



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

**09-01 – CITY OF COLORADO SPRINGS  
WORKERS' COMPENSATION  
CLAIMS RESERVE FUND**

**PUBLIC REPORT**

**JANUARY 21, 2009**

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## Office of the City Auditor Public Report

Date: January 21, 2009  
To: Honorable Mayor and Members of City Council  
Re: 09-01 – City of Colorado Springs Workers' Compensation Claims Reserve Fund

We performed an audit of the City of Colorado Springs (City) Workers' Compensation Claims Reserve Fund (Fund). The audit period was January 2006 through December 2007. The City is a self-insured, self-administered employer with regard to Workers' Compensation since January 1989 governed by the 2007 Colorado Workers' Compensation Act (the Act). Both the City and Colorado Springs Utilities pay their Workers' Compensation claims from the Fund. Both organizations use the Fund to set aside reserves for anticipated claims. As of December 31, 2007, the Total Net Assets of the Fund was (\$4,248,260).

The purpose of the audit was to review the Workers' Compensation Claims Reserve 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 Claims Reserve Fund.

We conclude proper underwriting techniques were used and claim procedures were properly followed. However, since the Total Net Assets of the Workers' Compensation Fund was (\$4,248,260) as of December 31, 2007 [with the City's share being (\$4,249,107)], we cannot conclude that adequate loss reserves existed, and by default, that sound funding procedures existed. Colorado Springs Utilities funding, with December 31, 2007 Total Net Assets of \$847, appeared to be adequate. Increased contributions by the City are necessary to provide for adequate reserves for the Fund. Finding 1 addresses the adequacy of the loss reserve. We also identified areas where changes to internal controls and operating procedures would reduce risks and improve operational efficiencies.

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

Sincerely,

A handwritten signature in purple ink that reads "Jeff Litchfield".

Jeff Litchfield  
City Auditor

Cc: City of Colorado Springs:

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Terri Velasquez, Chief Financial Officer  
Vicki Phillips, Accounting/Payroll Manager  
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# 09-01 – CITY OF COLORADO SPRINGS WORKERS’ COMPENSATION CLAIMS RESERVE FUND

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### Abbreviations and Acronyms used in this Report

The Act	2007 Colorado Workers' Compensation Act
Division	State of Colorado Department of Labor and Employment Division of Workers' Compensation
City	City of Colorado Springs
Fund	Workers' Compensation Claims Reserve Fund
Claim Manual	Risk Management Office Functional Claim Handling and Processing Procedures Manual
PSHR	PeopleSoft Human Resources System
Risk Management	Risk Management Department of the City of Colorado Springs
HIPAA	Health Insurance Portability and Accountability Act
CMRRS	Colorado Municipal Records Retention Schedule

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## Introduction

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### AUTHORIZATION

We performed an audit of the City of Colorado Springs (City) Workers' Compensation Claims Reserve Fund (Fund) for the period January 2006 through December 2007. We conducted this audit under the authority of Chapter 1, Article 5, Part 602(I) which states:

#### 1.5.602(I): WORKERS' COMPENSATION CLAIMS 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 Claims 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 was the Risk Management Department of the City of Colorado Springs (Risk Management), which is under the reporting structure of the City Manager. The City Manager is a City Council Appointee.

### SCOPE AND METHODOLOGY

The purpose of this 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 also included a review and evaluation of internal controls related to the documentation and payment of Workers' Compensation claims.

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.

Our review covered the period January 2006 through December 2007.

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## Introduction

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### BACKGROUND

The City is a self-insured, self-administered employer with regard to Workers' Compensation since January of 1989 and is governed by the 2007 Colorado Workers' Compensation Act (the Act). Both the City and Colorado Springs Utilities pay their Workers' Compensation claims from the Fund. The Fund is also used by both organizations to set aside reserves for anticipated claims. As of December 31, 2007, the Total Net Assets of the Fund was (\$4,248,260). See Table 1 for comparative Workers' Compensation statistics related to the organizations.

### Related Audit Reports

On August 17, 2006, we issued audit report 06-117 - Workers' Compensation Claims Reserve Fund, which covered the two year audit period January 1, 2004 to December 31, 2005. That report contains six findings and is available for review at [www.cityauditor.org](http://www.cityauditor.org). Two of the findings from that report are repeated in this report as Findings 1 and 6.

On May 14, 2007, the State of Colorado Department of Labor and Employment Division of Workers' Compensation (Division) issued a Compliance Audit Report. The report stated Compliance levels were not reached in the areas of timely filing of First Reports of Injury, temporary disability benefits calculated and admitted correctly, and termination of temporary disability benefits supported. At the conclusion of the Division's audit, corrective actions were agreed upon by Risk Management and the Division.

On July 23, 2008, we issued audit report 08-07 – Colorado Springs Claims Reserve Fund. That report is available for review at [www.cityauditor.org](http://www.cityauditor.org). Since the Claims Reserve Fund and the Workers' Compensation Fund are administered by the same office and use the same computer system, we determined that findings 2 and 3 of that report are applicable to this audit as well. The findings relate to daily backup process of the system and internal controls over the claim payment process.

### OVERALL OPINION

We conclude proper underwriting techniques were used and claim procedures were properly followed. However, since the Total Net Assets of the Workers' Compensation Fund was (\$4,248,260) as of December 31, 2007 [with the City's share being (\$4,249,107)], we cannot conclude that adequate loss reserves existed, and by default, that sound funding procedures existed. Colorado Springs Utilities funding, with December 31, 2007 Total Net Assets of \$847, appeared to be adequate. Increased contributions by the City are necessary to provide for adequate reserves for the Fund. Finding 1 addresses the adequacy of the loss reserve. We also identified 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 City of Colorado Springs did not have adequate loss reserves for Workers' Compensation in the Workers' Compensation Claims Reserve Fund.

The City Auditor is charged with determining whether the Fund has adequate reserves per City Code 1.5.602(I).

We have determined that the City's portion of the Fund as of December 31, 2007 was under-funded for future liabilities by approximately \$4.2 million. Unfunded liabilities in this Fund ultimately become a liability of the City's General Fund.

The City Code 1.5.602(B) states, "Adequate reserves shall be maintained in the Workers' Compensation Claims Reserve Fund subject to available appropriations made by the City Council at its discretion." The Code then continues to state, "Each fund balance shall include sufficient funds to cover and discharge all known and potential Workers' Compensation liability." These two statements appear to be in conflict. The first statement allows maintaining adequate reserves to be at the discretion of City Council. The second statement requires the Fund to have sufficient funds.

This finding was originally reported in our public audit report dated August 17, 2006. When originally reported, the City was under-funded for future liabilities by approximately \$2.7 million as of December 31, 2005. The under-funding has grown by approximately \$1.5 million between December 31, 2005 and December 31, 2007.

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

As previously recommended, this section of the City Code should be reviewed and modified to reflect the intended funding policy. Fund reserves should be set according to the intended funding policy with the understanding that any unfunded liability in the Fund becomes a liability of the General Fund.

#### ***City's Response:***

Risk Management agrees with the auditor's recommendations and supports the initiative to better define the terminology adequate reserves. Discussions about adequate funding occur annually during the Claim Reserve Funding committee meetings. Following the committee meeting on May 6, 2008, interpretive guidelines on fund governance were sent to the committee members (June 9, 2008). We will review the wording of 1.5.602 (B) with the Claim Reserve Funding committee in 2009 to determine if any changes are needed.

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## Findings, Recommendations, and Responses

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### 2. The Risk Management Functional Claim Handling and Processing Procedures Manual (Claim Manual) contained contradictory policies regarding record retention.

The City has adopted the *Colorado Municipal Records Retention Schedule* (CMRSS). Per the CMRSS, Schedule 15.310-PERSONNEL RECORDS / WORKERS COMPENSATION injury reports, supplemental reports, and claim records are to be maintained for six years plus current for a total of seven years. Per the Claim Manual:

*All claim files must be permanently stored. The closed claim files will carry a destruction date, which should be no sooner than 2 years after the final payment on the claim is made or file closure. Destruction date for those cases involving a minor will carry a destruction date of 2 years after their date of emancipation. Closed file material will be retained by the Risk Management Office for a period of 60 days following the date of closure.*

These guidelines are contradictory and not in compliance with CMRRS. The procedure specified in the Claim Manual for archiving closed Workers' Compensation claim files does properly indicate that the destruction date is seven years.

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

We recommend that the contradictory language be removed from the Claim Manual as it relates to destruction and retention of Workers' Compensation closed claim files and the Claim Manual comply with CMRRS.

#### **City's Response:**

Risk Management adopted a record archive policy on June 25, 2005 when this policy was added to the Claim Manual (Functional Claim Handling & Processing Procedures Manual). We believe the archive policy is compliant with the records retention schedule. The language in the Claim Manual has been modified to reflect the exception for the destruction of claim records where a minor child sustained injury and settled a claim without Court approval.

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## Findings, Recommendations, and Responses

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### 3. The Workers' Compensation claim file review process was not documented in the Claim Manual.

The process followed by the Risk Management supervisor to review Workers' Compensation claim files was not documented in the Claim Manual; the Claim Manual is incomplete.

***Auditor's Recommendation:***

We recommend that the Claim Manual be updated to include details on the Workers' Compensation claim file review process. Details such as the selection criteria, number of claim files to be reviewed each month, a timeline for review, and the use of review results should be included.

***City's Response:***

Risk Management agrees with the auditor's recommendation and added guidelines to the Claim Manual for closed claim reviews commensurate to current practices. In addition, the Claim Manual has a section that discusses claim service standards, the quality of claim investigations, reporting and supervisory involvement in the handling of claims.

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## Findings, Recommendations, and Responses

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### 4. The reconciliation of Workers' Compensation disbursements was not adequate.

The reconciliation of Workers' Compensation disbursements requested from the Claims Administration software and PeopleSoft disbursements made was not accurate. A majority of the amounts presented on the reconciliation are not accurate and did not represent the amounts intended. For example, the amounts listed for Claim Payment Requests did not agree to the Claims Administration software or the PeopleSoft general ledger.

***Auditor's Recommendation:***

We recommend that the reconciliation process be improved.

***City's Response:***

Risk Management has a long standing practice of reconciling its claim payments on a monthly basis. It is our understanding this process can be enhanced and we have agreed to work with the auditor in establishing best practices. This meeting has tentatively been scheduled for the middle of December 2008.

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## Findings, Recommendations, and Responses

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### 5. City of Colorado Springs departments were not appropriately charged for Workers' Compensation.

City departments were charged for Workers' Compensation based upon eligible payroll dollars and rates determined by Risk Management. The amounts charged to City departments were added to the Fund balance. The process to charge departments was executed biweekly in conjunction with the City's pay days. The process was automated through the City's PeopleSoft Human Resources (PSHR) system. This process did not correctly charge City departments for Workers' Compensation during 2006 or 2007. During 2006 and 2007, City departments were undercharged by \$75,617 and \$61,876, respectively. This undercharging contributed to the inadequate fund balance as detailed in Finding 1 above.

This finding was originally reported in our public audit report dated August 17, 2006. At that time, Risk Management acknowledged the finding and agreed to resolve the issue with the Payroll Department. This issue was resolved after our audit review period. Changes were made to the program to correctly charge City departments and we tested the period January to June 2008.

#### ***Auditors' Recommendation:***

Since the report was corrected after our review period, our recommendation is the information in the report be periodically reviewed to ensure accurate amounts are charged to City departments.

#### ***City's Response:***

Risk Management meets annually with the Claim Reserve Fund Committee providing historic claim costs and recommendations for the future funding of reserves to pay claims. The information regarding revenue for the self-insurance funds is included in the budget process. Risk Management provides NCCI (National Council on Compensation Insurance) classification codes and national insurance premium rates compared to its costs to the budget and funding committees. Risk Management agreed with the recommendation as proposed in the August 17, 2006 report and will ask the budget staff to verify its funding calculations match our recommendations. Oversight will be performed on an annual basis.

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## Findings, Recommendations, and Responses

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**6. Workers' Compensation rates were not updated in the PeopleSoft Human Resources system to increase contributions to the Workers' Compensation Claims Reserve Fund.**

The Claims Reserve Fund Committee recommended increasing the contributions to the Fund by \$500,000 in 2007. As discussed in Finding 5 above, a PSHR process charged City departments for Workers' Compensation based on rates set by Risk Management. Although the Claims Reserve Fund Committee recommended an increase in contributions for 2007, the Workers' Compensation rates were not updated. The actual Workers' Compensation contributions for 2007 increased by only \$197,977 over 2006 actual contributions, not \$500,000 as recommended. The increase was the result of salary increases not a change in Workers' Compensation rates.

***Auditors' Recommendation:***

We recommend Risk Management verify that changes to Workers' Compensation rates that have been approved in the budgeting process have been communicated to the Payroll department and appropriate rates are charged.

***City's Response:***

The rates provided for contributions to the Payroll Department were provided by the Budget Department and were correct based on calculations completed by the Budget Department. However, during the 2008 budget process, a decision was made to increase the contribution to the Worker's Compensation Fund by \$500,000. This amount should have been reflected in the budget as a transfer from general fund to the workers compensation fund. However, the Budget Department inadvertently spread this amount through all departments as part of their final budget process. This resulted in each department's budget being higher than what was to be paid through the contribution rates established.

As part of the review of the fund, it was determined that the \$500,000 should have been reflected as a transfer rather than being allocated to each department. Rather than move budgets throughout general fund, a transfer was made out of each department totaling the \$500,000 that should have transferred. At the end of 2008, the amount of contribution that should be made based on the rates and the additional contribution will be correct for the City.

**Table 1 Comparative Statistics – City of Colorado Springs and Colorado Springs Utilities**

	2007		2006	
	<u>City</u>	<u>Colorado Springs Utilities</u>	<u>City</u>	<u>Colorado Springs Utilities</u>
Number of Full Time Equivalent Employees <sup>(1)</sup>	2,565	1,911	2,519	1,916
Number of Claims Opened <sup>(2)</sup>	431	100	410	138
Number of Claims Closed <sup>(2)</sup>	477	142	430	137
Open Claims as of 12/31 <sup>(2)</sup>	129	50	178	94
Claims per 100 Full Time Equivalent Employees <sup>(3)</sup>	16.80	5.23	16.28	7.20
Total Contributions <sup>(4)</sup>	\$3,885,000	\$1,937,687	\$3,687,023	\$1,950,433
Other Income (Investment and Other Earnings) <sup>(4)</sup>	\$58,615	\$83,618	\$133,096	\$88,217
Total Claims Paid <sup>(4)</sup>	\$2,986,126	\$1,285,825	\$3,046,366	\$2,163,542
Other Expenses (Insurance and Administrative) <sup>(4)</sup>	\$939,418	\$857,123	\$926,787	\$875,377
Average Cost of Closed Claim <sup>(2)</sup>	\$7,470	\$18,229	\$7,508	\$9,502
Total Outstanding Claims <sup>(4)</sup>	\$4,308,891	\$2,199,410	\$3,839,451	\$2,495,771
Fund Balance Including Outstanding Claims <sup>(4)</sup>	\$(4,249,107)	\$847	\$(3,797,738)	\$(174,718)

(1) Source – 2007 and 2006 City of Colorado Springs Comprehensive Annual Financial Reports

(2) Source – City of Colorado Springs Risk Management Department

(3) Calculation - Number of Claims Opened / (Number of Full Time Equivalent Employees / 100)

(4) Source - City of Colorado Springs Finance Department