

# **Liability Claims Audit Report**

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# INTERNAL AUDIT DEPARTMENT

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#### **Authorization**

We have conducted an audit of the Risk Management Department's Liability Claims. This audit was conducted under the authority of Article VII, Section 5 of the Garland City Charter and in accordance with the Annual Audit Plan approved by the Garland City Council.

# Objective

- 1. Determine if segregation of duties is in place and operating effectively.
- 2. Verify accuracy and test for irregularities of liability claims.

# **Scope and Methodology**

We conducted this performance audit in accordance with Generally Accepted Government Auditing 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. This included a review of current processes within the Risk Management and Finance Departments, the use of stratified samples for testing and an analysis using Benford's Law (see Exhibit A). We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives. Our audit scope focused on liability claims filed with the City of Garland from October 1, 2009 thru January 31, 2012.

While we report to the Mayor and City Council and present the result of our work to the Audit Committee, we are located organizationally outside the staff or line of management functions we are auditing. Therefore, this Audit organization may be considered free of organizational impairments to independence to audit internally and report objectively to those charged with governance.

To adequately address the audit objectives, we:

- Obtained and reviewed Risk Management policies and procedures regarding the filing of liability claims with the City. (Obj. 1 & 2)
- Developed a flow chart to better understand the process of filing, investigating and paying liability claims. (Obj. 1 & 2)
- Used Benford's Law to compare previous fraudulent activity with current data to test for irregularities. (Obj. 2)
- Analyzed access rights to the Financial system as well as batch entries and approvals to ensure segregation of duties. (Obj. 1)
- Obtained Risk Management Log sheets (RM Logs) and City Secretary Log (CS Logs) sheets for gap analysis and data mining. (Obj. 2)
- Used Excel's ActiveData feature to select different samples for each analysis performed. (Obj. 1 & 2)
- Used the full population in the General Ledger to search and resolve any outlying or duplicate data. (Obj. 2)

- Used stratified samples across four years of data to reconcile the General Ledger with the RM Log sheets and vice versa to ensure that claims processed matched claims paid. (Obj. 2)
- Obtained and reviewed physical documentation to ensure:
  - Clear documentation showing appropriate ownership of damaged property. (Obj. 2)
  - Appropriate approvals from the Finance Department. (Obj. 1)
  - Appropriate documentation of the investigation. (Obj. 2)
  - Notification to the affected department. (Obj. 2)
- Used internet search engines, Secretary of State website, PublicData.com and telephone contacts to review and research estimate invoices provided by claimant to ensure businesses used were legitimate.
- Sampled invoices to ensure VIN #s listed on the invoice matched the vehicle involved. (Obj. 2)
- Sampled invoices to ensure no alterations were detected. (Obj. 2)
- Obtained front and back cleared check copies and compared to signatures on submitted claim forms to detect possible fraud. (Obj. 2)

#### **Overall Conclusion**

Our review of liability claims revealed that there were no issues regarding segregation of duties during the audit period.

In verifying and testing for irregularities of liability claims, we noted that the Risk Management Department needs a better method for tracking of liability claims due to our inability to rely on the data included in the RM Logs. The Finance Department does not periodically contact the affected departments to verify the reliability of the claim processed.

In addition, we utilized Benford's Law to compare previous audit data with current audit data to check for potential fraud. Our analysis indicated that the liability claim payments closely followed the probability distribution of Benford's Law.

## Background

The City Risk Management department is responsible for reviewing City programs, projects and activities to identify potential exposures to loss; and to develop methods to transfer, finance, prevent, reduce, or control losses.

Programs include design of property and liability insurance and self-insurance programs; acquisition of insurance coverage; development of contract insurance provisions and review of contractor insurance and bonds; design and management of safety and loss prevention programs including policies, procedures, training, compliance and awareness; investigation, negotiation, and adjudication of liability claims; management of workers compensation programs; coordination and management of

insured / self-insured property and casualty claims; and consultation and review of City programs, projects, and contractual relationships.

The Risk Management Department's mission is to minimize the potential for losses of the City's human, fiscal, and physical assets; and to ascertain the impact losses have on the organization so that resources can be directed toward the needs of other City programs. The department identifies and evaluates the exposure to loss; and designs and administers programs to prevent, reduce, control, or provide financing for losses.

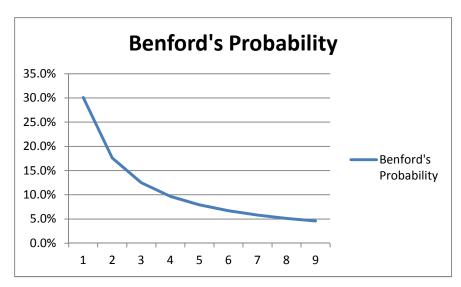
Source: COG website - http://www.ci.garland.tx.us/gov/rz/risk.asp

# Benford's Law (first digit law) Analysis and Results

Benford's Law states that for many real-life sources of data, the first digit will be "1" about 30% of the time and that small first-digits will occur more frequently than large first-digit numbers.

The probability distribution of Benford's Law is as follows:

Benford's Probability
20 10/
30.1%
17.6%
12.5%
9.7%
7.9%
6.7%
5.8%
5.1%
4.6%



From the previous audit dated June 12, 2008, Internal Audit obtained data which included fraudulent payments for liability claims from March 15, 2006 to March 14, 2008. We then compared this data to payments made for liability claims during October 1, 2009 to September 30, 2011. In our comparison, we found that the average deviation from the probability distribution of Benford's Law was 3.5% in the data dated March 15, 2006 to March 14, 2008. The average deviation of the data dated October 1, 2009 to September 30, 2011 was 1.1% which indicated that the distribution of payments made was much closer to the probability distribution of Benford's Law. This analysis gave no indication of fraud. (See Exhibit A.)

Source: ExcelUser.com, Use Benford's Law with Excel to Improve Business Planning

# **Management Accomplishments**

With regard to liability claims, Risk Management has implemented additional liability claim handling controls based on discussions with the FBI in preparation of recent criminal trials following the 2008 claims fraud case. The additional controls include department management direct receipt of payment acknowledgements from departments and placement of management signed acknowledgements in claim files. The additional controls have been incorporated into claim handing procedures.

#### **Opportunities for Improvement**

During our audit we identified certain areas for improvement. Our audit was not designed or intended to be a detailed study of every relevant system, procedure, and transaction. Accordingly, the Opportunities for Improvement section presented in this report may not be all-inclusive of areas where improvement might be needed.

## Finding #1 (Obj. 2)

#### Condition (The way it is)

The Risk Management Department tracks and maintains data for liability claims in a Risk Management Log for each fiscal year. The data within these logs are submitted for independent actuarial analysis.

A. In reviewing Risk Management's liability claim logs (RM Logs) for FY2009 through FY2012, Internal Audit noted that there were errors or incompleteness in some of or all of the key data elements.

Out of 270 sample claims reviewed, we found 36 errors as follows:

Types of Errors Noted	FY2009	FY2010	FY2011	FY2012
Claims logged twice or filed under different names		4		
Incorrect claim numbers entered on RM Logs or GL	3	3	3	5
Amounts not updated on RM Logs	5	7	1	5
Total Errors for Each Year	8	14	4	10

B. In addition, we identified liability claim payments by the claim number listed as a description in the general ledger. We eliminated any accruals, reversals and other payments that we could not trace to the RM Logs. We compared this identified data in the general ledger with the data listed in the RM Logs. We found that the total amount of payments that we could identify in the general ledger as liability claim payments for the audit period was understated in the RM Logs by approximately \$169,848 (see Exhibit B). We also found that out of a combined total number of payments that we could identify as liability claim payments (667) from the general ledger, 111 or 17% of those were not updated in the RM Logs (also see Exhibit B).

Because the data could potentially lead to an incorrect assessment, we could not rely on the data provided by Risk Management's RM Logs.

## Criteria (The way it should be)

The data entered into the RM Logs is accurate, complete and reconciles with the General Ledger.

#### Cause (Difference between condition & criteria)

- Discrepancies were caused by a lack of update and reconciliations as well as appropriate management review.
- Reconciliation is not listed in Liability Claim Payment Procedures.

## Effect (So what?)

The effects of unreliable data are as follows:

- Integrity of the RM Logs is compromised.
- Information provided for statistical analysis is not accurate.
- Reconciliation between the RM Logs and the General Ledger is difficult given the inaccuracies noted.
- Management can have no assurance of the accuracy of the data listed in the RM Logs.
- The audit trail is incomplete and inaccurate.

#### Recommendation

Management should:

- Ensure that an accurate and complete tracking mechanism is in place.
- Include reconciliation in the Liability Claim Payment Procedures and perform monthly reconciliation to the general ledger.

# **Management Response**

Risk Management concurs with the need for improved claim tracking. Currently, liability claims are tracked on an Excel spreadsheet, (RM File Log) along with other types of claims and incident reports handled by Risk Management. Each report and claim is assigned an RM file number and logged into the spreadsheet. The log consists of over 800 claims and reports received each year and includes:

- Employee injury (workers compensation) reports from departments
- Vehicle accident reports involving City vehicles
- Reports of damage to City vehicles or equipment
- · Reports of damage to City buildings or equipment
- Reports of damage to City infrastructure (street lights & signs, traffic signals & signs, etc.)
- Reports of theft or loss of City property
- Reports of injury or potential injury of patrons on City property
- Auto and general liability claims filed with the City Secretary
- Lawsuits filed against the City
- Subrogation claims filed against other parties for recovery of City damage
- Claims filed with City insurance companies for insured damage or loss

The RM File Log is an internal tool intended to be as the name implies, a "Log" of files to assist in recording and referencing occurrences, and in locating physical reports and files. The log is not intended to be a financial reporting tool for liability claim payments, workers compensation claim payments, or other types of payments

or recoveries. As such, reconciliation of the RM log with the general ledger is not part of the liability claim or file log procedures. We consider the Finance system to be the financial tracking tool for liability claim payments, the Fleet system for vehicle damage cost, and our third party administrator for workers compensation claims. File details and backup documentation is retained in the physical file.

Liability claim costs are identified in the RM log for reference. However, the amount indicated in the log may not always be updated to reflect supplemental payments such as rental car expense, especially if it occurs in subsequent years.

In response to the claims being logged twice or under separate names, these scenarios do arise. Various components and documents related to an incident are often received over a considerable period of time, in different forms, from different sources, in duplicate, and under different names depending on their relationship to the incident. Examples include:

- Claims involving multiple payees (injured party, vehicle owner, repair vendor, medical vendor, rental car vendor, insurers, attorney, etc.)
- City Secretary Office logging multiple or duplicate claims as a new claim
- Multiple claims arising from same incident
- Claim expense spanning multiple fiscal years and extending up to 2 years

These issues present challenges in identifying and relating files over an extended time period. Although attempts are made to note related files in the RM Log and the physical file, in some cases multiple RM numbers may be issued for a related incident.

#### **Action Plan**

Risk Management requested funding for a Risk Management Information System (RMIS) in 2007 to improve incident and claim tracking, provide financial loss data, and assist in tying related files, multiple payments and other loss information together. Attached as Exhibit C is a copy of the project request. Funding for the RMIS system was approved but the project was only recently scheduled for implementation by the IT Department. Development of an RFP is currently underway with selection of a vendor and implementation to begin by end of 2012.

#### **Implementation Date**

The current schedule indicates selection of a vendor and start of implementation by end of 2012.

# Finding #2 (Obj. 2)

## Condition (The way it is)

The Risk Management Department forwards liability claim files to Finance to verify the reliability of the data prepared prior to entry of the claim payment in the Finance system. In our review of this procedure, we noted that Finance does not randomly contact the affected department to ensure the validity of the claim.

## Criteria (The way it should be)

To help protect the City against fraudulent claims, Finance should randomly contact the affected department to ensure they have knowledge of the claim prior to approval.

# Cause (Difference between condition & criteria)

A lack of awareness as to what could happen.

#### Effect (So what?)

By not randomly contacting the affected department, Finance risks approving a fraudulent claim.

#### Recommendation

Finance should randomly contact the affected department to ensure the department is aware of the pending claim and maintain a record of the contact.

# **Management Response**

Concur.

#### **Action Plan**

The recommendation will be incorporated in the existing procedure.

#### **Implementation Date**

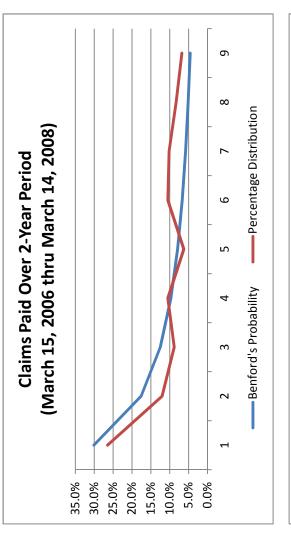
Immediately.

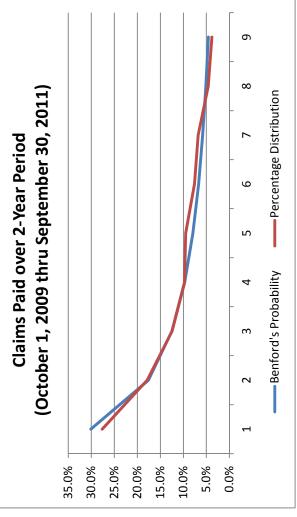
# Benford's Law Analysis

Incidence of Digits 1-9	First Digit	Benford's Probability	Percentage Distribution
156	1	30.1%	26.5%
71	2	17.6%	12.1%
52	33	12.5%	8.8%
62	4	9.7%	10.5%
37	2	7.9%	6.3%
62	9	%2'9	10.5%
09	7	5.8%	10.2%
49	8	5.1%	8.3%
40	6	4.6%	6.8%
589	•	Avg. Deviation	3.5%

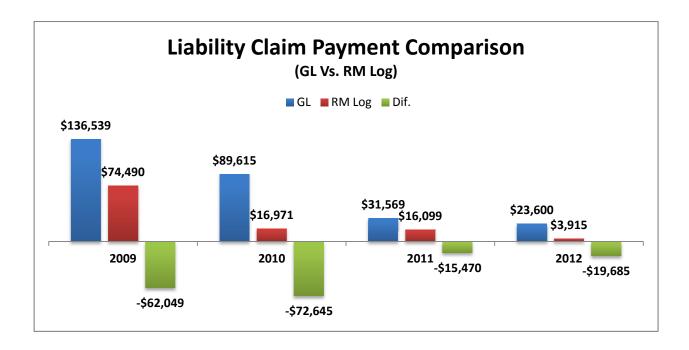
Source: Previous Audit

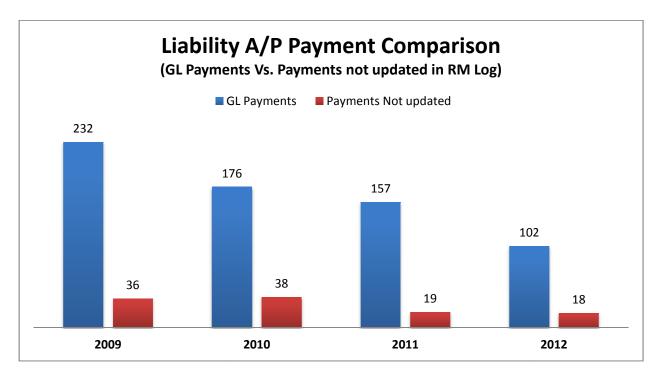
:			
Incidence of Digits 1-9	First Digit	Benford's Probability	Percentage Distribution
102	1	30.1%	27.6%
99	2	17.6%	17.9%
46	က	12.5%	12.5%
36	4	9.7%	8.6
35	2	7.9%	9.5%
28	9	%2'9	7.6%
25	7	5.8%	8.9
17	8	5.1%	4.6%
14	6	4.6%	3.8%
369		Avg. Deviation	1.1%





#### Exhibit B





Source: General Ledger (FY2009 – 2012) and RM Logs (FY2009 – FY2012)

**Note:** This total does not represent the total amount of General Ledger payments for each year. It only represents the payments in the General Ledger that Internal Audit could identify with a RM number.

#### FY 2007-08 Budget Request



This form is intended to assist with IT project requests in the upcoming budget year. Examples of projects include new or expanded systems, process automation, web-enabling an application, and integrating imaging capabilities. Projects will be reviewed on the following criteria. Please attach any supporting documentation and submit with this form. This is the only opportunity to submit Project Requests. Mid-year IT Project Requests (except for true emergencies) will not be considered.

Project Name: 08-028 Risk Management Information System

Department: Risk Management

Project Champion: Robby Neill

- 1.0 Project Description (What is the specific business problem you are trying to solve?)
  - 1.1 Acquire a Risk Management Information System (RMIS) to effectively manage over \$625 million in City property values, nearly \$2 million in annual workers compensation claims, \$1.6 million in annual insurance premiums, nearly \$800,000 in annual liability and property claims, and over \$500,000 in annual litigation expense.
  - 1.2 Automate manual processes currently used in handling nearly 400 liability claims, 400 employee injuries, 200 vehicle accidents, over 100 incidents of damage to City property, and several large property losses per year.
  - 1.3 Integrate loss information by occurrence.
  - 1.4 Manage insurance policies and coverage provisions.
- 2.0 Is there a mandatory implementation deadline? If yes, explain.
  No
- 3.0 How does this impact your ability to perform your duties? (Project Justification)
  - 3.1 Provides informational trail of claim investigation, communications, payments, and payment justification or other disposition, for staff and claimant inquiry, future litigation, and claim audits.
  - 3.2 Reduces time required to prepare data for insurance acquisition, property valuations, budget allocations, exposure and loss analysis, and loss reporting to third party administrators.
  - 3.3 Allows reporting of losses by occurrence to departments for departmental accountability and action.
  - 3.4 Allows identification of areas to focus resources for development of loss prevention and control programs.
  - 3.5 Reduced risk of insurance coverage shortfalls.
  - 3.6 Allows for accurate data to be efficiently accessed for acquisition of best possible insurance coverage pricing.
- 4.0 What is the desired end result? What are the project deliverables? What value does this project add (e.g., ROI)?
  - 4.1 Integrate auto, general, professional, workers compensation, and property exposure and loss data for development of effective risk management programs.
  - 4.2 Ability to report loss information to departments with industry and internal comparative information.
  - 4.3 Maintain adjuster notes, claim and litigation documents, photos, record of contacts, attorney, payment, claimant and witness statements, and other information in claim files for continuity of claim handling, to comply with appropriate claim adjusting procedures, and for claim audits.
  - 4.4 Identification of all activities and total cost of claims and accidents.
  - 4.5 Identify subrogation opportunities and initiate and track subrogation claims for collection of

	for timely initiation of workers compensation benefits
in compliance with statutes. 4.7 Maintain property data for more efficien property values, and budget allocation.	t insurance acquisition, exposure analysis, updating
4.8 Target resources for more effective loss p	prevention programs
	nanage insurance policies and coverage provisions.
5.0 Does the department have a proposed sold We have looked at purchased software and v   ☐ Canned Software Purchase ☐ Customizab ☐ Other:	[2018] [4] [4] [4] [4] [4] [4] [4] [4] [4] [4
6.0 If your department has a proposed solution solutions.  Use of vendor hosted software.	n, please describe alternative non-IT or partial-IT
7.0 Is your proposed technology commonly use Yes, most organizations, both public and premanage their programs through a RMIS.	sed within the industry? If so, please explain. ivate, with exposures similar to the City of Garland
worst-case cost scenarios if these risks an Worst case scenario is not implementing the effectively managing the program, leading to 8.1 Sustaining a large property loss with values to cover the loss. 8.2 Sustaining a property loss with an una 8.3 Inability to control losses leading to co 8.4 Death or serious injury to an employe through effective analysis and loss control.	a property not being insured or insufficient insurable anticipated coverage exclusion. Intinued escalation of costs. The arising from a risk that should have been identified ense costs for a major occurrence that could have
9.0 Financial Implications:	
Preliminary Cost Estimate (if known):  ☐ Initial Start-up (One Time) \$ \$40,000  ☐ Ongoing (Maintenance/Operation) \$ \$5,000	Funding Source: Fund 405  New Grant To Be Determined  □ To Be Determined
10.0 Instructions for Submission: Submit this copy to your Budget Analyst.	form in electronic copy to Reggie Patrick with a
REQUEST F	REVIEWED BY:
Requesting Managing Director	IT Manager
Signature:	Signature:
Date:	Date:
Approved by ITB	☐ Denied by ITB