

Office of the City Auditor

CONSENT CALENDAR

June 2, 2009

To: Honorable Mayor and Members of the City Council
From: Ann-Marie Hogan, City Auditor
Subject: Audit Report: Workers' Compensation Costs Can Be Reduced by Improved In-House Processing and Adherence to Contract Terms

RECOMMENDATION

Request the City Manager to report back on or before September 1, 2010, and every six months thereafter, regarding the implementation status of the audit recommendations in the attached audit report until each recommendation is fully implemented.

SUMMARY

Human Resources (HR) has been successful in reducing the number of workers' compensation claims filed and their costs in recent years. However, by addressing the following concerns identified in our audit, HR can further reduce workers' compensations costs:

- HR's excessive role in claims processing hindered the City's third party claim administrator, which increased claim and legal costs by up to \$300,000 per year.
- HR did not systematically monitor the administrator's performance under the contract.
- The City needs to report claims to the administrator timely.
- The City's early return to work program could be improved to promote recovery of injured employees and reduce costs.
- The City's Workers' Compensation benefits exceed statutory requirements.
- The administrator could reduce costs by contacting physicians sooner.
- Supervisor's Investigation reports did not always state the cause of injury or how to prevent similar injuries.
- There were control gaps in the workers' compensation checking account.
- HR has not reported on the implementation status of recommendations in two consultant studies conducted in 2002 and 2004.

FISCAL IMPACTS OF RECOMMENDATION

Implementing our recommendations should result in significant cost savings. If total workers' compensation costs could be reduced by just five percent, it would save almost \$375,000 per year. About 48 percent of the annual savings, or almost \$180,000, should benefit the General Fund. Over a five-year period the cost savings would accumulate to almost \$1,900,000 including almost \$900,000 in savings to the General Fund.

RATIONALE FOR RECOMMENDATION

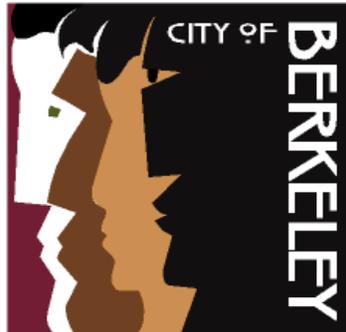
Though costs have declined in recent years, workers' compensation is still a major fiscal burden on the City. The City paid \$6.2 million in workers' compensation costs in fiscal year 2008. The City also incurred over \$1.2 million of administrative cost related to workers' compensation.

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1. Audit Report: Workers' Compensation Costs Can Be Reduced by Improved In-House Processing and Adherence to Contract Terms

City of Berkeley



Audit Report: Workers' Compensation Costs Can Be Reduced By Improved In-House Processing and Adherence to Contract Terms

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Presented to Council June 2, 2009

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I. OBJECTIVE OF THE AUDIT

The objective of the audit was to identify opportunities to further reduce the City's workers' compensation benefits costs. To meet this objective, we determined if the City's workers' compensation policies and procedures, as well as those of Innovative Claims Solutions (ICS - the City's third party administrator) conform to industry best practices. We evaluated:

- The timeliness of workers' compensation claims processing;
- Human Resource's efforts to monitor ICS's performance under its contract with the City; and
- The adequacy of the City's return to work program.

In addition we planned to determine whether:

- The City's injury prevention program focuses on the greatest risks;¹ and
- The City performed corrective actions recommended in a 2004 review of the City's workers' compensation program by Bickmore Risk Services.

II. SUMMARY

Accomplishments Recognized

The HR Director and his staff have been successful in reducing injuries and workers' compensation costs over the past five years. Both the number of claims filed by City employees and the overall costs of those claims have fallen sharply in recent years. (Exhibit 1) In addition, Berkeley's recent workers' compensation loss rate, incident rate, and average cost per claim compares favorably with other Northern California cities.

¹ We did not pursue this original objective due to a 2002 study of the City's safety and risk control efforts by Bickmore Risk Services. Bickmore made more than 100 recommendations for improvement. See Finding 7.

Improvements Needed

There are opportunities to further reduce the City's workers' compensation benefits costs. The City and ICS did not comply with some key industry best practices. An area for improvement for both the City and ICS was timeliness. The City should improve the timeliness of internal claims processing, and ICS should improve the timeliness of physician contact.

Human Resources (HR) does not actively monitor ICS's performance. HR's monitoring of ICS is ad hoc. HR should establish performance measures and guidelines to monitor and evaluate ICS' contract performance.

Accounting did not have the information needed to effectively reconcile (a monitoring procedure) the worker's compensation checking account. There were control gaps and at least two duplicate payments in the workers' compensation checking account.

Improvements could be made to the City's early return to work program such as charging costs to claimant's departments and maintaining contact with employees on workers compensation through departmental diplomats. In addition, the Supervisors' Investigation reports do not always state the cause of injuries, or how to eliminate the cause. This could result in unsafe conditions not being corrected.

Finally, the City did not implement certain recommendations reported in a 2004 workers compensation study performed by Bickmore Risk Services. By implementing Bickmore's recommendation to reduce HR's involvement in claims processing, the City could have reduced workers' compensation costs by as much as \$300,000 per year. In addition, the City continues to provide negotiated workers' compensation benefits that exceed statutory requirements.

Bickmore issued an earlier report on safety and risk control assessment in 2002. HR did not have information on the implementation status of the 2002 recommendations or the remaining recommendations in the 2004 Bickmore report.

III. RESULTS

**Workers' Compensation Claims and Costs
Have Declined Steadily in Recent Years**

Human Resources (HR) should be commended for its efforts to reduce workers' compensation costs. The number of claims filed by City employees decreased by just over 49 percent, and total claim costs declined by just over 55 percent from fiscal year 2004 to fiscal year 2008. HR attributes this steady improvement to continued efforts by HR staff to improve workplace safety and claims management.

**Exhibit 1
City of Berkeley Claims Filed and Cost of Claims
As of June 30, 2008 (1)**

| Fiscal Year | Number of Claims Filed | Total Payments | Reserves for Future Payments² |
|--------------------|-------------------------------|-----------------------|---|
| 2008 | 192 | \$865,809 | \$1,195,181 |
| 2007 | 227 | \$2,365,611 | \$1,151,580 |
| 2006 | 245 | \$2,721,896 | \$759,523 |
| 2005 | 273 | \$3,986,793 | \$1,033,991 |
| 2004 | <u>377</u> | <u>\$3,514,458</u> | <u>\$1,070,948</u> |
| Totals | 1,314 | \$13,454,567 | \$5,211,223 |

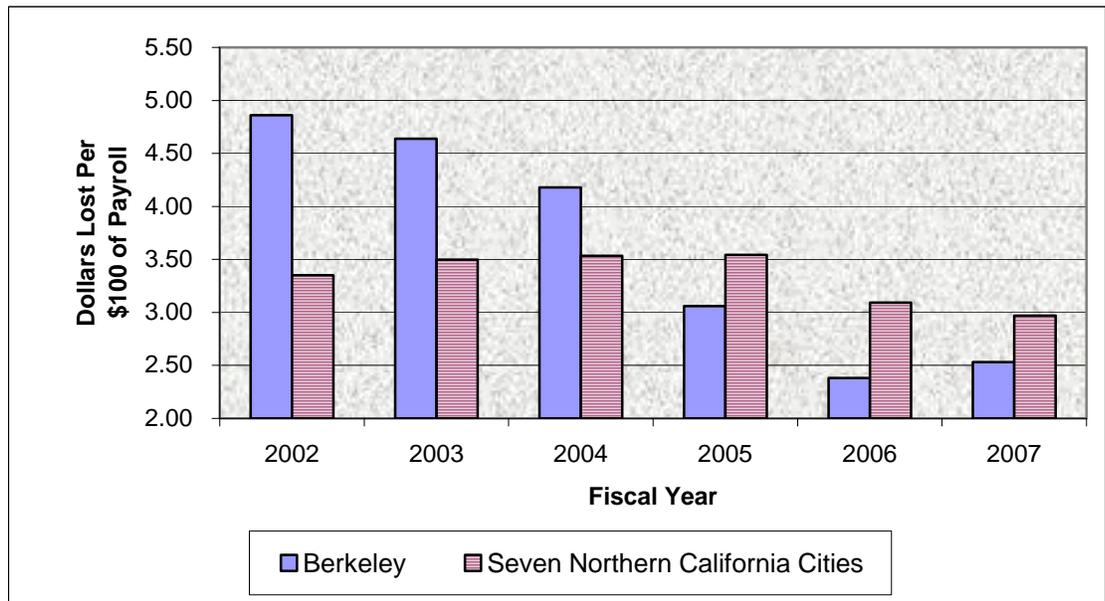
(1) Source: Innovative Claims Solutions, Inc

² Each year the City continues to make payments on prior year claims and expenses reserves to cover future payments.

Loss Rate

The continued improvement is evident when Berkeley's recent workers' compensation history is compared to seven other Northern California cities. A good example is the City's loss rate per \$100 of payroll. Berkeley had a loss rate of \$4.86 in fiscal year 2002, compared to the seven-city average of \$3.35.³ Berkeley and the seven other cities improved by fiscal year 2007, but Berkeley improved substantially more, with a loss rate of only \$2.53, compared to the seven cities' average of \$2.97.

**Exhibit 2
Workers' Compensation
Loss Rate Per \$100 Payroll
City of Berkeley vs. Seven Northern California Cities**

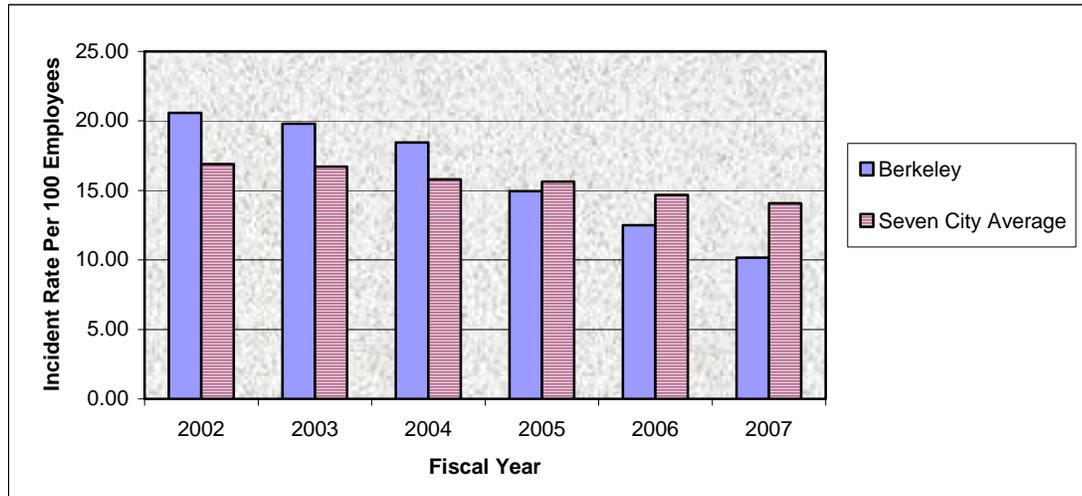


³ The source of our data was the California Institute of Public Risk Analysis (CIPRA) website. The seven comparison cities were Fremont, Modesto, Palo Alto, Sacramento, Stockton, Sunnyvale, and Hayward. The cities were selected primarily based on similarity to Berkeley in number of employees and total payroll. Sacramento was included at the suggestion of the Human Resources Director because that city, like Berkeley, performs solid waste removal in house. Most cities contract for this service. Fiscal Year 2007 was the most current year that information was available when we conducted our research.

Incident Rate

In fiscal year 2002 Berkeley had an incident rate of 20.59 per 100 employees, compared to the seven-city average of 16.90. However, by fiscal year 2007 Berkeley's rate fell more than 50 percent to 10.17, while the seven-city average rate decreased less than 17 percent to 14.08. Berkeley went from having an incident rate that was 21 percent higher, to one that was 28 percent lower than the other cities.

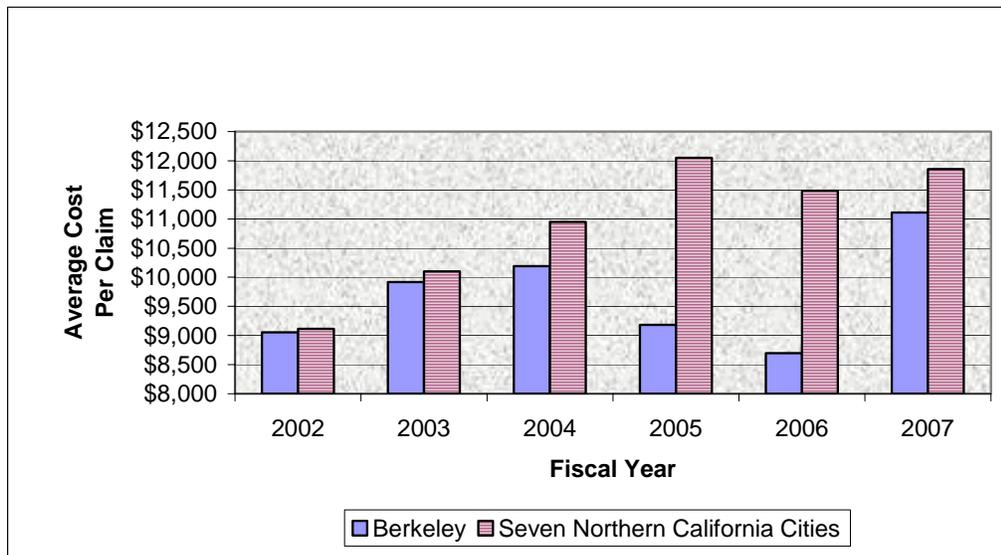
**Exhibit 3
Workers' Compensation Incident Rate
Per 100 Employees
City of Berkeley vs. Seven Northern California
Cities**



Average Cost Per Claim

Only in average cost per claim did Berkeley and the other seven cities as a whole fare worse in fiscal year 2007 than in fiscal year 2002. Berkeley's average cost, as well as that of the other seven-cities, rose substantially from 2002 to 2007. However, Berkeley's 2007 average cost of \$11,113 per claim was less than the seven-city average of \$11,855. Berkeley's average cost fell substantially between 2004 and 2006 before rising sharply in 2007. We did not determine the reason for this abrupt increase, nor did we assess the influence of higher wages and rising medical costs.⁴

**Exhibit 4
Average Cost Per Workers Compensation Claim
City of Berkeley vs. Seven Northern California Cities**



⁴ The data obtained from the third party administrator (Exhibit 1) shows higher costs per claim for Berkeley. Since we use CIPRA data for comparative purposes only, we did not address the differences between CIPRA and the administrator.

Opportunities for Improvement

Though progress has been made in recent years, there is still considerable room to improve the City's workers' compensation operations. Our audit identified the following concerns:

There is room for further improvement, which can reduce costs.

- Problems identified in a 2004 consultant study increased claim and legal costs by up to \$300,000 per year, and possibly more. (Finding 1)
- HR did not systematically monitor ICS's performance under the contract. (Finding 1.2)
- Untimely claims reporting possibly increased claim costs. (Finding 2)
- The City's early return to work program could be improved to promote recovery of injured employees and reduce costs. (Finding 3)
- The city's workers' compensation benefits exceed statutory requirements. (Finding 4)
- The City's third party administrator could reduce costs by improving timeliness of physician contact. (Finding 5)
- Supervisor's Investigation reports did not always state the cause of the injury, or how to prevent similar injuries. (Finding 6)
- There were control gaps in the workers' compensation checking account. (Finding 7)
- HR has not reported on the implementation status of recommendations in two consultant studies conducted in 2002 and 2004. (Finding 8)

IV. BACKGROUND

Benefits Mandated by State Law

Workers' compensation is the nation's oldest social insurance program. It is a state program that mandates that employers compensate a worker for lost wages and medical costs from a job related injury or illness.

California joined most of the other states in passing its workers' compensation law almost 100 years ago. Historically, workers' compensation in California provided six basic benefits: medical care, temporary disability pay, permanent disability payment, supplemental job displacement benefits, vocational rehabilitation, and death benefits.

The California Labor Code provides for disability pay for up to 104 weeks for any injury. Within certain limits, the Labor Code sets disability pay at 2/3 of the injured employee's average weekly wage. However, it provides full pay to safety employees (law enforcement officers and firefighters) for the first 52 weeks of disability.

There are two types of workers' compensation claims. A medical only claim does not involve time lost from work and only covers the cost of providing medical treatment to the injured worker. An indemnity claim involves lost time, and covers the costs of treatment, plus temporary disability pay. The City is self-insured for workers' compensation obligations.⁵

SB899

In April 2004, in response to rapidly accelerating workers' compensation costs, which were believed to have caused many employers to leave the state, California enacted Senate Bill 899. SB 899:

- Shortened the time that an injured worker can collect temporary disability pay in most cases from 240 to 104 weeks;
- Eliminated vocational rehabilitation benefits for injuries occurring after January 1, 2004; and
- Provided for reducing permanent disability benefits, if the disability is partially caused by a previously existing condition.

⁵Per California Labor Section 3700 (c).

Claim Administration

The City contracted with Innovative Claim Solutions, Inc. (ICS) to serve as third party administrator for all workers' compensation claims. It is ICS's responsibility to:

- Review and process claims in accordance with state regulations, and determine the City's liability;
- Pay certain claim costs with funds provided by the City;
- Maintain contact with injured workers, as well as their supervisors and health care providers;
- Settle claims up to \$10,000, and request settlement authority from Human Resources for settlements that will exceed \$10,000;
- Estimate amounts to be reserved for future liability on each claim;
- Assist in preparing all reports required by government agencies with respect to selfinsurance;
- Arrange for legal representation on litigated claims, and pay attorney's fees with funds provided by the City; and
- Submit various reports to the City on claims activity and costs.

The HR Department is responsible for the City's workers' compensation program. HR serves as liaison between ICS, the various City departments, and health care providers. HR's responsibilities include:

- Monitoring ICS's work under the contract;
- Investigating claims that are suspected of being fraudulent; and
- Training department personnel on their responsibilities in workers' compensation claims administration.

HR is also responsible for the City's safety program, which is a key component of the City's efforts to reduce workers' compensation costs. HR directs an on-going illness and injury prevention program.

The City's workers' compensation policies and procedures are set forth in Administrative Regulation (AR) 2.7. According to HR, AR 2.7 was being revised for easier readability. In October 2008, HR staff stated that the expected completion date was March 1, 2009.

Healthcare Provider

U.S. HealthWorks is the City's primary healthcare provider for occupational injuries and illnesses. Under the Labor Code, an employee has a right to pre-designate a physician to treat occupational injuries and illnesses. If a claimant has not pre-designated a physician, the City is entitled to choose the treating physician. However, after 30 days of treatment, the employee is entitled to seek treatment from a personal physician.

Workers' Compensation Costs

FY08 workers' compensation costs for the City was more than \$7.4 million.

The City maintains a Workers' Compensation Fund to account for workers' compensation costs. Each year other City funds contribute to the Workers' Compensation Fund. In the five years ended June 30, 2008, contributions to the Workers' Compensation Fund totaled \$40,352,917. The General Fund contributed 47.8 percent⁶ of that amount.

Though costs have declined in recent years, workers' compensation is still a major fiscal burden on the City. According to HR and ICS, the City paid \$6.2 million in workers' compensation costs in fiscal year 2008. This amount included payments on fiscal year 2008 and all prior year claims. The City also incurred over \$1.2 million of administrative cost related to workers' compensation. That amount consisted of \$662,000 in salaries and employee benefits⁷ for workers' compensation administration, plus over \$555,000 in ICS fees. Total program costs exceeded \$7.4 million.

To a certain extent workers' compensation cost are not controllable. However, implementing our recommendations will result in significant cost savings. If total workers' compensation costs could be reduced by just 5 percent, the City could save almost \$375,000 per year, of which almost \$180,000 would be savings to the General Fund. Over a five-year period savings would total almost \$1,900,000, including almost \$900,000 to the General Fund.

⁶ Source: City Budget Office

⁷ Salary and benefit costs do not include additional overhead costs. The \$6.2 million does not include the cost of vacation and sick leave used by employees while absent due to injuries.

V. FINDINGS AND RECOMMENDATIONS

Finding 1: Implement Corrective Actions Recommended in the 2004 Consultant Study to Reduce Workers Compensation Costs

HR has not addressed two issues identified five years ago by Bickmore Risk Services. The first issue involved a lack of clearly defined responsibilities for HR claims processing staff. This might have resulted in the City workers' compensation costs being as much as \$300,000 per year higher than necessary, based on consultants' estimates. The second issue involved excessive control by HR staff over distributing information within departments, which could result in loss of information and adversely impact management decision making.

The City pays the costs of a worker's compensation claim. It is not paid by some insurance policy.

Problems Identified by Consultants

In a January 2004 draft report entitled "City of Berkeley Audit and Analysis of the Workers' Compensation Program," Bickmore Risk Services disclosed that the level of involvement by HR in all City claims demonstrated a lack of confidence in ICS and affected ICS's ability to settle claims. Bickmore reported that HR was essentially overseeing 500 claims, though its staff was not trained to administer claims.⁸ Bickmore also reported that HR did not approve settlement authority timely. As a result, ICS's claims examiners had to repeatedly request settlement authority. Bickmore added that the settlement process had taken as much as 18 months, and that delays in settling claims increased their costs.

Bickmore's findings were consistent with the findings of a 2003 review by Lindy West and Associates. In its October 2003 report, Lindy West made recommendations aimed at reducing duplicative interaction between HR and ICS. Lindy West estimated that implementing its recommendations would result in cost savings of at least \$150,000 in the first year.⁹

⁸ It is a recognized best practice in workers' compensation claims administration to limit claims examiners (adjusters) to a caseload not to exceed 150 claims.

⁹By increasing this amount for inflation, then reducing it to reflect the decline in claims volume since 2003, we estimate that implementation of the consultant's recommendations could have resulted in cost savings of about \$120,000 in fiscal year 2008. There would be comparable cost savings in each past and future fiscal year.

Current Situation

Delays in processing a claim can increase its cost.

Based on our discussion with ICS, the situation had not improved as of October 2008, almost five years after the Bickmore report. ICS officials told us that claim work becomes “bottlenecked” because of extensive involvement of HR in most of the City’s claims.¹⁰ They said that HR would frequently contact claims examiners on questions that could be answered through remote access to the ICS claims management system.¹¹ They also said that HR did not always adhere to agreed-on protocols. As a result, Berkeley claims continue to take substantially longer to process and to settle.¹² However ICS officials told us that their comments reflect historical issues, and that turnaround time on settlements has improved.

Problems identified by consultants have not been corrected. Result: up to \$120,000 in higher claims costs, and up to \$180,000 in higher legal costs.

Increased Legal Costs

ICS officials told us that the increased settlement time caused by HR staff resulted in more hearings, which increased legal costs. In addition, they said that HR often contacted attorneys that represented the City in litigated claims with questions that duplicate questions asked by ICS, or which could be answered via the claims management system. The unnecessary frequent legal contacts substantially increased the City’s attorney fees. To illustrate, they said that another ICS city client’s¹³ attorney fees were 70 percent less than Berkeley’s in fiscal year 2008, though it had 32 percent fewer claims. If Berkeley’s ratio of attorney fees to the number of claims had been the same as the other city, Berkeley would have avoided approximately \$180,000 in legal costs.

Distributing Information

In their 2004 report, Bickmore also reported that one HR employee maintained excessive control over distribution of workers’ compensation information within the various City departments. Bickmore added that if the supervisor or department head is not directly involved, critical information pertinent to claims handling may be eliminated, and the department’s ability to address issues regarding staffing, personnel, and management decisions may be hindered. Bickmore recommended decentralizing this process to include department heads.

¹⁰ At June 30, 2008, the City had 410 open indemnity claims, plus 21 open medical only claims. During that fiscal year, the City closed 280 claims.

¹¹ ICS uses “Renaissance,” which is workers’ compensation industry specific software, as its claims management system. This system provides a diary of claim activity.

¹² The agreed on protocols give ICS settlement authority up to \$10,000.

¹³ ICS did not identify this city, but did provide a page from a report that shows the amount of legal cost it incurred.

Lack of Written Procedures is an Underlying Problem

The excessive staff involvement, as well as excessive control over distributing information, may be tied to a lack of written procedures. HR personnel involved in processing workers' compensation claims do not have standard operating procedures that cover key areas of claim processing and administration. The only written procedures in place were agreed-on protocols for dealings between HR and ICS that provided limited guidelines for staff involvement in the claims process.¹⁴ According to ICS, HR did not always adhere to the protocols.

Recommendations for Human Resources

- 1.1. Develop standard written operating procedures to cover all aspects of in-house workers' compensation claims processing. The procedures should cover interaction between HR personnel and the third party administrator, as well as monitoring the administrator's performance under the contract.
- 1.2. Ensure that written procedures are consistent with agreed-on protocols.
- 1.3. Ensure that written procedures discourage HR personnel from making unnecessary or redundant contacts with claims examiners and attorneys.
- 1.4. Arrange for ICS to notify HR management of situations in which HR personnel deviate from the agreed-on protocols, unless in ICS's judgment deviation was appropriate under the circumstances.
- 1.5. Ensure that HR is in compliance with agreed on protocols prior to the ICS contract renewal date, to increase the City chances of negotiating favorable contract fees.
- 1.6. Consider implementing the Bickmore recommendation to decentralize workers' compensation information distribution to include department heads.

¹⁴ A.R. 2.7, which is primarily a policy manual, contains very general procedures for claims processing. The A.R. should not be used as a replacement for detailed desk procedures.

City Manager's Response

The Director of Human Resources agreed with the finding and recommendations. According to the Director, Recommendation 1.6 has been fully implemented, and Recommendation 1.1, 1.4, and 1.5 were in process of implementation as of April 22, 2009. The recommendations will be fully implemented by September 30, 2009.

Finding 2 Systematically Monitor ICS's Performance Under the Contract

HR did not systematically monitor ICS's performance under the contract. Instead, monitoring was mostly ad hoc. HR stated that there are few specific monitoring or performance measures for ICS. Instead, if HR has questions or concerns with ICS, it quickly contacts ICS and resolves the issue. HR also stated that it meets with ICS semi-annually (and plans to meet quarterly) to discuss problems and procedures. Finally, HR told us that it receives various reports from ICS, some of which it uses to monitor limited aspects of ICS performance.

Active monitoring could have saved the City \$30,000.

The contract contains few performance metrics. This increases the need for HR to establish specific guidelines for evaluating ICS's performance. Closer monitoring of ICS's performance could have triggered intervention by HR management to alleviate problems described in Finding 1.

The lack of monitoring is illustrated by a claim settlement request that HR received from ICS in January 2009. The request pertained to a claim on a 1996 injury. In February 1998 the settlement amount was projected at \$12,480, based on a disability rating of 21.2 percent. The claimant's condition was rated as permanent and stationary in September 2000. By the time ICS finally requested authorization in January 2009 to settle the claim, the disability rating had increased to 49 percent, and the requested settlement amount was \$44,030. The City might have saved about \$30,000 by settling the claim years ago. By systematically monitoring ICS, HR should have realized years ago that the claim was stagnant, and that ICS should take action to settle the claim.

Recommendations for Human Resources

- 2.1 Ensure that procedures developed in response to recommendation 1.1 include specific criteria and directions to systematically monitor ICS's performance under the contract.
- 2.2 Consider establishing performance measures tied to workers' compensation operations for City staff and the contractor.

City Manager's Response

The Director of Human Resources agreed with the finding and recommendations. The recommendations will be implemented by September 30, 2009.

Delays in processing a claim can increase total claim costs.

Finding 3: Improve Timeliness of the Internal Claims Process by Developing Performance Measures and Reporting the Departments' Results Semi-Annually

In its "City of Berkeley Annual Program Review for fiscal year 2007/2008," ICS reported that, for claims filed during the fiscal year, the City took an average¹⁵ of 9.2 days from the date it learned of an injury to notify ICS of the injury. ICS further reported that the median delay was 6 days, and 56 percent of claims were not filed within the State guidelines of 5 days.¹⁶ We found similar delays in our test sample.

**Exhibit 5
Days Lapsed Between Date Supervisor
Learned of Injury to Date ICS Was Notified
State Guidelines are Five (5) Days**

| Description | Days Lapsed | |
|---------------|-------------|--------|
| | Average | Median |
| Calendar days | 13 | 9 |
| Work days | 9 | 7 |

¹⁵ As used in this report, "average" refers to the arithmetic mean.

¹⁶ The California Code of Regulations requires an employer to file an Employer's Report of Occupational Injury or Illness, Form 5020, with the California Department of Industrial Relations within 5 days of learning of an occupational injury or illness. [8CCR14001 (a) (c) & (d)]

Delays occurred in claimants' work units and in Human Resources.

Twenty-five claims were tested.¹⁷ The median workdays lapsed from the date the claimant filed the claim with his/her supervisor before HR received it was 3 days. Seven claims took from 4 to 7 days each. We found no information in the claim files to justify the supervisors' procrastination in forwarding claims to HR.

Though the median workdays lapsed between HR receipt of the claim and ICS notification was only 2 days, there were 3 claims that took 6, 13, and 18 workdays respectively.¹⁸ The California Code of Regulations¹⁹ provides that within 1 day of receipt of a claim form, an employer is required to provide a dated copy to its claims administrator.²⁰

HR maintains a claims log that captures the date each claim is received in HR, and the date it is transmitted to ICS. Other information captured includes whether HR received a complete claim, and if not, what information or document was missing. Based on claims received from July 1 through December 31, 2008, HR usually transmitted claims to ICS the same day it received them or the next day.

However, for nine of 122 claims received in this period (7.4 percent), either 3 or 4 workdays lapsed between receipt by HR and transmittal to ICS. The delays in submission to ICS cannot be attributed to HR receiving incomplete claims, since all 9 claims were logged-in as complete.

¹⁷ Since our sample was non-statistical, we cannot assume that this average is representative of all claims filed during the audit period.

¹⁸ The remainder of the nine workdays between supervisor's knowledge of an injury and ICS notification consisted of 3 plus average days between the date of supervisor's knowledge and the date the claim was filed. Supervisors may have waited until the injured worker filed the claim to submit the supervisor's investigation report to HR.

¹⁹ 8CCR10140 (a)

²⁰ According to the ICS Unit Manager, to meet this requirement the supervisor would have to bypass HR and submit the claim directly to ICS electronically. The control provided by HR review would be lost. She said state regulators realize that the requirement is not realistic.

Exhibit 6
Workdays Lapsed
Between Different Stages of Claim Reporting
From Supervisor Learning of Injury to ICS Notification

| Description | Average Workdays Lapsed | Median Workdays Lapsed |
|---|-------------------------|------------------------|
| Date supervisor learned of injury to date claim filed (1) (2) | 3.7 | 1 |
| Date claim filed to date HR received claim | 2.7 | 3 |
| Date HR received claim to date ICS was notified ²¹ | <u>3.0</u> | <u>2</u> |
| Total average days lapsed | 9.4 | 7(3) |

- (1) We show this average only to account for the 9 days. It does not indicate reporting delays.
- (2) There were 10 claims where the supervisor first learned of the injury on the day the claim was filed, but 4 other claims were filed from 10 to 37 days after the supervisor learned of the injury. This accounts for the large difference between average and median days.
- (3) The median for total days lapsed was calculated independent of the other medians, and was based on all 25 sampled claims. We based the other medians on less than 25 claims because we could not determine certain dates, or certain dates were deemed not applicable for various reasons. This explains why the column does not add to 7.

Not shown in the table was the average delay of 4.3 workdays between the date the claimant's supervisor learned of the injury and the date the supervisor prepared the Supervisor's Investigation report. While the median was only 1 day, there were 3 claims that took 45, 17, and 14 days respectively. Administrative Regulation 2.7, Subpart 3.3 requires that the supervisor complete a report of accident investigation within 24 hours of learning of an injury.²² The supervisor will have a better chance of remembering the circumstances of an injury immediately after it occurs.

²¹ HR currently transmits the claims to ICS by PDF file, but it previously faxed them.

²² The AR states that the supervisor's investigation report should be completed immediately, but it also states that it should be completed in conjunction with Form 5020. Since the AR requires the supervisor to complete Form 5020 within 24 hours of learning of an injury, we interpret that timeframe as also applying to the investigation report.

Recommendation for Human Resources

- 3.1 Include measures for timeliness of internal claims processing in HR's performance measures (see recommendation 1.5.)

Recommendations for City Manager and Human Resources

- 3.2 Consider rating all supervisors on compliance with AR 2.7 in their performance evaluations.
- 3.3 The Director of Human Resources should provide a semi-annual report to the City Manager and department heads, that lists injuries and claims where the employees' supervisors failed to report the injury, or to submit all required documentation within the time required by the AR. This report should be broken out by department.
- 3.4 The Director of Human Resources should include in the semi-annual report to the City Manager (per recommendation 3.3) all incidences where: a) HR did not notify ICS of a potential claim within one work-day of receipt of injury notification from the employee's supervisor, and b) HR failed to provide ICS with a dated copy of a claim within one work-day of receipt by HR. The report should include explanations for all deviations.

City Manager's Response

The Director of Human Resources agreed with the finding and recommendations. Recommendation 3.2 will be implemented by May 15, 2009. Recommendation 3.3 will be implemented annually in June and December. Recommendations 3.1 and 3.4 will be implemented by September 30, 2009.

Finding 4: Improve the City's Early Return to Work Program

The longer an injured worker stays away from work, the more the claim will cost, and the greater the risks are that the employee will never return to work. Various workers' compensation experts agree that a key to reducing claim costs is to bring the injured worker back to work as soon as possible. Injured workers recover faster when they return to work as soon as possible. The City can improve its early return to work program by better use of modified duty, and by implementing a formal policy of encouraging City departments to maintain frequent contact with injured workers.

Modified Duty

While an injured worker may not be sufficiently recovered to perform his/her full range of normal duties, the employee may be able to work in a limited capacity. A well designed modified or light duty program is critical to a successful early return to work program²³. There are two ways for the City to improve the modified duty program.

HR does not track the effectiveness of the modified duty program.

First, HR did not have formal policies, criteria and procedures for monitoring the success of the modified duty program. HR told us that the success of the program is evaluated on a case-by-case basis. In fact, HR did not routinely receive reports that could be used to identify employees that were approved for but not assigned modified duty. HR did not even receive reports that identified all employees whose physicians approved modified duty. When HR was asked for a list of employees that worked modified duty, it had to request the information from Payroll Audit.

Charging employees' own department for the cost of performing modified duties could increase modified duty assignments.

Second, a workers' compensation expert suggested that all or part of the cost of modified duties should be born by the employee's regular department. The idea is that the employee's regular department would be more likely to find a modified duty assignment within the department if it will have to pay for modified duty in another department.

AR 2.7 provides that if an employee is placed in a modified duty assignment within a City department other than the employee's regular department, the cost of the modified duty may be pro-rated. The acquiring (user) department would be charged for the value of the services received, and the employee's regular department would be charged for the balance of cost in excess of the amount charged to the user department. However, the AR does not specifically mandate pro-ration of costs.

Another department might be more likely to make a modified duty assignment available if it will not be charged for the value of the services received. While this arrangement may be disadvantageous to the injured employee's own department, the City as a whole would benefit. Since the City has to provide full pay to the injured worker, it should attempt to receive some benefit in return.

²³ The City's modified duty program is described in subpart XI.B.2 of AR 2.7.

Frequent Contact

Effective contact with injured workers to remind them they are valued City employees could increase their desire to return to work.

A policy of maintaining contact with an injured employee, if carefully implemented, could be beneficial in reducing the length of time the employee is away from work. The focus of such contact should be to express concern for the injured worker and let the injured worker know that she or he is missed. One workers' compensation professional told us that contact should be made every 15 to 30 days. An employee is more likely to want to return to work if the employee is made to feel that he or she is still part of the workplace.

The City does not have a formal policy of maintaining frequent contact with injured employees. The Workers' Compensation Analyst suggested that a frequent contact program would open the City to harassment charges. According to the HR Director, HR essentially depends on ICS to maintain formal contact with the employee unless the employee is represented by an attorney. In that case contact is between attorneys. However, he said that departments are informally encouraged to maintain contact.

One expert suggests that employers designate an "employee diplomat" to maintain contact with injured workers. Another expert told us that the emphasis of such contacts should be on "how are you doing," not "when are you coming back." Contact by an employee diplomat with emphasis on "how are you doing," would not likely be viewed as harassment.

Recommendations for Human Resources

- 4.1 Develop formal policies, criteria, and procedures for monitoring the success of the light duty program. Such monitoring should provide sufficient information to modify and update the program as needed.
- 4.2 In consultation with the City Manager, consider modifying AR 2.7 to require that the cost of a modified duty assignment be born by the employee's regular department.
- 4.3 Consider coordinating with the City Manager to establish a Citywide policy that would require each department to establish a departmental employee diplomat to maintain contact with injured workers. HR should be responsible for providing guidance to the various employee diplomats.

City Manager's Response

The Director of Human Resources generally agreed with the finding and recommendations, though he expressed reservations about frequent contact. The recommendations will be implemented by September 30, 2009.

Finding 5: Eliminate Workers' Compensation Benefits that Exceed Statutory Mandates

Workers' compensation benefits exceeded statutory mandates by almost \$148,000.

In its 2004 draft report, Bickmore Risk Services stated that the City's workers' compensation benefits far exceeded statutory obligations. The City's Memoranda of Understanding with the various labor unions provide that all employees shall receive their full regular pay for the first 365 days of worker's compensation leave. Full salary continuation for non-safety employees is based on pre-disability net pay. The California Labor Code only provides full pay for safety employees (law enforcement officers and firefighters).²⁴ It limits other employees to 2/3 of lost wages, or 2/3 of their average weekly wage.²⁵ In fiscal year 2008, the City paid salary continuation to non-safety claimants that was almost \$148,000 in excess of what they were entitled to receive under the California Labor Code.

Full pay benefits may be a disincentive for injured workers to return to work.

There could also be hidden costs to these generous benefits in that they may encourage employees to remain on workers' compensation longer than necessary. An injured employee receives the same disposable income when absent on workers' compensation as when working, and earns full benefits, such as vacation and sick leave. Thus the injured worker may lack incentive to return to work as soon as possible.

Recommendations for the City Manager and Human Resources

- 5.1 Evaluate the possibility of having discussions with the various employee unions, with the objective of eliminating salary continuation benefits that exceed the limit of benefits mandated by statute.

²⁴ Section 4850.

²⁵ Sections 4653 through 4655. The Code specifies that benefits shall be 2/3 of average weekly pay for a temporary partial disability, or 2/3 of lost wages for a temporary permanent disability. Section 4453 limits average weekly earnings used to calculate disability pay to a specified amount, which is adjusted annually, or 1 ½ times the statewide average weekly wage, whichever is greater.

City Manager's Response

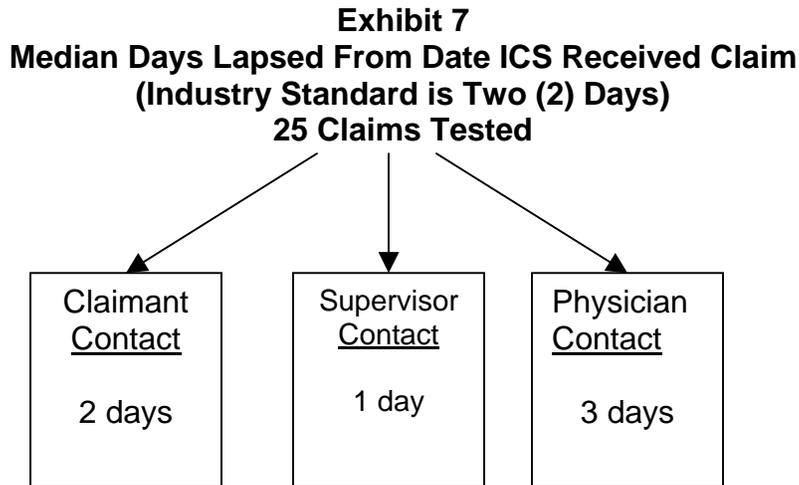
The Director of Human Resources agreed with the finding and recommendation. The recommendation will be implemented by June 30, 2010.

Finding 6: Ensure That ICS Contacts Physicians Within Industry Standard of 48 Hours

Prompt contact reduces the likelihood of litigation.

It is a best practice in workers' compensation claims administration for the employer (or employer's third party administrator, such as ICS) to make timely "three point" contact. The industry standard time for contacting the claimant, the claimant's supervisor, and the claimant's treating physician or other health care provider is within 2 days of receipt of a claim.

Prompt contact helps minimize claim costs by expediting the claim process and reducing the likelihood of a claim being litigated. ICS appears to make timely claimant and supervisor contact, but is less timely in contacting the physician.



The median days lapsed between the dates that ICS received the claims in our sample, and the dates of claimant contact was 2 days. The median for supervisor contact was 1 day.

The average time lapsed for physician contact was 4.9 days²⁶ with a median of 3 days. ICS is required under its contract with the City to maintain close contact with the treating physician, but the contract does not address timeliness of such contact. As a result, claim resolution may have been delayed.

Recommendations for Human Resources

- 6.1 Request ICS to contact the claimant's health care provider within 48 hours of receipt of a claim.
- 6.2 Modify the contract with ICS if necessary to require physician contact within 48 hours.

City Manager's Response

The Director of Human Resources agreed with the finding and recommendations. ICS formally agreed on May 4, 2009 to contact the claimant's physician within 48 hours of receipt of the claim in all lost time cases. Recommendations 6.1 and 6.2 are fully implemented.

Finding 7: Require Department Directors to Ensure Cause of Injury and How to Prevent Similar Injuries is Included in the Supervisors' Investigation Reports

Administrative Regulation 2.7 requires a supervisor to prepare a Supervisor's Investigation report within 24 hours of learning of an injury. This form includes fields to describe the incident (who/what/when/how), and to suggest ways to avoid similar incidents in the future. This information is critical to correct the situation that led to the injury and to enable HR to identify the greatest risks for future injuries.

Unsafe conditions may still exist which could result in avoidable injuries.

²⁶ This is an adjusted average. In calculating this average, we excluded one claim where physician contact was considered less important because the claimant did not lose time from work, and another where there was indication of earlier physician contact, but we could not determine the exact date. The unadjusted average was 6.5 days. Note that if the claims examiner attempted to contact the physician and left a message, we counted the date of this first attempt as the date of initial contact.

It appears that the supervisors did not attempt to determine the cause of injury in 18 percent of sampled claims. Also, in 22.7 percent, the supervisor did not state the best way to prevent similar injuries in the future. While it may not always be possible to identify the cause of an injury, the supervisor should always attempt to discover the cause, and what could be done to eliminate the cause and prevent similar injuries in the future. If unable to discover the cause, the supervisor should so state.

As a result, the conditions that led to the injuries may not have been corrected, and HR may lack the information needed to identify the greatest risks. Inspections and training may not have targeted the greatest risks, and avoidable employee injuries may continue to occur.

Recommendation for Human Resources

- 7.1 Require department directors to ensure that supervisors' describe the cause of the incident, as well as suggestions for future avoidance, in the Supervisor's Investigation Report.

Recommendation for the City Manager

- 7.2 Consider requiring the Director of Human Resources to include in the semi-annual injury and claim report (see Recommendation 3.3 above), all injuries where the supervisors failed to adequately complete all fields in the supervisor's investigation report.

City Manager's Response

The Director of Human resources agreed with the finding and recommendations. The recommendations will be implemented by September 30, 2009.

Finding 8: Provide Accounting With the Information and Authority Needed to Reconcile and Monitor the Workers' Compensation Checking Account

A City owned checking account that ICS used to pay workers' compensation costs placed City funds at risk. Both ICS and the City's Accounting unit reported difficulty monitoring the account. Accounting did not receive sufficient information to reconcile the account, and ICS reported difficulty determining if checks were paid, which resulted in at least one duplicate payment. Also, the bank's check processing may not have been reliable.

Consistent with the contract, the City provided ICS with signatory authority over a City owned bank checking account. ICS used the account to disburse workers' compensation disability pay,²⁷ fees to health care providers, and other costs incidental to a claim. The Finance Department wired funds periodically to replenish the account. ICS disbursed just over \$4.5 million from the account in fiscal year 2008.

Such an arrangement between a third party administrator and a municipality is not unusual. However, the City Manager and City Auditor may not have been fully aware that they were delegating oversight of City funds when they signed the contract. The provision is contained in an exhibit to the contract, and the City processes hundreds of contracts each year.

Accounting received the bank statement and was responsible for the monthly reconciliation. However, Accounting did not have sufficient information to reconcile timely and answer all questions that arose during the course of reconciliation. ICS provided Accounting with an abbreviated check register that only showed check number, check date, and amount. HR received a complete register that had additional columns for claim number, claimant's name, date of injury, dates of service, pay type, and payee name.

²⁷Workers' compensation salary continuation and temporary disability payments for the first 365 days of a claim are disbursed through the City's payroll system. ICS disburses temporary disability payments after 365 days. See finding 8 (subpart on "Full Pay for Non-Safety Employee") below.

According to the Accounting Manager, ICS was not authorized to provide Accounting with a complete register due to a perceived need to protect claimant identity. However, Accounting received a facsimile image of all paid checks, which identified payees (which include claimants). Therefore, HR's reluctance to provide a complete check register appears unwarranted. The Accounting Manager also stated that the bank would not provide Accounting with requested information about account transactions because Accounting was not an authorized signer for the account.

Based on two incidents described by Finance and ICS, the bank's check processing may not have been reliable. First, it appears the bank debited the City's account twice for one check. Also, the bank told ICS that another check had not cleared, when in fact it had. ICS issued a replacement check, resulting in a duplicate payment. ICS was pursuing recovery of the duplicate payment.

According to HR and the Systems Accountant, ICS began disbursing from an account at a different bank starting in January 2009. Finance plans to close the problem account by June 30, 2009.

Recommendations for Human Resources

- 8.1 Arrange for ICS to provide Accounting with a complete check register.
- 8.2 Work with ICS and the successor bank as needed to ensure that the bank is responsive to Accounting's request for information.

Recommendation for Human Resources and Finance

- 8.3 Require ICS to obtain authorization from Finance to reissue a payment.

Recommendations for the City Manager

- 8.4 Reevaluate whether it is in the City's best interest for ICS to have signatory authority over a City owned depository account. If ICS signatory authority is not considered in the City's best interest, close the successor bank account and arrange for all workers' compensation disability payments to be disbursed through the payroll system, and for all other workers' compensation costs to be disbursed by Finance. A factor to consider is the impact on the operating budgets and staffing requirements of Finance and Payroll Audit from making all payments in-house.

- 8.5 Implement a policy that, in a situation where executing a contract would result in delegating signatory authority held by the City Manager and the City Auditor, a separate instrument must be used to explicitly delegate that authority.

City Manager's Response

The Directors of Finance and Human Resources agreed with the finding and recommendations. Recommendations 8.1 through 8.4 have been fully implemented. The Director of Human Resources believes that it is in the City's best interest for ICS to retain signatory over the new checking account due to the large volume of workers' compensation payments. Recommendation 8.5 will be implemented by June 30, 2009 via an amendment to "Contracts On-Line" and creation of a form that will be used to explicitly delegate authority.

Finding 9: Report the Status of the Recommendations From the 2002 and 2004 Bickmore Risk Services Consultant Studies

The City contracted with Bickmore Risk Services for two studies. The first was a 2002 safety and risk control assessment. The second was a 2004 study of the City's workers' compensation program.

Council & City Manager still do not know if problems have been fixed.

Bickmore made over 100 recommendations for improvement in the 2002 study, and nine recommendations for improvement in the 2004 report. As of January 2009 - from five to almost seven years after the reports were issued - HR did not have available information on the implementation status of the consultant's recommendations.

The Director of HR committed to providing the auditors with a status report on the recommendations in the 2004 Bickmore report by February 28, 2009, and report to the City Manager on the status of the 2002 report by September 30, 2009. Until HR provides these status reports, the City Council, the City Manager, and the City Auditor do not have information on corrective actions taken.

Recommendation for Human Resources

- 9.1 Report on the implementation status of recommendation in the two Bickmore reports by the promised dates.

City Manager's Response

The Director of Human Resources agreed with the finding and recommendation. He will report on the 2002 report by September 30, 2009. The Director submitted a report to the City Council on April 27, 2009 that addressed part of the recommendations in the 2004 report (See Appendix A). He will report on the remaining recommendations by June 30, 2009. Recommendation 9.1 is partially implemented.

VI. FISCAL IMPACT

Implementing our recommendations should result in significant cost savings. If total workers' compensation costs could be reduced by just five percent, it would save almost \$375,000 per year.²⁸ About 48 percent of the annual savings, or almost \$180,000, should benefit the General Fund. Over a five-year period the cost savings would accumulate to almost \$1,900,000 including almost \$900,000 in savings to the General Fund.

VII. CONCLUSION

Though progress has been made in recent years, there is still room to improve the City's workers' compensation operations. First, the City can significantly reduce workers' compensation costs by implementing recommendations in the 2004 consultant study entitled *City of Berkeley Audit and Analysis of the Workers' Compensation Program*, performed by Bickmore Risk Services. Additional savings could be realized by improving the early return to work program, and by eliminating benefits that exceed statutory requirements. Costs could be further reduced if the claims administrator would contact treating physicians more timely, and if City supervisors would increase efforts to always try to determine and document the cause of an injury, and how to eliminate the cause. Lastly, controls and accountability for workers' compensation could be improved if Human Resources would more closely monitor the administrator's performance.

The City Auditor's Performance Audit Division thanks the Director of Human Resources and his staff for their cooperation. We also thank the Accounting Manager and Systems Accountant for information about the checking account used by ICS. Finally, we thank ICS management and

²⁸This amount is based on payments made in fiscal year 2008 on current and prior year claims, plus: 1) HR and Payroll Audit salaries and benefits for workers' compensation administration, 2) ICS fees, and 3) miscellaneous expenses. The costs used to calculate the annual savings do not include overhead, nor do they include the cost of vacation and sick leave used by employees while absent due to injuries.

staff for their cooperation during our visit to test claim files, and for providing information on the City's workers' compensation program.

APPENDIX A



Human Resources Department
Office of the
Director of Human Resources

April 27, 2009

To: Honorable Mayor and
Members of the City Council

From: David W. Hodgkins, Director of Human Resources

Subject: Audit of Workers' Compensation Policies and Procedures

The Human Resources Department is committed to improving the delivery of workers' compensation services, has taken action to update administrative procedures and sought the advice from outside subject matter experts to examine various aspects of the program. In January 2004, Bickmore Risk Services performed a comprehensive audit and analysis of the workers' compensation program. One of the elements of the workers' compensation program that we asked Bickmore to review and provide advice was the fiscal and budgetary impact of the program. The City requested this assistance because in the three fiscal years prior to the report, the City had experienced a significant shortfall in the Workers' Compensation Self-Insurance Fund (Fund 875) balance.

Bickmore Risk Services identified several problems with the funding and budgeting of the Workers' Compensation Self-Insurance Fund and made several recommendations to solve these problems. As a result, the Human Resources Department has implemented the following changes:

1. We have contracted for annual rather than biennial actuarial studies so that any problems with funding and budgeting are identified sooner and we are able identify trends earlier and can make adjustments. We have also had the actuarial firm present the results to the Budget Manager and the Director of Finance to enable accurate interpretation of this extremely complex report.
2. We have required the actuary to calculate and provide for the internal costs of the workers' compensation program and the third-party administrator for the calculation of Unreported Loss Allocation Expense (ULAE).
3. We have required that the actuary calculate funding rates at various confidence levels.
4. We have required actuarial assistance for the analysis of a deficit recovery plan over an appropriate term and a cost allocation plan. As a result of this advice, we charge each department its specific funding rate based on their respective loss experience by each position. This is done utilizing the State of California Department of Industrial Relations workers' compensation coding system. By

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establishing separate funding rates, higher costs are allocated to classifications with a higher workers' compensation incidence of injury and higher loss amount. The practical effect is that the aggregate cost is distributed in a way that allocates higher costs to higher risk occupations. This also takes financial pressure off the General Fund and allocates costs to other funds, e.g., the Sewer Fund for manual labor occupations.

As a result of these efforts we feel we have a better understanding of the funding of the workers' compensation program and have built up a positive fund balance in the Workers' Compensation Self-Insurance Fund.

cc: Christine Daniel, Deputy City Manager

APPENDIX B

SCOPE AND METHODOLOGY

Our audit focused on best workers' compensation practices, the City's workers' compensation policies and procedures, and claims filed by City employees in fiscal years 2004 through 2008. We researched workers' compensation laws, City policies and procedures, and shared best practices. We also reviewed various external audit reports on workers' compensation. In addition we interviewed applicable City employees and external experts. Finally, we obtained data on claims filed by City employees, and tested claims filed in fiscal years 2006 through 2008 for attributes related to best practices.

Our audit was conducted from May 14, 2008 through March 5 , 2009 and was limited to those areas specified above. We conducted this performance audit in accordance with generally accepted government audit 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 objective.

We did not evaluate the design and effectiveness of information systems controls intended to ensure reliability of the data provided by ICS or the Payroll Audit Division. The Payroll Audit Division provided limited information used in this audit. The Deputy City Auditor for Payroll Management reports directly to the City Auditor. This had no impact on the results of the audit.

This performance audit was initiated by the Auditor's Office and scheduled as part of the fiscal year 2009 Audit Plan, which was presented to Council on June 24, 2008.