

October 3, 2003

Internal Audit Report 2003-11
Ward North Contract Compliance
Risk Management
Municipal Manager

Introduction. Since 1976 the Municipality of Anchorage (Municipality) had contracted for professional services with Scott Wetzel Services, Inc. (Wetzel) to provide claims adjusting services and appraisal and data processing services for all workers' compensation, general and automobile liability claims. In November 1998, in connection with Wetzel's bankruptcy, Ward North America Holding, Inc. (Ward North) purchased substantially all of Wetzel's operating assets. Ward North has continued to provide these services to the Municipality. In 2002 Ward North processed 892 claims, paying out \$3.9 million on those claims.

Objective and Scope. The objective of this audit was to determine whether Ward North is complying with the contract requirements for claims adjusting services. As part of our audit, we reviewed 54 claims from May 2002 to May 2003. Specifically, these claims were randomly selected and reviewed for contract compliance and consisted of both open and closed workers' compensation and liability claims. A judgmental sample was also selected to review and verify the status of 31 open claims prior to May 2002.

The audit was conducted in accordance with generally accepted government auditing standards, except for the requirement of an external quality control review, and accordingly, included tests of accounting records and such other auditing procedures as we considered necessary in the circumstances. The audit was performed during the period of May through August 2003. The audit was requested by the Administration.

Overall Evaluation. Ward North had not complied with many contract requirements for adjusting claims for the Municipality. In our opinion, there is potential for cost savings to the Municipality in workers' compensation, general and automobile liability claims if the contractor better managed claims in compliance with the contract. Specifically, our review found contract deliverables were not clear or measurable, open claims had not been properly managed, and adjusters did not have the required experience. In addition, reserves were not reflective of the ultimate probable cost of the claims, subrogation had not been adequately identified or pursued and adjusters had not been consistently supervised. Finally, required back injury statements had not been taken; the Modified Work Program was not effectively coordinated; and the Municipality may be unnecessarily paying for the cleanup of sewer backups.

FINDINGS AND RECOMMENDATIONS

1. Contract Deliverables Not Clear or Measurable.

- a. Finding.** Although the contract providing claims adjusting services contained some specific deliverables, most deliverables could not be measured or were not clearly defined. For example, no time frames were specified to ensure claims were processed timely and employees returned to work as soon as medically feasible. In addition, the contract also states the contractor is to "Provide a competent claims examiner/director to supervise the Contractor's Anchorage Office's investigations evaluations of claims made against Anchorage." However, the contract did not specify what experience a competent claims examiner/director should possess.

We also found the contract did not contain any requirements for maintenance of claim files. During our review, we found claim documents had not been filed for three months and the documents in the files were not compiled in an organized manner. Furthermore, we found some files contained duplicate copies of invoices and medical records with multiple files for one claim. Proper records management is

necessary for effective claims processing. Additionally, there were no performance incentives set forth in the contract.

Specific and clearly defined deliverables provide the Municipality with the ability to monitor contracts toward the accomplishment of intended goals. On the other hand, vague deliverables increase the risk of disagreement and confusion between the Municipality and contractor. As such, the contract may not accurately reflect what needs to be accomplished.

- b. **Recommendation.** To help improve contract administration, the Risk Management Division should establish clearly defined and measurable contract deliverables. Further, performance incentives should be used to help enhance performance. For example, payments could be withheld if the contractor does not provide the required deliverables.

- c. **Management Comments.** Management concurred and stated, “Risk Management will work with appropriate personnel to develop a new contract to include “time frames” for performance and experience requirements for the adjusting staff, supervisors and manager. Additionally the contract should specify case loads and require approval of adjusting staff prior to assignment to Municipal account. To be included in next required RFP for 12/31/04.”

- d. **Evaluation of Management Comments.** Management comments were responsive to the audit finding and recommendation.

2. **Open Claims Not Properly Managed.**

- a. **Finding.** Ward North was not properly managing all open claims. During our review of 31 open claims initiated prior to May 2002, we found 9 instances where

the claim had not been properly coded to reflect its current status. For example, we found one case from 1986 involving a police officer who was fatally wounded. As of July 2003, this case was coded as “Rehabilitation”. We further noted 8 instances where the adjuster had not worked on the claim for at least 90 days. For example, Ward North had agreed to file a Compromise and Release for a worker’s compensation claim that had been open since 1999; however, they have been waiting for the Compromise and Release to be signed and filed since December. As of July 2003, the adjuster had not followed up on this case to determine the status of the Compromise and Release.

As of July 2003, there were 316 open claims dating back to 1980, as shown in the following table.

Year of Loss	Number of Claims Still Open
2003	135
2002	83
2001	34
2000	22
1995-1999	34
1980-1994	8
Total Open Claims	316

- b. Recommendation.** The contract administrator should ensure Ward North is properly managing all of the open claims and trying to resolve them in an expeditious manner.

- c. **Management Comments.** Management concurred and stated, “Risk Management reviews and provides direction to Ward North for claims reserved over \$20,000 on a monthly basis. Risk Management will require Ward North to input all discussions regarding specific claims into the ACMS data base to allow Risk Management to track the adjuster’s compliance with our direction. Began this process 9/3/03 with Sept. review.”
- d. **Evaluation of Management Comments.** Management comments were responsive to the audit finding and recommendation.

3. **Inadequate Adjusting Experience.**

- a. **Finding.** Our review of Ward North’s Anchorage office staff resumes revealed three of the eight adjusters in the Anchorage office did not have the experience required by the contract. The contract states that “. . . claims adjusters provided by Contractor to handle workers’ compensation or liability claims against Anchorage shall have no less than three years of experience as adjusters.” We found one adjuster currently assigned to handle the Municipality’s workers’ compensation claims had only one and a half years adjusting experience. In addition, the adjuster assigned to handle the Municipality’s “medical only” claims had only 2 years of adjusting experience which also did not meet the required three years of experience to adjust claims. Finally, the third adjuster assigned to handle excess workers’ compensation claims for the Municipality did not have any experience adjusting claims. Although he has been a workers’ compensation attorney for 20 years, he has not adjusted claims.
- b. **Recommendation.** The contract administrator should ensure adjusters meet the minimum experience requirements required by the contract.

- c. **Management Comments.** Management concurred and stated, “Will be contained in 12/31/04 RFP & Contract.”
- d. **Evaluation of Management Comments.** Management comments were responsive to the audit finding and recommendation.

4. **Reserves Not Reflective of Ultimate Probable Cost.**

- a. **Finding.** Our review of reserves for 43 claims revealed that the estimated costs for 26 claims were not adequate to pay the final costs of the claims. The claims we reviewed were undervalued by up to \$83,472, indicating that reserves were not properly set. For example, estimated costs for one claim were \$13,452, but current costs are \$62,106, and still accruing. The contract states that “Initial and subsequent claim reserves will reflect Contractor’s best judgment of ultimate probable cost.”

According to Risk Management, having improper reserves affects the status of the Municipality’s self-insured certificate with the State of Alaska Workers’ Compensation Board. The self-insured fund balance is based on an actuarial study derived from the reserves set by Ward North. If the reserves are not adequate to cover the ultimate probable cost of the claim, then the Municipality’s self-insured fund will be underfunded. Consequently, the Municipality may not be able to pay for potential claims when they occur. In addition, the Alaska Workers’ Compensation Board may not issue the Municipality its Certificate of Self-Insurance.

- b. **Recommendation.** The contract administrator should monitor the contract to ensure proper reserves are set and the Municipality retains its Certificate of Self-Insurance.

- c. **Management Comments.** Management concurred and stated, “Risk Management has been working with adjusting staff to post more realistic reserves. Addressed monthly in claim review.”
- d. **Evaluation of Management Comments.** Management comments were responsive to the audit finding and recommendation.

5. **Subrogation Not Identified or Pursued.**

- a. **Finding.** In 11 of 18 claims we reviewed, Ward North did not identify and pursue subrogation¹ interests. For example, in March of 2003, a Municipal employee was injured on the job while inspecting a building. A potential subrogation interest was identified early in the life of the claim. However, the claim was closed in May of 2003 and the subrogation interest was never followed-up on. The contract states the Contractor will attempt to identify all subrogation interests for each claim and conduct necessary follow-up.
- b. **Recommendation.** The contract administrator should monitor the contractor to ensure that subrogation interests are adequately pursued.
- c. **Management Comments.** Management concurred and stated, “Risk Management has been reviewing and providing direction for all claims with subrogation potential prior to submission to Ward North. Risk Management will work to revise contract for professional claims adjusting services to include a performance incentive for the contractor to pursue all subrogation interests on a percentage basis. Contain clause in RFP and Contract 12/31/04. Consider Legal handling WC subrogation.”

¹ To substitute a third party in place of the party having the claim, demand, or right against another party.

- d. **Evaluation of Management Comments.** Management comments were responsive to the audit finding and recommendation.

6. **Inadequate Supervision of Adjusters.**

- a. **Finding.** In 24 of 50 claims we reviewed, claims adjusters were not adequately supervised. For example, from August 2002 through December 2002, Ward North did not provide a competent claims examiner/director to supervise the claims adjusters. The contract states that the contractor is to “Provide a competent claims examiner/director to supervise the Contractor’s Anchorage Office’s investigations evaluations of claims made against Anchorage.”
- b. **Recommendation.** The contract administrator should ensure a competent claims examiner/director is provided to supervise the claims adjusters as required by the contract.
- c. **Management Comments.** Management concurred and stated, “Risk Management will work to rewrite the contract to require the contractor provide a substitute manager and supervisor for all periods of absents by a supervisor or manager in excess of 5 working days. Contain clause in RFP and contract 12/31/04.”
- d. **Evaluation of Management Comments.** Management comments were responsive to the audit finding and recommendation.

7. **Back Injury Statements Not Taken.**

- a. **Finding.** During our review of 12 claims involving back-related injuries, we found no evidence that statements had been taken in all 12 instances, as required by the contract. The contract states, “A statement will be taken on all back injury cases,

covering prior work and medical history regarding the injured claimant, the circumstances of the incident and all other facts relevant to the claim.”

- b. **Recommendation.** The contract administrator should ensure that statements are taken for claims involving back related injuries as stated in the contract.
- c. **Management Comments.** Management concurred and stated, “Risk Management will ensure a statement has been taken for each back claim to insure compliance with contract. Immediately.”
- d. **Evaluation of Management Comments.** Management comments were responsive to the audit finding and recommendation.

8. **Modified Work Program Not Effective.**

- a. **Finding.** The Municipality does not have an effective coordinated program to return employees out on Workers’ Compensation injuries to productive employment as soon as possible. As a result, individuals that should return to work may not be returning to work. Policy and Procedure (P&P) 40-12, Modified Work Program, established a Modified Work Program Coordinator (coordinator) in the Employee Relations Department to help ensure Municipal employees who incur a work-related injury or illness while working for the Municipality participate in the Modified Work Program. We asked Ward North if they knew who coordinated the Municipality’s Modified Work Program. Ward North did not know and stated that they typically deal directly with Municipal departments. We also asked four Municipal Departments, having workers’ compensation claims, who the coordinator was for the Municipality. One department did not know and all four Departments stated that they worked directly with Ward North. In addition, departments we talked to did not seem adequately trained regarding the Modified Work Program.

Furthermore, we asked the Modified Work Program Coordinator how the program was working and was told P&P 40-12 was not current and no one followed it. We also asked the coordinator for a listing of all employees currently on workers' compensation and a list of all employees on light work duty. The coordinator was unable to provide this information stating it was maintained in a PeopleSoft database for OSHA reporting purposes. Although an injury and illness incident report (OSHA log) is maintained on a PeopleSoft database, it does not contain current or complete information regarding the status of employees on workers' compensation, and efforts made to return them to work using a modified work program. Finally, the coordinator stated that the Municipality could save money if someone was dedicated full-time to coordinate workers' compensation issues with returning employees to work. However, the Position Description for the position identified as the Modified Work Program Coordinator states, among other assigned duties, that the coordinator is responsible for:

- The implementation, coordination and administration of the Modified Work Program.
- Revising and developing policies and procedures to ensure communication and consistency throughout the Municipality.
- Providing on-going support to departments in developing and monitoring light duty jobs.
- Obtaining information from medical providers to allow for light duty release to work.
- Provide training as needed.

b. **Recommendation.** The Employee Relations Director should evaluate the Municipality's program to return employees to work that are out for work related

injuries. The review should include the adequacy of P&P 40-12 as well as how the Modified Work Program should be coordinated.

- c. **Management Comments.** Management (Employee Relations) stated, “Employee Relations agrees that an evaluation of the Municipality’s Modified Work Program is in order. P&P 40-12 is grossly out-of-date and has not been updated to include language relative to changes in federal employment law. *P&P 40-12 should be rescinded immediately* and redrafted to include these updates as well as to provide better direction to Departments on their duties and responsibilities. A draft revision was previously submitted to two prior Administrations with no action being taken. Employee Relations and Risk Management will dust this document off, make any appropriate adjustments and re-submit it to the Municipal Manager for action. In the meantime, a memo reminding Department Heads who to contact for assistance when a staff member is able to return to modified work will be sent out.

“Part of the evaluation of this program will include a review of what would be appropriate staffing to implement and monitor an effective Modified Work Program. Experience suggests that the amount of work relative to tracking employees who are off on Workers Compensation and seeing that they are placed back to work as soon as they are released to light duty is sufficient to warrant a new position either in Risk Management or Employee Relations. The savings relative to Workers Compensation dollars spent should be sufficient to cover the expense of an additional position.

“It is evident from the Audit findings that only the tip of the iceberg, those most visible Workers Compensation Modified Work Program situations, are currently being monitored. In order to assure that Municipal workers compensation dollars are not being wasted, the program evaluation and revitalization should be undertaken as soon as possible.”

Management (Risk Management) stated, “Do not entirely concur---A new P&P 40-12 was submitted by what has been identified in this audit as the ‘Work Program Coordinator’ and Risk Manager in 1998 to both the City Manager and Employee Relations Director. It was never submitted to the Assembly. Recommend is be resubmitted. Further Risk Management sees the position of ‘Work Program Coordinator’ being transferred to Risk/Safety to ensure coordination of the Modified Work Program as required by both versions of P&P 40-12, as well as coordinate disciplinary issues and substance abuse programs. Also to insure all programs are in compliance with the FMLA and ADA. Return to work programs should not be a negotiable issue in contract negotiations. Immediately.”

- d. **Evaluation of Management Comments.** Although management only partially concurred, management’s comments were responsive to the audit finding and recommendation.

9. **Unnecessary Sewer Expenditures.**

- a. **Finding.** The Municipality may be unnecessarily paying for the cleanup of sewer backups resulting from general liability claims processed through Ward North. According to Ward North, in 2002 the Municipality paid \$144,840 for cleaning up sewer backups regardless of liability. For example, on April 28, 2003, the Municipality responded to a sewer backup caused by an uncapped sewer clean-out pipe located in the crawl space of a commercial building. The Municipality paid \$19,894 to cleanup this sewer backup, without determining liability. There is currently no Municipal Code or Utility Tariff requiring the Municipality to pay for sewer cleanup that it was not liable for. As a result, the Municipality may be spending more than is necessary to fulfill its obligation to the general public.

According to Risk Management staff, the Municipality is one of only a few cities in the country that voluntarily pays for all sewer cleanup regardless of liability. The Municipality has already taken some steps to reduce the cost of sewer backups by informing the general public on how to prevent them. Risk Management, working with Anchorage Water and Wastewater Utility, produced a brochure explaining how to prevent backups and what the Municipality's responsibilities are, as well as suggesting homeowners purchase a sewer and water backup endorsement under their homeowner's policy.

Other cities have done more to fund the cleanup of sewer backups. For example, cities in North Dakota and Washington have established policies limiting the amount the city will pay for sewer backups, regardless of liability. Further, Kennewick, Washington, has created a separate sewer cleanup fund by placing a surcharge of up to 2 percent on sewer accounts. This surcharge is then placed in a separate fund and the sewer cleanup charges are paid from this fund, instead of from city funds.

- b. **Recommendation.** The Municipality should consider alternate methods for funding cleanup of sewer backups. In addition, the Municipality should consider seeking reimbursement for costs associated with sewer cleanup where the Municipality is not at fault.
- c. **Management Comments.** Management concurred and stated, "Risk Management will explore alternate methods for funding cleanup of sewer backups. In addition, the Municipality will seek reimbursement for costs associated with sewer cleanup where the Municipality is not at fault."
- d. **Evaluation of Management Comments.** Management comments were responsive to the audit finding and recommendation.

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Discussion With Responsible Officials. The results of this audit were discussed with appropriate Municipal officials on August 25, 2003.

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