



Monterey County

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Board Report

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Receive a Report of Compliance Review of County's Claims Procedures for General Liability and Workers' Compensation Claims from the Office of the Auditor-Controller and support recommendations for corrective actions.

RECOMMENDATION:

It is recommended that the Board of Supervisors:

Receive a Report of Compliance Review of County's Claims Procedures for General Liability and Workers' Compensation Claims from the Office of the Auditor-Controller and support recommendations for corrective actions.

SUMMARY:

It came to the attention of the Office of the Auditor-Controller (ACO) that certain weaknesses in internal controls around processes and procedures for managing and paying for General Liability and Workers' compensation claims exist. After discussions with the CAO and County Counsel/Risk Management it was determined that a review would be beneficial in understanding and correcting any internal control weaknesses that may be confirmed. The firm of White Nelson Diehl Evans LLP (WNDE) Certified Public Accountants & Consultants was engaged to perform the review.

The final report with recommended corrections is attached (attachment A). In addition, based on the report, the ACO has additional recommendations based on the review follow-up. These recommendations, if followed will result in cost savings, more efficient and professional investigations and processing of claims, and better transparency, reporting and accountability around management of the significant cost associated with Workers' Compensation and General Liability litigation.

DISCUSSION:

It came to the attention of the Office of the Auditor/Controller that certain weaknesses in internal controls around processes and procedures for addressing general liability and workers' compensation claims exist. After discussions with the CAO, County Counsel/Risk Management it was determined that a review would be beneficial in understanding and correcting any internal control weaknesses that exist. The firm of White Nelson Diehl Evans LLP (WNDE) Certified Public Accountants & Consultants was engaged to perform the review.

The review revealed several internal control and process weaknesses. The weaknesses needing correction include:

1. Lack of a robust Risk Management Function
2. Underutilization of Risk Management Third Party Administrator (TPA)
3. Lack of appropriate Separation of Duties
4. Incomplete/Inaccurate Internal Revenue Service (IRS) 1099 Disbursement Reporting

Lack of a Robust Risk Management Function:

For fiscal year 2016/17 alone there were \$8.95 million expenditures in the General Liability Internal Service Fund and \$20.84 million expenditures in the Workers' Compensation Fund. Managing risk to minimize the cost of litigation is critical in protecting the public interest and public assets.

Risk management is a profession that specializes in identifying potential causes of accidents or loss, recommending and implementing preventive measures, and devising plans to minimize costs and damage should a loss occur, including the purchase of insurance. The primary goal of the risk management function is to protect an organization from vulnerability and to decrease financial risks. Risk management is designed to provide protection to employees and the public from damaging events that have a direct effect on them.

In the County of Monterey, risk management is mostly utilized to process claims and acquire insurance. In a more fully functioning program, risk management would primarily be focused on risk assessment, prevention and mitigation. Additionally, the program would provide better accountability and transparency by giving regular reports of the financial impact of litigation and on the steps taken to lower the risks of loss. This is especially critical now as budgets are uncertain.

There are different types of risk management plans used to mitigate an organization's risks. Common workplace-related risks include accidents, natural disasters and fires. Legal risks include sexual harassment, fraud and theft. Risk management is useful for protecting physical facilities, securing information and protecting physical assets an organization uses or owns. Risks are properly managed in an organization by recognizing the consequences associated with individual risks and developing plans to mitigate them.

In order to properly mitigate risk, the Risk Management team must have a strong working relationship with the Office of the Auditor/Controller, the Equal Opportunity Office, County Counsel, Health Services (including the hospital), Public Safety and the Resource Management Agency.

It is also important for transparency that the Risk Manager, on a regular basis, provide a public report on General Liability and Workers Compensation costs, as well as the steps being taken to mitigate identified risks throughout the County. An example of such a public report is included in Attachment B. For brevity, only portions of the report have been included in the Attachment. Complete copies are available on-line at the County of Los Angeles website.

Underutilization of Risk Management Third Party Administrator (TPA):

Monterey County contracts for certain risk related services with an independent professional Third Party Administrator. The intended purpose of a TPA contract is to provide professional, independent and objective analysis of incidents. Separate contracts are let, one for Workers' Compensation and one for General Liability.

Contracted services for General Liability include:

- Initial incident triage
- Professional investigative services
- Damage appraisals
- Case setup documentation
- Loss reserve estimates
- Litigation Management
- Attorney and other vendor invoices examined for reasonableness and accuracy
- Resolution Plan

The attached review indicates that a significant portion of these important services are not being utilized. Subsequent follow-up by the ACO confirmed that this is the case, both with the previous TPA (Carl Warren) and the current TPA (InterCare). For example, both TPAs confirmed that per direction to the TPA by County Counsel/Risk Management, professional investigative services are mostly not being utilized, although they are paid for. Typically, untrained department personnel where the incidents occurred have performed the investigations. As such, the County is positioned to experience vulnerability in mitigating and managing risk. Because investigations are not being performed by the TPA, the TPA is unable to recommend appropriate reserves due to incomplete information.

Additionally, required Internal Revenue Service (IRS) 1099 reporting for disbursements could not be properly reported by the TPA. The TPA has had to rely on information provided by County Staff, rather than have firm, first-hand knowledge of facts regarding disbursement of awards. The deficiency with respect to TPA incident investigation and control has led to improper U.S. Department of the Treasury, Internal Revenue Service Form 1099 in reporting.

The current contract with InterCare is a fixed fee contract for \$328,000 annually. However, as mentioned, the County is not receiving the benefits of most of these annual expenditures. If these paid for services were to be utilized, County staff now performing these duties would be free to conduct their normal functions. This results in cost savings and the efficient use of internal County resources.

It is important to see Attachments C & D for more detailed benefits and deficiencies.

Lack of Appropriate Separation of Duties:

Segregation of Duties (SOD) is defined by the American Institute of Certified Public Accountants (AICPA) as; "a basic building block of sustainable risk management and internal controls for a business. The principle of SOD is based on shared responsibilities of a key process that disperses the

critical functions of that process to more than one person or department. Without this separation in key processes, fraud and error risks are far less manageable.”

In Monterey County, all responsibilities around General Liability and Workers’ Compensation claims investigation, negotiation, litigation and settlement are concentrated in one office, County Counsel. County Counsel is responsible for TPA contract and service monitoring, and has unilateral authority to settle cases under \$100,000. And, per County Counsel, unilateral authority to contract and pay for some outside counsel services. The intended purpose of a TPA contract is to provide professional, independent and objective analysis to the Risk Manager and County Counsel. Risk Management is intended to analyze, manage and mitigate overall County risk. Additionally, the TPA provides an independent professional perspective in addition to County Counsel to assist the Board of Supervisors in determining which claims to settle and which to defend.

The attached WNDE review was provided to Carl Warren, our previous TPA for General Liability, in April 2016. The ACO was contacted by executive management of Carl Warren requesting an in-person meeting to discuss the findings of the review. That meeting occurred on April 19, 2016. At that meeting, executive management confirmed the accuracy of the review. Additionally, they enumerated the same concerns that InterCare has provided in Attachments C & D. In July of 2016, County Counsel did not elect to exercise optional contract extensions with Carl Warren, and they were replaced by InterCare as the General Liability TPA.

Incomplete/Inaccurate Internal Revenue Service (IRS) 1099 Disbursement Reporting:

The WNDE review revealed that of a sample of 16 General Liability disbursements, 10 were incorrectly reported per IRS 1099 reporting requirements.

At the April 19, 2016 meeting with Carl Warren, the question was presented as to why this had occurred. They indicated that because of direction from County Counsel not to participate in most investigations, that they were not privy to pertinent details of the settlements and therefore were forced to rely solely on information provided by County Counsel to make the IRS 1099 reporting. Therefore, they did not have the ability to review the information for reporting accuracy. As a result, the 10 reporting exceptions were 1099-MISC forms that were properly reported with the attorneys, but not with the plaintiffs.

As the TPA (Carl Warren) was making disbursements for settlements based on County Counsel direction, Carl Warren was responsible for preparing and forwarding IRS 1099-MISC forms. However, it is the responsibility of the ACO to ensure that “proper” IRS 1099 reporting occurs on behalf of the entire County. Because of the findings of this review, the ACO is compelled to review previous years IRS 1099-MISC reporting and make any needed corrections following the IRS 1099 correction procedures. County Counsel is now requesting that the ACO review and approve all disbursements related to settlements. This is a positive step in mitigating this issue proactively.

RECOMMENDATIONS:

The Office of the Auditor/Controller recommends the following to address the internal control

weaknesses identified in this report:

- 1) Follow the County of Los Angeles Model for Management of Countywide risk, including but not limited to:
 - a. Transfer of the Risk Management function and resources from County Counsel to either the CAO or Human Resources. This will provide for more balanced and complete information when determining litigation issues.
 - b. Direct that the County Administrative Office (CAO) contract for and manage the TPA services around all General Liability and Workers' Compensation claims
 - c. Direct the Director of Human Resource to create a "Risk Manager" classification, work with the CAO to determine an appropriate financing source and initiate a recruitment
 - d. Direct the County Counsel to revise all local codes and ordinances to transfer all Risk Management responsibilities, including financial responsibilities to the newly created "Risk Manager." Changes to the codes and ordinances eventually to be approved by the Board of Supervisors.
 - e. Create a risk oversight board comprised of the County Counsel, Risk Manager, Auditor/Controller and CAO, or their designee to ensure that all aspects and possibilities around settlements and litigation have been considered. If consensus is not reached, then the Board of Supervisors should provide the final decision.
 - i. For example: In the County of Los Angeles, the Claims Board approves settlements above \$20,000, up to and including \$100,000. The Claims Board also reviews proposed settlements over \$100,000 and refers such settlements, with a recommendation, to the Board of Supervisors for final action. The Claims Board's settlement recommendations generally appear on the Board of Supervisors' agenda two weeks after the Claims Board has acted.
 - ii. Limits for the County of Monterey to be defined per Board direction.

OTHER AGENCY INVOLVEMENT:

The CAO, Human Resources, County Counsel/Risk Management were integral to this review.

It is worthy of note that the attached review is dated April 15, 2016, almost 18 months from the date of this Board Report. This late presentation is because it is the policy of the ACO to attempt to work with Departments to secure solutions for deficiencies reported, prior to presentation to the Board. This is to assure the public and the Board that solutions are already in place, or that they are being implemented. This review is no exception. Working with the above-mentioned Departments, it was eventually agreed that the County would use the County of Los Angeles risk management approach as a model for our own risk management needs. However, as of the date of this report, the ACO cannot report any substantial progress towards this goal.

FINANCING:

The cost of this review was absorbed in FY2015-16 appropriations. No additional financing is necessary.

BOARD OF SUPERVISORS STRATEGIC INITIATIVES:

The Board's most recent Strategic Planning Workshop was dedicated to making Monterey County government more transparent and accountable. Internal controls are the most basic building blocks of transparency and accountability of any business. Government is no exception. Weak internal controls lead to financial waste and operational inefficiencies. The recommendations provided above will help insure that the Board of Supervisor, the Auditor/Controller, the Risk Manager and the County Counsel are more confident that the funds entrusted to the County Government are more properly safeguarded.

Mark a check to the related Board of Supervisors Strategic Initiatives

- ☐ Economic Development
- ☒ Administration
- ☐ Health & Human Services
- ☐ Infrastructure
- ☐ Public Safety

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Attachments:

- (A) Report of Compliance Review of County's Claims Procedures for General Liability and Workers' Compensation Claims - White Nelson Diehl Evans LLP, Certified Public Accountants & Consultants
- (B) Portions of the County of Los Angeles Annual Risk Management Report
- (C) Letter from InterCare TPA to the Auditor/Controller dated April 21, 2017
- (D) Letter from InterCare TPA to the Auditor/Controller dated November 13, 2017