

September 13, 2007

Internal Audit Report 2007-10
Contract Compliance
NovaPro Risk Solutions, LP
Risk Management Department

Introduction. Since 1998, the Municipality of Anchorage (Municipality) has contracted for professional services with NovaPro Risk Solutions, LP (NovaPro), formerly Ward North America Holding, Inc., to provide adjusting, appraisal and data processing services for all workers' compensation, general liability and automobile liability claims. In January 2005, the Municipality renewed its contract for claims adjusting services with NovaPro for a maximum annual fee of \$425,000 for the first year. The contract also contains four one-year renewal options that include a yearly increase in contract fees of 4 percent over the prior year. In 2006, NovaPro received 753 new claims for the Municipality and, according to Controller Division staff, the Municipality disbursed a total of \$6,441,159 for workers' compensation, general liability and auto liability claims.

Objective and Scope. The objective of this audit was to determine whether NovaPro complied with the contract requirements for claims adjusting services, especially with the specific measurable objectives in Appendix A of the contract. Specifically, we selected a total of 111 workers' compensation, general liability and automobile liability claims and reviewed the claim files for contract compliance. In addition, we reviewed resumes and licenses for NovaPro staff working on Municipal claims to ensure staff had the required work experience and were licensed with the State of Alaska. Moreover, we tested if NovaPro submitted the required reports and made timely payments on claims in accordance with Alaska State Statutes. Finally, we followed up on prior audit findings contained in audit reports 2003-11 and 2004-11.

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 July 2007. The audit was requested by the Administration.

Overall Evaluation. Generally, NovaPro complied with the contract requirements for claims adjusting services. However, some of the specific measurable objectives listed in Appendix A of the contract needed improvement. Initial reserves were not always timely set and the three-point contact was made late. In addition, we found that the NovaPro branch manager was not licensed with the State of Alaska and did not have the required seven years of multi-line experience. Finally, our follow-up on prior audit findings revealed that back injury statements were not taken, the Municipality has not yet adopted a policy and procedure for sewer and water cleanup, and Municipal Policy and Procedure (P&P) 40-12, *Modified Work Program*, was not in compliance with federal regulations and had not been officially rescinded.

FINDINGS AND RECOMMENDATIONS

1. Back Injury Statements Not Taken.

- a. Finding.** NovaPro staff did not obtain statements for back injury claims. During our review of eight claims involving back-related injuries, we found statements had not been taken for all eight claims. The contract, Appendix A, Section D.1, states: “A telephonic 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.” A similar finding was identified in prior audit reports 2003-11 and 2004-11.
- b. Recommendation.** The contract administrator should ensure that statements are taken for claims involving back-related injuries as required by the contract or revise the contract accordingly.

- c. **Management Comments.** Management concurred and stated, “Currently, the Workers Compensation Coordinator and the Risk Manager do a monthly review of all claim files reserved and incurred over \$20,000.00. We also note on Medical Only claims a recorded interview should be taken. It was the impression of the Nova Pro Manager that statements were only taken on Time Loss files. This has been corrected and the Workers Compensation Coordinator will do a monthly random check.”
- d. **Evaluation of Management Comments.** Management comments were responsive to the audit finding and recommendation.

2. **Specific Measurable Objectives Not Always Met.**

- a. **Finding.** Overall, claims were actively managed by NovaPro staff, including detailed claim notes and plans of action to bring claims to a timely conclusion. However, we found that two of the specific measurable objectives required by the contract could be improved. Our review revealed the following:

Initial Reserves Not Always Timely Set - We found that for 5 of 63 claims (8%) the initial reserves were not set within 7 days of receipt of the claim. The contract, Appendix A, Section B.1, states: “Timely Reserves: Initial reserves set within 7 days of receipt of claim by Ward North America, LP.” Initial reserves should be timely set to ensure claims are covered by adequate funds.

Three-Point Contact Made Late - For 13 of 63 claims (21%) the required three-point contact was late. While 11 of those 13 claims were between one and five days late, we found two claims where the contact had been made weeks after the incident happened. The contract, Appendix A, Section B.2, states: “Contact: One business day for claims received at WNA [Ward North America, now NovaPro] by 3:00 PM. Claims received after 3:00 PM, one business day from the following business day.”

Generally, when claimants are timely contacted, the claim has a better chance of progressing smoothly and costs may be reduced.

b. Recommendation. The contract administrator should ensure that reserves are timely set and the three-point contact is timely made in accordance with the contract.

c. Management Comments. Management concurred and stated,

“a. Initial Reserve Not Always Set Timely-8% of files reviewed had this deficiency.

“It is possible that these deficient files were the result of a prior adjuster’s work load who had a medical retirement. NovaPro has since replaced the adjuster. Risk Management will request a monthly report on timely reserves in the future. Also note that the local NovaPro office has the authority to set reserves up to \$250,000.00. Reserves over \$250,000 have to be set by NovaPro’s corporate office, after receiving instructions from Risk Management. If a reserve has to be set above \$250,000 on a Friday or during vacation time it can cause a delay in setting the reserve.

“b. Three Point Contact Not Always Made-21% or 13 of 63 claims were late.

“This could be a result of the prior adjuster who took medical leave. We are working very closely with NovaPro to entirely reduce or eliminate this deficiency.”

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

3. **NovaPro Manager Not Licensed.**

- a. **Finding.** Although NovaPro's branch manager was licensed in another State, the branch manager was not licensed with the State of Alaska as required by the contract. Appendix A, Section C, of the contract states that, "All adjusters, supervisors, managers & directors are to be licensed with the State of Alaska." A license generally ensures that the person holding the license has knowledge of applicable State laws and regulations and of those areas which are important when acting on behalf of an insured when negotiating and settling claims.

In addition, we found that the branch manager did not have the required seven years of multi-line experience. The contract, Appendix A, Section C, states, ". . . and managers must have a minimum of seven years multi-line experience." Since the term multi-line was not defined in the contract, we researched the term and found it referred to multiple types of claims including, but not limited to, general liability, professional and products liability, mobile homes, workers' compensation and automobile liability. While the branch manager has the required professional experience for workers' compensation claims, she has little experience with general and automobile liability claims. Without a thorough knowledge of the subject matter, it may be difficult to perform the required file review and to properly support adjusting staff.

- b. **Recommendation.** The contract administrator should ensure that the branch manager is licensed in the State of Alaska and has the professional experience as required by the contract.
- c. **Management Comments.** Management concurred and stated,

"Licensed in the State of Washington

“All NovaPro adjusters are licensed as individuals in a firm with the State of Alaska and the Manager will be licensed by year end. As to experience, while the current manager was a paralegal dealing in multi-line claims her claim experience has been primarily in Workers Compensation. For part of the contract year I had a corporate supervisor monitoring the general liability and automobile liability claims. Once I became comfortable with the general/automobile liability adjuster and the overview of the claims by Claim Officer David Baldwin and myself, as well as the Legal Department, I eliminated this requirement. The NovaPro Manager still supervises the administrative aspect of the general/automobile liability claims but basically Risk Management and the Legal Department monitor this adjuster directly. At contract renewal I will eliminate this requirement.”

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

4. **Unnecessary Sewer Expenditures.**

- a. **Finding.** The Municipality may be unnecessarily paying for the cleanup of sewer backups and water main line breaks resulting from general liability claims processed through NovaPro. According to Risk Management staff, the Municipality paid about \$248,399 for sewer and water claims in 2005, \$81,718 in 2006, and \$196,170 through May 31, 2007, regardless of liability. For example, on March 21, 2007, the Municipality responded to a sewer service line break caused by a broken fire hydrant due to the unusually cold weather. The sewer service line break resulted in damage to the garages and storage areas of an adjacent four-plex. The Municipality paid \$24,161 for cleanup for this claim even though the city denied liability since forces of nature caused the problem. There are currently no Municipal code, policy and procedure, or utility tariff requiring the Municipality to pay for sewer or water cleanup that it is not liable for. As a result, the Municipality may be spending more

than is necessary to fulfill its obligation to the general public. A similar finding was identified in prior audit report 2003-11.

According to Risk Management staff, the Municipality is one of only a few cities in the country that voluntarily pays for sewer and water cleanup, regardless of liability. Other cities have established policies limiting the amount the city will pay for sewer backup and water line breaks or have created separate sewer and water cleanup funds by placing a small surcharge on water and sewer accounts.

- b. **Recommendation.** The Risk Manager should ensure that the Municipality has an officially adopted policy and procedure in place, defining what is covered, authorizing the discretionary financial cleanup assistance and governing the process.

Corrective action had progressed during the audit to correct these deficiencies. The Risk Management Department has written a policy and procedure to establish a limit on the amount the city will pay for water and sewer cleanups. The policy and procedure is currently in the process of being officially adopted and approved.

- c. **Management Comments.** Management concurred and stated,

“Paying for Cleanup

“The Municipality has had this procedure to eliminate a health hazard as well as to buy time until we complete the liability investigation. This has been a public relations gesture on behalf of the Municipality for over 20 years. It was Risk Management that identified the rising costs of these cleanup call outs. I instructed Claim Officer David Baldwin to gather information from other jurisdictions and work on a policy draft to limit our exposure to \$5,000.00 per occurrence. The policy was submitted to the Legal Department over two years ago. I am pleased to say that

of last week, under the direction of our new City Attorney, the policy is out of committee and on its way to the Office of Management and Budget for the next step in the process.”

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

5. **P&P 40-12 Not in Compliance With Federal Regulations.**

- a. **Finding.** In 2003, P&P 40-12 was rescinded by a memorandum from the Mayor to the Employee Relations Director. The memorandum stated: “This memo is to notify you that I am rescinding P&P 40-12, Modified Work Program. It has come to my attention that this P&P is out of date and does not comply with ADA [Americans With Disabilities Act] and FMLA [Family and Medical Leave Act] regulations that were passed since the P&P was written in 1991.” The Mayor’s memorandum further requested, “I direct you to work with the Risk Manager and others to develop a new policy that takes the federal regulations into consideration and will provide a workable document for Department Heads to follow when an injured employee is able to return to light duty.”

Despite the Mayor’s request, we found that P&P 40-12 was still included in the official Municipality of Anchorage Policy and Procedure Manual and had not been revised to comply with federal regulations nor been updated to reflect current Municipal business practices. Without proper policies and procedures, duties and responsibilities for the Modified Work Program may not be clearly defined and assigned. In addition, without a current P&P it may be difficult to administer the program. Finally, non-compliance with federal regulations may expose the Municipality to litigation and, consequently, may lead to a loss of funds. A similar finding was identified in prior audit report 2004-11.

- b. Recommendation.** The Employee Relations Director should ensure that the 1991 version of P&P 40-12 is rescinded and removed from the Municipality of Anchorage Policy and Procedure Manual. In addition, a new policy and procedure should be developed that more fully considers federal regulations and current Municipal business practices.
- c. Management Comments.** Management stated, “ER agrees with your audit findings. The PP is grossly out of date. I have cancelled the old P and P to avoid any future confusion.”
- d. Evaluation of Management Comments.** Management comments were responsive to the audit finding and recommendation.

Discussion With Responsible Officials. The results of this audit were discussed with appropriate Municipal officials on July 19, 2007.

Audit Staff:
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