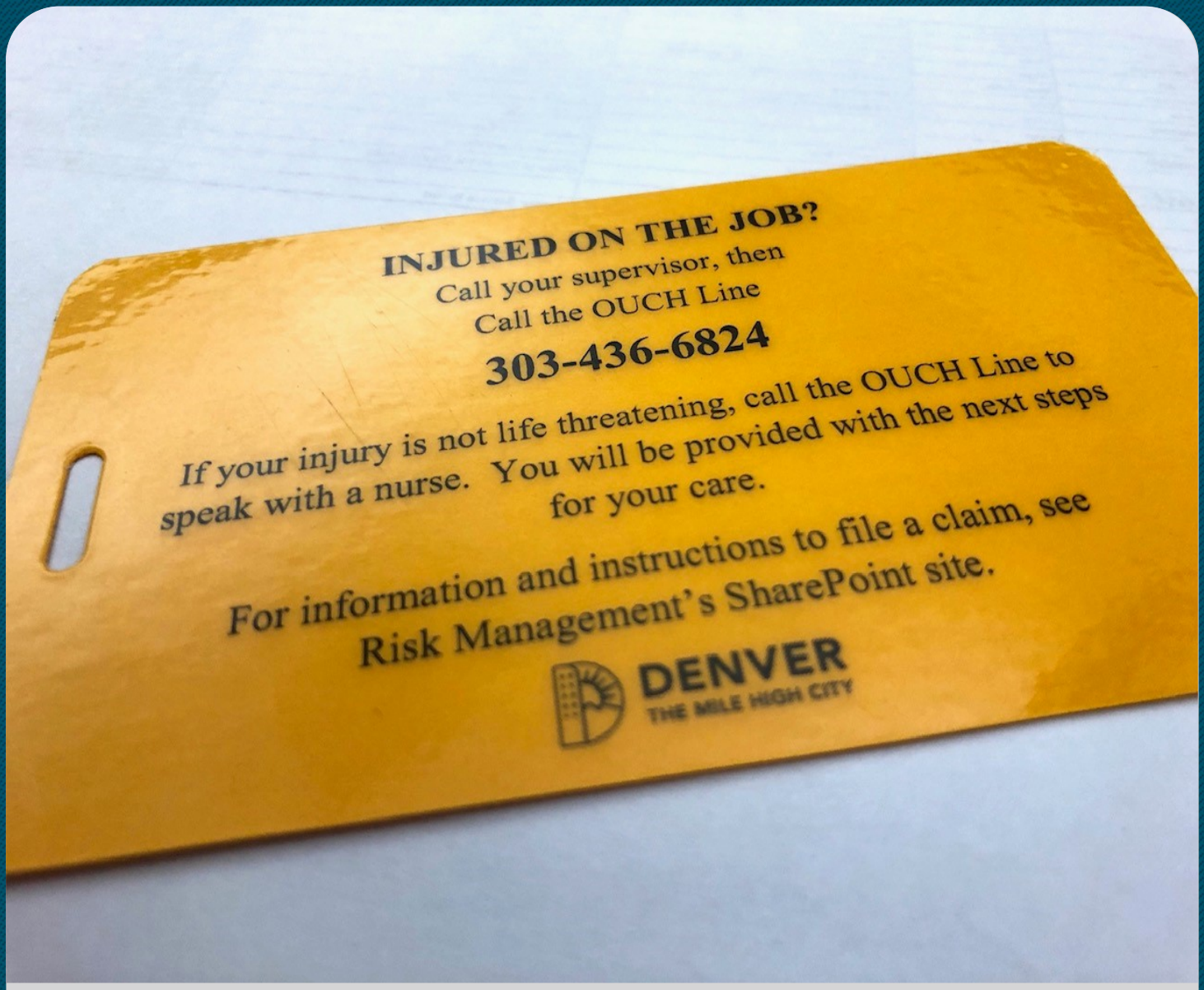
AUDIT REPORT
Department of Finance
Workers' Compensation Program
October 2018



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October 18, 2018

AUDITOR'S REPORT

We have completed our audit of the Workers' Compensation Program. The objective of the audit was to determine whether the City and County of Denver's self-insured and self-administered workers' compensation program model delivers services to employees in a cost-effective and efficient manner. Additionally, we assessed whether the City properly funds its self-insured program and is reporting in compliance with Generally Accepted Accounting Principles.

As described in the attached report, our audit revealed that the Risk Management Office's Workers' Compensation Unit needs to account fully for related costs and liabilities in the Workers' Compensation Internal Service Fund, formalize strategic plans, update policies and procedures for monitoring of contract and subcontractor controls, as well as update or create key performance indicators for financial and managerial reporting, and update its risk management information system software to include better automated controls for claims-processing effectiveness and efficiency.

Through stronger formalized policies and procedures as well as effective manual and automated system controls, the Workers' Compensation Unit will be able to ensure more accurate and transparent reporting of financial accounts and performance for employees and the public. Our report lists several related recommendations.

This performance audit is authorized pursuant to the City and County of Denver Charter, Article V, Part 2, Section 1, *General Powers and Duties of Auditor*, and was conducted in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

We extend appreciation to Department of Finance personnel, especially Risk Management and the Workers' Compensation Unit, who assisted and cooperated with us during the audit.

Denver Auditor's Office

Timothy M. O'Brien, CPA
Auditor

REPORT HIGHLIGHTS

Workers' Compensation
October 2018

Objective

The objective of this audit was to determine whether the City and County of Denver's self-insured workers' compensation program model delivers services to employees cost effectively and efficiently. Additionally, we assessed whether the City properly funds its self-insured program and is reporting in compliance with Generally Accepted Accounting Principles.

Background

The 2017 Colorado Workers' Compensation Act allows employees to claim workers' compensation benefits for injuries and occupational diseases arising out of and during the employee's employment. The City maintains a self-insured and self-administrated program to process and purchase excess insurance to cover costs greater than $2.5 million for an individual occurrence. In 2017, the Workers' Compensation Unit of the City's Risk Management Office processed 927 claims with incurred costs of approximately $6.8 million, according to infographics prepared by the Workers' Compensation Unit. This reflects a continuing trend of reduced claims and cost of claims.

A glossary of key terms can be found in Appendix C.

Highlights

In our second audit of the program, we identified issues with strategic planning and policies and procedures that should be updated to improve accounting presentation, the process and system controls environment as well as operational effectiveness and efficiency.

Program Costs Understated – Workers' compensation salary continuation benefits are not charged to the Workers' Compensation Internal Service Fund, which results in an understating of the total cost of workers' compensation by approximately 10 percent. As a result, the internal service fund may not comply with financial accounting standards for an internal service fund. Additionally, the liability associated with salary continuation is not reported in the City's annual comprehensive annual financial report.

No Formal Strategic Plan – Risk Management does not have a formal strategic planning approach to evaluate and compare different workers' compensation organizational and operational models. A more comprehensive approach inclusive of total program costs and formal key performance indicator reporting could lead to more efficient and effective program management to potentially uncover new cost savings opportunities and provide more transparency to the City's employees and the public.

Policies and Procedures Need Revision – The Workers' Compensation Unit has not updated its internal policies to reflect current business practices. The audit also identified an ineffective supervisor report and check-logging controls and controls that should be upgraded, including formal contract monitoring and reviews of subcontractor control environments that provide outsourced operational and financial processes to the unit. The unit should also attempt to accept electronic fund transfers. Also, the unit should review the fund balance target policy and consider modifications.

Risk Management Information System Does Not Support Current Business Processes – STARS, used for reporting and tracking workers' compensation claims, does not support current business processes effectively and efficiently. Limitations include the lack of ad hoc reporting for lost and restricted duty days, a lack of built-in data entry controls, allowing records to be deleted versus deactivated, and a lack of custom views and tools to work more effectively and efficiently.

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BACKGROUND

Mandated by the State of Colorado, Workers' Compensation Programs Compensate Employees for Work-Related Injuries and Illnesses

Colorado first enacted workers' compensation laws in 1915 as a form of no-fault insurance. As with workers' compensation systems in other states, Colorado's evolved out of the Industrial Revolution, as manufacturing and other heavy industries brought an increase in work-related injuries. Since its inception, the system's benefits have been modified to mirror wage increases, and legislative reforms have focused on mitigating litigation, backlogs in dispute resolution, and the impacts on premiums as well as attempting to contain costs so the state can continue to attract and retain businesses, who can more reliably predict costs.

State law requires every employer, regardless of the employer's method of insurance, to provide medical care and treatment needed at the time of the injury or occupational disease and during the disability.[1] The law also sets out how compensation rates are determined for specific injuries and spells out the number of weeks of benefits allowed as well as instances where benefits may be reduced when employees have not followed safety procedures. The law further provides employees with partial wage replacement while they heal and, in the case of a fatality, death benefits to dependent survivors.

The workers' compensation process is the "exclusive remedy," meaning it is the only compensation for the work-related injury or occupational disease. The eligibility for benefits depends on the facts and circumstances of each individual claim.

In the case of City employees, career service rules establish definitions and requirements for salary continuation leave and workers' compensation leave.[2]

Salary continuation benefits for City employees, above and beyond state-mandated benefits, for on-the-job injuries and illnesses, are defined as a benefit provided by the City for disability leave paid. For career service employees, this continuation is paid at the rate of 80 percent of an employee's gross salary for up to 90 consecutive calendar days from the date of injury. Employees receiving salary continuation are not entitled to use other available paid leave. The rule applies to all career service employees and does not apply to Denver Police Department, Denver Fire Department, or Denver Sheriff

[1] The 2017 Colorado Workers' Compensation Act, Article 42, Benefits

[2] Career Service Rule 12, Leave and Accommodations for Pregnancy and Extended Illnesses or Injuries, last revised May 22, 2018.

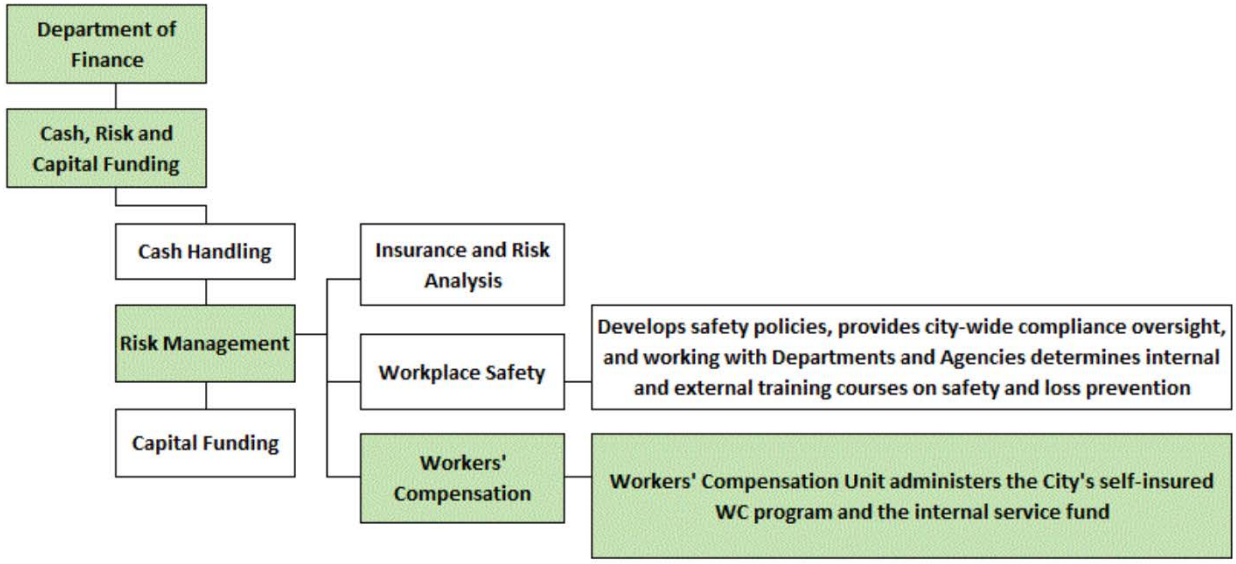
Department employees covered under collective bargaining agreements.

Salary continuation for police and fire employees under their respective bargaining agreements is 100 percent of their salaries for up to one year or an equivalent 2,080 hours. For the Sheriff Department, deputies are entitled to 180 days of salary over the equivalent of 18 months.

If an employee remains unable to return to work in his or her job without accommodation or modified duty after salary continuation leave is exhausted, he or she will be placed on workers' compensation leave for absences related to the occupational injury or illness until the employee is no longer eligible to receive temporary disability benefits under state law. Typically, workers' compensation disability payment is 66 2/3 percent of total pay.

The Workers' Compensation Unit of the Denver Risk Management Office is organized under the City's Department of Finance's Cash, Risk, and Capital Funding Division, represented in Figure 1.

Figure 1. Department of Finance Risk Management and Workers' Compensation Organization Chart 2018. Green boxes in the figure represent the hierarchy of City agencies and departments that influence workers' compensation management and policies and procedures.



Source: City and County of Denver's Auditor's Office

Currently, the Workers' Compensation Unit includes 19 employees, including six claims adjusters, a claims supervisor, and a fiscal administrator overseeing five administration and accounting support

personnel, three safety administrators, two nurses, and a return-to-work coordinator. The Financial Director of the Risk Management Office oversees the unit. The Insurance and Loss Department's Risk Administrator, its senior risk analyst, and its business process analyst provide additional support for workers' compensation. These departments are overseen by the Cash, Risk, and Capital Funding Manager who reports directly to the Chief Financial Officer.

The Workers' Compensation Unit is responsible for the intake, review, and administration of City employees' workers' compensation claims, and provides safety training and loss prevention for all City agencies. The City must comply with City ordinances and career service rules and must follow compensation terms included in collective bargaining agreements with the City and the Fraternal Order of Police, Denver Sheriff Lodge 27, and Denver Firefighters – Local 585, IAFF. Additional criteria for the Worker's Compensation Program include Executive Order 65, which defines the role of risk management personnel as well as agency heads, supervisors, and employees.

The City uses a system called STARS for reporting and tracking of all insurance claims and incidents against the City, including property, auto, general liability, and workers' compensation. The Workers' Compensation Unit uses STARS for the specific state-required reporting and to manage the Workers' Compensation Program.

As defined in the state law and the state's Workers' Compensation Rules of Procedure, there are four ways in which an employer in Colorado may obtain workers' compensation coverage:

- Self-funding individual insurance;
- Self-funding group or pool insurance;
- Commercial insurance; and
- Insuring through Pinnacol Assurance. Pinnacol is the insurer required by state law to write insurance policies for any Colorado employers who apply, including those in high-risk industries.[3],[4]

The City's workers' compensation system is self-insured and self-administered.

According to the City's Workers' Compensation Manual, Denver's City Council, through ordinance, decided to create a self-insured and self-administered system in the belief the City would have greater control over the cost of claim administration. Self-insured entities pay their own claims.

[3] State of Colorado Workers' Compensation Rules of Procedure with Treatment Guidelines
[4] C.R.S. Title 8, articles 40-47

The Workers' Compensation Unit's goals are to:

- Provide City agencies and their employees with workers' compensation education, guidance, and information that will promote safety, knowledge, and active participation;
- Develop and implement programs to contain the cost of workers' compensation claims;
- Provide appropriate medical treatment, return the injured workers back to their jobs as soon as medically possible, and ensure that any financial benefit due is paid in a timely manner;
- Establish strategies designed to ensure that benefits resulting from admitted claims are paid promptly and properly; and
- Investigate claims thoroughly to ensure the legitimacy of a claim and reduce unwarranted expenditures.

The City Spent Approximately $13 Million on Claims, Personnel, Contractual Services, and Other Operating Expenses for Fiscal Year 2017

For financial reporting purposes, the City's Workers' Compensation Program is accounted for in a dedicated fund, the Workers' Compensation Internal Service Fund. The fund's expenses include all direct costs, including medical and time-off payments and direct overhead expenses such as salaries, supplies, contractual payments to vendors for services, and self-insured retention insurance premiums. [5]. The financial results for the past three years are as follows.

[5] Self-insured retention definition, see Appendix C: Key Terms

TABLE 1. Condensed Statement of Workers' Compensation Internal Service Fund Net Position at December 31(in thousands)[6]

	2017	2016	2015
Assets			
Cash and cash equivalents	$ 40,579	$ 38,553	$ 36,678
Other current assets	3,358	2,472	1,742
Total assets	**43,937**	**41,025**	**38,420**
Liabilities			
Claims reserve liability	26,282	27,813	29,449
Other current liabilities	991	855	1,148
Other noncurrent liabilities	123	115	101
Total liabilities	**27,396**	**28,783**	**30,698**
Total net position	**$ 16,541**	**$ 12,242**	**$ 7,722**

Source: 2017, 2016, and 2015 City and County of Denver Comprehensive Annual Financial Reports

TABLE 2. Condensed Statement of Revenues, Expenses, and Changes in Net Position (in thousands)

	2017	2016	2015
Revenues			
Charges for services	$ 12,000	$ 13,001	$ 7,991
Other revenue	5,306	3,784	5,054
Total revenues	**17,306**	**16,785**	**13,045**
Expenses			
Claims payments	9,105	8,309	9,592
Other expenses	3,902	3,956	3,999
Total expenses	**13,007**	**12,265**	**13,591**
Change in net position	**4,299**	**4,520**	**(546)**
Net position – January 1	12,242	7,722	8,268
Net position – December 31	**$ 16,541**	**$ 12,242**	**$ 7,722**

Source: 2017, 2016, and 2015 City and County of Denver Comprehensive Annual Financial Reports

[6] Net position definition, see Appendix C: Key Terms

The Mayor's 2018 Budget Book reported that expenditures for the Workers' Compensation Internal Service Fund was $12.3 million for the 2016 Fiscal Year, while it was appropriated $15.1 million for 2017 and has been recommended $15.3 million for 2018. Table 3 shows the internal service fund expenditures by expense type from 2016 through 2018.

TABLE 3. 2018 Budget Book by Expense Type (in thousands)

Expense Type	2016 Actual	2017 Appropriated	2018 Recommended
Medical and Indemnity	$ 8,309	$ 10,830	$ 10,830
Administration	3,956	4,286	4,507
Total	**$ 12,265**	**$ 15,116**	**$ 15,337**

Source: 2018 City and County of Denver Mayor's Budget Book

Direct costs include insurance premiums for an excess insurance policy. This insurance policy provides coverage for worker compensation claims over $2.5 million per occurrence in 2017. An occurrence is defined as an event or accident that can result in one claim or multiple claims, both of which pay out after the City has first paid out $2.5 million. According to its financial disclosure, the City had no settlements in the past three years that exceeded its self-retention levels. The City is required by state law to purchase this insurance.

The City Holds a Required Fund to Pay Employee Claims and Reports a Liability in Its Annual Financial Statements for Estimated Future Claims

As discussed in the City's Comprehensive Annual Financial Report, the City maintains a self-insurance trust established in accordance with state law to be held for the benefit of the City's employees, which is accounted for in the Workers' Compensation Internal Service Fund.[7] The Colorado Department of Labor and Employment establishes the amount of funding required each year for a municipality to maintain its self-insurance permit. The requirement is calculated using the average amount of claims paid over the previous three years, plus the outstanding liability for claims at the end of the previous year. The City's requirement at December 31, 2017, for 2018 was approximately $17.2 million. The internal service fund includes current assets and appropriations set aside in 2017 to satisfy the state's requirement. The

[7] Comprehensive Annual Financial Report -- City and County of Denver, p. 108, last accessed August 27, 2018. https://www.denvergov.org/content/dam/denvergov/Portals/344/documents/CAFR/2016_CAFR.pdf

funds can only be used to pay workers' compensation benefits and administrative costs.

Liabilities are recorded in the internal service fund when a probable loss has occurred, and the amount of the loss can be reasonably estimated, which also includes an estimate for claims "Incurred But Not Reported."[8] The liability recorded also considers the effects of inflation, recent claim settlement trends, and other economic and social factors. Further, the liability is discounted for investment income derived from the trust fund. Table 4 shows a decreasing liability between fiscal year ended 2017 and 2016.

As an example, if an employee has a serious work-related injury on December 31, then the City must estimate the total cost of providing medical care and the amount of lost time paid. This estimate of the total claim cost is recorded as a liability that the City owes as of December 31, even if no payments are made until the next year. The estimated cost of all existing workers' compensation claims that will extend past the end of the year are added up to calculate the total workers' compensation liability.

TABLE 4. Ending Liability Balance for the Workers' Compensation Liability (in thousands)

	2017	2016
Beginning balance, undiscounted – January 1	$ 27,813	$ 29,449
Current year claims and changes in estimates	13,457	12,965
Claims paid	(9,105)	(8,309)
Ending balance undiscounted	32,165	34,105
Less discount	(5,883)	(6,292)
Ending balance – December 31	**$ 26,282**	**$ 27,813**

Source: City and County of Denver 2017 Comprehensive Annual Financial Report

As shown in Table 5 below, the total new claim count decreased from 1,087 in 2015 to 927 in 2017, a decrease of approximately 15 percent in two years. Incurred total cost also decreased from $11.4 million in 2015 to $6.8 million in 2017.[9]

[8] Incurred but not Reported definition, see Appendix C: Key Terms
[9] Incurred Cost definition, see Appendix C: Key Terms

TABLE 5. Annual Claim Count and Incurred Total Claims Cost 2013-2017

Year	Total Claim Count	Incurred Total Claim Cost (in thousands)
2013	1,017	$ 7,579
2014	1,035	10,622
2015	1,087	11,358
2016	1,036	6,918
2017	927	6,789

Source: City and County of Denver's Workers' Compensation Unit

An Actuary Recommends Funding Reserves

The City has contracted with an actuary to estimate outstanding liability for the previous and current year as well as forecast liability for the current and subsequent year.[10]

The International Actuarial Association defines the principal roles of an actuary in workers' compensation, which include rate setting, reserve evaluation, solvency monitoring, and evaluation of any proposed benefit changes, as well as calculating an estimate of long-term liability for future workers' compensation benefits.

The actuary estimated the program's liability for outstanding claims to be $26.3 million and $27.8 million, respectively, in 2017 and 2016. The $26.3 million is characterized as the liability required to be recorded by the City at December 31, 2017, under standards promulgated by the Governmental Accounting Standards Board, which sets Generally Accepted Accounting Principles followed by state and local government entities.[11] More specifically, these standards require the City to accrue a liability on the financial statement for the ultimate cost of claims and expenses associated with all reported and unreported claims.

[10] Actuary definition, see Appendix C: Key Terms

[11] Governmental Accounting Standards Board Statement #10, *Accounting and Financial Reporting for Risk Financing and Related Insurance Issues, last accessed August 27,2018*
https://www.gasb.org/jsp/GASB/Document_C/DocumentPage?cid=1176160030317&acceptedDisclaimer=true

An experience modification factor below 1.0 is considered favorable

Experience Modification Factor

The Compensation Insurance Rating Board developed the "experience modification factor."[12] Insurers use the experience modification factor to gauge both the past cost of injuries and future chances of risk; therefore, the lower the factor, the lower the premium charged. An experience modification factor of 1.0 is considered the industry standard, while below 1.0 is considered a favorable rating, and above 1.0 is considered an unfavorable rating.

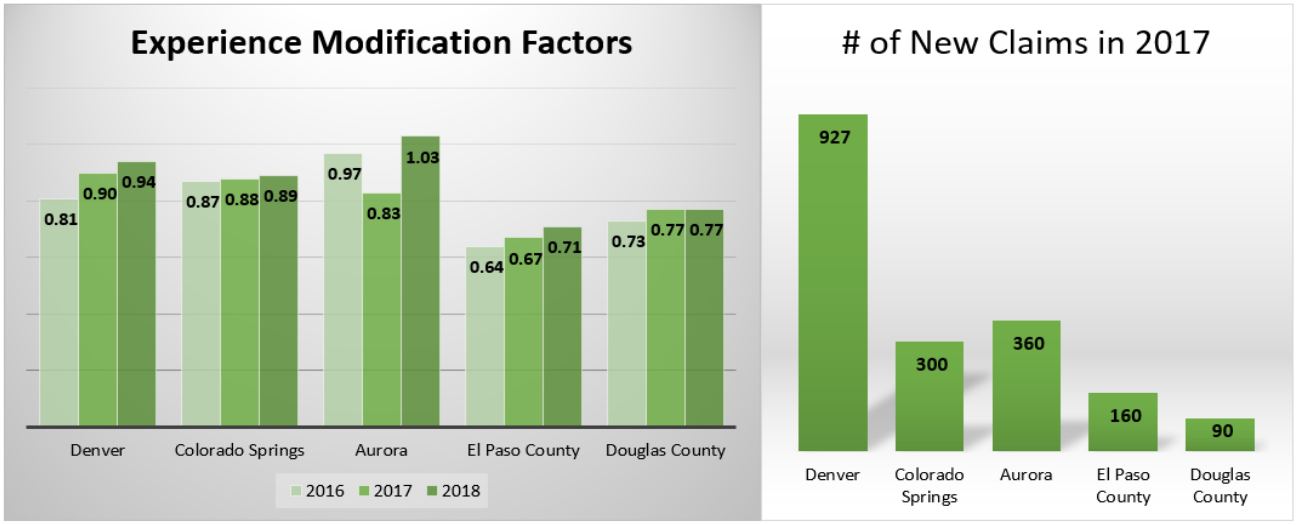
The National Council on Compensation Insurance, a national nonprofit organization owned by U.S. insurance companies, generates the experience modification factor rating. The City's Workers' Compensation Unit annually reports a variety of information to the organization to obtain a rating.

Figure 2 shows the City's experience modification factor rating compared to the ratings of five large Colorado local governments by size (left to right in the chart) for years 2016, 2017, and 2018. The rating is provided by the National Council on Compensation Insurance for the coming year based on the previous three years of data provided by the entity. Additionally, the trend line shows the number of new claims processed by each entity in 2017.

According to the Financial Director of the City's Risk Management Office, Denver's experience modification factor has mainly risen the past three years due to the City adding more full-time equivalent employee positions to payroll during the period, and that salaries have significantly risen during the same period. Payroll costs are a key input in developing the experience modification factor. Although Denver is higher than other benchmarked entities, the City processes more claims per year and often has a higher cost of injuries than the other entities but still has had a favorable rating, below 1.0, each of the three years.

[12] Experience Modification Factor definition, see Appendix C: Key Terms

Figure 2. Experience Modification Factors for Benchmarked Colorado Local Governments 2016- 2018

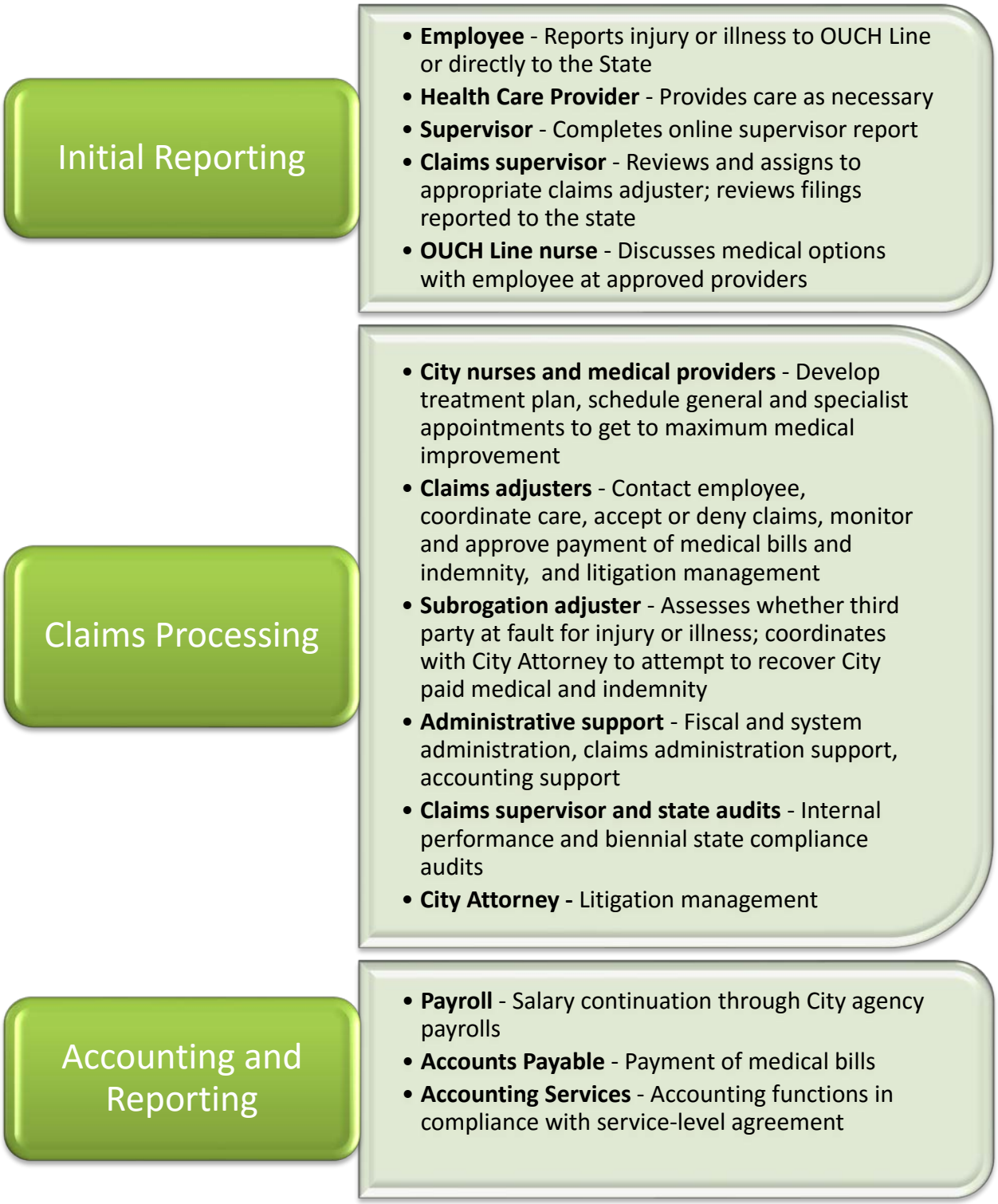


Source: ASD Benchmarking with Colorado Local Governments

Employee Compensation Timeline

Employees who claim on-the-job injuries must report their claims to the City's Workers' Compensation Unit in accordance with City accident reporting procedures. Appendix A explains, in detail, the timeline of workers' compensation for an injured employee or one suffering from an occupational disease from date of injury to maximum medical improvement (MMI) date, defined as an injury or illness that has become stable and requires no further medical treatment to improve the condition, as well as other detailed information related to the claims management process. In addition, Figure 3 shows the typical flow of information for workers' compensations claims through the Workers' Compensation Unit.

Figure 3. Workers' Compensation Claim Process



Source: City and County of Denver Auditor's Office.

Workers' Compensation Key Performance Indicators

Every year the Workers' Compensation Unit prepares a Claims Overview infographic that provides performance indicators such as total claims per city agency and departments and costs incurred per claim. Costs incurred per claim is defined by the Workers' Compensation Unit as all costs—including medical, indemnity, and legal—paid through the internal service fund plus outstanding reserves estimated by the claims adjuster for expected future expenses to be paid on an individual claim.[13]

Table 6 ranks the top five agencies and departments by 2017 by total incurred cost and Table 7 ranks the top five incident types by 2017 total claims and total incurred cost. These infographics are not released publicly but are maintained on a document management and storage system for Risk Management personnel and safety administrators as well as agency safety personnel to access.

TABLE 6. 2017 Top 5 Agencies by Total Number of Claims and Total Incurred Costs

Department	Total Claim Count	Total Incurred Cost (in thousands)
Fire Department	153	$ 2,132
Police Department	278	2,024
Sheriff Department	122	662
Public Works	101	554
Denver Int'l Airport	60	460

Source: 2017 Workers' Compensation Unit Claims Overview

TABLE 7. 2017 Top 5 Incident Types, Ranked by Percent of Number of Claims and Incurred Cost

Incident Type Ranked by Annual Claims	Percent of Total Claims	Percent of Total Incurred Cost
Overexertion	27.5	31.8
Struck by	17.2	18.6
Slip, Trip, Fall	12.5	15.7
Exposure to	12.3	9.7
Contact With/By	9.3	7.6

Source: 2017 Workers' Compensation Unit Claims Overview

[13] Indemnity and reserves definitions, see Appendix C: Key Terms

The City's Workers' Compensation Unit received scores between 97 and 100 percent compliance in its most recent state compliance audit.

State Compliance Audits - In addition to process audits periodically conducted by the Workers' Compensation Unit claims supervisor, the state of Colorado performs biennial audits for compliance with state regulations. Key compliance areas for the state audit include the following:

- Timely filing with the state;
- Meeting state criteria for a workers' compensation claim number;
- Timely filing of position of liability;
- Timely payment of compensation benefits;
- Accurate calculation, payment, and admission of compensation benefits;
- Timely payment or contest of medical bills;
- Properly supported and timely termination or modification of temporary disability benefits;
- Accurate, complete, promptly filed, and properly supported final admissions;
- Accurate calculation and admission of average weekly wage based on wage record;
- Accurate admission and payment of the waiting period; and
- Exchange of medical reports in a timely manner.

The state considers compliance below 90 percent in a compliance category on at least two consecutive audits to be repeated noncompliance, which can result in fines. The City's Workers' Compensation Unit was audited on March 15, 2018 and scored between 97 percent to 100 percent compliance.

FINDING 1

Revenues, Costs, and Liabilities Are Not Fully Accounted For in the Workers' Compensation Internal Service Fund

The City provides paid disability leave, known as "salary continuation," to eligible employees if the employee has a disability due to an on-the-job injury or disease and is unable to perform the duties of the position or any other position. Currently, these costs are paid directly by the agency and are not recorded in the Workers' Compensation Internal Service Fund, thus understating total workers' compensation costs by almost 10 percent. In addition, the liability associated with this benefit is not calculated or reported in the City's Comprehensive Annual Financial Report.

Salary Continuation Costs Are Not Recorded or Reported in the Workers' Compensation Internal Service Fund

City agencies, through their payrolls, pay for salary continuation from appropriations received from the City's general fund rather than through the Workers' Compensation Internal Service Fund. Over fiscal years 2015-2017 the amount of salary continuation has been from $1.7 million to $1.3 million. These payments are not billed back to the internal service fund. In addition, when salary continuation costs are recovered through subrogation, the funds are recorded as revenue in the internal service fund rather than being returned to the agency that paid the salary continuation costs.[14] As a result, revenue resulting from recoveries of salary continuation costs does not match with expenses incurred on a fund level. Because the City is not recording all costs related to workers' compensation in the Workers' Compensation Internal Service fund, the fund may be failing to meet the Governmental Accounting Standards Board's criteria for an internal service fund.[15] Furthermore, the Workers' Compensation Internal Service Fund is not billing other City agencies for the full cost of operating the workers' compensation program as would be expected for an internal service fund.

The City is not reporting all related costs in the Workers' Compensation Internal Service Fund.

Salary continuation benefits for on-the-job injuries and illnesses are defined as paid disability leave benefits that are above the state-mandated level. Generally, the state requires workers' compensation disability leave payments be 66 2/3 percent of total salary—with some exceptions. An employee receiving salary continuation is not entitled

[14] Subrogation definition, see Appendix C: Key Terms
[15] Governmental Accounting Standards Board Codification Section 1300.110

to use other available paid leave. This benefit is based on the type of employee as follows:

1. All eligible Career Service Authority employees receive 80 percent of their gross salary for up to 90 consecutive calendar days from the injury date.
2. Police Department employees receive 100 percent of their salary for up to one year or the equivalent 2,080 hours in accordance with their collective bargaining agreement.
3. Fire Department employees receive 100 percent of their salary for up to one year or the equivalent 2,080 hours in accordance with the City Charter Fire Department rules.
4. Sheriff Department deputies receive 100 percent of their salary for up to 180 days over the equivalent of 18 months in accordance with their collective bargaining agreement.

Salary Continuation Liability Is Not Being Calculated or Reported

The City is not recording or reporting the liability for salary continuation costs. After the first three days that an employee has a disability due to an on-the-job injury or disease and is unable to perform the duties of the position, or any other position, the salary continuation payments will begin. At the time of the event that caused the disability, the City should recognize the liability for the total estimated salary continuation costs based on the type of employee, as noted above. Currently, the City expenses the salary continuation costs as they are incurred because the City considers this to be a benefit and not a workers' compensation indemnity payment. This results in an understatement of the internal service fund's claim reserve liability in a range of $100,000 to $500,000. The exact amount of the annual liability arising from salary continuation has not been calculated or accrued in the City's comprehensive annual financial report nor has the City considered the need to report the liability arising from salary continuation.

The City is not reporting the liability for salary continuation costs.

This liability could be calculated as part of the overall workers' compensation claim liability, however, it is not currently included in the liability calculation because the salary continuation costs are not given to the actuary to include in the overall claim liability calculation. Although salary continuation is considered a benefit by City agencies, it is the result of a workers' compensation claim. Therefore, it should be aggregated with other claim costs reported to the actuary and used to determine the claim reserve liability.

To ensure that all workers' compensation program costs are accounted for, salary continuation should be processed through the Workers' Compensation Internal Service Fund. The fund can then recover the costs through annual premiums charged to City agencies.

This also would ensure that all salary continuation costs are collected in the STARS system and reported to the actuary for determination of claim reserve liabilities. Finally, this would ensure that the full cost of the workers' compensation program is captured in the internal service fund and ensure that the internal service fund is compliant with Governmental Accounting Standards Board requirements.

Because of the current accounting practices, management cannot determine or fully monitor the individual or overall claim costs. It also impacts the reported claim liabilities reserve, which could potentially impact whether sufficient funds are available for future claim costs. Therefore, it is important that all workers' compensation-related costs, salary continuation payments, salary continuation liability and recovery of funds through subrogation, are recorded to the appropriate claim when incurred to help monitor program costs and reporting to the actuary as well as ensure the costs of operating the Workers' Compensation Program are accurately recorded and reported.

RECOMMENDATION 1.1

Salary Continuation Accounting and Reporting – We recommend the Workers' Compensation Unit, in conjunction with the Department of Finance, develop an accounting and funding approach that allows salary continuation payments related to workers' compensation claims to be:

- Accounted for in the Workers' Compensation Internal Service Fund; and
- Calculated and report the liability associated with salary continuation in the Workers' Compensation Internal Service Fund.

Agency Response: Agree, Implementation Date – May 31, 2019

Workers' Compensation Pay Is Not Being Paid Out of the Payroll System

Once the salary continuation pay is exhausted, the employee is then paid out of the Workers' Compensation Internal Service Fund through the accounts payable system. Workers' compensation pay is based on state law and is paid at a rate of 66 2/3 percent of the employee's base pay (indemnity pay). Indemnity pay is not taxed. Currently, when an employee moves from salary continuation to indemnity pay, payment processing is moved from the Controller's Office's payroll department to the Workers' Compensation Unit. Because indemnity pay is paid out of accounts payable, there is no option to deduct any amounts (for example, health insurance) because accounts payable systems are not set up to handle this type of transaction. Having indemnity pay processed by payroll would allow employees to pay for deductions such as health insurance out of the indemnity payment.

The City recently moved to a new primary payroll system, which may better facilitate processing these payments through the primary payroll system than the old system. Therefore, we recommend that the Workers' Compensation Unit work with the Controller's Office to determine whether it would be more efficient and effective to pay indemnity payments out of the payroll system instead of accounts payable.

RECOMMENDATION 1.2

Use Payroll System for Indemnity Payments – Before the end of 2018, we recommend the Workers' Compensation Unit, in conjunction with the Controller's Office, review the process for indemnity payments to determine whether it would be more efficient and effective to use the payroll system instead of the accounts payable system.

Agency Response: Agree, Implementation Date – Complete

FINDING 2

No Formal Strategic Plan Exists for the Workers' Compensation Program

The City, the Risk Management Office, and the Workers' Compensation Unit do not have a formal strategic planning approach to evaluate and compare different workers' compensation organizational and operational models. A more comprehensive approach that includes total program costs and formal reporting of key performance indicators could lead to more efficient and effective program management, potentially uncover new cost savings opportunities, and provide more transparency to the City's employees and the public.

A Strategic Plan Would Aid in Achieving Goals and Performance Measures

The City may not have the most cost-effective and efficient workers' compensation program model.

Workers' compensation management has not developed a formal workers' compensation strategic plan, and as a result, the City may not have the most cost-effective and efficient workers' compensation program model. Specifically, the Workers' Compensation Unit does not periodically assess whether the self-insured, self-administered program, and its excess insurance coverage level, is the most cost-effective and efficient means of delivering the Workers' Compensation Program to City employees.[16] The state recognizes other approved delivery models: self-funding groups or pools and private commercial insurance companies as well as the state-authorized Pinnacol Assurance. Along with a formal strategic plan, key performance indicators should be developed to help evaluate the Workers' Compensation Program model and how well it is meeting its goals.

The U.S. Government Accountability Office's guidance highlights the importance of performance information in helping organizations improve decision-making and achieve results. The guidance also states that to increase the usefulness of performance information, an organization should align its strategic goals, objectives, and performance measures to reinforce the connection between those goals and its day-to-day activities. Accordingly, the Workers' Compensation Unit should update its performance management approach to include strategic goals and performance measures that reflect its current administrative practices.[17]

[16] Excess insurance, also known as reinsurance definition, see Appendix C: Key Terms

[17] U.S. Government Accountability Office, "Managing for Results: Enhancing Agency Use of Performance Information for Management Decision Making," GAO-05-927 (Washington, D.C.), Sep. 9, 2005, last accessed August 27, 2018. https://www.gao.gov/products/GAO-05-927

The strategic planning process typically involves clarifying mission and values, developing a vision of the future, analyzing external challenges and opportunities, assessing internal strengths and weaknesses, developing strategic goals and objectives, identifying strategic issues, developing and evaluating alternative strategies, and developing action plans.[18]

Strategic planning has been widely studied by public administration scholars and cited as an important element in strategic management. One scholar defined strategic planning as "a disciplined effort to produce fundamental decisions and actions that shape and guide what an organization is, what it does, and why it does it."[19]

Further, the scholar's report outlines benefits of strategic planning that include: thinking strategically; clarifying future direction; making today's decisions considering their future consequences; developing a coherent and defensible basis for decision making; exercising maximum discretion in the areas under organizational control; solving major organizational problems; improving performance; dealing effectively with rapidly changing circumstances; and building teamwork and expertise.[20]

In fact, in a 2005 study of more than 500 municipal managers, a large majority of managers reported they were satisfied with the implementation of their strategic initiatives, and 90 percent of them said the benefits outweighed the costs of undertaking the efforts.[21]

The Workers' Compensation Unit Does Not Periodically Assess Whether Its Program Delivery Model Is the Most Cost-Effective and Efficient Choice

Managers for the Risk Management Office and the Workers' Compensation Unit say it is desirable to keep the self-insured and self-administered program model. As a result, there has been no formal strategic analysis to determine whether a different model would provide improved service delivery at a lower cost.

State law requires all Colorado employers with more than one employee have workers' compensation coverage by (1) using the state's quasi-governmental Pinnacol Assurance Fund, (2) using a stock or mutual corporation authorized to transact workers' compensation insurance in Colorado, or (3) be self-insured. Insurance pools and

[18] T.H. Poister and G. Streib, "Elements of Strategic Planning and Management in Municipal Government: Status after Two Decades," Public Administration Review, (2005), p. 65, pp. 45-56

[19] John M. Bryson, *Strategic Planning for Public and Nonprofit Organizations: A Guide to Strengthening and Sustaining Organizational Achievement.,* (1995), Rev. ed. San Francisco: Jossey-Bass p.6, last accessed August 27, 2018 http://citeseerx.ist.psu.edu/viewdoc/download?doi=10.1.1.458.5630&rep=rep1&type=pdf

[20] ibid.

[21] T.H. Poister, and G. Streib, "Elements of Strategic Planning and Management in Municipal Government: Status after Two Decades," Public Administration Review, (2005), p. 54

special funds are also permissible for special qualifying circumstances.[22],[23]

The City has opted to self-insure, directly paying medical providers approved by the program, and indemnity payments (or time off) through the Worker's Compensation Internal Service Fund and salary continuation through agency payrolls. The salary continuation payments are not included in the internal service fund, as noted in Finding 1 above.

The City must follow myriad state reporting rules when accepting liability for a worker's injury claim. Though the City uses its own employees to administer the program, it also uses third-party vendors:

- To review medical costs against state-mandated fee schedules, controlling medical costs by ensuring health care providers are paid in accordance with the schedule;
- To obtain collective and reduced pricing on medication prescriptions and medical equipment; and
- To provide specialized claim case management that cannot be provided by City employees due to independence or other conflicts of interest.

The state requires any employer seeking to self-insure its workers' compensation program to annually apply to the Colorado Department of Labor and Employment for a self-insurance permit. The City submitted its application for 2017 on February 22, 2018. The City provided the state total cash and equivalents as of year-end, claims history data, three-year trended Incurred But Not Reported factors as well as the outstanding liability from the claim history sheet.[24]

Other Alternatives Exist - Other local governments around the state use a variety of workers' compensation program models, including self-insurance. We performed a bench-marking of the City against other large Colorado cities and counties and determined that the majority are also self-funding their programs. However, we found that several local governments, such as El Paso County and Douglas County, had outsourced the administration of their entire programs to third-party administrators.[25] El Paso County, for example, does not hire employees to administer claims management and outsources the work to a third-party vendor, acting as the administrator. Douglas County switched

[22] C.R.S. Title 8, articles 40-47
[23] State of Colorado Workers' Compensation Rules of Procedure with Treatment Guidelines
[24] Incurred But Not Reported, or IBNR, is an actuarial estimate to reflect workers' compensation expenses that have been incurred but are not yet known by an organization.
[25] Third-Party Administrator definition, see Appendix C: Key Terms

from a self-insurance model to using Pinnacol Assurance, an entity created by Colorado legislators and regulated by state law.

As described in the background section of this report, the City's Workers' Compensation Program is self-insured, and by employing its own claims management staff, program officials say that they maintain a positive experience for injured workers who, rather than talking to strangers, feel the adjusters they communicate with, also City employees, are vested in their well-being. The City does contract with a third-party provider for certain cases where discretion or conflict of interest is best supported by using external adjusters for case management. For example, if a Workers' Compensation Unit employee files a workers' compensation claim, privacy rules remain in effect when handled by an adjuster outside the department. Additionally, the third party is used for overflow cases, if the internal adjusters are overburdened by existing cases or on vacation or extended sick leave.

The Workers' Compensation Unit Does Not Fully Evaluate the Self-Insurance Retention Level

For any single occurrence, the maximum that the City would have to pay is $2.5 million.

There is a state requirement for self-insured entities to purchase third-party excess insurance, where the third-party insurer is liable for payment of any amount of a claim more than a retained, predetermined amount paid by the self-insured employer. The predetermined amount is called the "self-insurance retention."

The self-insurance retention amount for the City is $2.5 million per claim and has not changed since 2008. This means that for any single occurrence, the maximum that the City would have to pay is $2.5 million, with only one such occurrence since the year 2000.[26] While the excess insurance is required, the self-insured retention amount is not defined by statute. Raising or lowering the self-insurance retention will affect the cost of the premium. The City uses the services of an insurance broker to request rates from commercial insurance carriers. The broker has obtained quotes for lowering the self-insurance retention, which would lower the City's out-of-pocket costs in the event of a high-dollar claim but increase the City's premium.

However, the broker has not been asked to obtain quotes for a higher self-insurance retention or for splitting the self-insurance retention between higher- and lower-risk pools. From claims experience data, the Workers' Compensation Unit consistently knows that most of its claims and costs arise from the Department of Safety—Police, Fire, and Sheriff departments—because of the nature of their work. The self-

[26] Single occurrence is defined as one event, which may be a single employee's injury or may cover multiple employees' injuries in one event.

insurance retention could be split between this higher risk pool and lower risk pools such as the Department of Finance, or the overall level might be raised, which could potentially lower the City's insurance premium cost. Since these options have not been evaluated in recent years, the ultimate impact of changing the self-insurance retention cannot be quantified.

We learned in our benchmarking with five Colorado government entities and three large U.S. government entities outside of Colorado that some split their self-insurance retention limits, including negotiating a higher self-insurance retention for their high-risk pools, such as law enforcement, and a lower self-insurance retention for departments identified as lower-risk pools. This does not change the coverage offered to employees but can result in a lower-cost program.

The Workers' Compensation Unit Does Not Analyze the Total Cost of the Workers' Compensation Program

The cost model the Workers' Compensation Unit uses in its key performance indicators is limited to medical and indemnity costs and other certain costs such as legal fees, as well as direct costs such as payroll for claims adjusters, insurance premiums, third-party contractor fees, etc. However, the Workers' Compensation Unit does not include indirect cost allocations from other agencies and the salary continuation costs, as noted in Finding 1 above, into its analysis of the total cost of the Workers' Compensation Program.

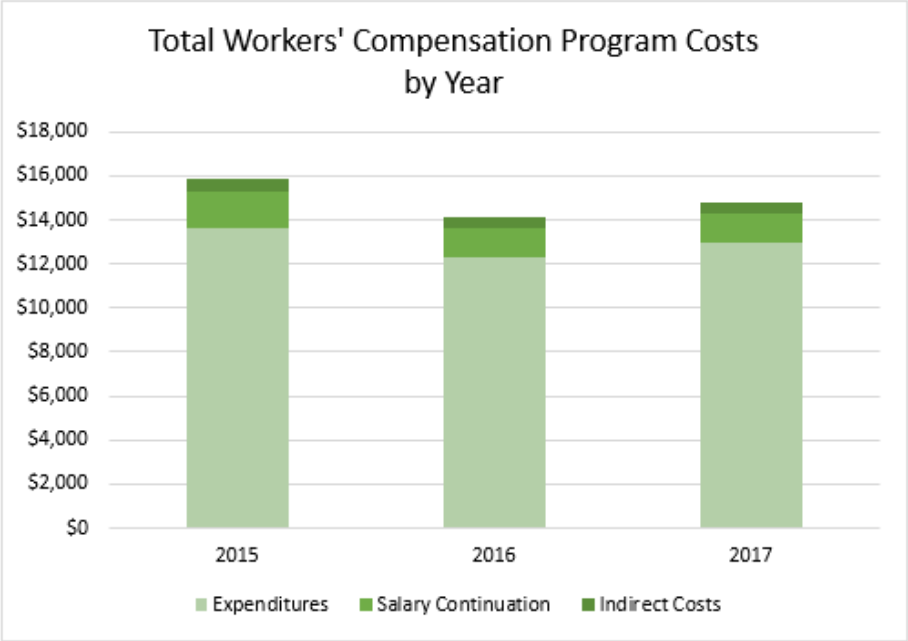
Reducing unwarranted costs is a primary goal. According to the Workers' Compensation Manual, Denver's City Council, through ordinance, decided to create a self-insured and self-administered system in the belief the City would have greater control of the cost of claim administration. Not calculating the total cost of the program limits the opportunity to track and evaluate how well the City is meeting this goal and what improvements could be made.

We define the total cost of the program, from a managerial analysis perspective, to be:

1. All expenditures recorded in the Workers' Compensation Internal Service Fund;
2. Salary continuation as required by City Charter and collective bargaining agreements. The Workers' Compensation Unit only tracks the 66 2/3 percent required by state law and does not include the full salary continuation cost as noted in Finding 1; and
3. Indirect cost allocations, such as for Technology Services and General Services.

In 2017, including categories 2 and 3 above would increase total cost by $1.8 million, from $13 million to $14.8 million.

Figure 4. Total Workers' Compensation Program Costs 2015-2017 (in thousands)



Source: City and County of Denver's Auditor's Office

This financial approach would better define total cost and would aid the Workers' Compensation Unit in evaluating various program models.

If a City employee is injured by an at-fault third party, some claim costs can be recovered through subrogation and restitution payments. These payments made to the City reduce the total claim cost. We have not included these recoveries in our total cost calculation because these amounts represent revenues, and the timing of the payments received can span years after the claim costs have been finalized. In 2017, approximately $1.5 million was recorded in the internal service fund as insurance recovery.

The Workers' Compensation Unit Lacks a Framework of Reportable Key Performance Indicators for Program Effectiveness and Efficiency

For several years, certain Workers' Compensation Unit key performance indicators were included in the Mayor's Budget Book. However, due to a citywide decision by the Budget and Management Office to standardize and streamline the Budget Book, as of 2018, these performance indicators are no longer presented. With this change, Budget and Management expected agencies would report their key performance indicators on City-facing or public-facing websites, as appropriate, or in their annual reports.

While the Workers' Compensation Unit annually prepares infographics of internal key performance indicators—such as annual total claim count, number and cost of claims by incident type, and number and cost per claim by department—the information is not reported to City employees or the public. As noted in Finding 1, the cost data prepared by the Workers' Compensation Unit does not include salary continuation costs and are thus understated. As a result, the cost and frequency of workers' compensation claims is not as transparent as it could be to City employees and the public. According to U.S. Government Accountability Office guidelines, reporting performance metrics can prompt feedback, including from internal management, City employees, and the public, which can result in continuous improvement.

Going forward, in addition to medical and indemnity cost analyses, total program costs should be added in the key performance indicators to provide a complete record of the cost to the City. As a result, we recommend the Workers' Compensation Unit develop a public or City-facing webpage, or both, to display this important information.

RECOMMENDATION 2.1

Formal Strategic Plan – We recommend the Risk Management Office and the Workers' Compensation Unit develop a formal strategic plan to address how to best provide workers' compensation insurance in the most effective manner, including cost and level of service provided to injured employees. This plan should be developed by mid-2019 and be used to drive any identified process and program changes prior to the next budget and insurance bidding process.

Agency Response: Agree, Implementation Date – April 30, 2019

RECOMMENDATION 2.2

Update Formal Strategic Plan – In addition, we recommend a process be implemented to update the strategic plan on a regular basis to adjust for any changes in the workers' compensation requirements or needs.

Agency Response: Agree, Implementation Date – April 30, 2019

RECOMMENDATION 2.3

Self-Insurance Retention Evaluation – We recommend the Risk Management Office and the Workers' Compensation Unit evaluate the self-insurance retention level at higher, lower, and split levels based on higher- and lower-risk pools in conjunction with broker analysis and bidding to market for a new insurer whenever these insurance items are sent to bid.

Agency Response: Agree, Implementation Date – July 1, 2019

RECOMMENDATION 2.4

Calculate and Report Total Program Cost – We recommend the Workers' Compensation Unit annually calculate and report on the total cost of the program, including medical, indemnity, direct and indirect administrative costs, and complete salary continuation costs.

Agency Response: Agree, Implementation Date – May 31, 2019

RECOMMENDATION 2.5

Develop Standard Key Performance Indicators – We recommend the Workers' Compensation Unit develop standard key performance indicators for total program cost, claims processing, claims costs, and customer service, to help evaluate the program periodically against other model alternatives. All cost data should include all costs to the program.

Agency Response: Agree, Implementation Date – June 30, 2019

RECOMMENDATION 2.6

Report Key Indicators – We recommend the Workers' Compensation Unit report its key performance indicators in an annual report or publish certain key indicators regarding workers' compensation cost and efficiency on either public- or City-facing websites, as soon as possible.

Agency Response: Agree, Implementation Date – December 31, 2019

FINDING 3

Policies and Procedures Are Not Current, and Opportunities Exist to Address Gaps and Improve Efficiencies

The Workers' Compensation Unit has not updated its internal written policies and procedures to reflect current business practices. Our audit also identified an ineffective control and several areas for internal control improvement surrounding supervisor reports, check handling, contact monitoring, and reviewing subcontractor controls. We also identified gaps in internal policies surrounding funding reserves for workers' compensation.

The Workers' Compensation Unit's Policy and Procedure Manual was last updated in 2016.

During our audit, we found that the Workers' Compensation Unit's Policy and Procedure Manual was last updated in 2016 and does not:

- Reflect current business processes, including the addition of Workday Financials as the system of record for the City to record transactions into the Workers' Compensation Internal Service Fund;
- Include an updated table of contents, which was last updated in 2013;
- Include guidance regarding the controls used to ensure supervisor reports are completed for on-the-job injuries and illnesses reported by City employees;
- Include check logging for checks received from insurance companies and courts for subrogation and restitution payments made to the City;
- Include a formal contract monitoring program as required by Executive Order 8, "Contracts and Other Written Instruments";
- Include procedures to request Service Organization Control (or SOC 1) reports of its vendors providing key support in workers' compensation extraordinary case management, and other operational and financial processes, including medical billing review, dispensing medications, and getting necessary medical equipment to help employees recover from their illness or injury; or
- Include a management-level formal review procedure for injured workers with multiple claims spanning multiple years to ensure treatment and costs are assigned to (and accounted for in) the proper claim number.

The U.S. Government Accountability Office's "Standards for Internal Control in the Federal Government" specifies that documentation is a critical component of an organization's control environment.[27] In particular, the standards emphasize the importance of developing and maintaining documentation that communicates information critical to the effectiveness and efficiency of an organization's operations.

The lack of up-to-date administrative policies and procedures places the Workers' Compensation Unit at risk of losing key institutional knowledge about its administrative operations and hampers critical knowledge sharing by limiting the information available to the current personnel. Accordingly, the Workers' Compensation Unit should update its administrative policies and procedures to reflect current practices and enable knowledge transfer by and between current and future personnel. It appears that the Workers' Compensation Unit prioritizes policy and procedure updates only as time allows, which has resulted in outdated policy and procedure. If not kept up-to-date, employees do not have written procedures to reference as a resource to do their jobs in line with management expectations.

Supervisors of injured employees are required to complete and submit an online Supervisor Report of Accident or Incident and submit the signed form to the Risk Management Office within five working days of the incident. During the audit, we found that although supervisor compliance appears to be improving over time, approximately 10 percent of 6,056 workers' compensation cases between 2012 and 2017, or 622 claims, were not supported by the required supervisor report. Therefore, evidence confirming the injury or illness by the employee's direct supervisor is not captured to allow for a better assessment of whether the City should accept liability for the injury or illness, medical cost, and employee time.

The Workers' Compensation Unit received approximately 150 physical checks per month that need to be deposited into the City's bank account. The Workers' Compensation Unit's written check-handling policies and procedures do not include a requirement to log in all checks as received. Without check logging, checks can be misplaced and/or not deposited in a timely manner, which can increase the risk of a payment being lost or misappropriated and incur costs to the City. The unit is also not using the online payment function established by

[27] United States Government Accountability Office. Standards for Internal Control in the Federal Government, GAO-14-704G (Washington, D.C.: Sep. 10, 2014). These standards, commonly referred to as the "Green Book," may also be adopted by state, local, quasi-governmental entities and not-for-profit organizations as a framework for an internal control system.

Enterprise Cashiering Solution, a City system that oversees electronic funds transfer receipt functionality.

The City's Fiscal Accountability Rule 3.4 regarding receipts and deposits does not preclude the use of checks in receiving payments from payers. A Government Finance Officers Association best practice guide recommends "that state and local governments perform cost/benefit analysis, implement safeguards, and routinely evaluate opportunities to make and receive electronic payments."[28] This practice encourages a reduction in handling physical financial instruments whenever possible to reduce risk and increase cost effectiveness. Additionally, in 2017, the City's Director of Cash and Investments supported moving agencies to electronic funds transfer even though the Fiscal Accountability Rule does not expressly require it.

Monitoring Multiple Claims Over Multiple Years

During the audit, we found that the Workers' Compensation Unit is not conducting formal reviews of multiple claims over multiple years for individual claimants. Formal policy and procedures do not include controls to ensure treatment and costs are coded to the proper claim, subrogation efforts are proper, approved treatments are not exceeded, and salary continuation and indemnity payments are accounted for properly across multiple claims spanning many years. This can have adverse effects for claimants and the City due to possible accounting errors affecting payment caps and subrogation.

Monitoring of Service Organization Controls

During our audit, we noted the fiscal administrator conducts periodic but informal reviews of the performance of the third-party who checks medical bills against the state-mandated fee schedules. The reviews appear to be used in a periodic performance evaluation that are considered during new contract bids. However, it does not appear that the results of the monitoring are shared with the vendor as part of a formalized performance evaluation program. The Financial Director of Risk Management stated that he believes the Workers' Compensation Unit has adequate informal contract monitoring procedures.

The Workers' Compensation Unit uses third parties to handle the claims management process and relies on the contractor's system of internal accounting and administrative controls. The Workers' Compensation

[28] Government Finance Officers Association, "Best Practice: Electronic Payment and Electronic Collection Systems," accessed August 27, 2018, http://www.gfoa.org/sites/default/files/GFOATIMBPECommerce.pdf.

Unit should confirm this by obtaining assurance from vendors that their systems and/or processes include sufficient effective internal controls and provide the City with accurate and reliable financial data. Standards published by the American Institute of Certified Public Accountants require that service providers provide an independent audit attesting to the suitability of the design and operating effectiveness of the controls in their processing system.[29] An independent firm formally provides this assurance.

Table 8 describes types of reports that can be prepared to describe a service organization's internal control environment.

TABLE 8. Types of Service Organization Control 1 (SOC1) Reports for Service Organizations

Report Type	Report Description
SOC I, Type I	Independent audited report that provides assurance over the design of the internal control environment over the financial reporting process provided by a contracted service provider, without testing of the effectiveness of the control implementation.
SOC I, Type II	Independent audited report that provides assurance over the design and implementation of the effectiveness of the internal control environment over the financial reporting process provided by a contracted service provider.

Source: City and County of Denver Auditor's Office

The Workers' Compensation Unit has not formally requested a Service Organization Controls 1 Report for internal processes such as medical bill reviews, prescription filling, and extraordinary case management. Without this assurance report, the Workers' Compensation Unit would need to develop a manual internal control framework to review and test whether a vendor's internal processes provide an effective operational and financial control environment.

The Workers' Compensation Unit is also not in compliance with Executive Order 8, which requires the initiating agency establish and implement policies and procedures for monitoring contracts by specifying accountable employees, developing guidance on addressing noncompliance with contract vendors, and ensuring the vendor is paid promptly in compliance with the City's prompt payment ordinance. Additionally, the executive order requires agencies to monitor contracts through the life of the agreement to ensure that: a) all terms are met; b) all bonding and insurance requirements are continually met; and c) documentation exists to show that monitoring is

[29] American Society of Certified Public Accountants, Statement on Standard for Attestation Engagements (SSAE) No. 18, accessed August 27, 2018, https://www.aicpa.org/content/dam/aicpa/research/standards/auditattest/downloadabledocuments/ssae-no-18.pdf

occurring with appropriate deliverables by reporting on contract performance periodically.

When developing its contract monitoring program, the Workers' Compensation Unit should be certain to include specific procedures to monitor and track its vendor compliance with contract terms, including ensuring compliance to the mandated medical services fee schedules, adherence to medical care provider preauthorization, and developing a mechanism to obtain assurance that operational and financial processes performed on the Workers' Compensation Unit's behalf by third parties is monitored.

RECOMMENDATION 3.1

Update Policy and Procedures Annually – We recommend the Workers' Compensation Unit dedicate resources to update policies and procedures at least annually to reflect current business processes.

Agency Response: Agree, Implementation Date – September 30, 2019

RECOMMENDATION 3.2

Strengthen Check Handling Controls – To strengthen existing internal controls, we recommend the Workers' Compensation Unit use a daily check log and update workers' compensation policies and procedures to include this requirement and consider setting up an Enterprise Cashiering Solution online receipting function for subrogation and restitution payments.

Agency Response: Agree, Implementation Date – Complete

RECOMMENDATION 3.3

Supervisor Reports – To strengthen existing internal controls, we recommend the Workers' Compensation Unit:

- Continue its emphasis on training agency supervisors on their responsibilities to complete a timely supervisor report and develop a formal mechanism that measures noncompliance; and
- Establish an automated reminder process for past due supervisor reports with escalation to higher levels of management as part of the implementation of a new reporting system.

Agency Response: Agree, Implementation Date – June 30, 2019

RECOMMENDATION 3.4

Contract Monitoring – To strengthen vendor contract monitoring, we recommend the Workers' Compensation Unit strengthen its existing contract monitoring program for all vendors providing services supplementing workers' compensation operational and financial processes by:

- Identifying and assigning a designee(s) within the Workers' Compensation Unit to manage the contract monitoring program; and
- Developing procedures to identify and address noncompliance with contract terms by service.

Agency Response: Agree, Implementation Date – February 28, 2019

RECOMMENDATION 3.5

Service Organization Controls – To strengthen internal controls surrounding subcontracted operational and financial controls, we recommend the Workers' Compensation Unit request that all organizations providing services that affect operational and financial processing perform a Service Organization Control 1, Type II, report covering the company's system of controls over services provided to the City. In the absence of such a report, we recommend the Workers' Compensation Unit develop a mechanism of formal controls to ensure that subcontracted operational and financial controls are adequate and reliable.

Agency Response: Agree, Implementation Date – February 28, 2019

RECOMMENDATION 3.6

Multiple Claims Review – We recommend that the Workers' Compensation Unit add a formal process to the workers' compensation policies and procedures to include regular management review of cases where injured workers have multiple claims, sometimes spanning many years, to ensure that treatment and costs are coded to the proper claim, subrogation efforts are proper, approved treatments are not exceeded, and salary continuation and indemnity payments are accounted for properly.

Agency Response: Agree, Implementation Date – September 30, 2019

Workers' Compensation Fund Balance Target Policy Does Not Agree with Actuarial Recommended Fund Balance Target

The City uses a third-party actuarial firm to calculate the workers' compensation claim fund liability. This firm also makes recommendations on how much money the City should have set aside above the claim reserve liability because the estimates of claim costs are subject to uncertainty. The Workers' Compensation Unit has established a funding target range that is $1 million below the level recommended by the actuary.

The Workers' Compensation Program is self-insured by the City. The Colorado Department of Labor and Employment establishes the amount of funding required each year for the City to maintain its self-insured permit. The requirement is calculated using the average amount of claims paid over the previous three years plus the outstanding liability for claims as of the end of the previous year. For example, this requirement at December 31, 2017, for 2018, was about $17.2 million. The Workers' Compensation Internal Service Fund had current assets and appropriations set aside in 2017 to satisfy this requirement. These funds may only be used for payment of workers' compensation benefits and administrative costs.

In the fund, current assets consist primarily of cash and cash equivalents of about $40 million. The largest liability is the reserve for claims, which totals about $26.3 million.

The Governmental Accounting Standards Board's Principles Require Recording the Claim Reserve Liability

Governmental Accounting Standards Board principles provide guidance on identifying, estimating, and recording liabilities.[30] These include guidance related to discounting and a range of estimates, if applicable. Specifically, these accounting standards require governmental entities such as Denver to report an estimated claim liability if it is probable that such liability will occur and can be

[30] Governmental Accounting Standards Board Statements No. 10., *Accounting and Financial Reporting for Risk Financing and Related Insurance Issues*, and No. 30, *Risk Financing Omnibus—an amendment of GASB Statement No. 10*

reasonably estimated. Discounted and undiscounted cost estimates at various confidence levels are discussed in more detail below. [31]

The actuarial firm calculates the expected total remaining cost of all open workers' compensation claims, less expected future investment earnings, to determine the year-end workers' compensation claim liability that is recorded in the City's Comprehensive Annual Financial Report. The City records the workers' compensation claim reserve liability in accordance with the principles set by the Governmental Accounting Standards Board.

Each year the City provides the actuary with the prior year data for all claims, which includes medical costs and indemnity. This data is used by the actuary to estimate the cost of claims and expenses for the next year and the program's liability for total outstanding claims. During the audit, we found that salary continuation benefits related to workers' compensation claims were not included in the data provided, as noted in Finding 1, resulting in an understated liability.

Actuarial Review and Recommendations

The actuary uses several different techniques in estimating the ultimate claim loss for the program. Each technique relies on a specific set of assumptions about the stability of the claims environment and thus provides additional insight into trends in claims costs. Thus, the methods applied act as checks and balances against one another and, within reason, the more methods, the better.

The following table provides the actuary's 2017 estimated claim reserve liability at various confidence levels including the expected liability of $26.2 million, which the City has recorded as the workers' compensation claim liability as of December 31, 2017. The actuary recommends that an amount in addition to the discounted expected minimum liability be set aside for contingencies. The table shows the actuarily recommended range of funding levels with a recommended target of an 80 percent confidence level, or $30.2 million.

[31] Confidence level definition, see Appendix C: Key Terms

Figure 6. Actuarial Report Recommendation for Unpaid Loss and Loss Adjustment Expenses at December 31, 2017[32]

Actuary Calculated Funding Guidelines for December 31, 2017
Additional Amount above Actuarial Calculated Expected Claim Liability
(Amounts Shown in Thousands)

	Marginally Acceptable	Recommended Range			Conservative
Confidence Level of Adequacy	70%	75%	80%	85%	90%
Margin for Adverse Experience (Amount above Expected Liability)	$ 2,129	$ 2,996	$ 3,969	$ 5,151	$ 6,728
Expected Liability	$ 26,282	$26,282	$26,282	$26,282	$ 26,282
Total Required Assets	$ 28,411	$29,278	$30,251	$31,433	$ 33,010

Source: Actuarial Review of the Self-Insured Workers' Compensation Program – 2017

The City's Workers' Compensation Internal Service Fund policy has a target to build funding to a 75 percent confidence level to ensure adequacy of funding for claims. This practice is aligned with the actuary's recommendations to fund above the minimum estimate. However, it falls short of the actuary's recommended target of an 80 percent confidence level for funding the liability because of uncertainty in the estimates.

City's Target Base Fund Policy Focuses on Fund Assets

In 2013, the Workers' Compensation Program proposed the current fund balance target. Although considered an official City policy by the Department of Finance, the target is not formally a policy included in the City's financial and reserve policies.

The City records the actuary's estimated liability consistent with the workers' compensation target base fund policy. The policy is based on maintaining the funding level by using internal service fund assets (cash and equivalents), if necessary. Specifically, the policy states that:

> "The City shall maintain the fund balance of the Workers' Compensation Fund so that at no time will the fund be less than the 50% confidence level for adequacy of funding to meet all claims against the fund based upon an annual actuarial report. Annual budget premiums will be allocated to the agencies to build the fund balance until a 75% confidence level for adequacy of funding for claims is reached. During challenging

[32] Actuarial Report and Loss Adjustment Expense definitions, see Appendix C: Key Terms

economic times, the balance may decrease, but never drop below a 50% confidence. During normal or strong economic times, the annual premiums will be increased to build over time until the targeted 75% confidence level is reached."

Although we understand the City also relies on other reserves during adverse economic times, we believe those funds need to be available for other purposes that will be impacted by the same adverse conditions, if applicable. The City's other reserves are intended to be available for unexpected events or shortfalls due to revenue declines during economic downturns. However, workers' compensation claim liabilities are probable and can be estimated.

We recognize the Department of Finance may want to maintain a flexible funding approach. Therefore, we believe the Workers' Compensation Unit in conjunction with the Cash, Risk, and Capital Funding Division should revise the workers' compensation funding level policy to target the 80 percent confidence level for liability in normal economic times, while establishing a floor of a "marginally acceptable" level of 70 percent. This will help ensure more comprehensive reporting, particularly if all costs including salary continuation are used in actuarial estimates as discussed below. Since funds are already available in the internal service fund accounts, this will not require any additional funds from other agencies. However, it will ensure dedicated funds are available for outstanding claims. Finally, we recommend the policy be formally incorporated into the City's financial and reserve policies.

RECOMMENDATION 3.7

Current Target Fund Policy – We recommend the Workers' Compensation Unit in conjunction with the Cash, Risk, and Capital Funding Division consider revising its current target base fund policy for the Worker's Compensation Internal Service Fund to:

- Adopt the actuarily determined 80 percent confidence funding level;
- Specify a minimum 70 percent confidence funding level; and
- Incorporate the workers' compensation claim reserve and fund reserve policy into the City's financial and reserve policies.

Agency Response: Disagree

FINDING 4

The Workers' Compensation Unit's Risk Management Information System Does Not Support Current Business Processes Effectively and Efficiently

The STARS system does not effectively and efficiently support current business processes.

The STARS system, used for reporting and tracking of all insurance claims and incidents against the City, including property, auto, general liability, and workers' compensation, does not effectively and efficiently support current business processes. Limitations include those identified by the Workers' Compensation Unit, including lack of ad hoc reporting for employee time off from work or days the injured employee is restricted from performing their full duties. The system security functions are difficult to navigate without advanced knowledge, and there are limited opportunities to automate information-sharing between systems without manual intervention. Additionally, auditors found further limitations and control deficiencies during claims testing, including a lack of edit controls, the ability to delete records, the inability to allow custom views, as well as further control and operational deficiencies described below.

During the audit, the Workers' Compensation Unit management said that a request for proposal for a new risk management information system was submitted on February 14, 2018, and a vendor selection was to be made in September 2018, with full implementation five months later. The Workers' Compensation Unit has extended its contract with the current vendor until April 2019. As part of the audit, we interviewed the risk management business analyst who worked extensively on improving business processes in the Risk Management Office and the Workers' Compensation Unit. The business analyst provided several system limitations that affect the daily effectiveness and efficiency of the workers' compensation claims management process including the following:

- Claims adjusters cannot enter a beginning date with no firm ending date;
- STARS does not allow on-the-spot reporting of lost days or restricted duty days;
- STARS does not have system interfaces for the OUCH Line, with subcontractors such as the medical fee schedule reviewer, the medicine and medical equipment prescription provider, and third-party case managers;

- Mail merging does not work properly for physical mail requirements; and
- State look-up tables cannot be added to STARS, so claims adjusters must make manual claim detail calculations.

Through an audit of STARS' data completeness and a detailed judgmentally sampled claims testing, we noted the following limitations that affect the effectiveness and efficiency of the Workers' Compensation Unit's business processes:

- Fields cannot be designated as required fields to be completed;
- Field edit checks do not require certain formats and reasonableness checks (not allowing a return-to-work date of 06/25/2042);
- The system does not allow claims to be deactivated, only deleted;
- The system does not provide edit reports of changes made to security or record deletion; STARS does not allow for custom user views to be built;
- STARS does not calculate the true average cost per claim, either over the life of the claim or for one year;
- STARS does not have a way to mark claims where a legal decision, called a stipulation, was made during settlement to allow future treatment related to the previous work injury;
- STARS does not have automated controls to identify when three fields do not match: claim number, date of injury, and body part injured; and
- It does not have built-in system controls to help adjusters manage multiple claims over multiple years.[33]

Without data field edit checks requiring completion or a specific format, STARS data can often be left incomplete or entered incorrectly. Additionally, we noted that fields were not consistently completed over time, including four return-to-work fields. Without complete, accurate, and consistent data entry, information required for internal analysis and or internal and external reporting can be deficient.

The National Institute of Standards and Technology provides guidance for security and privacy controls for federal information systems and organizations that can easily be adopted by local government. The agency recommends systems have information

[33]Stipulation, see Appendix C: Key Terms

input validation controls where the system checks the validity of information input into the system and includes error handling by generating error messages when the information does not match the data entry requirements, for example, a return-to-work date far into in the future. [34] These system controls should be adopted by the Workers' Compensation Unit as it implements a new risk management information system to allow for more automated checking of data entered into the system to help ensure data completeness and integrity for later uses. How to use data fields included in the system should be well conceived during design of the system and documented in internal policies and procedures surrounding the use of the system in claims management.

Additionally, the Workers' Compensation Unit should also consider incorporating further efficiencies into the design of the new system, if possible. Claims adjusters should be able to build custom views of the approximately 250 fields that may or may not be populated currently in STARS. At present, STARS only provides standard and prepopulated screens, which does not allow flexibility for the claims adjusters or management to build field view reports or screens that would most easily aid their work style or routines. The Workers' Compensation Unit should reconsider the number of fields it includes in the new STARS design to also aid in reducing unneeded data entry while balancing anticipated internal and external reporting needs.

The Workers' Compensation Unit should also consider custom screen designs to allow for easy identification of cases with stipulations for future medical treatment (e.g., a settlement was reached allowing for submission of medical bills in the future for treatment of the original injury). This design should decrease manual investigation or time lost if a medical bill is inadvertently rejected when it should have been accepted for payment by the claims adjuster.

During claims testing, we noted that a payment was applied to the wrong claim for injuries sustained by the same employee in different accidents over multiple years. These errors could be mitigated by including an edit check into the new risk management information system to verify that claim number, date of injury and body part injured match. This could be accomplished with a built-in data entry error message to prevent this mistake from occurring often.

[34] Special Publication 800-53 Revision 4, U.S. Department of Commerce National Institute of Standards and Technology, April 2013, last accessed August 27, 2018, Control SI-10, https://csrc.nist.gov/csrc/media/publications/sp/800-53/rev-4/archive/2013-04-30/documents/sp800-53-rev4-ipd.pdf

Deleting records in the system is not a proper control and affects the ability to report the completeness of claims management recordkeeping, especially if the system also does not provide reporting on deleted records for subsequent approval and archiving. In the case of the Workers' Compensation Unit, this is coupled with the control deficiency of allowing multiple persons access to delete records in the system: the administrator; the process improvement business analyst; and the third-party host administrator. Currently, the Workers' Compensation Unit can only delete claims for errors, duplication, or process timing issues. There is no edit reporting available showing a complete listing of deletions, including when the record was deleted, by whom, and a reason code for deleting the record. Management is unable to explain the multiple gaps the auditors found in the claims number sequence between 2012 and 2017.

RECOMMENDATION 4.1

Risk Management Information System Controls and Functionality – To strengthen internal controls and increase efficiencies in the claims management process, we recommend the Workers' Compensation Unit:

- Ensure that data application controls such as required fields, drop-down selection menus, field edit controls, record deactivation capabilities, and system security and record edit reports be included in system requirements for the new risk management information system;
- Update departmental policy and procedures defining data field use and what is expected for data entry, especially for data fields that will have more open-ended information requirements;
- Improve controls and claims-processing efficiencies by including customizable screen views, flags for stipulations from previous claims, a three-point edit check for claim number, date of injury and body part injured match, and system enhancements to help adjusters better manage multiple claims for multiple injuries over multiple years;
- Automate interfaces between all IT systems used to the extent possible; and
- Develop additional manual compensating controls for all controls that cannot be implemented in the application.

Agency Response: Agree, Implementation Date – April 30, 2019

RECOMMENDATIONS

1.1 **Salary Continuation Accounting and Reporting** – We recommend the Workers' Compensation Unit, in conjunction with the Department of Finance, develop an accounting and funding approach that allows salary continuation payments related to workers' compensation claims to be:

- Accounted for in the Workers' Compensation Internal Service Fund; and
- Calculate and report the liability associated with salary continuation in the Workers' Compensation Internal Service Fund.

Auditee Response: Agree, But Further Analysis is Required, Implementation Date – May 31, 2019

Auditee Narrative: The Workers' Compensation program is administered in accordance with state Workers' Compensation Department regulations and state statutes. It also complies with all legal requirements, including negotiated collective bargaining agreements, Human Resources Rules, and the D.R.M.C. The Department of Finance does not agree that the current accounting practices place the Workers' Compensation Fund (WC Fund) in non-compliance with GASB requirements. Yet, the audit recommendation does warrant careful review of past practice and possibly a revision of how salary continuation should be treated. As part of the review, the cost/benefit of amending the City's long-standing practice for allocating approximately $1 million of salary continuation against the $750 million annual payroll budget, the treatment of agency funding of personnel costs, and the billing back of the costs captured in the WC Fund to the various agencies will need to be considered.

Because this recommendation requires coordination amongst the Controller's Office, the Budget Office, Risk Management, and the City Attorney's Office to determine the impacts of changing the City's long-standing practice of defining and applying salary continuation as a benefit governed by the D.R.M.C., HR rules, and Collective Bargaining Agreements, we will be unable to effect this change in the 2019 budget process. The Department of Finance will commit to more disclosure in the 2018 financial statements by reporting the salary continuation amounts. Development of procedures, processes, and policies that do not double bill or result in "stranded budget' will need to be developed. Because indemnity payments impact individuals on more than just a financial basis, a communication process will also need to be developed. Upon completion of this analysis and evaluation, any changes adopted will be initiated into the budget for the year 2020.

1.2 **Use Payroll System for Indemnity Payments** – Before the end of 2018, we recommend the Workers' Compensation Unit, in conjunction with the Controller's Office, review the process for indemnity payments to determine whether it would be more efficient and effective to use the payroll system instead of the accounts payable system.

Auditee Response: Agree, Implementation Date – Complete

Auditee Narrative: As the result of the discussions of the exit conference and the audit report, Workers' Compensation staff, the CR&CF Manager, the Controller, and the Payroll unit met regarding the feasibility of applying the new Workday software to process workers' compensation payments. After reviewing the legal requirements under the state statutes and the Workday functionality, it was determined that the payroll system was not suitable for processing the indemnity payments.

The issues preventing using the payroll system include:

- *Not all indemnity payments are made to employees. Recipients include law firms representing clients, ex-employees, and or family members of an injured party.*
- *The state statutes required hard deadlines for payment resulting in workers' compensation periods inconsistent with the City's payroll schedule.*
- *Indemnity payments can start and stop in mid-periods which the payroll system is not designed to accomplish without extensive manual practices.*
- *Processing payments in two different systems increases the risk for errors that can result in the City being fined by the state.*

2.1 **Formal Strategic Plan** – We recommend the Risk Management Office and the Workers' Compensation Unit develop a formal strategic plan to address how to best provide workers' compensation insurance in the most effective manner, including cost and level of service provided to injured employees. This plan should be developed by mid-2019 and be used to drive any identified process and program changes prior to the next budget and insurance bidding process.

Auditee Response: Agree, Implementation Date – April 30, 2019

Auditee Narrative: No less than once a year, the Workers' Compensation Unit reviews the goals and established metrics for the program with the Executive Manager. Further, in 2018, a focused strategic plan process was undertaken by each division of the Finance Department; however, the processes do not meet the definition of a 'formal strategic plan' as detailed in the audit report. The relatively small staff size and many years of workers' compensation experience have enabled the Unit to establish goals and objectives similar to a strategic plan's outcomes that are known by the staff. However, we agree that a more formal, documented process for strategic planning would have benefits to improve the program. This process will be undertaken and completed prior to the next budgetary cycle.

2.2 **Update Formal Strategic Plan –** In addition, we recommend a process be implemented to update the strategic plan on a regular basis to adjust for any changes in the workers' compensation requirements or needs.

Auditee Response: Agree, Implementation Date – April 30, 2019

Auditee Narrative: We agree to be meaningful, strategic plans require periodic up-dating. As part of the planning process in Recommendation 2.1, a process to up-date will be incorporated into the 2019 plan.

2.3 **Self-Insurance Retention Evaluation** – We recommend the Risk Management Office and the Workers' Compensation Unit evaluate the self-insurance retention level at higher, lower, and split levels based on higher- and lower-risk pools in conjunction with broker analysis and bidding to market for a new insurer whenever these insurance items are sent to bid.

Auditee Response: Agree, Implementation Date – April 30, 2019

Auditee Narrative: Over the past fifteen years, Risk Management has periodically sought bids from brokers for different retention levels and splitting the risk pools. Retention levels have been reviewed every three years; however, an insurance marketing effort which includes splitting the retention pool (separate retention and limits for the Department of Safety) has not been fully assessed since 2012. When the next broker selection process is undertaken in May 2019, bids for various retention levels and a split program will be sought. All future bid processes will be well documented with potential changes reviewed at least every three years, or as the insurance market and the City's loss experience warrants.

2.4 **Calculate and Report Total Program Cost** – We recommend the Workers' Compensation Unit annually calculate and report on the total cost of the program, including medical, indemnity, direct and indirect administrative costs, and complete salary continuation costs.

Auditee Response: Agree, Implementation Date – July 1, 2019

Auditee Narrative: The analysis to be undertaken related to Recommendation 1.1 will determine how salary continuation should be treated in the future. The indirect costs attributed to the Workers' Compensation Program as calculated in the 2017 Cost Allocation Plan was less than $500,000, which is considered immaterial to the annual program costs. If the General Fund charged the Workers' Compensation Fund for indirect costs, the Fund would turn around and increase the premium charged to the General Fund to cover the increased Workers' Compensation Fund's costs. The current process eliminates this circular billing inflation of costs.

2.5 **Develop Standard Key Performance Indicators** – We recommend the Workers' Compensation Unit develop standard key performance indicators for total program cost, claims processing, claims costs, and customer service, to help evaluate the program periodically against other model alternatives. All cost data should include all costs to the program.

Auditee Response: Agree, Implementation Date – May 31, 2019

Auditee Narrative: Workers' Compensation has established and reported on industry standard and key metrics for many years. The audit report supports the difficulty in comparing Denver's program to other Colorado communities. Douglas County, which was reported to transition from a self-funded program to an outside insurer, reported 90 claims in 2017 versus Denver's 927 claims. Performance indicators are reviewed throughout each year, both by management and with agency representatives. It seems that the issue of how salary continuation and indirect costs are treated are the impetus driving this recommendation. Upon completion of the review committed to in Recommendation 1.1 above, performance indicators will be adjusted.

2.6 **Report Key Indicators** – We recommend the Workers' Compensation Unit report its key performance indicators either in an annual report and publish certain key indicators regarding workers' compensation cost and efficiency on either public- or City-facing websites, or both, as soon as possible.

Auditee Response: Agree, Implementation Date – December 31, 2019

Auditee Narrative: Historically, performance metrics and indicators have been published in past City annual budgets and reviewed with the agencies of the City. Further, they are on the Risk Management SharePoint website. The commitment has been made to re-establish Risk and Workers' Compensation metrics in future City budgets. The implementation of a new Risk Management Information System (RMIS) in early 2019 is expected to improve statistical capabilities, but the conversion will limit staff availability for website design; however, the annual loss report will continue to be posted on the Risk Management SharePoint site. The Department of Finance is in the process of refining the reporting of performance metrics agency wide, and as part of this work, the Workers' Compensation Unit will establish report capabilities to agencies and the public.

3.1 **Update Policy and Procedures Annually** – We recommend the Workers' Compensation Unit dedicate resources to update policies and procedures at least annually to reflect current business processes.

Auditee Response: Agree, Implementation Date – September 30, 2019

Auditee Narrative: The audit accurately reflects that the most recent comprehensive review of the Workers' Compensation policies and procedures was in 2016. Recognizing that in 2017 a RFP was developed for a new RMIS system, the acquisition of which will most likely require extensive revision of the Worker's Compensation Unit's policies, such a review was postponed. As a result, the updating process will be accomplished in conjunction with the expected new system's implementation in 2019.

3.2 **Strengthen Check Handling Controls** – To strengthen existing internal controls, we recommend the Workers' Compensation Unit use a daily check log and update workers' compensation policies and procedures to include this requirement and consider setting up an Enterprise Cashiering Solution online receipting function for subrogation and restitution payments.

Auditee Response: Agree, Implementation Date – Complete

Auditee Narrative: After receiving the feedback from the audit, the Workers' Compensation administrative staff established a daily check log as recommended and is in the process of documenting this requirement. The amount of the checks received vary widely, ranging from checks for as little as $0.25 and can exceed $100,000. Because Enterprise Cashiering is overseen by other staff in Cash Risk & Capital Funding (CR&CF) we are pleased the auditors recognize the functionality of the ECS system. We strongly agree that whenever possible the ECS online system is preferable. CR&CF staff have outreached to agencies with this recommendation; however, certain individual agencies elect to not follow this recommendation for their business practices.

3.3 **Supervisor Reports** – To strengthen existing internal controls, we recommend the Workers' Compensation Unit:

- Continue its emphasis on training agency supervisors on their responsibilities to complete a timely supervisor report and develop a formal mechanism that measures noncompliance; and

- Establish an automated reminder process for past due supervisor reports with escalation to higher levels of management as part of the implementation of new reporting system

Auditee Response: Agree, Implementation Date – June 30, 2019

Auditee Narrative: With the number of agencies and disbursed locations, it is an ever-challenging process to obtain compliance with supervisory responsibilities related to Workers' Compensation incidents. The Workers' Compensation Unit has continually communicated and outreached to the agencies and provided informal feedback to agencies on instances of noncompliance. An on-line supervisory training class was developed on City-U in 2017. Reporting has steadily improved and has reached a 93% compliance level in 2018. It is desired that the new RMIS system will have a means to automate the communication process. After selection and conversion is underway, alternatives to improve the reminder process for supervisory reports will be reviewed to further improve the compliance.

3.4 **Contract Monitoring** – To strengthen vendor contract monitoring, we recommend the Workers' Compensation Unit strengthen its existing contract monitoring program for all vendors providing services supplementing workers' compensation operational and financial processes by:

- Identifying and assigning a designee(s) within the Workers' Compensation Unit to manage the contract monitoring program; and

- Developing procedures to identify and address noncompliance with contract terms by service.

Auditee Response: Agree, Implementation Date – February 28, 2019

Auditee Narrative: The Workers' Compensation is responsible for several contracts that are monitored and regular meetings with vendors are held to provide performance feedback and address noncompliance issues. This process has not been as formal and documented as it could be. The Director of Risk will compile a list of the WC contracts as well as other Risk related agreements and establish procedures to more formally monitor contracts, including designating a staff person responsible for each contract. This information and results of any meetings with vendors will be reviewed and reported to the CR&CF Executive Manager at least quarterly.

3.5 **Service Organization Controls** – To strengthen internal controls surrounding subcontracted operational and financial controls, we recommend the Workers' Compensation Unit request that all organizations providing services that affect operational and financial processing

perform a Service Organization Control 1, Type II, report covering the company's system of controls over services provided to the City. In the absence of such a report, we recommend the Workers' Compensation Unit develop a mechanism of formal controls to ensure that subcontracted operational and financial controls are adequate and reliable.

Auditee Response: Agree, Implementation Date – February 28, 2019

Auditee Narrative: In conjunction with the contract monitoring activities in 3.4 above, the Director of Risk will work with the Controller's Office to identify those vendors for which SOC reporting is needed. The identified vendors will be required to provide the SOC reports and the Director will review the information with the Controller's Office to ensure adequate controls are in place.

3.6 **Multiple Claims Review** – We recommend that the Workers' Compensation Unit add a formal process to the workers' compensation policies and procedures to include regular management review of cases where injured workers have multiple claims, sometimes spanning many years, to ensure that treatment and costs are coded to the proper claim, subrogation efforts are proper, approved treatments are not exceeded, and salary continuation and indemnity payments are accounted for properly.

Auditee Response: Agree, Implementation Date – September 30, 2019

Auditee Narrative: The selection of a new RMIS that has expanded capacity to better monitor and address multiple claims is one of the functionalities being sought through the RFP process. In conjunction with the up-dating of policies and procedures in 3.1 above, a formal process for reviewing multiple open claims will be documented. Such review will be reported to the Director of Risk by the WC supervisor at least quarterly.

3.7 **Current Target Fund Policy** – We recommend the Workers' Compensation Unit in conjunction with the Cash, Risk, and Capital Funding Division consider revising its current target base fund policy for the Worker's Compensation Internal Service Fund to:

- Adopt the actuarily determined 80 percent confidence funding level;
- Specify a minimum 70 percent confidence funding level; and
- Incorporate the workers' compensation claim reserve and fund reserve policy into the City's financial and reserve policies.

Auditee Response: Disagree

Auditee Narrative: The Actuary provides the annual calculation of the Workers' Compensation Fund liability which is used to report on the program in the Comprehensive Annual Financial Report and for budgeting the premium the Fund charges City agencies. To arbitrarily report and fund a greater amount distorts the Fund's status. Various confidence levels are provided and are evaluated in accordance with the policy adopted by the program. Arbitrarily establishing greater reserves than the current policy of no less than the liability calculated and a target of each year at a 75% confidence level have been more than sufficient to address claims against the fund. It provides management flexibility to address other program needs.

The policy balances having sufficient financial resources each year to address claims while not overly committing resources that can be applied to other worthwhile objectives.

Denver's financial structure further supports the current policy in that the Charter requires the City budget include a 2% contingency each year. In the unlikely event the City experiences a catastrophic loss that depletes the fund below the calculated liability, this contingency can be drawn upon. Because claims are paid out over time, shortfalls can be made up over several years. The City currently self-insures for claims up to $2.5 million when its insurance kicks in to cover claims.

The audit focused solely on the component that oversees payments to injured workers and did not review the other key component of the Workers' Compensation program, namely injury prevention and awareness. Over the past five years, emphasis has been on preventing injuries through greater awareness and outreach programs. An industrial safety officer has been embedded in the Department of Safety (comprised of the three agencies with the greatest number of claims). Physical therapists have been stationed in fire houses to eliminate the need for injured fire fighters to leave work to receive treatment, with the bonus that individuals who have a minor ailment can seek advice on how to carryout duties without further aggravation of the injury. A city-wide safety survey has been conducted. The well-received Active Shooter training provided in conjunction with the Police Department was developed based upon feedback from that survey. The Denver Ready Program is actively being rolled out in conjunction with Emergency Management to further provide advice on responding to emergencies both at work and home.

As the audit points out, the number of claims dropped by 10.5% year over year in 2017 and the dollar amount of claims have decreased by 40% in 2017 from 2015. These decreases occurred while full time equivalent employees increased by 7% (to 11,300 FTEs).

Stranding dollars arbitrarily that could otherwise be used on efforts to prevent and reduce injuries would seem to be contrary to the best interest of the Workers' Compensation mission.

4.1 **Risk Management Information System Controls and Functionality** – To strengthen internal controls and increase efficiencies in the claims management process, we recommend the Workers' Compensation Unit:

- Ensure that data application controls such as required fields, drop-down selection menus, field edit controls, record deactivation capabilities, and system security and record edit reports be included in system requirements for the new risk management information system;

- Update departmental policy and procedures defining data field use and what is expected for data entry, especially for data fields that will have more open-ended information requirements;

- Improve controls and claims-processing efficiencies by including customizable screen views, flags for stipulations from previous claims, a three-point edit check for claim number, date of injury and body part injured match, and system enhancements to help adjusters better manage multiple claims for multiple injuries over multiple years;

- Automate interfaces between all IT systems used to the extent possible; and
- Develop additional manual compensating controls for all controls that cannot be implemented in the application.

Auditee Response: Agree, Implementation Date – April 30, 2019

Auditee Narrative: We are extremely pleased and appreciative for the comprehensive evaluation and recommendations for the RMIS replacement system. The evaluation of responses is underway and the Auditor's Office comments will be considered in this process. It is unrealistic to expect any one system to have every desired functionality, but we anticipate the replacement to be a vast improvement over the current one.

AGENCY RESPONSE TO AUDIT RECOMMENDATIONS

MICHAEL B. HANCOCK
Mayor

DEPARTMENT OF FINANCE

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October 2, 2018

Auditor Timothy M. O'Brien, CPA
Office of the Auditor
City and County of Denver
201 West Colfax Avenue, Dept. 705
Denver, Colorado 80202

Dear Auditor O'Brien,

The Office of the Auditor has conducted a performance audit of Denver's Workers Compensation Program.

This letter provides a written response for each recommendation noted in the Auditor's Report final draft that was sent to us on September 11, 2018. This response complies with Section 20-276 (c) of the Denver Revised Municipal Code (D.R.M.C.).

Agency Introduction: On behalf of the Department of Finance's Workers Compensation (WC) Section, I want to express my staff's and my personal appreciation for the hard work and thought put into the audit of the WC program. When we met in April to kick-off this audit, it was expressed that the challenges and complexity of the state statute governed program would pose difficulties. Significantly contributing to these difficulties is that each state has its own, unique WC laws and there isn't a Colorado government WC program comparable to Denver's. We are pleased that your staff recognized that the administration of the City's WC program has earned the favorable rating from the National Council on Compensation Insurance with a Modification Factor below 1.0 and that the WC program was audited by the Colorado Department of Workers Compensation earlier this year and received scores of 97-100% on the 10 WC factors audited. These scores are indicative of the dedicated staff and the Section's commitment. Also, of note, in the past two years Denver's WC Section has received recognition by the Colorado Professionals in Workers Compensation by receiving the Workers Compensation Employer of the Year, Nurse Case Manager of the Year and WC Claims Adjuster of the Year awards, as well a national recognition.

Your team's recognition of the competency in the day-to-day administration of the WC program resulted in an audit scope that seemed more focused on policy and program practices than past internal audits. While some disagreement exists on certain recommendations, this review has provided valuable insight and thought-provoking recommendations that will be evaluated as discussed below.

311 for City Services
Denver gets it done!

AUDIT FINDING 1
Revenues, Costs, and Liabilities Are Not Fully Accounted For in the Workers Compensation Internal Service Fund

RECOMMENDATION 1.1

Salary Continuation Accounting and Reporting – We recommend the Workers' Compensation Unit, in conjunction with the Department of Finance, develop an accounting and funding approach that allows salary continuation payments related to workers' compensation claims to be:

- Accounted for in the Workers' Compensation Internal Service Fund; and
- Calculated and report the liability associated with salary continuation in the Workers' Compensation Internal Service Fund.

Agree or Disagree with Recommendation	Target date to complete implementation activities (Generally expected within 60 to 90 days)	Name and phone number of specific point of contact for implementation
AGREE – But Further Analysis is Required	May 31, 2019	Bob Gibson 720-913-9383

Narrative for Recommendation 1.1
The WC program is administered in accordance with state Workers Compensation Department regulations and state statutes. It also complies with all legal requirements, including negotiated collective bargaining agreements, Human Resources Rules, and the D.R.M.C. The Department of Finance does not agree that the current accounting practices place the WC Fund in non-compliance with GASB requirements. Yet, the audit recommendation does warrant a careful review of past practice and possibly a revision of how salary continuation should be treated. As part of this review, the cost/benefit of amending the City's long-standing practice for allocating approximately $1 million of salary continuation against the $750 million annual payroll budget, the treatment of agency funding of personnel costs, and the billing back of the costs captured in the WC Fund to the various agencies will need to be considered.

Because this recommendation requires coordination among the Controller's Office, the Budget Office, Risk Management, and the City Attorney's Office to determine the impacts of changing the City's long-standing practice of defining and applying salary continuation as a benefit governed by the DRMC, HR Rules, and Collective Bargaining Agreements, we will be unable to effect this change in the 2019 budget process. The Department of Finance will commit to more disclosure in the 2018 financial statements by reporting the salary continuation amounts. Development of procedures, processes, and policies that do not double bill or result in "stranded budget" will need to be developed. Because indemnity payments impact individuals on more than just a financial basis, a

communication process will also need to be developed. Upon completion of this analysis and evaluation, any changes adopted will be initiated into the budget for the year 2020.

RECOMMENDATION 1.2

Use Payroll System for Indemnity Payments - Before the end of 2018, we recommend the Workers' Compensation Unit, in conjunction with the Controller's Office, review the process for indemnity payments to determine whether it would be more efficient and effective to use the payroll system instead of the accounts payable system.

Agree or Disagree with Recommendation	Target date to complete implementation activities (Generally expected within 60 to 90 days)	Name and phone number of specific point of contact for implementation
COMPLETE	September 30, 2018	Beth Machann and Bob Gibson 720-913-5515 and 720-913-9383

Narrative for Recommendation 1.2

As the result of discussions at the Exit Conference and the Audit Report, WC staff, the CR&CF Manager, the Controller, and the Payroll unit met regarding the feasibility of applying the new Workday software to process WC payments. After reviewing the legal requirements under the state statutes and the Workday functionality it was determined that the payroll system was not suitable for processing WC indemnity payments.

The issues preventing using the payroll system include:

1. Not all indemnity payments are made to employees. Recipients include law firms representing clients, ex-employees, and/or family members of an injured party.
2. The WC statutes require hard deadlines for payments resulting in WC periods inconsistent with the City's payroll schedule.
3. WC payments can start and stop in mid periods which the payroll system is not designed to accomplish without extensive manual practices.
4. Processing payments in two different systems increases the risk for errors that can result in the City being fined by the state.

AUDIT FINDING 2
No Formal Strategic Plan Exists for the Workers' Compensation Program

RECOMMENDATION 2.1

Formal Strategic Plan - We recommend the Risk Management Office and the Workers' Compensation Unit develop a formal strategic plan to address how to best provide workers' compensation insurance in the most effective manner, including cost and level of service provided to injured employees. This plan should be developed by mid-2019 and be used to drive any identified process and program changes prior to the next budget and insurance bidding process.

Agree or Disagree with Recommendation	Target date to complete implementation activities (Generally expected within 60 to 90 days)	Name and phone number of specific point of contact for implementation
AGREE	April 30, 2019	Ray Sibley 720-913-3349

Narrative for Recommendation 2.1
No less than once a year, the WC Section reviews the goals and established metrics for the WC program with the Executive Manager. Further, in 2018, a focused strategic plan process was undertaken by each division of the Finance Department; however, the processes do not meet the definition of a "*formal strategic plan*" as detailed in the audit report. The relatively small staff size and many years of WC experience have enabled the Section to establish goals and objectives similar to a strategic plan's outcomes that are known by the staff. However, we agree that a more formal, documented process for strategic planning would have benefits to improve the program. This process will be undertaken and completed prior to the next budgetary cycle.

RECOMMENDATION 2.2

Update Formal Strategic Plan – In addition, we recommend a process be implemented to update the strategic plan on a regular basis to adjust for any changes in the workers' compensation requirements or needs.

Agree or Disagree with Recommendation	Target date to complete implementation activities (Generally expected within 60 to 90 days)	Name and phone number of specific point of contact for implementation
AGREE	April 30, 2019	Ray Sibley 720-913-3349

Narrative for Recommendation 2.2

We agree that to be meaningful, strategic plans require periodic up-dating. As part of the planning process in 2.1 a process to up-date will be incorporated into the 2019 plan.

RECOMMENDATION 2.3

Self-Insurance Retention Evaluation - We recommend the Risk Management Office and the Workers' Compensation Unit evaluate the self-insurance retention level at higher, lower, and split levels based on higher- and lower-risk pools in conjunction with broker analysis and bidding to market for a new insurer whenever these insurance items are sent to bid.

Agree or Disagree with Recommendation	Target date to complete implementation activities (Generally expected within 60 to 90 days)	Name and phone number of specific point of contact for implementation
AGREE	July 1, 2019	Devron McMillin 720-913-3345

Narrative for Recommendation 2.3

Over the past 15 years, Risk Management has periodically sought bids from brokers for different retention levels and splitting the risk pools. Retention levels have been reviewed every 3 years; however, an insurance marketing effort which includes splitting the retention pool (separate retention and limits for the Department of Safety) has not been fully assessed since 2012. When the next broker selection process is undertaken in May 2019, bids for various retention levels and a split program will be sought. All future

bid processes will be well documented with potential changes reviewed at least every three years, or as the insurance market and the City's loss experience warrants.

RECOMMENDATION 2.4

Calculate and Report Total Program Cost – We recommend the Workers' Compensation Unit annually calculate and report on the total cost of the program, including medical, indemnity, direct and indirect administrative costs, and complete salary continuation costs.

Agree or Disagree with Recommendation	Target date to complete implementation activities (Generally expected within 60 to 90 days)	Name and phone number of specific point of contact for implementation
AGREE	May 31, 2019	Ray Sibley 720-913-3349

Narrative for Recommendation 2.4

The analysis to be undertaken related to recommendation 1.1 will determine how salary continuation should be treated in the future. The indirect costs attributed to the WC program as calculated in the 2017 Cost Allocation Plan was less than $500,000, which is considered immaterial to the annual program costs. If the General Fund charged the WC Fund for indirect costs, the WC Fund would turn around and increase the premium charged to the General Fund to cover the increased WC Fund's costs. The current process eliminates this circular billing inflation of costs.

RECOMMENDATION 2.5

Develop Standard Key Performance Indicators – We recommend the Workers' Compensation Unit develop standard key performance indicators for total program cost, claims processing, claims costs, and customer service, to help evaluate the program periodically against other model alternatives. All cost data should include all costs to the program.

Agree or Disagree with Recommendation	Target date to complete implementation activities (Generally expected within 60 to 90 days)	Name and phone number of specific point of contact for implementation
AGREE	June 30, 2019	Ray Sibley 720-913-3349

Narrative for Recommendation 2.5

WC has established and reported on industry standard and key metrics for many years. The audit report supports the difficulty in comparing Denver's program to other Colorado

communities. Douglas County, which was reported to transition from a self-funded program to an outside insurer, reported 90 claims in 2017 versus Denver's 927 claims. Performance indicators are reviewed throughout each year, both by management and with agency representatives. It seems that the issue of how salary continuation and indirect costs are treated are the impetus driving this recommendation. Upon completion of the review committed to in 1.1 above, performance indicators will be adjusted.

RECOMMENDATION 2.6

Report Key Indicators – We recommend the Workers' Compensation Unit report its key performance indicators either in an annual report and publish certain key indicators regarding workers' compensation cost and efficiency on either public- or city-facing websites, or both, as soon as possible.

Agree or Disagree with Recommendation	Target date to complete implementation activities (Generally expected within 60 to 90 days)	Name and phone number of specific point of contact for implementation
AGREE	December 2019	Ray Sibley 720-913-3349

Narrative for Recommendation 2.6

Historically, performance metrics and indicators have been published in past City annual budgets and reviewed with the agencies of the City. Further, they are on the Risk Management SharePoint website. The commitment has been made to re-establish Risk and WC metrics in future City budgets. The implementation of a new Risk Management Information System (RMIS) in early 2019 is expected to improve statistical capabilities, but the conversion will limit staff availability for website design; however, the annual loss report will continue to be posted on the Risk Management SharePoint site. The Department of Finance is in the process of refining the reporting of performance metrics agency wide, and as part of this work, the WC Section will establish reporting capabilities to agencies and the public.

AUDIT FINDING 3
Policies and Procedures Are Not Current, and Opportunities Exist to Address Gaps and Improve Efficiencies

RECOMMENDATION 3.1

Update Policy and Procedures Annually – We recommend the Workers' Compensation Unit dedicate resources to update policies and procedures at least annually to reflect current business processes.

Agree or Disagree with Recommendation	Target date to complete implementation activities (Generally expected within 60 to 90 days)	Name and phone number of specific point of contact for implementation
AGREE	September 30, 2019	Ray Sibley 720-913-3349

Narrative for Recommendation 3.1
The audit accurately reflects that the most recent comprehensive review of the WC policies and procedures was in 2016. Recognizing that in 2017 a RFP was developed for a new RMIS system, the acquisition of which will most likely require extensive revision of the WC polices, such a review was postponed. As a result, the updating process will be accomplished in conjunction with the expected new system's implementation in 2019.

RECOMMENDATION 3.2

Strengthen Check Handling Controls – To strengthen existing internal controls, we recommend the Workers' Compensation Unit use a daily check log and update workers' compensation policies and procedures to include this requirement and consider setting up an Enterprise Cashiering Solution online receipting function for subrogation and restitution payments.

Agree or Disagree with Recommendation	Target date to complete implementation activities (Generally expected within 60 to 90 days)	Name and phone number of specific point of contact for implementation
COMPLETE	September 30, 2018	Robin Gray 720-913-3333

Narrative for Recommendation 3.2
After receiving the feedback from the audit, the WC administrative staff established a daily check log as recommended and is in the process of documenting this requirement. The amount of the checks received vary widely, ranging from checks for as little as $0.25 and can exceed $100,000. Because Enterprise Cashiering is overseen by other staff in

CR&CF, we are pleased the auditors recognize the functionality of the ECS system. We strongly agree that whenever possible the ECS online system is preferable. CR&CF staff have outreached to agencies with this recommendation; however, certain individual agencies elect to not follow this recommendation for their business practices.

RECOMMENDATION 3.3

Supervisor Reports – To strengthen existing internal controls, we recommend the Workers' Compensation Unit:

- Continue its emphasis on training agency supervisors on their responsibilities to complete a timely supervisor report and develop a formal mechanism that measures noncompliance; and
- Establish an automated reminder process for past due supervisor reports with escalation to higher levels of management as part of the implementation of new reporting system

Agree or Disagree with Recommendation	Target date to complete implementation activities (Generally expected within 60 to 90 days)	Name and phone number of specific point of contact for implementation
AGREE	June 30, 2019	Ray Sibley 720-913-3349

Narrative for Recommendation 3.3

With the number of agencies and disbursed locations, it is an ever-challenging process to obtain compliance with supervisory responsibilities related to WC incidents. The WC Section has continually communicated and outreached to the agencies and provided informal feedback to agencies on instances of noncompliance. An on-line supervisory training class was developed on City-U in 2017. Reporting has steadily improved and has reached a 93% compliance level. It is desired that the new RMIS system will have a means to automate the communication process. After selection and conversion is underway, alternatives to improve the reminder process for supervisory reports will be reviewed to further improve the compliance.

RECOMMENDATION 3.4

Contract Monitoring – To strengthen vendor contract monitoring, we recommend the Workers' Compensation Unit strengthen its existing contract monitoring program for all vendors providing services supplementing workers' compensation operational and financial processes by:

- Identifying and assigning a designee(s) within the Workers' Compensation Unit to manage the contract monitoring program; and
- Developing procedures to identify and address noncompliance with contract terms by service.

Agree or Disagree with Recommendation	Target date to complete implementation activities (Generally expected within 60 to 90 days)	Name and phone number of specific point of contact for implementation
AGREE	February 28, 2019	Ray Sibley 720-913-3349

Narrative for Recommendation 3.4

The WC Section is responsible for a number of contracts that are monitored and regular meetings with vendors are held to provide performance feedback and address noncompliance issues. This process has not been as formal and documented as it could be. The Director of Risk will compile a list of the WC contracts as well as other Risk related agreements and establish procedures to more formally monitor contracts, including designating a staff person responsible for each contract. This information and results of any meetings with vendors will be reviewed and reported to the CR&CF Executive Manager at least quarterly.

RECOMMENDATION 3.5

Service Organization Controls – To strengthen internal controls surrounding subcontracted operational and financial controls, we recommend the Workers' Compensation Unit request that all organizations providing services that affect operational and financial processing perform a Service Organization Control 1, Type II, report covering the company's system of controls over services provided to the City. In the absence of such a report, we recommend the Workers' Compensation Unit develop a mechanism of formal controls to ensure that subcontracted operational and financial controls are adequate and reliable.

Agree or Disagree with Recommendation	Target date to complete implementation activities (Generally expected within 60 to 90 days)	Name and phone number of specific point of contact for implementation
AGREE	February 28, 2019	Ray Sibley 720-913-3349

Narrative for Recommendation 3.5

In conjunction with the contract monitoring activities in 3.4 above, the Director of Risk will work with the Controller's Office to identify those vendors for which SOC reporting is needed. The identified vendors will be required to provide the SOC reports and the Director will review the information with the Controller's Office to ensure adequate controls are in place.

RECOMMENDATION 3.6

Multiple Claims Review – We recommend that the Workers' Compensation Unit add a formal process to the workers' compensation policies and procedures to include regular management review of cases where injured workers have multiple claims, sometimes spanning many years, to ensure that treatment and costs are coded to the proper claim, subrogation efforts are proper, approved treatments are not exceeded, and salary continuation and indemnity payments are accounted for properly.

Agree or Disagree with Recommendation	Target date to complete implementation activities (Generally expected within 60 to 90 days)	Name and phone number of specific point of contact for implementation
AGREE	September 30, 2019	Ray Sibley 720-913-3349

Narrative for Recommendation 3.6
The selection of a new RMIS that has expanded capacity to better monitor and address multiple claims is one of the functionalities being sought through the RFP process. In conjunction with the up-dating of policies and procedures in 3.1 above, a formal process for reviewing multiple open claims will be documented. Such review will be reported to the Director of Risk by the WC supervisor at least quarterly.

RECOMMENDATION 3.7

Current Target Fund Policy – We recommend the Workers' Compensation Unit in conjunction with the Cash, Risk, and Capital Funding Division consider revising its current target base fund policy for the Worker's Compensation Internal Service Fund to:

- Adopt the actuarily determined 80 percent confidence funding level;
- Specify a minimum 70 percent confidence funding level; and
- Incorporate the workers' compensation claim reserve and fund reserve policy into the City's financial and reserve policies.

Agree or Disagree with Recommendation	Target date to complete implementation activities (Generally expected within 60 to 90 days)	Name and phone number of specific point of contact for implementation
DISAGREE	N/A	N/A

Narrative for Recommendation 3.7
The Actuary provides the annual calculation of the WC Fund liability which is used to report on the program in the CAFR and for budgeting the premium the WC Internal Service Fund charges City agencies. To arbitrarily report and fund a greater amount distorts the Fund's status. Various confidence levels are provided and are evaluated in accordance with the policy adopted by the WC program. Arbitrarily establishing greater reserves than the current policy of no less than the liability calculated and a target of each year at a 75% confidence level have been more than sufficient to address claims against the fund. It provides management flexibility to address other program needs. The policy balances having sufficient financial resources each year to address claims while not overly committing resources that can be applied to other worthwhile objectives.

Denver's financial structure further supports the current policy in that the Charter requires the City budget include a 2% contingency each year. In the unlikely event the City experiences a catastrophic loss that depletes the fund below the calculated liability, this contingency can be drawn upon. Because claims are paid out over time, shortfalls can be made up over several years. The City currently self-insures for claims up to $2.5 million when its insurance kicks in to cover claims.

The audit focused solely on the component that oversees payments to injured workers and did not review the other key component of the WC program, namely injury prevention and awareness. Over the past 5 years, emphasis has been on preventing injuries through greater awareness and outreach programs. An industrial safety officer has been embedded in the Department of Safety (comprised of the three agencies with the greatest number of WC claims). Physical therapists have been stationed in fire houses to eliminate the need for injured fire fighters to leave work to receive treatment, with the added bonus that individuals who have a minor ailment can seek advice on how to carryout duties without further aggravation of the injury. A city-wide safety survey has been conducted. The well-received Active Shooter training provided in conjunction with the Police Department was developed based upon feedback from that survey. The Denver Ready Program is actively being rolled out in conjunction with Emergency Management to further provide advice on responding to emergencies both at work and home.

As the audit points out, the number of claims dropped by 10.5% year over year in 2017 and the dollar amount of claims have decreased by 40% in 2017 from 2015. These decreases occurred while Full Time Equivalent employees increased by 7% (11,300).

Stranding dollars arbitrarily that could otherwise be used on efforts to prevent and reduce injuries would seem to be contrary to the best interest of the WC mission.

AUDIT FINDING 4
The Workers' Compensation Unit's Risk Management Information System Does Not Support Current Business Processes Effectively and Efficiently

RECOMMENDATION 4.1

Risk Management Information System Controls and Functionality – To strengthen internal controls and increase efficiencies in the claims management process, we recommend the Workers' Compensation Unit:

- Ensure that data application controls such as required fields, drop-down selection menus, field edit controls, record deactivation capabilities, and system security and record edit reports be included in system requirements for the new risk management information system;

- Update departmental policy and procedures defining data field use and what is expected for data entry, especially for data fields that will have more open-ended information requirements;

- Improve controls and claims-processing efficiencies by including customizable screen views, flags for stipulations from previous claims, a three-point edit check for claim number, date of injury and body part injured match, and system enhancements to help adjusters better manage multiple claims for multiple injuries over multiple years;

• Automate interfaces between all IT systems used to the extent possible; and • Develop additional manual compensating controls for all controls that cannot be implemented in the application.

Agree or Disagree with Recommendation	Target date to complete implementation activities (Generally expected within 60 to 90 days)	Name and phone number of specific point of contact for implementation
AGREE	April 30, 2019	Ray Sibley 720-913-3349

Narrative for Recommendation 4.1
We are extremely pleased and appreciative for the comprehensive evaluation and recommendations for the RMIS replacement system. The evaluation of responses is underway and the Auditor's Office comments will be considered in this process. It is unrealistic to expect any one system to have every desired functionality, but we anticipate the replacement to be a vast improvement over the current one.

Please contact Ray Sibley at 720-913-3349 with any questions.

Sincerely,

R.O. Gibson
Cash, Risk & Capital Funding Manager

cc: Valerie Walling, Deputy Auditor, CPA, CMC®
Kevin Sear, CPA, CIA, CISA, CFE, CGMA, Audit Manager
Jeremy Creamean, CPA, Audit Supervisor
Brendan J. Hanlon, CFO
Beth Machann, Controller
Stephanie Adams, Budget Manager
Ray Sibley, Director of Risk
Devron McMillin, Risk Manager

OBJECTIVE

The objective of this audit was to determine whether the City and County of Denver's self-insured workers' compensation program model delivers services to employees cost effectively and efficiently. Additionally, we assessed whether the City properly funds its self-insured program and is reporting in compliance with Generally Accepted Accounting Principles.

SCOPE

The audit scope included workers' compensation claims from 2012-2017 and a limited review of the subrogation process and related cost recoveries for amounts paid by the City. The audit assessed the Workers' Compensation Unit's strategies for risk management, total program performance and costs, as well as accounting assumptions and recorded reserves included in the 2017 Comprehensive Annual Financial Report. The Risk Management Workplace Safety group, which is part of the Workers' Compensation Unit, and embedded agency safety programs were excluded from the scope of the audit.

METHODOLOGY

We applied multiple methodologies to gather and analyze information pertinent to the audit scope, which included the following:

- Reviewing the 2017 Colorado Workers' Compensation Act and Rules of Procedures as well as Colorado state compliance audits covering the City's Workers' Compensation Program;
- Reviewing City policy and procedures, executive orders, and Fiscal Accountability Rules;
- Reviewing expenditures and liability reserves information to ensure that they are being recorded in financial records in accordance with General Accepted Accounting Principles;
- Assessing the qualifications of the City's actuary;
- Reviewing the actuary's annual claim liability reserve determination, including data and assumptions provided by the program and recommendations to the City;
- Assessing the City's claim liability reserve policy and claim liability reserve amount recorded in the City's Comprehensive Annual Financial Report;
- Interviewing:
    - Leadership and management of the Workers' Compensation Unit, including the Financial Director of the Risk Management Office, the fiscal administrator for administration of the Workers' Compensation Unit, and the claims supervisor of the Workers' Compensation Unit; and
    - Claims adjusters, the subrogation adjuster, and the accounting technician who support the Workers' Compensation Unit;
- Benchmarking with Colorado municipalities and other local and national governmental entities;

- Testing a sample of employee claims and subrogation recoveries against internal policy and procedures for compliance and evaluated process controls for effectiveness and efficiency; and
- Evaluating the capabilities of the risk management information system, STARS, in supporting the Workers' Compensation Unit's business properties.

APPENDICES

Appendix A – Claims Process Narrative

As explained in Employee Workers' Compensation Procedures, when injured in an accident or reporting a work-related disease, the employee is required to call the OUCH Line, a phone line operated by Denver Health, one of two allowed medical providers in the City's Workers' Compensation Program.

This contact should be completed within four days of injury. A nurse on the OUCH Line discusses medical options with the injured worker and informs the worker of the authorized choices available, either Denver Health or Concentra, an urgent care health provider.

The employee's supervisor is required to complete an online Supervisor Report of Accident or Incident and submit the signed form to the Risk Management Office within five working days of the incident.

In addition to the current choices of Center for Occupational Safety and Health at Denver Health (COSH) and Concentra, a third option is available after July 2018: Workwell Occupational Medicine. Injured employees can choose Workwell, COSH, or Concentra.

Written OUCH Line reports are received by the Risk Management Office throughout the day. The OUCH Line reports are printed out, date-stamped at the front desk, and the information is entered in STARS by administrative support personnel who will generate a claim number to set up a pharmacy account with the City's pharmacy benefits manager, Mitchell. The OUCH Line report is attached to the STARS claim so that anyone who needs to review it can pull it up in the specific claim through the attachment in STARS.

The workers' compensation nurse or nursing programs manager reviews the OUCH Line reports. The nurse triages and assigns claims for initial contacts by the nurse, modified duty coordinator, and/ or one of the adjusters. The workers' compensation nurse/nursing programs manager or modified duty coordinator/adjuster contacts (or attempts to contact) the injured employee within one business day of the receipt of the OUCH Line report and documents the contact in STARS.

The claims supervisor reviews and assigns the OUCH Line report forms as either a medical-only claim or the case is assigned to a lost-time adjuster for investigation and handling.

Medical-only and lost-time claim adjusters handle all aspects of claims including but not limited to the following:

- Investigating claims;
- Authorizing reasonable, necessary, and related treatment as necessary;
- Authorizing and assuring timely payment of medical bills and indemnity payments;
- Providing communication with internal and external customers. This includes both the initiation of communication and responding to inquiries from the injured employee, providers, agencies, and the state Division of Workers' Compensation;

- Monitoring and ensuring progression of medical treatment;
- Impacting total cost of claim through regular, aggressive, and proactive claims management;
- Setting medical and indemnity reserves and revising as necessary;
- Filing correct, and timely position statements as directed by the Colorado Workers' Compensation Act and State's Workers' Compensation Rules of Procedure;
- Handling correspondence and other communication (i.e., phone calls, emails, supervisor notes, etc.) daily;
- Communicating with attorneys of both the claimant (plaintiff) and respondent, and assisting in the evaluation and handling of litigated claims; and
- Updating and ensuring the accuracy of applicable STARS fields as claims status changes to ensure accurate data in risk analysis and reporting.

The claims supervisor job duties include the following:

- Assigning or assuring the proper assignment of new claims appropriate to the level of expertise required in each case;
- Conducting file audits to measure a specific adjuster's performance in meeting the standards of the position;
- Reviewing and addressing individual claim reserve requests over the adjuster's authority;
- Being the liaison with City agencies, managers, medical providers, business partners, and external customers regarding the City's Workers' Compensation programs, or the specifics of given claims;
- Coordinating and moderating quarterly claims reviews with specific agencies within the City;
- Providing training to City supervisors throughout the City regarding Workers' Compensation issues; and
- In conjunction with the Director of Risk Management, helping establish and steer claims priorities, strategies, procedures, and goals.

Medical-only and lost-time adjusters are supported by administrative operational staff and accounting staff. Administrative support includes answering phones and voicemails; mail sorting, opening and research; accepting and/or preparing certified mail; receiving, handling, recording, and distributing OUCH Line and Denver Health and Concentra medical reports; filing documents in claimant case files; physical file room security and operations; coordinating off-site file storage; obtaining claim numbers from STARS; and supporting the completion of required statutory documentation.

The accounting technician supports adjusters by processing medical bills to be paid and providing information to the City's Accounts Payable Division to prepare checks to medical service providers as well as coordinating with payroll to reimburse employees for time off under workers' compensation.

The City has the right to subrogate (recover) monies when an employee, while in the course and scope of employment, is injured or contracts an occupational disease due to the negligence of a third party that is not a City employee. The City is entitled to attempt to collect medical and indemnity costs from a third party or the third party's insurer on behalf of the employee. These receipts are remitted to the City for the City's total out-of-pocket costs and the remaining remittance by law is returned to the injured employee.

The Workers' Compensation Unit includes one specialist subrogation claims adjuster to investigate and perform subrogation activities. Subrogation happens more often for incidents involving motor vehicle accidents, defective machinery, and slip-and-falls, where a third party may be at fault for the employee's injury.

The workers' compensation subrogation adjuster is responsible for pursuing the third party for recovery. The subrogation adjuster will obtain the police report on all auto accidents and other nonvehicle subrogation when applicable to find the insurance company to bill the final demand to. The adjuster also searches through the Denver Court database for arrests or citations to determine whether the at-fault party is being held in the Denver judicial system and can be required to provide restitution for harm caused or property damaged.

Once the employee has reached Maximum Medical Improvement and all bills have been received regarding medical cost and all time off has been captured, a final demand letter is sent by the adjuster to the applicable insurance company or to the courts through either the City or District Attorney. In cases where the City is demanding restitution from an incarcerated liable party, restitution claims are submitted to the victims' rights advocate.

Employees may also use their tort right to sue third parties for injuries and occupational diseases caused by a third party. If an employee receives a settlement or award, medical and indemnity amounts paid by the City must be reimbursed by the employee to the City, which is often demanded through a lien.

Appendix B – Information Systems Used in Claims Processing

Clear Sight STARS: A Risk Management Information System that Risk Management and Workers' Compensation personnel use to process and report on insurance claims processing including general liability, property, vehicle, and workers' compensation.

Oscar link: Workers' compensation specialist referral system that allows adjusters and care providers to schedule referred specialist care and is hosted by BTE Technologies.

CareMC: CorVel Corporation Workers' Compensation bill review/approval system, through which the Workers' Compensation Unit has access to review medical bills being processed by this third-party medical cost reviewer.

Mitchell Script Advisor: Pharmacy benefit authorization/review portal through which the Workers' Compensation Unit has access to review medication prescriptions offered to claimants.

Appendix C – Key Terms

Term	Description
Actuary	An individual, often holding a professional designation—for example, Fellow of the Casualty Actuarial Society (FCAS)—who computes statistics relating to insurance, typically estimating loss reserves and developing premium rates.
Actuarial Report	The product of an actuary's study of an organization's loss experience using probability theory and other methods of statistical analysis. Can be used to determine an insured's projected losses, a self-insured's liability accruals, the adequacy of a property-casualty (P&C) insurer's statutory loss reserves, or a life insurer's unearned premium (technical) reserves. May be the basis of rate development.
Confidence Level	An estimated probability that a given level of funding will be adequate to pay actual claims costs. For example, the 80 percent confidence level refers to an estimate for which there is an 80 percent chance that the amount will be sufficient to pay loss costs. The confidence level, or percentage, is interpreted as the long-run probability that the estimates will hold true over many simulated estimate periods.
Discount Factor	A factor to adjust estimated loss costs to reflect anticipated investment income from assets held prior to actual claim payout.
Experience Modification Factor	A factor used by insurance companies to gauge both past cost of injuries and future chances of risk. The lower the factor, the lower the premium charged. A factor of 1.0 is considered industry standard, below 1.0 is considered a favorable rating; above 1.0 is considered an unfavorable rating.
Indemnity Payments	A term-of-art synonymous with an employee's paid time off from work due to a work-related injury or occupational disease as well as payments caused by permanent partial disability, agreed settlements between the City and employee for rights to future benefits, death benefits to eligible dependents.
Incurred But Not Reported (IBNR) Losses	Losses for which the accident has occurred, but the claim has not yet been reported. This is the ultimate value of losses, less any amount that has been set up as reported losses by the claims adjuster. It includes both amounts for claims incurred but not yet received by the administrator and loss development on already reported claims.
Incurred (or Total Incurred)	The sum of any paid (paid-to-date) amounts and any outstanding reserves. This is the total of the past/present costs and the future expected costs of the claim.
Lost Adjustment Expense	The cost of investigating and adjusting losses, LAEs need not be allocated to a particular claim, if they are allocated to a particular claim, they are called "allocated loss adjustment expenses' (ALAE); otherwise, they are unallocated loss adjustment expenses (ULAE).
Net Position	Net position is the difference between assets, liabilities, deferred inflows of resources, and deferred outflows of resources.

Reserves - Claim	Claim Reserves are defined as dollars set aside at present to cover all expected future expenditures for the duration of a specific claim. These reserves are based on the information regarding the specific claim that is available at the time the reserves are arrived at or reviewed by a lost-time or medical-only adjuster, claims supervisor, Director of Risk Management, or other person directly involved in the handling of the claim. Because the understanding of the expected future medical expenditures is going to change over time during the handling of some claims, accurately projecting the future costs for a claim is an ongoing process. Proper claim reserving is part science, where mathematic principles govern the calculations, and part art, where the claims handler's knowledge and experiences govern the ability to anticipate for the expectations of future developments and expenditures.
Reinsurance	A transaction in which one party, the "reinsurer," in consideration of a premium paid to it, agrees to indemnify another party, the "reinsured," for part or all the liability assumed by the reinsured under a policy of insurance that it has issued. The reinsured may also be referred to as the "original" or "primary" insurer or the "ceding company."
Self-insurance	A system whereby a firm sets aside an amount of its monies to provide for any losses that occur—losses that could ordinarily be covered under an insurance program. The monies that would normally be used to premium payments are added to this special fund for payment of losses incurred. Self-insurance is a means of capturing the cash flow benefits of unpaid loss reserves and offers the possibility of reducing expenses typically incorporated within a traditional insurance program. It involves a formal decision to retain risk rather than insure it and is distinguished from noninsurance or retention of risks through deductibles by a formalized plan or system to pay losses as they occur.
Self-Insured Retention (SIR)	The level at which an excess insurance policy is triggered to begin payments on a claim. Financially, this is like an insurance deductible. This is the maximum amount of any given claim that the City will have to pay. Reinsurance applies to any amounts greater than the SIR.
Stipulation	A condition, demand, or promise in an agreement or contract.
Subrogation	The assignment to an insurer by terms of the policy or by law, after payment of a loss, of the rights of the insured to recover the amount of the loss from one legally liable for it.
Third-Party Administrator (TPA)	In the case of the City's self-insured Workers' Compensation program, this is an outside company contracted to do claims investigation and handling when there is a conflict of interest or overflow in the office or on a case-by-case basis.

Sources: International Risk Management Institute, Glossary, https://www.irmi.com/glossary, last accessed August 13, 2018, City and County of Denver 2017 Comprehensive Annual Financial Report, page 59, https://www.denvergov.org/content/dam/denvergov/Portals/344/documents/CAFR/Report_CAFR_2017.pdf , las accessed September 11, 2018, and Workers' Compensation Unit Policy and Procedures

Office of the Auditor

The **Auditor** of the City and County of Denver is independently elected by the citizens of Denver. He is responsible for examining and evaluating the operations of City agencies and contractors for the purpose of ensuring the proper and efficient use of City resources. He also provides other audit services and information to City Council, the Mayor, and the public to improve all aspects of Denver's government.

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