA



Transmittal Letter



Audit No. 2921 June 3, 2010

TO: Thomas G. Mauk
County Executive Officer

FROM: Dr. Peter Hughes, CPA, Director
Internal Audit Department

SUBJECT: Internal Control Audit: CEO/Risk Management
Workers' Compensation and Liability & Property
Claim Disbursements

We have completed an Internal Control Audit of disbursements made by the CEO/Risk Management for Workers' Compensation and Liability & Property claims for the year ending June 30, 2009. We performed this audit in accordance with our *FY 2009-10 Audit Plan and Risk Assessment* approved by the Audit Oversight Committee and the Board of Supervisors. Our final report is attached for your review.

Please note we have a structured and rigorous **Follow-Up Audit** process in response to recommendations and suggestions made by the Audit Oversight Committee (AOC) and the Board of Supervisors (BOS). As a matter of policy, our **first Follow-Up Audit** will begin at six months from the official release of the report. A copy of all our Follow-Up Audit reports is provided to the BOS as well as to all those individuals indicated on our standard routing distribution list.

The AOC and BOS expect that audit recommendations will typically be implemented within six months and often sooner for significant and higher risk issues. Our **second Follow-Up Audit** will begin at six months from the release of the first Follow-Up Audit report, by which time **all** audit recommendations are expected to be addressed and implemented.

At the request of the AOC, we are to bring to their attention any audit recommendations we find still not implemented or mitigated after the second Follow-Up Audit. The AOC requests that such open issues appear on the agenda at their next scheduled meeting for discussion.

We have attached a **Follow-Up Audit Report Form**. Your department should complete this template as our audit recommendations are implemented. When we perform our first Follow-Up Audit approximately six months from the date of this report, we will need to obtain the completed document to facilitate our review.

Letter from Dr. Peter Hughes, CPA



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.

As always, the Internal Audit Department is available to partner with your staff so that they can successfully implement or mitigate difficult audit recommendations. Please feel free to call me should you wish to discuss any aspect of our audit report or recommendations.

Additionally, we will request your department complete a [Customer Survey](#) of Audit Services. You will receive the survey shortly after the distribution of our final report.

ATTACHMENTS

Other recipients of this report are listed on the [OC Internal Auditor's Report](#) on page 5.

OC Internal Auditor's Report



*Internal Control Audit:
CEO/Risk Management Workers' Compensation and
Liability & Property Claim Disbursements
Audit No. 2921*

For the Year Ending
June 30, 2009

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OC Internal Auditor's Report



Audit No. 2921

June 3, 2010

TO: Thomas G. Mauk
County Executive Officer

FROM: Dr. Peter Hughes, CPA, Director
Internal Audit Department

SUBJECT: Internal Control Audit: CEO/Risk Management
Workers' Compensation and Liability & Property
Claim Disbursements

Audit Highlights

During FY 2008/2009, CEO/Risk Management and the third-party claims administrator (SCRMA) disbursed approximately **\$26 million** for Workers' Compensation payments to County employees and service providers representing **3,459 claims**.

CEO/Risk Management Liability & Property provides in-house handling of all liability claims filed against the County of Orange. During FY 2008/2009, they disbursed over **\$8 million for 342 claim settlements and related expenditures**.

We identified two (2) **Significant Issues** and five (5) **Control Findings** to improve and enhance existing internal controls and processes over claim disbursements.

OBJECTIVES

The Internal Audit Department conducted an Internal Control Audit of disbursements in County Executive Office/Risk Management (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. Our audit was conducted in conformance with professional standards established by the Institute of Internal Auditors. The objectives of our audit were to:

- Workers' Compensation: Administration by CEO/Risk Management** Evaluate CEO/Risk Management's internal controls and processes to ensure Workers' Compensation payments are based on valid claims, contain appropriate supporting documentation, and are authorized by CEO/Risk Management and/or the Third-Party Administrator (SCRMA).
- Workers' Compensation: Monitoring of Third-Party Administrator** Evaluate CEO/Risk Management's controls and monitoring processes over the performance of the Third-Party Administrator (SCRMA) responsible for processing and disbursing Workers' Compensation payments on behalf of the County.
- Liability & Property Claim Disbursements** Evaluate CEO/Risk Management's controls for processing Liability & Property claim disbursements to ensure transactions are prepared accurately, completely, timely, are valid, and have appropriate supporting documentation and management authorization.
- Process Efficiency/Effectiveness** Evaluate the efficiency and effectiveness of the Workers' Compensation and Liability & Property claim disbursement processes in CEO/Risk Management to determine if there are backlogs, duplication of work, or manual processes that could benefit from automation.



BACKGROUND

The County is self-insured for Workers' Compensation and Liability & Property claims and has established Internal Service Funds to set aside funds for paying all claim costs, including statutorily required payments, settlements and related expenses and judgments associated with these losses. The Risk Management section of the County Executive Office (**CEO/Risk Management**) acts as the "insurance company" for the County. It manages the self-insurance funds; operates programs for Liability & Property claims, administers and provides oversight to a third-party administrator for Workers' Compensation benefits, operates the Countywide Safety and Loss Prevention Program, and provides program advisory and consultation services to the departments to assist in the cost-effective use of funds. The mission of CEO/Risk Management is to preserve and protect the human resources and capital assets of the County of Orange from injury or loss.

Workers' Compensation

The Workers' Compensation program provides state mandated benefits to County employees and other qualified recipients resulting from work-related injuries. CEO/Risk Management contracts with a third-party administrator (TPA) to administer the program. CEO/Risk Management staff coordinates benefit provisions for all County departments and agencies, provides oversight of the TPA's performance, and assists with problem resolution.

During the audit period, **Southern California Risk Management Associates (SCRMA)**, a subsidiary of **York**, was the TPA contracted to administer the Workers' Compensation program. (Note: On March 10, 2010, SCRMA officially changed their name to York. However, for purposes of this report, we will refer to the TPA and/or SCRMA.) The County established a **\$2.9 million contract** with SCRMA for claims processing, handling fees and overhead costs. SCRMA is responsible for evaluating and investigating claims; determining disability benefits; and processing all Workers' Compensation payments to vendors and some indemnity payments to qualified recipients. SCRMA issues these payments from the County's zero balance bank account, known as ZBA, which is a checking account in which a balance of zero is maintained by automatically transferring funds from a master account in an amount only large enough to cover payments presented. Some indemnity payments are processed through the County's payroll system.

For the year ending June 30, 2009, approximately **\$25.8 million** in Workers' Compensation disbursements were made; **\$21.2 million** through SCRMA, and **\$4.6 million** via County payroll (see details below). These payments represented **3,459 cases**, including some cases originating prior to July 1, 2008.

Pay Type	Payments Made Through County Payroll System	Payments made Through SCRMA Disbursement Process	Total
EXPENSE PAYMENTS	N/A	\$2,591,731	\$2,591,731
MEDICAL PAYMENTS	N/A	\$8,989,722	\$8,989,722
INDEMNITY PAYMENTS/ TEMP. AND PERM. DISABILITY	\$5,007,480	\$9,793,485	\$14,800,965
RECOVERIES	N/A	(\$212,142)	(\$212,142)
REVERSED PAYMENTS	(\$378,176)	N/A	(\$378,176)
Total	\$4,629,304	\$21,162,796	\$25,792,100



Liability & Property Claims Management

Liability & Property Claims Management provides “in-house” handling of all liability claims filed against the County. These claims include bodily injury, use of force, civil rights violations, employment-related losses, property losses, vehicle damage claims, and pursuit of recovery of funds when the County sustains losses due to actions of a third party. A staff of four processes the liability claims. Information is gathered from departments/agencies involved in the claims and additional investigation is conducted as needed.

One of the primary responsibilities of the program is litigation management and direction. Litigation cases are overseen by staff that supervise the work product of private contract attorneys and coordinate legal matters with County Counsel. On occasion, the program also utilizes private contractors for investigation services. CEO/Risk Management reviews all claims and processes invoices from defense attorneys for services, court fees, copies, expert fees, witness fees, and translator fees.

For the year ending June 30, 2009, there were **644 cases opened**. The following amounts were paid during FY 2008/2009 on **342 cases** involving Liability & Property claims:

Pay Type	Amount
BODILY INJURY	\$1,006,291
PROPERTY DAMAGE	\$221,292
OTHER EXPENSES, INCLUDING ATTORNEY FEES, COURT FEES, EXPERT FEES, ETC.	\$6,807,619
Total	\$8,035,202

SCOPE

Our audit evaluated internal controls over disbursements resulting from Workers' Compensation and Liability & Property claims for the period from July 1, 2008 through June 30, 2009. Our scope included the following elements:

- Determine if Workers' Compensation payments, including temporary and permanent disability benefits issued via County payroll, are based on valid claims; have appropriate supporting documents, and are authorized by management.
- Evaluate CEO/Risk Management's monitoring processes over SCRMA/York to ensure Workers' Compensation claims processing complies with the contractual requirements, and that disbursements made by SCRMA are accurate, based on valid claims, and have appropriate supporting documentation and management's authorization.
- Determine if Liability & Property claim payments are accurate, complete and have appropriate supporting documentation and management's authorization.
- Evaluate efficiency/effectiveness of the above processes by observing for backlogs, duplication of work, and manual processes that could be automated.

SCOPE EXCLUSIONS

We did not audit Workers' Compensation claims processing performed by SCRMA, including evaluating individual claims for propriety of treatment or services incurred. We did not assess the performance of SCRMA and did not validate SCRMA's calculation of benefit payments. Also, we did not audit CEO/Risk Management's compliance with State Workers' Compensation rules/regulations and for meeting all contract requirements. Furthermore, we did not evaluate the information systems used in the disbursement process at SCRMA.



RESULTS

Overall, we found controls and processes are in place in CEO/Risk Management over Workers' Compensation and Liability & Property claim disbursements to ensure the payments are valid, supported, allowable and are processed completely, accurately and timely. There are **two (2) Significant Issues** we identified that, when implemented, will greatly enhance the County's oversight of its third-party claims administrator, and **five (5) Control Findings** to enhance existing controls and processes in CEO/Risk Management. These are discussed in the *Detailed Observations, Recommendations and Management Responses* section of this report. See *Attachment A* for a description of Report Item Classifications. Based on our audit objectives, we noted the following:

- ▶ **Objective #1 – Workers' Compensation: Administration by CEO/Risk Management** *Evaluate CEO/Risk Management's internal controls and processes to ensure Workers' Compensation payments are based on valid claims, contain appropriate supporting documentation, and are authorized by CEO/Risk Management and/or the Third-Party Administrator (SCRMA).*
- ▶ **Results:** Internal controls and processes in place to ensure Workers' Compensation payments are based on valid claims, contain appropriate supporting documents, and are properly authorized. We noted **two (2) Control Findings** concerning negotiated discounts and late payment interest charged to the County, and penalty reports and reimbursements submitted to the County by the third-party administrator. (See **Observations Nos. 1 and 2** below)
- ▶ **Objective #2 – Workers' Compensation: Monitoring of Third-Party Administrator** *Evaluate CEO/Risk Management's controls and monitoring processes over the performance of the Third-Party Administrator (SCRMA) responsible for processing and disbursing Workers' Compensation payments on behalf of the County.*
- ▶ **Results:** We found that controls and monitoring processes are in place in CEO/Risk Management over the Third-Party Administrator's (SCRMA) processing of Workers' Compensation payments. However, we identified **two (2) Significant Issues** related to the contract with SCRMA concerning payments made for Managed Care Services and for performing claims audits. (See **Observation Nos. 3 and 4** below)
- ▶ **Objective #3 – Liability & Property Claim Disbursements:** *Evaluate CEO/Risk Management's controls for processing Liability & Property claim disbursements to ensure transactions are prepared accurately, completely, timely, are valid, and have appropriation supporting documentation and management's authorization.*
- ▶ **Results:** We found controls are in place to ensure Liability & Property claims disbursements are valid, supported, and are processed completely, accurately and timely. We identified **two (2) Control Findings** in the areas of confidential invoice procedures, monetary authority amounts for Claims' Adjusters, and document retention. (See **Observation Nos. 5 through 6** below)
- ▶ **Objective #4 – Process Efficiency/Effectiveness:** *Evaluate the efficiency and effectiveness of the Workers' Compensation and Liability & Property claim disbursement processes in CEO/Risk Management to determine if there are backlogs, duplication of work, or manual processes that could benefit from automation.*
- ▶ **Results:** We did not note any backlogs, duplication of work, or manual processes that could benefit from automation. We identified **one (1) Control Finding** regarding immaterial differences in benefits paid between the County's and SCRMA's records. (See **Observation No. 7** below)



Management's Responsibilities for Internal Controls

In accordance with the Auditor-Controller's County Accounting Manual section S-2 – *Internal Control Systems*, "all County departments/agencies shall maintain effective internal control systems as an integral part of their management practices. This is because management has primary responsibility for establishing and maintaining the internal control system. All levels of management must be involved in assessing and strengthening internal controls. Control systems shall be continuously evaluated and weaknesses, when detected, must be promptly corrected." The criteria for evaluating an entity's internal control structure is the Committee of Sponsoring Organizations (COSO) control framework. Our Internal Control Audit enhances and complements, but does not substitute for CEO/Risk Management's continuing emphasis on control activities and self-assessment of control risks.

Inherent Limitations in Any System of Internal Control

Because of inherent limitations in any system of internal controls, errors or irregularities may nevertheless occur and not be detected. Specific examples of limitations include, but are not limited to, resource constraints, unintentional errors, management override, circumvention by collusion, and poor judgment. Also, projection of any evaluation of the system to future periods is subject to the risk that procedures may become inadequate because of changes in conditions or the degree of compliance with the procedures may deteriorate. Accordingly, our audit would not necessarily disclose all weaknesses in the CEO/Risk Management's operating procedures, accounting practices and compliance with County policy.

Acknowledgment

We appreciate the courtesy extended to us by CEO/Risk Management. If we can be of further assistance, please contact me directly; or Eli Littner, Deputy Director at 834-5899, or Michael Goodwin, Senior Audit Manager at 834-6066.

Attachments

Distribution Pursuant to Audit Oversight Committee Procedure No. 1:

Members, Board of Supervisors
Members, Audit Oversight Committee
Bob Franz, Deputy CEO, Chief Financial Officer
Tom Phillips, Risk Manager, CEO/Risk Management
Laurie Browning, Workers' Compensation Manager, CEO/Risk Management
Sunny Bittle, Claims Manager, CEO/Risk Management
Bryan Berea, Administration & Financial Manager, CEO/Risk Management
Darleen J. Bloom, Clerk of the Board of Supervisors
Foreperson, Grand Jury

DETAILED OBSERVATIONS, RECOMMENDATIONS AND MANAGEMENT RESPONSES



Audit Objective No. 1 – Workers’ Compensation: Administration by CEO/Risk Management Our objective was to evaluate CEO/Risk Management’s internal controls and processes to ensure Workers’ Compensation payments are based on valid claims, contain appropriate supporting documentation, and are authorized by CEO/Risk Management and/or the Third-Party Administrator (SCRMA).

When a work-related injury occurs, employees can receive some or all of the following Workers’ Compensation benefits:

1. **Medical Care:** Includes treatments by a doctor, hospital services, physical therapy, lab tests, x-rays and medicines. The claims administrator will pay the costs directly and there is a limit on some medical services.
2. **Payment for Temporary Disability (lost wages):** Typically is two-third of the average weekly pay of the employee, within minimum and maximums set by the State law.
3. **Payment for Permanent Disability:** The amount depends on the level of permanent disability, age, occupation, diminished future earning capacity, and date of injury.
4. **Vocational Rehabilitation (VR):** A benefit for injuries that occurred prior to 2004. The claims administrator will pay the costs up to a maximum set by State law.
5. **Supplemental Job Displacement Benefits:** A benefit for injuries occurring on or after 1/1/04. The claims administrator will pay the costs up to a maximum set by State law based on a percentage of permanent disability.
6. **Death Benefits:** Payments made to relatives or household members who were financially dependent on the deceased worker.

The injured employee’s supervisor completes a **Form 5020 ~ Employer’s Report of Occupational Injury or Illness** and submits it to CEO/Risk Management to report the incident. *Form 5020* initiates the claim; however, acceptance of *Form 5020* is not an admission of the liability. CEO/Risk Management receives the forms electronically, verifies employment, and then forwards all cases to SCRMA for a secondary review. SCRMA determines if an investigation is needed after conducting a 3-point contact (i.e. verifying the information with the employee, supervisor and treating physician). SCRMA determines if the case is to be accepted, delayed, or denied within 90 days.

- If the claim is accepted and the employer is able to accommodate the work restriction, (e.g. re-assign employee to a desk job), the claimant will not receive any indemnity/disability payments.
- If the claim is accepted and the employer is unable to accommodate the work restriction, the claimant is eligible for indemnity payments. Based on the wage statement provided by the County, SCRMA is responsible for calculating the weekly rate for Temporary Disability benefits. Also, SCRMA notifies CEO/Risk Management to begin benefit payments, and notifies the claimant of the claim status, including the benefit amount and period.
- The County payroll system processes some indemnity and Labor Code Section 4850 payments, and all supplemental Workers’ Compensation benefits (see description below). These transactions are recorded in the *County of Orange Workers Compensation Report*. SCRMA also records all of these transactions, except for supplemental Workers’ Compensation benefits, on a monthly *Voucher Register* that is provided to CEO/Risk Management for monitoring.
- SCRMA processes some disability benefit payments and all Workers’ Compensation related expenses, e.g. settlements, medical bills, and legal fees. These transactions are recorded in SCRMA’s monthly *Check Register* that is provided to CEO/Risk Management for monitoring. Claim settlements over \$75,000 require approval from the Board of Supervisors. Since these payments do not go through County’s disbursement system, these transactions do not appear in the County’s financial system.



Temporary and Permanent Disability Benefits

As noted above, employees may be eligible for Temporary and Permanent Disability benefits. The *California Labor Code* governs the computation of the disability benefits and its effective periods. This benefit is known as regular Worker's Compensation (regular) benefits. Peace officers are entitled to *Labor Code Section 4850* benefits, which allow employees to receive full salary in lieu of temporary disability for up to one year. Therefore, these claimants can receive benefit payments equal to 100% of their regular earnings when entitled to receive benefits. In addition, the County has Memorandums of Understanding (MOUs) with certain labor unions to supplement the regular Worker's Compensation benefits for one year. Under these MOUs, claimants can receive benefit payments equal to 80% of the claimant's regular earnings.

Control Strengths Over Workers' Compensation Administration

Control strengths we noted to ensure the validity of Workers' Compensation claims include:

- ✓ A standard form (*Form 5020*) is used to initiate a claim.
- ✓ A unique number is assigned to each claim and a file is created to track each payment.
- ✓ Procedures are in place at CEO/Risk Management to review and update the status of each active case (e.g. rate changes or benefit termination) prior to the processing of County payroll to ensure benefit payments made through County payroll are proper.
- ✓ Procedures are in place at CEO/Risk Management to verify the *County of Orange Workers Compensation Report* for actual disability benefit payments (rate and period) paid against the claim documentation.
- ✓ Workers' Compensation payments by SCRMA over \$5,000 are required to provide support to CEO/Risk Management for their review and approval of the payments.

Results

To accomplish our objective, we selected a sample consisting of the following items:

- **Fifty (50)** Workers' Compensation expense payments totaling **\$266,884**.
- **Nineteen (19)** Workers' Compensation benefit payments totaling **\$21,400**.
- **Thirty (30)** Workers' Compensation payments (over \$5,000) totaling **\$418,616**.
- **Six (6)** Workers' Compensation penalty payments reimbursed to County totaling **\$1,304**.

Based on our testing, we found internal controls are in place to ensure Workers' Compensation expense and benefits payments, and Temporary and Permanent Disability payments were supported by a valid claim, contained proper supporting documentation, and were authorized by CEO/Risk Management and/or SCRMA on their behalf. We identified **two (2) Control Findings** to enhance controls and processes in reviewing the *Check Register* for negotiated discounts and late interest payments, and for reporting and submitting penalty payment reports and reimbursements as discussed below:

DETAILED OBSERVATIONS, RECOMMENDATIONS AND MANAGEMENT RESPONSES



Observation No. 1 – Negotiated Discounts from Medical Savings and Interest Payment Billed to County (Control Finding) We noted that the County paid **negotiated discounts** totaling **\$16,769** to reimburse a provider, another York subsidiary, for savings found during the medical bill review process performed as part of claims processing. CEO/Risk Management did not detect these payments when they were processed, and does not agree they should be billed to the County. These payments were not detected because the amounts were under the dollar threshold for approval by CEO/Risk Management.

We also noted one expense regarding an **interest payment** totaling **\$120.47** for an untimely payment made by SCRMA. In accordance with the Contract Agreement, SCRMA is responsible for the timely processing of claims and should reimburse the County for any interest or penalties associated with late payments. The County did not receive reimbursement for the interest paid. Note: As a result of reporting this issue during the audit, the County subsequently received reimbursement of this amount.

SCRMA's monthly *Check Register* submitted to CEO/Risk Management has charge codes established for all Workers' Compensation payments and expenses, including codes for provider reimbursement of negotiated discounts and interest payments. A review of these specific charge codes should be regularly performed to identify questionable payments, discounts and interest for reimbursement.

Recommendation No. 1

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.

CEO/Risk Management Response:

Concur. Although the check register indicated \$16,769 in checks had been issued, some checks had not been cashed so the amount of the reimbursement due to the County was actually \$14,782. A check in the amount of \$14,782 was issued to the County on 11/10/09 and deposited into the County's account. The remaining checks totaling \$1,987 were voided. CEO/Risk Management has taken the following steps to enhance the Check Register review process:

- 1.) Met with SCRMA to clearly define all payment code types and under what circumstances each should be used.
- 2.) Requested that SCRMA program our claims system to reject entries if payment codes are used which have not been approved by the State of California.
- 3.) In addition to the monthly check register we already receive, we have requested a quarterly summary of all payments by pay code as well as a quarterly detail report. These reports have several uses, such as allowing us to identify incorrectly coded payments, detect questionable payments and evaluate cost drivers by tracking "like" expenditures from quarter to quarter and year to year.



Observation No. 2 – Timely Notification and Reimbursement of Penalty Payments (Control Finding) SCRMA did not submit to CEO/Risk Management the *Penalty Check Register* and the related reimbursement checks in a timely fashion. SCRMA provided these items between 2 to 8 months after each quarter. Procedures did not define the expected timeframes for SCRMA to report and reimburse the penalties to the County. The **Penalty payments** that we tested ranged from **\$92 - \$425**.

The SCRMA *Contract Agreement*, Attachment A, Section B, states that “the Contractor shall reimburse the County for any penalties assessed the County which is found to be the result of the Contractor’s lack of proper claim handling, including late payments and costs incurred due to late/improper notifications.” Although penalty payments are identified in monthly *Check Register*, procedures should be enhanced to require timeframes for generating and submitting the quarterly *Penalty Check Register* and related reimbursements.

Recommendation No. 2

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

CEO/Risk Management Response:

Concur. Item #16 (Assessment of Administrative Penalties Payment) of the County’s contract with SCRMA requires the Contractor to notify the County of penalties within 10 days of notice or payment and to reimburse the County within 90 days after the close of the quarter in which the penalty was paid. SCRMA has implemented the following procedure to ensure timely reporting and reimbursement of penalties to the County of Orange:

- 1.) Upon recognition that a penalty is due, a penalty form is completed by SCRMA explaining the reason for the penalty, and the penalty payment is generated in SCRMA’s Claims Connect system and pends to the Supervisor’s check queue.
- 2.) The Supervisor and the Branch Manager review and approve the penalty form within one business day, and the penalty check is released.
- 3.) The Branch Manager provides the penalty form to the Compliance department, and a copy is emailed to the County of Orange Workers’ Compensation Program Manager within 10 days of issuance of the penalty.
- 4.) A Check Register showing all penalties incurred due to SCRMA’s lack of proper claims handling along with a check reimbursing the County of Orange for such penalties will be provided no later than 90 days from the end of the quarter in which the penalty was paid.
- 5.) SCRMA’s Client Relations department ensures that the Check Register and reimbursement is provided to the County of Orange within the required timeframe.
- 6.) To ensure compliance with contract provisions, internal monitoring of the monthly check register of quarterly pay code report is performed by the County of Orange Workers’ Compensation Program Manager.

DETAILED OBSERVATIONS, RECOMMENDATIONS AND MANAGEMENT RESPONSES



Audit Objective No. 2 – Workers’ Compensation: Monitoring of Third-Party Administrator. Our objective was to evaluate CEO/Risk Management’s controls and monitoring processes over the performance of the Third-Party Administrator (SCRMA) responsible for processing and disbursing Workers’ Compensation payments on behalf of the County.

During our audit period, **Southern California Risk Management Association (SCRMA)** was the contracted Third-Party Administrator (TPA) to administer the Workers’ Compensation Claims Program. It is a **fixed fee contract** for an annual amount of **\$2.9 million**. This amount is for claim handling fees, including salaries and benefits for 28 SCRMA staff, overhead costs and profit. SCRMA is a subsidiary of York. (Note: On March 10, 2010, SCRMA officially changed their name to York.) SCRMA processed Workers’ Compensation payments in the amount exceeding **\$21 million** during the audit period. CEO/Risk Management relies on SCRMA’s expertise and professionalism in claims processing to help determine the acceptance of a claim and in reviewing vendor and provider invoices.

Process and Control Strengths Over Monitoring of Third-Party Administrator

We noted the following processes and controls concerning the monitoring process:

- ✓ Written policies and procedures for monitoring Workers’ Compensation program are in place, including defined roles and responsibilities of SCRMA and CEO/Risk Management.
- ✓ A written contract exists between the County and SCRMA that further describes responsibilities and requirements of CEO/Risk Management and the TPA.
- ✓ SCRMA submits monthly payment reports (*Check and Voucher Registers*) for review at CEO/Risk Management. CEO/Risk Management reviews payments exceeding \$1,000 for reasonableness and propriety.
- ✓ CEO/Risk Management requires SCRMA to obtain their written approval for all payments over \$5,000 and for vendor selection for certain services (e.g. legal).
- ✓ Communications between CEO/Risk Management and SCRMA are regular and constant.
- ✓ CEO/Risk Management staff are knowledgeable regarding the Workers’ Compensation processes.

Results

To accomplish our objective, we selected **thirty (30) SCRMA check payments** with amounts exceeding \$5,000 (**totaling \$418,616**) to ensure they were all submitted to CEO/Risk Management for review and approval. We evaluated the adequacy of written procedures for monitoring the TPA’s performance. We observed evidence of CEO/Risk Management’s review of monthly disbursement registers and evidence of frequent communication between the parties. Overall, we found controls and processes in place in CEO/Risk Management for monitoring SCRMA’s processing and payment of Workers’ Compensation expenses and payment benefits. However, we noted **two (2) Significant Issues** where improvements are needed in the contract administration and monitoring that, when implemented, will greatly enhance the County’s oversight of the TPA.

DETAILED OBSERVATIONS, RECOMMENDATIONS AND MANAGEMENT RESPONSES



Observation No. 3 – Contracted Managed Care Services (Significant Issue)

SCRMA, a subsidiary of York, issued payments during the audit period totaling **\$21.2 million** for Workers' Compensation claim expenses and benefit payments. This amount included payments totaling **\$1.1 million** for Managed Care Services or bundled services (see below table for details). Many of these Managed Care Services vendors are subsidiaries of York. We noted that the billing rates of some Managed Care Services were included in SCRMA's Contract Proposal; however these services and rates were not included in the final Board-approved contract with SCRMA or supported by supported by a Contract Agreement.

Vendor Name	Amount	Paid for	Descriptions
Medical Audit & Management	\$448,661.85	Bill review fees	This service is for reviewing <u>all medical bills</u> to ensure accuracy, e.g. fees are billed based on a Medical Fee Schedule.
U.R. Integrated	\$403,698.50	Utilization review fees	This service is for utilization review on some recommended treatments to ensure medical treatments are appropriate and needed, e.g. the number of physical therapy sessions recommended.
Physician Review	\$165,605.00	Fees for UR performed by physician	This service is for utilization review conducted by physician on some recommended treatments to ensure medical treatments are appropriate and needed, e.g. the approval for surgical procedures.
WellCare RN	\$39,174.62	Nurse case management fees	This is to pay for medical assistance provided by a registered nurse for selected cases to minimize future losses. The nurse evaluates the patient's existing health condition, e.g. diabetic, and to communicate with the physician to ensure treatments are proper and to prevent permanent disability.
WellComp MPN	\$18,384.00	MPN access fees	This service is charged for all new claims using In-Network doctors. Currently, there are 3,500 doctors in the network.
York Claims Service	\$17,594.00	Index checks through ISO system	This service is for background check and is applied to <u>all new</u> claims.
WellComp MPN Provider Reimbursement	\$16,769.02	Reimbursement for negotiated discounts	This is a reimbursement to SCRMA/York based on medical expense savings as per billed review.
Total	\$1,109,886.99		

According to CEO/Risk Management, the above are typical services provided in a claims administration contract and the expenses were necessary and appropriate as part of processing these claims.

Because SCRMA is the program administrator that determines the use of the majority of these services, there is no limit on total usage by them, and the County pays for the services; therefore, we believe these services need to be addressed and included in a Contract Amendment. Also, the County's *Contract Policy Manual*, Section 3.3, states the Board of Supervisors must approve all service contracts in excess of \$50,000. The above services and payments were not included in the final contract and formally approved by the Board.

DETAILED OBSERVATIONS, RECOMMENDATIONS AND MANAGEMENT RESPONSES



CEO/Risk Management met with SCRMA to discuss the Managed Care Services and the charges. As a result, a *Workers' Compensation Program Fee Adjustments* document, dated December 29, 2009, was provided to CEO/Risk Management itemizing the services and the billing rates. We reviewed the document and determined that it detailed the Managed Care Services and fee charges. However, we are unable to conclude if this document can officially be used as a contract amendment/modification. CEO/Risk Management should seek advice from County Counsel and the County Procurement Office on whether a contract amendment is needed and if the amendment requires Board approval.

Recommendation No. 3

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.

CEO/Risk Management Response:

Concur. On May 18, 2010, the Board of Supervisors approved MA-017-10012843, a contract amendment and extension with York Risk Services Group (Formerly SCRMA). Attachment B of Contract #MA 01710012843 formalized the pricing structure of managed care cost containment fees incurred during claims handling.

Observation No. 4 – Claims Audit of Third Party Administrator (Significant Issue)

SCRMA has been the contracted TPA for the County's Workers' Compensation program since July 2008. As of our fieldwork, an audit of contractor has not been performed.

At the onset of our audit, CEO/Risk Management informed the Internal Audit team that Workers' Compensation claims processing is a complicated and complex area that requires technical expertise and experience in order to perform a "claims audit." As such, CEO/Risk Management and the Internal Audit team concurred that the audit scope was not a claims audit of the TPA. Instead, we audited CEO/Risk Management's controls to monitor and oversee the performance and effectiveness of SCRMA's claims processing and compliance with the contract. The SCRMA Contract Agreement indicates that *"CEO/Risk Management, or an agent thereof, may perform a yearly audit of the Contractor's claims files. The audit will include open indemnity files, lifetime medical files, closed indemnity files and medical only files."*

Since the total payments processed for one year exceeded \$21 million, we believe CEO/Risk Management should ensure regular audits of the TPA are conducted. The audits should include detailed financial review of the payments and assessment of TPA's compliance and performance to ensure claims were properly accepted, payments are proper and accurate, and are in compliance with Labor Code governing Workers' Compensation. These audits should be conducted regularly and timely to ensure errors or irregularities are detected and corrected immediately, and the outcomes used for evaluating future contract renewal.

Recommendation No. 4

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.

DETAILED OBSERVATIONS, RECOMMENDATIONS AND MANAGEMENT RESPONSES



CEO/Risk Management Response:

Concur. After conducting an RFP to select a vendor to perform Workers' Compensation claim audits, the County contracted with AON Risk Consultant, Inc., 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. The report findings were that SCRMA's claim handling process was good overall, although some areas of improvement were noted and are currently being addressed.

Audit Objective No. 3 – Liability & Property Claim Disbursements: Our objective was to review the adequacy of internal controls, processes and systems used for processing Liability & Property disbursements and associated legal costs to ensure transactions are prepared accurately, completely, timely, are valid, and have appropriate supporting documentation and management authorization.

The process starts when a liability claim is submitted by a claimant to the Clerk of the Board. The Clerk of the Board forwards the claim to County Counsel for review for legal sufficiency. Upon review by County Counsel, the claim is forwarded to CEO/Risk Management's Liability & Property Claims Management. In-house staff of four Claims Adjusters is responsible for reviewing and documenting claims against the County, determining a reasonable settlement, and forwarding payment proposals to the Claims Manager for approval.

Each Claims Adjuster is assigned a monetary authority amount by the Claims Manager based on their level of experience. The assigned Claims Adjuster enters claim information into a Microsoft Access database created by CEO/Risk Management. The assigned staff requests information from the involved agency to enable staff to validate the claim. Based on information received from the agency, along with review of documentation such as witness statements and accident reports, the claim is either approved or denied.

CEO/Risk Management maintains a Board-approved roster of attorneys to contact as needed in investigating liability and property claims. One of the primary responsibilities of the program is litigation management and direction. Litigation cases are overseen by staff that supervise the work product of private contract attorneys and coordinate legal matters with County Counsel. On occasion, the program also utilizes private contractors for investigation services.

Control Strengths Over Liability & Property Disbursements:

- ✓ The duties of processing and approving claim disbursements are segregated.
- ✓ Independent reconciliations are performed between CEO/Risk Management's Liability & Property database and the Auditor-Controller's General Ledger.
- ✓ CEO/Risk Management ensures liability & property liability claims are first reviewed by County Counsel for legal sufficiency.
- ✓ Liability & Property claims adjusters' have set monetary authority settlement authority. All liability & property liability claims over \$50,000 must be approved by the Board of Supervisors.
- ✓ CEO/Risk Management staff are knowledgeable regarding the liability and property claims handling processes.

DETAILED OBSERVATIONS, RECOMMENDATIONS AND MANAGEMENT RESPONSES



Results

To accomplish our objective, we tested **twenty-five (25) disbursements totaling \$873,877**. We found internal controls are in place to ensure Liability & Property claim disbursements are valid, supported, allowable and are processed completely, accurately and timely. We identified **two (2) Control Findings** to enhance processes and controls in the areas of confidential invoice procedures, monetary authority amounts for Claims' Adjusters, and document retention.

Observation No. 5 – Confidential Invoice Procedures (Control Finding)

CEO/Risk Management processes several invoices related to claims falling under the "attorney-client privilege." CEO/Risk Management's practice is to mark such invoices as "confidential" so when the invoices are processed and digitally scanned by the Auditor-Controller, they are scanned by the Auditor-Controller as "confidential"; thereby limiting access to restricted personnel. We found one invoice was not marked as "confidential" and its viewing in the Auditor-Controller's online general ledger was not restricted. Ensuring such invoices are marked "confidential" will help ensure case-related defense strategy is not compromised.

Recommendation No. 5

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

CEO/Risk Management Response:

Concur. CEO/Risk Management will review and reiterate existing policies and procedures with affected staff to ensure compliance.

Observation No. 6 – Monetary Authority Amounts (Control Finding)

CEO/Risk Management's procedure for "*Risk Management Liability Payments and Settlements*" requires the Claims Manager to establish monetary authority amounts for each Claims Adjuster. Claims Adjusters must process claims within their monetary authority amounts. There are four Claims Adjusters in the section. We noted documentation showing the monetary authority amount for only one Claims Adjuster, and CEO/Risk Management indicated documentation showing the monetary authority amounts was misplaced.

We also noted an instance where a claim was processed by a Claims Adjuster in excess of her monetary authority amount. We were informed Claims Adjusters can process claims in excess of their monetary authority amounts with the approval from the Claims Manager.

Recommendation No. 6

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

CEO/Risk Management Response:

Concur. CEO/Risk Management re-issued the monetary settlement authority documentation to its staff and will ensure such documentation will remain readily available whenever requested.

DETAILED OBSERVATIONS, RECOMMENDATIONS AND MANAGEMENT RESPONSES



Audit Objective No. 4 – Process Efficiency/Effectiveness

Our audit included an evaluation of efficiency and effectiveness review of CEO/Risk Management's disbursement process, such as for backlogs, duplication of work, and manual processes that could be automated. Our audit did not find any of these instances. However, we noted the following **one (1) Control Finding** that CEO/Risk Management should evaluate the cost/benefit of addressing:

Observation No. 7 – Differences Between County and SCRMA's Records

(Control Finding) We noted instances where Workers' Compensation Disability benefit payments made through County Payroll did not agree with SCRMA's *Voucher Register* report. These were immaterial differences ranging from \$0.02 to \$0.09. CEO/Risk Management was aware of the differences and should evaluate whether this is a system or rounding issue that can be corrected in a cost-beneficial manner.

Recommendation No. 7

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

CEO/Risk Management Response:

Concur. The State of California permits adjusters to use 3 different formulas to calculate average weekly wage. In addition, the auto-calculate feature of SCRMA's Claims Connect system calculates daily and weekly rates to 4 decimal points while County payroll calculates to 2 decimal points. SCRMA has adopted one formula for calculating benefit rates and that will eliminate, or greatly minimize, the differences between the benefit notices and the payroll reports.



ATTACHMENT A: Report Item Classifications

For purposes of reporting our audit observations and recommendations, we will classify audit report items into three distinct categories:

▶ **Material Weaknesses:**

Audit findings or a combination of Significant Issues that can result in financial liability and exposure to a department/agency and to the County as a whole. Management is expected to address "Material Weaknesses" brought to their attention immediately.

▶ **Significant Issues:**

Audit findings or a combination of Control Findings that represent a significant deficiency in the design or operation of processes or internal controls. Significant Issues do not present a material exposure throughout the County. They generally will require prompt corrective actions.

▶ **Control Findings:**

Audit findings concerning internal controls, compliance, or efficiency/effectiveness issues that require management's corrective action to implement or enhance processes and internal controls. Control Findings are expected to be addressed within our follow-up process of six months, but no later than twelve months.

DETAILED OBSERVATIONS, RECOMMENDATIONS AND MANAGEMENT RESPONSES



ATTACHMENT B: CEO/Risk Management Responses



County Executive Office

Memorandum

June 1, 2010

To: Dr. Peter Hughes, Director
Internal Audit Department

From: Tom Phillips, Risk Manager
Robert Franz, Chief Financial Officer

Subject: Response to Draft Report on CEO/Risk Management Audit

RECEIVED
INTERNAL AUDIT DEPARTMENT
JUN 01 - 2 41 PM '10

Following is our response to the recommendations contained in the Draft Report on the CEO/Risk Management Workers' Compensation and Liability & Property Claims Disbursements Audit No. 2921.

Recommendation No. 1: 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.

CEO/Risk Management Response: Concur. Although the check register indicated \$16,769 in checks had been issued, some checks had not been cashed so the amount of the reimbursement due to the County was actually \$14,782. A check in the amount of \$14,782 was issued to the County on 11/10/09 and deposited into the County's account. The remaining checks totaling \$1,987 were voided. CEO/Risk Management has taken the following steps to enhance the Check Register review process:

- 1.) Met with SCRMA to clearly define all payment code types and under what circumstances each should be used.
- 2.) Requested that SCRMA program our claims system to reject entries if payment codes are used which have not been approved by the State of California.
- 3.) In addition to the monthly check register we already receive, we have requested a quarterly summary of all payments by pay code as well as a quarterly detail report. These reports have several uses, such as allowing us to identify incorrectly coded payments, detect questionable payments and evaluate cost drivers by tracking "like" expenditures from quarter to quarter and year to year.



ATTACHMENT B: CEO/Risk Management Responses (continued)

Response to Draft Report on CEO/Risk Management Audit
June 1, 2010
Page 2

Recommendation No. 2: CEO/Risk Management enforce contract provisions for the reporting and reimbursement of penalty payments to the County by the contracted Claims Administrator.

CEO/Risk Management Response: Concur. Item # 16 (Assessment of Administrative Penalties Payment) of the County's contract with SCRMA requires the Contractor to notify the County of penalties within 10 days of notice or payment and to reimburse the County within 90 days after the close of the quarter in which the penalty was paid. SCRMA has implemented the following procedure to ensure timely reporting and reimbursement of penalties to the County of Orange:

- 1) Upon recognition that a penalty is due, a penalty form is completed by SCRMA explaining the reason for the penalty, and the penalty payment is generated in SCRMA's Claims Connect system and pends to the Supervisor's check queue.
- 2) The Supervisor and the Branch Manager review and approve the penalty form within one business day, and the penalty check is released.
- 3) The Branch Manager provides the penalty form to the Compliance department, and a copy is emailed to the County of Orange Workers' Compensation Program Manager within 10 days of issuance of the penalty.
- 4) A Check Register showing all penalties incurred due to SCRMA's lack of proper claims handling along with a check reimbursing the County of Orange for such penalties will be provided no later than 90 days from the end of the quarter in which the penalty was paid.
- 5) SCRMA's Client Relations department ensures that the Check Register and reimbursement is provided to the County of Orange within the required timeframe.
- 6) To ensure compliance with contract provisions, internal monitoring of the monthly check register and quarterly pay code report is performed by the County of Orange Workers' Compensation Program Manager.

Recommendation No. 3: 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.

CEO/Risk Management Response: Concur. On May 18, 2010, the Board of Supervisors approved MA-017-10012843, a contract amendment and extension with York Risk Services Group (Formerly SCRMA). Attachment B of Contract #MA 01710012843 formalized the pricing structure of managed care cost containment fees incurred during claims handling.



ATTACHMENT B: CEO/Risk Management Responses (continued)

Response to Draft Report on CEO/Risk Management Audit
June 1, 2010
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Recommendation No. 4: 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.

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CEO/Risk Management Response: Concur. CEO/Risk Management will review and reiterate existing policies and procedures with affected staff to ensure compliance.

Recommendation No. 6: CEO/Risk Management develop policies and procedures documenting monetary authority amounts and instances where exceeding those amounts are allowed.

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cc: Thomas G. Mauk, County Executive Officer
Eli Littner, Deputy Director, Internal Audit
Mike Goodwin, Senior Audit Manager, Internal Audit