



**CITY OF COLORADO SPRINGS  
OFFICE OF THE CITY AUDITOR**

**10-15 – MEMORIAL HEALTH SYSTEM WORKERS'  
COMPENSATION SELF INSURANCE FUND**

**PUBLIC REPORT**

**July 22, 2010**

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## Office of the City Auditor

### Public Report

Date: July 22, 2010

To: Honorable Mayor and Members of City Council  
Members of the Memorial Health System Board of Trustees  
Members of the Memorial Health System Audit Committee

Re: 10-15 – Memorial Health System Workers' Compensation Self Insurance Fund

We performed an audit of Memorial Health System's (Memorial's) Workers' Compensation Self Insurance Fund. The audit period was January 1, 2007 through December 31, 2008.

The purpose of the audit was to review the Workers' Compensation Self Insurance Fund to determine that proper underwriting techniques, sound funding procedures, loss reserves, claims procedures, and accounting practices were being followed in the management and operation of the Workers' Compensation Claim Reserve Fund.

Based on the test work performed, we conclude that proper underwriting techniques and claim procedures were used except where reported. In addition, we conclude that sound funding procedures, loss reserves, and accounting practices were being following. However, during the course of our audit, we identified areas where internal controls could be strengthened. These areas are addressed in the attached report.

As always, feel free to contact me if you have any questions.

Sincerely,

A handwritten signature in black ink that reads "Denny Nester".

Denny Nester  
Interim City Auditor

cc: Dr. Larry McEvoy II, Chief Executive Officer  
Mike Scialdone, Chief Financial Officer  
Jeffrey Johnson, Director of Human Resources Officer  
Tracy Narvet, Controller  
John Wyckoff, Compliance Officer  
Colleen Azar, Director Employee/Occupational Health & Workers' Compensation  
Will Mercado, Workers' Compensation Administrator

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## Introduction

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# 10-15 – MEMORIAL HEALTH SYSTEM WORKERS' COMPENSATION SELF INSURANCE FUND

## PUBLIC REPORT

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### Abbreviations and Acronyms used in the Report

The Act	2008 Colorado Workers' Compensation Act
The City	City of Colorado Springs
Division	State of Colorado Department of Labor and Employment Division of Workers' Compensation
Finance	Memorial Health System's Finance Department
IT	Memorial Health System's Information Technology Department
Memorial	Memorial Health System
NCCI	National Council on Compensation Insurance
OWC	Memorial Health System's Office of Workers' Compensation

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## Introduction

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### AUTHORIZATION

We performed an audit of Memorial Health System's (Memorial's) Workers' Compensation Self Insurance Fund for the period January 1, 2007 through December 31, 2008. We conducted this audit under the authority of Chapter 1, Article 5, Part 601(I) which states:

1.5.602(I): WORKERS' COMPENSATION CLAIM RESERVE FUND:

The City Auditor or any person authorized by the City Auditor shall conduct an examination at least once every two (2) years to determine that proper underwriting techniques, sound funding procedures, loss reserves, claims procedures, and accounting practices are being followed in the management and operation of the Workers' Compensation Claim Reserve Fund. The City Auditor shall present a report of findings to the City Council.

### ORGANIZATIONAL PLACEMENT

The Office of the City Auditor is structured in a manner to provide organizational independence from the entities it audits. This independence is accomplished by the City Auditor being appointed by and reporting directly to the City Council. The audited entity in this audit, Memorial, is an enterprise of the City of Colorado Springs under the direction of its Chief Executive Officer. The Chief Executive Officer reports to the Memorial Board of Trustees, who are appointed by the City Council.

### SCOPE AND METHODOLOGY

The purpose of the audit was to comply with Section 1.5.602 (I) of the City Code that requires the City Auditor to conduct an examination at least every two years to determine if:

- proper underwriting techniques were used,
- sound funding procedures existed,
- adequate loss reserves existed, and
- claims procedures were being followed.

The audit covered the period January 1, 2007 through December 31, 2008.

The audit was conducted in accordance with the *International Standards for the Professional Practice of Internal Auditing*, a part of the Professional Practices Framework promulgated by the Institute of Internal Auditors. The audit included interviews with appropriate personnel and included such tests of records and other supporting documentation as deemed necessary in the circumstances. We reviewed the internal control structure and compliance tests were performed. Sufficient competent evidential matter was gathered to support our conclusions.

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## Introduction

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### BACKGROUND

Memorial has been a self-insured, self-administered employer with regard to Workers' Compensation since August 1994, and is governed by the 2009 Colorado Workers' Compensation Act (the Act). The Office of Workers' Compensation (OWC) was staffed by two claims analysts. As of December 31, 2008, Memorial had approximately \$2.4 million reserved for Workers' Compensation Claims.

### RELATED AUDIT REPORT

On April 30, 2008, we issued audit report 08-06 – Memorial Health System Workers' Compensation Self Insurance Fund, which covered the period May 2005 through December 2006. That report is available for review at [www.cityauditor.org](http://www.cityauditor.org). One of the nine findings from that report is repeated in this report as Finding 2.

### COMMENDABLE PRACTICES

We acknowledge the improvements made by the OWC staff during 2008. Improvements were noted in reporting, tracking, and processing claims. We recognize that the improvements were due to new procedures and policies implemented by the current staff, their attention to detail while performing claims reviews, and their willingness to implement more efficient procedures.

### OVERALL OPINION

Based on the test work performed, we conclude that proper underwriting techniques, and sound claim procedures were used except where reported. In addition, we conclude that funding procedures, loss reserves, and accounting practices were properly followed in the management and operation of the Workers' Compensation Claims Reserve Fund. We did identify four areas where changes to internal controls and operating procedures would reduce risks and improve operational efficiencies.

***We have made no determination as to which findings are more important than others. Therefore, the findings are not necessarily listed in order of importance.***

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## Findings, Recommendations, and Responses

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### 1. The Office of Workers' Compensation Business Continuity Plan did not address steps to implement in the event of long-term loss of resources.

Business continuity planning is a comprehensive approach to operate the business with minimum interruptions after a natural disaster and in the event of smaller disruptions including illness or departure of key personnel.

The OWC's Business Continuity Plan (BCP) did not adequately include action steps required to continue workers' compensation processes in the event that the OWC's resources are inaccessible due to a long-lasting event. The OWC's BCP did not provide complete documentation of who is responsible, how to take action and where the action would take place. The OWC BCP only considered short-term loss of connectivity to operating systems and reliance on the ability to contact the Information Technology Department (IT). Although elementary procedures were outlined, long-term disruption events were not considered. The lack of planned procedures to access offsite resources during long-term disruption events may result in the inability to restore operations in a timely manner.

#### ***Auditor's Recommendation:***

We recommend that the OWC review with IT steps required to continue the workers' compensation process during long-term loss of facilities, key personnel and the claims processing system. We recommend that the OWC complete an impact study outlining estimated costs should the workers' compensation payment process become inaccessible for long durations.

#### ***Memorial's Response:***

We agree with the recommendation. The MHS Workers' Compensation Business Continuity Plan was revised on November 20, 2009 to provide instructions on how to restore capability during long-term loss of facilities, key personnel, and interruption to the claims processing system. This is in addition to the steps already in place to restore capabilities in the event of partial outages. A copy of the revised continuity plan was provided to the City Auditor.

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## Findings, Recommendations, and Responses

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### **2. The Workers' Compensation payment process was not adequately segregated.**

In order to maintain proper internal controls, separate individuals should perform authorization, custody, record-keeping and reconciliation. Allowing a single individual to control two or more phases of a transaction or process could prevent detection and allow for concealment of errors or irregularities in the course of daily operations.

Claims analysts of the OWC had the ability to create a new claim, enter medical bills and create check requests in the claims administration software. The check requests were approved by the Director of Workers' Compensation. Processed payments received from Accounts Payable were returned to the OWC for distribution to claimants and medical providers.

Since the claims analysts had the ability to edit payment information in the claims processing system, an opportunity and risk for misdirection of payment and alteration exists. A fictitious claim could be created and illegitimate medical bills and settlement benefits could be paid without detection. Segregation of duties mitigates risk and errors while helping to protect staff from allegations.

This finding was originally reported in our public report dated April 30, 2008. When originally reported, Memorial accepted the risks associated with its lack of segregation of duties over the workers' compensation payment process.

#### ***Auditor's Recommendation:***

We recommend that the payment process be segregated. Access to checks should be restricted from staff with access to the claims administration system. In addition, the recording and approval process should be segregated.

#### ***Memorial's Response:***

We partially agree with the finding and recommendation. With the exception of settlement checks, which require special handling, processed payments issued by Accounts Payable are mailed directly by Finance to injured workers and individual vendors. Finance also mails checks to medical providers for payment of multiple claims and encloses copies of backup information so the proper accounts can be credited. As recommended in the 2007 City Audit, we provide Finance a list of all checks issued each month so that Finance can perform a general ledger reconciliation. Moreover, all check requests are fully justified in writing to ensure accountability and a strong audit trail. The software upgrade currently under implementation will allow for the direct input of medical bills by CorVel, the company which re-prices medical bills for Memorial under the Colorado Fee Guidelines. This allows for additional segregation. A key element is the requirement that should a member of the OWC staff or others closely associated with the program become injured on the job, potential conflict of interest provisions in the Workers' Compensation Policy and Procedures Manual require that particular claim to be managed by a third party administrator currently under contract. Beyond these measures, our limited staffing precludes further segregation of duties. We believe our financial controls have sufficient checks and balances to prevent the fraudulent issuance of payments.

Memorial acknowledges and accepts the risks associated with our current environment.

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## Findings, Recommendations, and Responses

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### 3. The Office of Workers' Compensation did not have documented policies regarding user additions and permissions for its claims administration software.

The OWC did not have documented policies regarding adding users and changing permissions for its claims administration software. There was confusion between the OWC staff system administrator and IT over who had the ability to add users and change permissions. As a result, two staff members without the proper authority had the ability to add and delete users from the claims administration software. Documented policies over user administration would strengthen internal controls.

#### ***Auditor's Recommendation:***

We recommend that the OWC develop policies regarding user additions and permissions for its claims administration software.

#### ***Memorial's Response:***

We agree with the recommendation. Currently, only persons with the need to know are authorized access to RiskEnvision. The following instructions will be added to the MHS Workers' Compensation Policy and Procedures Manual:

**Access to Claim Management Software:** Only Memorial employees with need to know are given access to RiskEnvision. The determination is made by the senior claims analyst. The Director of Workers' Compensation fulfills this role in the absence of the senior claims analyst. The access list in RiskEnvision will be reviewed at least annually and as needed to ensure it remains current. A list of employees with access is maintained in the S: Drive, Workers' Compensation Office, RiskEnvision. Each name has a justification for granting access, most recent date of access review, and the name of the individual granting access.

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## Opportunities for Improvement

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The following findings are presented in the context of City Code 1.2.709, which instructs the City Auditor to make periodic reports to Council which include “recommendations for lessening expenditures, for promoting frugality and economy in City affairs and for an improved level of fiscal management.”

**4. A review of the National Council on Compensation Insurance classifications used in the calculation of the bi-annual Premium Surcharge may result in cost savings for Memorial Health System.**

Memorial uses three National Council on Compensation Insurance (NCCI) classifications to report its approximate 3,600 employees in the calculation of the bi-annual Premium Surcharge. We reviewed the types of job codes assigned to each NCCI classification. After the review, we noted that there were job codes under the classification of ‘All Other’ that could be placed under another lower rated classification. As of June 30, 2009, the ‘All Other’ classification had a rate of 5.8%, which is significantly higher than many other classification codes.

***Auditor’s Recommendation:***

We recommend that Memorial conduct a comprehensive review of its job codes assigned to each NCCI classification and consider the possibility of using additional NCCI classifications.

***Memorial’s Response:***

We agree with the recommendation. A review of job codes resulted in placement of employees under lower rated classifications. As a result, we filed an amended payroll statement form requesting the Division of Workers’ Compensation refund Memorial for \$1,158.67 in overpaid payroll taxes.