Report to the Colorado State Auditor

Office of Risk Management
Department of Personnel and Administration

Performance Evaluation
September 2010

Submitted by

Bickmore Risk Services & Consulting

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September 13, 2010

Members of the Legislative Audit Committee:

This report contains the results of a performance evaluation of the Office of Risk Management (ORM), within the Division of Human resources, in the Department of Personnel and Administration. The evaluation was conducted pursuant to Section 24-30-1513, C.R.S., which requires the State Auditor to conduct an examination of the management and operation of the risk management fund. The State Auditor contracted with Bickmore Risk Services & Consulting to conduct this performance evaluation. The report presents our findings, conclusions, and recommendations, and the responses of the Office of Risk Management.

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Glossary of Terms and Abbreviations

Claim reserve – An amount set aside at the outset of a claim as an estimate of how much will eventually be paid on the claim.

COFRS - Colorado Financial Reporting System. The financial information system that maintains the official accounting records for Colorado state government.

GAB – GAB Robbins North America, Inc. The contractor that assists the Office of Risk Management in the adjustment of the State's liability and property claims

Marsh – Marsh USA, Inc. The contractor that serves the Office of Risk Management as the State's property and casualty insurance broker

McMillan – McMillan Claim Service. The contractor that assists the Office of Risk Management in the adjustment of the State's liability claims.

ORM – Office of Risk Management. The state agency, within the Department of Personnel and Administration, responsible for providing a comprehensive risk management program that serves all state departments and select institutions of higher education

Pinnacol – Pinnacol Assurance. The contractor used by the Office of Risk Management to administer workers' compensation claims and provides loss control services to the State.

STARS – The State's risk management automated information system, a web-based product that is used by ORM and department staff.

Subrogation – Refers to the right of the State to recover from another party a portion of the amount that the State has paid on a claim.

Bickmore Risk Services & Consulting

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Purpose and Scope

This performance evaluation of the Office of Risk Management (ORM), within the Division of Human resources, in the Department of Personnel and Administration (Department), was conducted by Bickmore Risk Services & Consulting (BRS) under contract with the Office of the State Auditor. The evaluation encompassed the following topic areas: risk financing, including the allocation of the cost of risk; loss control; claims; internal controls; the risk management information system; and contract management. BRS performed the work for this evaluation from February through September 2010. As part of the evaluation BRS interviewed staff of ORM, state departments and institutions of higher education, and third party contract service providers, and obtained and reviewed documentation related to the State's risk management program. BRS gratefully acknowledges the assistance and cooperation extended by ORM as well as the departments, institutions, and service providers contacted.

Overview

ORM is the state agency responsible for providing a comprehensive risk management program that serves all state departments and institutions of higher education. Institutions have the option of choosing to operate their own risk management programs; as of the time of this evaluation, the University of Colorado, the University of Northern Colorado, and Colorado State University had elected to have their own risk management programs and were excluded from this review. ORM supervises the investigation, adjustment, and legal defense of three types of claims: workers' compensation claims, arising out of injuries to state employees during the course of their employment; property claims for damage to state property; and liability claims against the State by the public for such matters as injuries that occurred on state property, as well as claims by state employees alleging wrongful employment practices.

The "cost of risk" is a critical part of a risk management program and refers to the total cost of protecting the State's assets and paying for losses. The State's total cost of risk includes: (1) cost of insurance premiums; (2) cost of retained losses; and (3) cost of administration**,** including ORM operating expenses (e.g., salaries and overhead), as well as amounts ORM pays to its third party administrators and legal counsel for claims administration, brokerage, and legal fees. From Fiscal Year 2005 through 2009, the total cost of risk for the State increased from $49 million to $55 million (12 percent). The cost of risk remained stable at about .3 percent of the State's total revenue, excluding higher education institutions with separate risk management programs.

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Key Findings

ORM is responsible for determining the best way for the State to manage its cost of risk and risk financing. The key findings from our review of ORM are summarized below.

Risk Financing

Balancing Risk Retention and Transfer. ORM has not conducted a formal, systematic evaluation of the State's capacity for retaining risk or of the State's exposure to catastrophic risk. As a result, there may be opportunities to strike a better balance between the amount of risk the State retains by electing to self-insure or increase deductibles, and the amount of risk the State transfers by purchasing insurance. The State may be able to reduce costs by increasing deductibles associated with its property, crime, automobile liability, and automobile physical damage coverage. In addition, the State should evaluate its property, crime, and workers' compensation policy limits and consider purchasing excess liability insurance to wrap around the protection offered by the Colorado Governmental Immunity Act (CGIA).

Allocation of Property Losses. ORM does not charge departments and institutions on the basis of their true property cost of risk. This is because ORM does not reflect property losses for each entity when allocating cost of risk for property among departments and institutions. Instead, ORM allocates property losses on the basis of each entity's property values. Allocating property costs based, at least in part, on loss experience presents a more equitable approach.

Loss Control

Initiatives to Control Loss. ORM needs to strengthen loss control efforts to establish a culture of safety in the departments and adequately protect the State's assets. First, ORM has a loss control program in place for workers' compensation, and should enhance its property and liability loss control efforts. Second, ORM does not provide information on loss control results for workers' compensation to departments, have incentives in place to promote safety or accountability measures to encourage departments to monitor loss control efforts, or provide effective oversight on departments' accident investigations. The State incurred over $44 million in self-retained losses in Fiscal year 2009, representing 80 percent of the State's total cost of risk. These are variable costs which can be reduced with sound loss control practices. With the continued stress on the State's budget, loss control initiatives provide an opportunity for controlling costs and increasing savings through the reduction of losses.

Claims

Processing Procedures. ORM's written procedures do not require that staff regularly update claims notes and periodically estimate the adequacy of reserve amounts for claims. In addition, ORM's risk management information system (STARS) has limitations that hamper ORM's ability to track property payments and deductibles effectively, as well as liability claims. Finally, ORM lacks adequate procedures for managing litigation claims, which may be contributing to increases in the State's litigation costs, and ORM's procedures for pursuing subrogation are deficient in all three areas: workers' compensation, property and liability. Better procedures in litigation management and subrogation in particular could have a direct, beneficial impact on reducing the State's cost of risk.

Risk Management Information System (STARS)

Operational Issues. In order to improve the functionality of STARS, ORM needs to address several deficiencies. Specifically, ORM should improve the completeness of the workers' compensation claims information, develop consistent protocols and reports for Departments to use when accessing STARS, and work with the STARS vendor to address problems with system performance and slow response times. STARS is a web-based system used by ORM and department staff to manage information for all lines of risk. ORM should also assess whether the benefits to added functionality in STARS are sufficient to justify further investment in the system.

Contract Management

Oversight of Vendors. ORM has not held two of its vendors accountable for providing information needed for the State to effectively manage its risk management program. For example, ORM has not ensured that Marsh USA, Inc., which is responsible for placing the State's property and casualty insurance coverage, furnishes an annual stewardship report. This report is required by contract, and is key to assisting with measuring broker performance and managing its insurance renewal process. In addition, ORM has not requested that Pinnacol Assurance, which is the State's third party administrator for workers' compensation claims, provide monthly loss prevention reports with the breakdown of costs by department. ORM needs this information to effectively monitor and guide individual department loss control efforts.

Our recommendations and the responses from the Office of Risk Management can be found in the Recommendation Locator and in the body of this report.

RECOMMENDATION LOCATOR

Agency Addressed: Office of Risk Management, Department of Personnel and Administration

Rec. No.	Page No.	Recommendation Summary	Agency Response	Implementation Date
1	17	Achieve the proper balance between risk retention and transfer to minimize its cost of risk by: (a) evaluating the State's risk retention levels to make sure they are consistent with its risk retention capacity and make adjustments as appropriate; and (b) conducting a comprehensive review of the State's insurance policies and purchase additional insurance where needed to sufficiently address catastrophic risk.	Agree	December 2010
2	18	Improve its methodology for allocating property cost of risk by taking into account the loss experience of each department and institution of higher education, using a weighting system that takes into account that the larger departments may have more predictable loss data, and developing a transition plan that covers a three to five year period and caps the amount of losses and percentage change used in the calculation.	Agree	November 2011
3	25	Protect the State's assets from loss and strengthen the State's loss control efforts by: (a) engaging departments and institutions to educate executive leadership, managers, appointing authorities, and supervisors on the importance of safety and loss control programs; (b) expanding loss control efforts to property and liability areas as well as workers' compensation; (c) developing more effective department incentives and accountability measures for loss control efforts; (d) improving loss control information provided to departments; (e) providing more effective oversight and quality review of accident investigations; (f) including on staff a person with technical qualifications necessary to oversee the State's loss control efforts.	Agree	July 2012
4	31	Improve its claims processing practices by developing written procedures to guide staff in updating claims notes, coding payment and recovery, estimating reserves, documenting delegation authority, managing litigation costs, and pursuing subrogation rights. Additionally, the STARS information system should support needed procedures with respect to tracking property payments and documenting assessments of liability claims. Finally, more reasonable caseloads should be assigned to the State Risk Manager and to the Assistant Claims Manager.	Agree	June 2011

RECOMMENDATION LOCATOR

Agency Addressed: Office of Risk Management, Department of Personnel and Administration

Rec. No.	Page No.	Recommendation Summary	Agency Response	Implementation Date
5	35	Strengthen controls over claims processing by: (a) establishing policies and procedures to ensure segregation of duties is maintained and conduct an audit of the claims processed between September 2009 and April 2010 to ensure payments were approved and paid appropriately; (b) amending the settlement authorization form to specify the dollar amount, as well as the title, for each required signor; and (c) working with the Department of Personnel and Administration to reconcile claims information in STARS with payment information in COFRS.	Agree	June 2011
6	39	Address the deficiencies in the current operation of STARS by: (a) improving management of workers' compensation claims data by uploading claims notes from the Pinnacol system into STARS, and ensuring that reserve take downs are not recorded twice; (b) establishing greater control over customization of STARS; and (c) performing routine system maintenance and continuing to work with the STARS vendor to resolve any system performance problems.	Agree	December 2011
7	41	Perform a needs assessment and return on investment analysis to determine if additional STARS applications should be developed and implemented.	Agree	June 2011
8	45	Ensure that contractors provide information required by contract necessary to support management decisions, including: (a) requiring that Marsh provide the required annual stewardship report and ensuring that Marsh provides a cost of risk analysis no later than 90 days following the end of each fiscal year; and (b) requesting that Pinnacol modify its monthly loss prevention reports to indicate loss control services by department and define codes to identify the specific type of services provided.	Agree	December 2010

Overview of Risk Management

Chapter 1

The State of Colorado, like other states, experiences losses from time to time arising from the risks inherent in state government operations. State employees are injured on the job, state property is damaged, and the State is sued and incurs liability for harm caused to others. The purpose of a risk management program is to manage these risks and losses by: (1) eliminating or minimizing risks; (2) providing a cost–effective means for the State to pay for losses; and (3) making sure that claims for losses are verified and paid in an accurate and timely manner.

The Office of Risk Management (ORM), within the Division of Human Resources, in the Department of Personnel and Administration, is the state agency responsible for providing a comprehensive risk management program that serves all state departments and selected institutions of higher education. At the time of our review the University of Colorado, the University of Northern Colorado, and the Fort Collins Campus at Colorado State University had their own risk management programs and were not among the institutions of higher education served by ORM. (Unless otherwise indicated, all references to departments in this report refer to all state departments and institutions of higher education served by ORM.)

ORM supervises the investigation, adjustment, and legal defense of the following three types of claims:

- **Workers' Compensation—**These claims arise out of injuries to state employees during the course of their employment. The State is responsible for the resulting medical and indemnity costs payable under the State's workers' compensation statutes [Section 8-40-101 et seq., C.R.S.].

- **Property—**These claims are made by departments for damage to state property. The State has approximately $11 billion in property values that are subject to damage or loss by fire, flood, and other perils.

- **Liability—**These claims are made against the State by members of the public for such matters as injuries that occurred on state property or automobile accidents involving state vehicles, as well as by state employees alleging wrongful employment practices.

Cost of Risk

Cost of risk refers to the total cost of protecting the State's assets and paying for losses. The State's total cost of risk includes expenditures for the following three elements:

- **Cost of insurance premiums—**These are amounts the State pays for insurance policies it purchases, thereby transferring the risk of loss to an insurance company.

- **Cost of retained losses—**The State has chosen to self-insure for some types of risk up to a specified amount of loss. When the State self-insures, the State retains the risk of loss and pays for the losses itself. This retained risk includes deductibles in insurance policies, losses that exceed the policy limits, and losses that are not covered by an insurance policy.

- **Costs for administration—**These are amounts the State pays to administer the risk management program, including ORM operating expenses (e.g. salaries and overhead), as well as amounts ORM pays to its contract service providers and legal counsel for claims administration, brokerage, and legal fees.

The following table sets forth the State's cost of risk for Fiscal Years 2005 through 2009.

Cost of Risk Fiscal Years 2005 through 2009 (in Thousands)						
Cost of Risk Component	**2005**	**2006**	**2007**	**2008**	**2009**	**Percent Change 2005 to 2009**
Insurance Premiums						
Liability	$473	$473	$482	$509	$664	40%
Workers' Compensation	370	370	295	278	334	(10)
Property	4,227	4,228	4,416	4,384	4,089	(3)
Subtotal	**$5,070**	**$5,071**	**$5,193**	**$5,171**	**$5,087**	**0%**
Retained Losses						
Liability	$4,424	$4,100	$6,700	$8,100	$8,100	83%
Workers' Compensation	30,393	29,300	35,800	35,700	34,400	13
Property	3,987	2,925	3,765	3,686	1,736	(56)
Subtotal	**$38,804**	**$36,325**	**$46,265**	**$47,486**	**$44,236**	**14%**
Administration						
Risk Management	$853	$800	$851	$838	$898	5%
Claims Handling	4,500	4,979	5,125	4,737	4,914	9
Broker Fees	160	235	235	258	258	61
Subtotal	**$5,513**	**$6,014**	**$6,211**	**$5,833**	**$6,070**	**10%**
Total Cost of Risk	**$49,387**	**$47,410**	**$57,669**	**$58,490**	**$55,393**	**12%**
Total State Revenue[1] (in Millions)	**$13,865**	**$16,028**	**$16,627**	**$17,339**	**$17,776**	**28%**
Cost of Risk as a Percent of Total Revenue	**.36%**	**.30%**	**.35%**	**.34%**	**.31%**	**(13)%**

Source: Department of Personnel and Administration, the State's Comprehensive Annual Financial Report (CAFR), and the audited financial statements for the Universities of Colorado and Northern Colorado and Colorado State University.

[1]Total State revenue excludes revenue for the University of Colorado and Colorado State University for Fiscal Years 2005 through 2009 and for the University of Northern Colorado for Fiscal Years 2007 through 2009, the years in which these institutions did not participate in the State's risk management program.

Role of ORM

In managing the State's risks, ORM has the following responsibilities and duties:

- **Risk financing—**The management of funds to pay losses. It includes determining the amount of risk an organization should retain, versus how much risk should be transferred to commercial insurers. It also includes allocating the cost of risk among departments within the organization. We discuss risk financing in Chapter 2 of this report.

- **Implementing loss control programs—**The purpose of a loss control program is to reduce the frequency and severity of claims. We discuss loss control in Chapter 3 of this report.

- **Processing claims—**ORM, with assistance from its third party administrator and contract adjusters, processes claims, to include the following: investigating of claims; rejecting invalid claims and paying valid claims; reserving funds for payments; obtaining recovery from insurers or other parties; and mitigating litigation. We discuss claims processing in Chapter 4 of this report.

- **Internal controls—**ORM is responsible for making sure that vital internal controls are in place to protect the State against mistakes or fraud related to the processing and payment of property, liability, and workers' compensation claims. We discuss internal controls in Chapter 5 of this report.

- **Information management—**ORM uses a risk management information system known as STARS to track claims and payment data and to generate management reports. We discuss ORM's management of STARS in Chapter 6 of this report.

- **Working with a third party claims administrator, contract adjusters, and the State's broker—**ORM contracts with Pinnacol Assurance (Pinnacol) to administer workers' compensation claims. Pinnacol provides claims handling, loss control, administration, legal, and other related services. ORM contracts with GAB Robbins North America, Inc. (GAB) and with McMillan Claim Service (McMillan) to assist in the adjustment of the State's liability claims. The State's primary property insurance carrier, Chartis Insurance, contracts with GAB to assist in the adjustment of the State's property claims. ORM contracts with Marsh USA, Inc. (Marsh) to serve as the State's property and casualty insurance broker. Marsh negotiates insurance policy terms with insurers. We discuss ORM's management of contracts with these contract service providers in Chapter 7 of this report.

ORM is appropriated nine FTE to conduct risk management activities. In addition, 45 risk management coordinators located in the departments and institutions of higher education help conduct risk management activities for each department and institution. These coordinators perform many risk management functions including identifying risk, controlling losses, and managing claims.

Scope of Evaluation and Methodology

According to statute [Section 24-30-1513, C.R.S.], the State Auditor's examination of the risk management program should "determine that proper underwriting techniques; sound funding procedures; loss reserves; claims procedures; and accounting practices are being followed in the management and operation of the risk management fund, the self-insured property fund, and the state employee workers' compensation account in the risk management fund." To fulfill this statutory requirement, the Office of the State Auditor contracted with Bickmore Risk Services & Consulting to conduct this performance evaluation. Bickmore reviewed documents, sampled files, and interviewed staff of ORM, state departments and institutions of higher education, and third party contract service providers. The evaluation encompassed the following topic areas: risk financing, including the allocation of the cost of risk; loss control; claims; internal controls; management information; and contracts with third party administrators.

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Risk Financing

Chapter 2

In making risk financing decisions, a large organization such as the State strives to strike the appropriate balance between the amount of risk it retains (by purchasing no insurance) and the amount of risk it transfers (by purchasing insurance policies from private insurance carriers). Retaining too much risk may expose the State to a significant financial disruption in the event of a catastrophic loss. Transferring too much risk may cause the State to pay too much in insurance premiums thereby increasing the State's cost of risk above what it needs to be. Risk financing refers to the strategies the State uses to strike a proper balance between retention and transfer of risk.

Balancing Risk Retention and Transfer

Ideally, organizations should retain risks that are predictable and affordable, and transfer to insurance companies the more volatile, catastrophic risks. Predictable risks are typically those that happen frequently. The loss of an employee's laptop computer is an example of a predictable risk. More volatile, catastrophic risks are those that occur relatively infrequently and involve larger losses. A major fire or embezzlement by an employee are examples of catastrophic risks. The goal of risk financing is threefold: (1) to ensure the ability to pay for losses without resulting in a negative impact on the on-going operations of an organization; (2) to effectively control the total cost of risk; and (3) to maximize the predictability of the cost of risk from year to year. Decisions on risk retention and transfer should be made with these goals in mind.

As indicated above, the State can retain risk by not purchasing insurance and it can transfer risk by purchasing insurance policies from private carriers. The following table displays the amount of risk the State retains and the amount of risk it transfers for each specific line of coverage. For valid claims per occurrence, the State is responsible for the deductible as well as any amount of claims in excess of the insurance coverage limit. For example, in the case of property, the State pays for the first $350,000 in claims resulting from any one occurrence. The State also pays for any claims in excess of $600 million resulting from the same occurrence. In the case of general liability, on the other hand, the State would be responsible for paying the entire amount of any claims, subject to any applicable statutory limits. Later in this chapter we discuss the limits set forth in the Colorado Governmental Immunity Act.

Office of Risk Management Risk Retained and Transferred		
	Risk Retained or Deductible[1] Per Occurrence	**Risk Transferred Per Occurrence**
Property	$350,000	$600,000,000
Boiler and Machinery	100,000	200,000,000
Crime (e.g., employee dishonesty)	50,000	5,000,000
Auto Physical Damage	1,000	Actual Cash Value of the Vehicle
General Liability (including employment practices, public officials, and law enforcement liability)	Unlimited	No Insurance Purchased
Automobile Liability	250,000	1,750,000
Aircraft	0	5,000,000
Workers' Compensation	$5,000,000	$25,000,000

Source: Marsh USA, Inc.
[1] For retained risks (typically referred to as self-insured retentions or SIRs), the insured directly pays losses falling within the retained amount. For deductibles, the insurer initially pays the loss, including the deductible amount, and then seeks reimbursement for the deductible from the insured.

We reviewed the levels of risk retention and transfer in each of the specific lines of risk indicated in the above table. We found that the State may have opportunities to adjust the levels of risk retention and transfer to reduce its overall cost of risk.

Retaining vs. Transferring Risk

In deciding on the appropriate retention levels for each line of risk, the State must weigh the cost of insurance, the predictability of claims, and its ability to control claims costs. In our professional judgment, decisions on retaining risk should be based on the certainty of existing revenue, the availability of reserves or unrestricted assets, the ability to raise additional revenue in the event of a loss (e.g., through increased taxes or issuance of bonds), and the State's subjective comfort level in terms of how much risk it believes it can sustain. We discuss opportunities to better balance the State's transfer and retention of risk in the next two sections.

Risk Retention and Deductibles

In our professional judgment, having considered the factors that would comprise a decision on risk retention, we conclude that the State has the financial capacity to retain risk of up to $10 million per occurrence. Accordingly, the State may have the potential to reduce its cost of risk by purchasing less insurance (i.e., having higher deductibles) and retaining additional risk associated with its property, crime, automobile liability, and automobile physical damage. We are not suggesting, however, that ORM should automatically establish a self-insured retention or deductible of $10 million on each policy. Rather, we suggest that ORM should determine its level of risk retention on the basis of a systematic evaluation of the State's capacity to sustain loss along with an assessment of the level of exposure to loss in each risk area. Neither ORM nor Marsh was able to indicate when a systematic evaluation was last undertaken to determine whether the State is spending too much on the purchase of insurance in light of the State's capacity to retain risk.

By undertaking a comprehensive evaluation, the State has an opportunity to limit or reduce its cost of risk and to make sure that it is retaining the appropriate levels of risk consistent with its risk retention capacity. ORM should obtain quotations for the cost of insurance polices that would reflect higher retention levels for property, crime, automobile liability, and automobile physical damage. In deciding on the optimal retention level for any policy, ORM should compare the premiums and the losses the State expects to incur within the proposed retention levels, and select the most cost effective option**.**

Risk Transfer

The State also has opportunities to adjust the amount of risk its transfers by purchasing additional insurance. We reviewed the State's current insurance program, including its policy limits, and found that the coverage and limits do not appear to be connected to any formal evaluation of the exposure to catastrophic risk. We identified problems with ORM's risk transfer decision-making methodology in each of the risk areas discussed below.

- **Property insurance limits—**Ideally, properties should in our professional judgment be appraised every five years. However, the State has not appraised its property in over ten years. Therefore, even though appraised values are adjusted for inflation, it is difficult to determine whether current property insurance limits are set adequately in relation to their values. Property insurance limits are reviewed annually by ORM's broker, Marsh, in relation to the values of state buildings and contents. Marsh evaluates the concentration of values by postal codes to ensure no one catastrophic loss would likely exceed the per occurrence limit. This is a reasonable approach to ensure limit adequacy. However, if values are understated, ORM may potentially have insufficient property insurance limits. ORM could better assess its property insurance limits if it conducted an appraisal of its major facilities. ORM should consider conducting appraisals of its facilities as soon as possible. If values are understated and the appraisal results in increased values, these values will need to be reported to the property insurers and an increase in coverage and premium would result. To minimize the cost associated with the appraisals, we recommend that ORM appraise facilities currently valued at $1 million or more. ORM could conduct appraisals over a three-year period to further minimize the impact on the annual budget.

- **Crime limits–**ORM has established a $5 million limit on its insurance policy for crime. The $5 million limit may be inadequate to protect the State against potential loss. For example, in Fiscal Year 2007 the State incurred an $11 million loss resulting from embezzlement by a Department of Revenue employee. We are aware of other public entities that have experienced crime losses in excess of $10 million as well. ORM should consider purchasing a crime policy with at least $10 million in coverage.

- **Liability limits—**The tort caps provided by the Colorado Governmental Immunity Act [Section 24-10-101 et seq., C.R.S.] protect the State against general liability, employment practices liability, public officials liability, and law enforcement liability claims. These tort caps are $150,000 per person (arising from any one occurrence) and $600,000 for two or more persons (arising from any one occurrence). The tort caps, however, do not apply to federal lawsuits. The State has full exposure—with no insurance coverage—to federal lawsuits, such as an employment practices lawsuit. The tort caps also do not apply to claims arising from occurrences outside the State, such as an automobile accident involving an employee in a state vehicle. A class action employment practices lawsuit, or an out-of-state vehicle accident involving multiple injuries or fatalities could result in a multi-million dollar loss. ORM should consider purchasing a broad excess liability policy that applies to losses not governed by the Colorado Governmental Immunity Act. This policy should include the following types of coverage, to the extent that coverage is needed because the liability cap is not applicable: general liability, automobile liability, public officials' liability, law enforcement liability, and employment practices liability. The State should obtain quotes for coverage with limits not less than $10 million.

- **Workers' compensation limits—**ORM does not set workers' compensation limits at a level sufficient to protect the State against significant risk of loss. The State operates large facilities occupied by hundreds of employees. A catastrophic event (e.g., a terrorist attack or a fire) in one of these facilities could result in numerous, severe casualties. For example, we estimated, based on the capacity of the building, that a terrorist event in the Capitol during a legislative session could injure or kill a significant number of people. If 50 people were injured or killed and the average claim resulting from such a scenario was $1 million, the State's workers' compensation losses would significantly exceed the current $25 million policy limit. ORM should consider increasing workers' compensation limits to not less than $50 million.

A primary goal of a risk financing program should be to ensure the ability to pay for losses that occur without having a negative impact on the on-going operations of an organization. ORM has an opportunity to limit or reduce the State's cost of risk by undertaking a comprehensive review to ensure that the State is retaining the appropriate levels of risk consistent with its risk retention capacity. At the same time, ORM should conduct a comprehensive review of the State's insurance program and make those changes needed to sufficiently address catastrophic risk.

Recommendation No. 1:

The Office of Risk Management should ensure that the State is achieving the proper balance between risk retention and transfer to minimize its cost of risk. To accomplish this goal, ORM should:

a. Evaluate the State's risk retention levels to make sure they are consistent with its risk retention capacity and make adjustments as appropriate.

b. Conduct a comprehensive review of the State's insurance policies and purchase additional insurance where needed to sufficiently address catastrophic risk.

Office of Risk Management Response:

Agree. Implementation Date: December 2010.

The Division of Human Resources, Office of Risk Management has begun evaluating existing risk retention levels and insurance policy coverage limits in existing policies. As a result of the evaluation to date, we have increased coverage limits for workers' compensation, crime, and auto liability. We will continue our evaluation and investigate the availability of a broad excess liability policy once the new broker contract is in place.

Allocation of Property Cost of Risk to Departments

ORM allocates cost of risk to departments and higher education institutions each year as part of the budgeting process. (Unless otherwise indicated, all references to departments in this report refer to all state departments and institutions of higher education served by ORM.) It is important that these allocations be made on the basis of sound principles so that the allocations are equitable and provide incentives for departments to control loss. We reviewed the basis on which ORM allocates costs and found that the underlying principles for allocation are sound for workers' compensation and liability. We found, however, that improvements in the allocation methodology are needed in the case of property.

As indicated above, cost of risk includes the losses that the State retains and incurs. It also includes overhead and other expenses such as insurance premiums. In reviewing ORM's cost allocation methodology, we found that ORM takes losses by each department into account when allocating cost of risk for workers' compensation and liability. For property, however, ORM does not take losses by each department into account when allocating cost of risk. ORM allocates cost of risk for property solely based on property values.

Because losses are such a large percentage of the cost of risk, allocating property cost of risk based only on property values does not equitably reflect the actual property losses of each department. Allocations of cost of risk can vary greatly when losses are factored into the formula in addition to property values. The Colorado Department of Transportation, for example, is allocated about 17 percent of the total cost of risk when only property value is taken into account. If losses were to be factored in, the Department of Transportation would be allocated about 32 percent of the total cost of risk. This would constitute an 88 percent increase in the Department's allocated cost of risk. Conversely, institutions of higher education are allocated 43 percent of the total cost of risk when only property value is taken into account. If losses were to be factored in, these institutions would be allocated about 24 percent of the total cost of risk. This would constitute a 44 percent decrease in the institutions' allocated cost of risk.

When property losses are not included in the allocation methodology, the true cost of each individual department's property cost of risk is not reflected. In addition, there is no incentive for departments to control property losses, and this may affect the State's cost of property insurance. Further, departments that have a significant percentage of the State's total property value and low occurrences of loss are subsidizing the losses incurred by other departments that have lower percentages of the property values and higher occurrences of losses.

ORM should modify its current property cost allocation plan to include historic loss experience variations by each department. ORM could use its current methodology for allocating the cost of risk in the case of workers' compensation and liability as a starting point. Also, based on our professional experience, larger departments typically tend to have a larger volume of historic loss data than smaller departments. A large volume of data provides a more reliable basis for predicting losses. Accordingly, to provide more stability over time to the property cost of risk allocations, ORM should consider granting additional weight in its methodology to loss data from larger departments. In order to ease the effect that a change in methodology might have on one or more departments, ORM should develop a three to five year transition plan. As part of the transition plan, ORM should also consider using the historic loss data to cap both the amount of losses used in the calculation and the change in the allocation percentage. This will help limit the impact of substantial increases or decreases in costs allocated across departments and allow a more reasonable and gradual transition over time.

Recommendation No. 2:

The Office of Risk Management should work with the Department of Personnel and Administration to improve its methodology for allocating property cost of risk by taking into account the loss experience of each department and institution of higher education.

ORM should also use a weighting system that takes into account that the larger departments may have more predictable loss data. To ease the impact of a change in methodology, ORM should develop a transition plan that covers a three to five year period and caps the amount of losses and percentage change used in the calculation.

Office of Risk Management Response:

Agree, subject to feasibility determination. Implementation Date: November 2011.

The Division of Human Resources, Office of Risk Management will work with our actuary to determine if it is possible to build and implement a model to allocate the property cost of risk to departments based upon a combination of property value, loss experience, and available loss data. If such a model is feasible, the Department will work with the Office of State Planning and Budgeting and the Joint Budget Committee to implement the model.

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Loss Control

Chapter 3

Self-insured losses are the largest component of the State's cost of risk. These losses constitute variable costs that can be reduced with an effective loss control program. A loss control program consists of a systematic series of steps taken to reduce the risk of loss. An important goal of a loss control program is to minimize the likelihood of accidents occurring (loss prevention) and to reduce the severity of losses that do occur (loss reduction). An example of a loss prevention measure is installing guards over a blade on machinery to eliminate the possibility of an employee injury. An example of a loss reduction measure is installing sprinklers in a building to stop the spread of a fire, should it occur.

There should be a comprehensive loss control program in place in the State for all three areas of risk: workers' compensation, property, and liability. The components of a comprehensive program should include:

- Creating incentives for department managers to implement loss control practices and measures to hold managers accountable for loss control results.

- Providing departments with information necessary to monitor and evaluate loss control efforts.

- Ensuring that departments conduct adequate accident investigations in order to determine and eliminate causes of accidents.

Further, a comprehensive loss control program involves creating a culture of safety that extends from the Governor down through all levels of each organization. Mobilizing state employees to embrace a culture of safety and adopt appropriate safety measures is the responsibility of not only ORM, but also leadership in all branches and levels of government.

We have evaluated ORM's loss control efforts and found problems in two areas. First, ORM's major loss control initiative, which is in the workers' compensation area, could be strengthened to better establish a culture of safety in departments throughout the State. Second, ORM has not integrated the risk areas of property and liability into a comprehensive loss control program.

Loss Control Initiatives

Loss control initiatives are critical in today's budgetary environment. With the continued stress on the State's budget, it is important for the State to find ways to cut costs. Loss control initiatives are a risk management program's primary means for controlling costs and increasing cost savings through the reduction of losses. In our experience, the more effective loss control efforts encompass all three lines of risk (property, liability, and workers' compensation), to include training, performance objectives, and accountability measures. ORM's loss control emphasis is in the workers' compensation area because it has the largest financial impact. ORM's initiative in this area is called "It's a New Day." Pinnacol, who provides loss control as well as claims administration services for workers' compensation to ORM, developed the New Day initiative in conjunction with ORM as a best practices guide for state agencies. The New Day initiative requires that each participating department have a formal safety policy, a safety committee, safety rules, safety awareness and loss control training, and a written list of designated medical provider(s) to who injured workers may go, along with written claims procedures.

Under the New Day initiative, ORM acts as a catalyst and has a supportive role to the departments, rather than acting as the primary loss control service provider. It is the primary responsibility of the departments to conduct basic loss control tasks such as safety inspections, injury investigations, and safety training.

We found that the New Day initiative has been helpful in making safety visible to department risk managers and staff. However, we found that the New Day initiative could be strengthened to more effectively establish a culture of safety in departments throughout the State. Specifically, we identified the following concerns:

- **Accountability—**The New Day initiative does not adequately hold department managers accountable for raising safety awareness or improving overall safety. While the initiative recognizes the importance of management support, the efforts to gain that support could be more effective. For example, at the onset of the program, senior department management are provided with a pre-scripted letter which is distributed to department managers to sign, thereby communicating that senior management supports the New Day initiative. The pre-scripted letter is not adequate for establishing management accountability. Mechanisms such as safety-related performance objectives are needed to clearly articulate the performance expectations of managers. Such performance objectives could include, for example, achieving accident reduction goals, completing scheduled safety inspections, and completing all accident investigations. There should be periodic reporting and review of the performance objectives by ORM as well as by the department's chain of command. Also, those with coordinating and supporting roles for safety in departments are not required to receive formal training on, or certification in, safety management.

- **Management Information—**The New Day initiative does not provide adequate information to help departments monitor loss trends and implement corrective actions. Although departments receive reports with claim counts and claim costs by type of injury, the reports do not provide the claims details for ORM or the individual departments to monitor performance relative to the exposure. By detail relating to exposure, we mean measuring the losses relative to the amount of risk through indicators such as the number of miles driven, employees involved, or hours worked. Therefore, ORM and the departments have limited use for these reports. With additional detail, ORM and the departments could use the reports to measure improvement and benchmark performance data relative to department, state, and national data.

- **Accident Investigations—**Governor's Executive Order DO138-89 acknowledges the State's duty to investigate and correct safety deficiencies. Based on our inquiries with department staff, we found that in many cases accident investigations are either not conducted at all or are not conducted in a complete and satisfactory manner. ORM provides training on accident investigations but does not have a process for following up, reviewing, or providing the departments with feedback on the quality of accident investigations. Senior management at the departments also appears to be minimally involved in overseeing and reviewing the accident investigation process.

While workers' compensation is the area of risk where most of the State's losses occur, losses do occur in the property and liability areas as well. ORM provides limited loss control support in the property or liability areas. For example, ORM staff conduct regional training sessions to assist the State's departments with workers' compensation loss control topics such as ergonomics; accident investigation; slip, trip and fall prevention; return to work; and safety leadership. These regional training sessions also include updates on the Family Medical Leave Act and the Americans with Disabilities Act, along with other employment issues. However, according to ORM staff, the State provides limited training in the human resources areas, such as discrimination and sexual harassment that often give rise to state and federal lawsuits. We note in Chapter 4 of this report that the growth in litigation expenses over the past five years has been driven largely by increased costs in federal liability cases. Most states have loss control programs that address all three areas of risk. ORM should expand its loss control efforts to address risks in the property and liability areas in addition to workers' compensation, as described below.

Enhanced Oversight by ORM

We found that ORM's loss control efforts could be strengthened if ORM assigned a staff person with the responsibility for oversight of loss control efforts in the departments, across all areas of loss including workers' compensation, property, and liability. While there is no regulatory standard or best practice guide regarding the specific skills required for this staff person, it is our professional judgment that the cost and complexity involved in the State's risk management program requires oversight of loss control by a staff person in ORM who has the following qualifications:

- 10+ years experience in workers' compensation, liability, and property safety management;
- A masters degree or equivalent experience in a safety-related field; and
- A Certified Safety Professional or Certified Industrial Hygienist credential.

Contributing to the deficiencies in the State's loss control efforts is the fact that ORM does not have a person on staff with the above qualifications to provide effective oversight and policy development with respect to loss control efforts. Currently ORM's loss control efforts include conducting training, attending meetings at the departments, and providing answers to questions that the departments may pose from time to time. If ORM staff included someone with the above qualifications, ORM could infuse a higher level of technical sophistication into the State's loss control efforts, working more proactively with the departments to ensure that each department establishes loss control performance objectives and accountability measures. Failure to invest in an ORM staff person with the above qualifications to effectively oversee and facilitate the implementation of the State's safety and loss control efforts will result in: (1) employee injuries that could reasonably be prevented; (2) higher than warranted loss rates; (3) loss control vendors who will not perform to the level needed by the State; and (4) inadequate direction and support for departments to ensure the safety of their employees.

Opportunities for Improvement

To both strengthen the New Day initiative for workers' compensation and establish loss control initiatives in the property and liability areas, the State should consider steps to encourage department managers to engage and invest more rigorously in loss control efforts, and to be held accountable for results. Additionally, ORM should consider providing more oversight of loss control efforts at departments to enhance accountability with respect to loss control. ORM should consider the following:

- Establishing a grant program to reward departments for effective loss control efforts. Such a grant program could award funds to a department based on the projected overall savings in cost of risk. The actuary with whom ORM contracts may be able to provide the basis for the grant funding based on the expected return on investment resulting from anticipated savings. A grant program of this nature was recommended in the 2004 performance audit of risk management but was not implemented by ORM.

- Establishing a system for the departments to utilize measurable performance objectives, benchmark loss control performance, and establish priorities. The use of loss control performance measures was recommended in the 2004 performance audit of risk management but was not implemented by ORM.

- Preparing key safety performance objectives and related performance outcomes and requesting that they be distributed by the Governor's Office to each department executive on a periodic basis, but no less than annually. Involvement by the Governor's Office may serve to motivate greater action by the departments with respect to loss control efforts.

- As a further incentive and accountability measure, losses should be measured for each department and a report generated to the Office of State Planning and Budgeting detailing the impact of losses on the operating budget, by department. The actuary with whom ORM contracts can establish a base rate for each department. As the losses develop over time, those departments with loss costs below the base rate would be identified, and ORM should provide departments with higher than expected losses appropriate direction and assistance to contain their loss costs. Considering the strain on the State's budget from the recent economic recession, steps to reduce loss-related expenditures are critical.

To improve the information provided to departments, ORM should publish risk management performance results by department in its quarterly report to the Office of State Planning and Budgeting. The results should reflect key indicators, including the percentage of employee injuries with accident investigations completed, the department injury rates, the facility inspections completed compared to the schedule, and the percentage of employees that have completed their scheduled safety training.

ORM should obtain accident investigations from departments for all employee injuries, property damage claims, and liability incidents and perform quality reviews on a representative sample of the accident investigations. ORM should send the quality reviews back to the executive director of the department and issue an annual report that measures progress by department.

Finally, it is important to note that developing a culture of safety is a statewide issue, critical to the success of all loss control efforts. Departments must embrace loss control initiatives and hold managers and staff accountable for results. To that end, ORM must focus on mobilizing leadership throughout state government and provide appropriate tools, resources, incentives and information in order to support department management. It is then incumbent upon department management to implement the appropriate accountability measures and an environment that promotes safety throughout state government. Without a strong loss control program, the State loses an opportunity for cost savings and the risks to state employee health and safety increase.

Recommendation No. 3:

The Office of Risk Management should work with the Department of Personnel and Administration to better protect the State's assets from loss and strengthen the State's loss control efforts by:

a. Engaging departments and institutions to educate executive leadership, managers, appointing authorities, and supervisors on the importance of safety and loss control programs.

b. Expanding loss control efforts to encompass potential losses in the property and liability areas as well as workers' compensation.

c. Developing and implementing more effective incentives and accountability measures for loss control efforts by department managers.

d. Improving the loss control information provided to departments.

e. Providing more effective oversight for accident investigations, including performing quality reviews on a sample of accident investigations at each department.

f. Including on staff a person with technical qualifications necessary to provide effective oversight of the State's loss control efforts.

Office of Risk Management Response:

Agree, subject to feasibility determination, state departmental cooperation and implementation, and obtaining resources. Implementation Date: July 2012.

The Division of Human Resources, Office of Risk Management is currently working on expanding its loss control efforts, including liability and property loss control trainings as well as other types of loss control measures in these areas. The Office of Risk Management, in conjunction with the Department will continue to work with the departments and covered institutions to educate executive leadership, managers, appointing authorities, and supervisors on the importance of safety and loss control programs. Specifically, we will develop and provide accountability and performance measures for the departments and covered institutions to implement. Further, Office of Risk Management will provide reports on performance measures and related outcomes and benchmarking to departments and covered institutions, including Executive Directors and Presidents and risk management coordinators no less than annually. The Department will also evaluate the development of a grant program for loss control efforts in the agencies.

The Office of Risk Management will expand the accident investigation training presented to all large departments and will endeavor to review incident reports from departments. However, at this time the Office of Risk Management has no authority to require agencies to submit accident reports for review. Furthermore, resource limitations may limit the extent to which the Office of Risk Management is able to implement these reviews in a comprehensive manner.

Finally, the Department will review the feasibility of hiring a staff member with the technical qualifications outlined in the report. While we agree that a person with these qualifications would be a benefit to the State's loss control efforts, we currently do not have the budgetary authority in which to hire such a person.

Claims

Chapter 4

Effective risk management requires that claims be processed in an accurate and timely manner to ensure that all valid claims are properly paid. Processing claims includes the following functions: investigating claims, rejecting invalid claims and paying valid claims, reserving funds for payments, obtaining recovery from insurers or other parties, and managing litigation. The State has processed an average of 3,360 workers' compensation claims annually from Fiscal Year 2005 to 2009. During the same period it has had an average of 115 property claims annually and an average of 1,210 liability claims annually.

Overall Claims Processing

We reviewed the State's and Pinnacol's written claims administration procedures and interviewed staff of ORM, Pinnacol, GAB, and McMillan. We tested compliance with procedures through a sampling of claim files. We found that both the procedures and compliance generally meet what we believe to be best practice guidelines for processing claims. Our evaluation is based on a scoring methodology we developed, which is consistent with principles put forth by the Insurance Institute of America. In our methodology we score several criteria for each of the components listed in the table below. Criteria include, for example, timeliness and accuracy of entering information into claims files, appropriate supervisory oversight, proper calculation of claims payments, and appropriate documentation of claims decisions and disposition actions.

In our evaluation we scored both the quality of the written procedures as well as compliance with the procedures in each best practice component for all of the State's three risk areas (liability, property, and workers' compensation). The score reflects the percentage of items in our sample that met best practice guidelines. In our judgment, scores in the range of 85 percent to 95 percent constitute commendable performance. Anything above 95 percent we consider to be superior performance. The State's relatively high scores are indicative of the overall strength of ORM's claims processes. The scores are calculated as an average of all of the criteria in each component. Thus, although the average scores are high, we still found weaknesses within some criteria, which we will discuss later in this Chapter. Our scores are summarized below:

Evaluation of Compliance with Procedures and Best Practice in Claims Processing for Liability, Property, and Workers' Compensation Claims			
Best Practice Components	**Liability Claims**	**Property Claims**	**Workers' Compensation Claims**
Claims Initiation	79%	94%	96%
Claims Investigation and Disposition	99%	100%	99%
Establishing and Monitoring Reserves	83%	99%	90%
Litigation Management	90%	N/A[1]	100%
Recovery Management	100%	N/A[1]	83%
Overall	**86%**	**96%**	**96%**

Source: Bickmore Risk Services & Consulting's evaluation of compliance with written procedures and against best practices for Liability, Property, and Workers' Compensation claims.

[1] There were no litigated property claims or property claims eligible for recovery during the period July 1, 2004 through March 10, 2010; therefore the review sample does not evaluate litigation management or recovery management for property claims.

We found "superior performance" in many areas, including claims investigation, even though in the preceding chapter we noted weaknesses in accident investigations. Accident investigations seek to determine the root cause of an accident resulting in injury, while claims investigation seeks to determine whether an accident was job related and therefore compensable, regardless of the root cause. The weaknesses we identified in the above table fall into the following three areas: (1) lack of written procedures; (2) problems with information systems; and (3) litigation management and the pursuit of subrogation opportunities.

Written Procedures

We found several examples where ORM written procedures are lacking and as a consequence, compliance is deficient. Absent written procedures, it is difficult to hold employees accountable for completing assigned work efficiently and in accordance with best practices guidelines. Also, good procedures can form the basis for necessary staff training. Inefficiencies and departures from best practices may cause increased claims losses and expenses.

- **Updating claims notes—**There are no written procedures to require ORM claims staff to regularly update claim notes. Claim notes indicate the steps required for staff to complete the claims process, and the notes provide staff with an important tool for processing and resolving claims accurately and timely. Best practice guidelines suggest that claims notes should be updated every 30 to 180 days.

- **Payment and recovery coding―**There are no written procedures for payment and recovery coding in the property and liability areas. Proper coding will indicate, for example, whether a legal expense was for inside or outside counsel. As a result of the lack of written procedures, we found that five of six liability claims had payments improperly coded. Proper coding helps ensure that the reserves required to fund the balance of the claim are calculated accurately. The existing informal and unwritten procedures for payment and recovery coding need to be updated and formalized in writing to help ensure proper coding.

- **Estimating reserves―**There are no procedures for periodically evaluating reserve amounts. A reserve amount is set aside at the outset of a claim as an estimate of how much will eventually be paid on the claim. The reserve amount needs to be adjusted from time to time as the claim moves forward and circumstances change. Procedures should require reserves to be reevaluated within 30 days of receipt of information that could change the amount of the liability. Additionally, written procedures should require a year-end evaluation of reserve amounts to ensure an accurate reserve calculation at year-end.

- **Delegated authority not documented―**ORM's claims procedures for workers' compensation provide that all departments have the delegated authority to resolve claims up to $10,000, with the exception of Department of Corrections and the Department of Transportation, which each have formal delegated authority of up to $60,000. ORM has informally delegated to the Judicial Department the authority to resolve claims up to $30,000. This delegation is not in writing. Any such delegation of authority should be part of a comprehensive written procedure.

Information Systems

We found examples where the development of good procedures has been hampered by limitations in the risk management information system (STARS). We discuss STARS in Chapter 7 of this report.

- **Tracking property payments―**ORM staff need to track property payments made by ORM against policy deductibles to make sure that the correct amounts of payments are received in accordance with the provisions of the policy. ORM staff are unable to do this tracking through STARS. Instead, staff must maintain an Excel spreadsheet to track claim payments. This process is time consuming and vulnerable to inaccuracy. STARS needs to be modified to track property payments. Also, there are no written procedures to guide ORM staff in this area. Procedures are needed to provide guidance with respect to tracking payments made against the deductibles and then requesting payments from the insurance carriers once deductibles are met. These procedures should initially address the Excel spreadsheet process until STARS is modified, at which time the procedures should be amended to cover the modifications made to the STARS process.

- **Documenting assessments for liability claims—**There are no procedures that require documenting the adjuster's assessment of how a liability claim might be ultimately resolved, and STARS does not allow such information to be captured and displayed. For example, high dollar claims that are assessed an uncertain outcome may require more monitoring to ensure the State does not pay more than it should to resolve the claim. Management reports lack information on the assessment. Consequently, supervisors lack important information for determining which claims are high-risk and thus warrant close monitoring. STARS should be modified to capture and display the adjustor's assessment of the claim.

Litigation and Subrogation Rights

We found two other areas where more robust procedures are warranted: litigation and subrogation. Procedures for litigation management should establish criteria for: obtaining liability assessments; assigning claims to counsel; evaluating proposed litigation plans including the costs and benefits of continuing litigation rather than negotiating a settlement; and appropriate levels of review for claims settled. Subrogation procedures should establish criteria for promptly identifying subrogation opportunities and analyzing the cost to be incurred in pursuing recovery compared to the estimated amount likely to be recovered. Better procedures in these areas may have a direct, beneficial impact on reducing the State's cost of risk.

- **Litigation—**The procedures for resolving liability claims do not establish expectations for litigation management and setting litigation expense authority. Currently the Attorney General's staff manage litigation expenses. We believe that the State's ratio of litigation expenses to total payments made in litigated cases is high. This ratio was 75 percent for Fiscal Year 2009, up from 42 percent in Fiscal Year 2005, and averaged about 43 percent over the five-year period. The growth has been driven largely by increased costs in federal liability cases. There may be opportunities to curtail litigation expenses by more rigorous ORM procedures, for example, in the following two areas: (1) conducting a cost benefit analysis to guide decisions of whether to pursue litigation or to reach a settlement, and (2) determining when outside counsel is required. Involving the ORM chain of command to evaluate claim settlement value, along with litigation planning and budgeting, will assist in ensuring focus on controlling expenses.

- **Subrogation—**Subrogation refers to the right of the State to recover from another party a portion of the amount that it has paid on a claim. ORM's procedures in all three areas of risk do not provide adequate guidance to ORM staff to ensure Pinnacol, McMillan, and GAB are recognizing and pursuing subrogation rights. When a state employee is injured in an automobile accident, for example, recoveries from the driver at fault may be available to offset the workers' compensation benefits due to the employee. Rights and responsibilities in these cases are often complex. Absent adequate guidelines, subrogation opportunities may be missed or more time or resources pursuing subrogation activities may be spent than is warranted for the claim. To avoid lost recovery opportunities and increased costs, ORM should develop procedures to guide its staff in overseeing the following areas: recognizing the State's subrogation opportunities; communicating with the appropriate parties to provide notice of the rights and the State's intent to pursue recovery; assigning an attorney to preserve subrogation rights; and properly accounting for recovered funds.

Claims Caseload

We found that ORM management carries high claims processing caseloads, limiting time available to provide supervision or monitor claims handling staff. For example, the State Risk Manager carried a caseload of 81 pending claims at the time of our evaluation. In contrast, our professional judgment is that the Risk Manager's caseload should not exceed 50 pending cases. Similarly, the Assistant Claims Manager carried a caseload of 535 liability claims. In our professional judgment, the Assistant Claims Manager should have responsibility for no more than 300 pending claims. ORM should consider options to reduce these caseloads. Such options might include, for example, delegating to administrative staff those cases requiring lower skill levels to monitor, or seeking a cost effective way for the independent field adjusters (GAB and McMillan) to take on more of the monitoring duties.

Recommendation No. 4:

The Office of Risk Management should improve its claims processing practices by developing written procedures to guide staff in updating claims notes, coding payment and recovery, estimating reserves, documenting delegation authority, managing litigation costs, and pursuing subrogation rights. Additionally, the STARS information system should support needed procedures with respect to tracking property payments and documenting assessments of liability claims. Finally, more reasonable caseloads should be assigned to the State Risk Manager and the Assistant Claims Manager.

Office of Risk Management Response:

Agree, subject to system functionality and available resources. Implementation Date: June 2011.

The Division of Human Resources, Office of Risk Management will establish all of the procedures identified in the audit report, some of which are already written. The Department is currently in the Request for Proposal (RFP) process for a Risk Management Information System (RMIS). Once a final decision is made regarding the RMIS, we will determine if the selected system will support tracking of property payments and documenting assessments of liability claims. If not, the Office of Risk Management will investigate the financial feasibility of modifying the system to do so. While we agree that more reasonable caseloads for the Risk Manager and the Assistant Claims Manager would be ideal, the Office of Risk Management has no way of reducing the claims load at this time. The Office of Risk Management does not have any open positions in which to hire additional claims personnel. Also, none of the other staff in the Office of Risk Management has the available time or the background to manage claims. The Office of Risk Management has made some changes to the procedures with the outside adjusters to make them more accountable and make the internal claims load more manageable. The Office of Risk Management will continue to monitor and evaluate the management of caseloads to determine if additional measures can be taken to more effectively manage the workload.

Internal Controls

Chapter 5

Good internal controls are a vital component of a risk management system. Such controls provide protection against mistakes or fraud, which could cost the State significant amounts of dollars. We reviewed the internal controls for the State's risk management system and identified the following three areas where controls need to be strengthened: (1) duties are not properly segregated; (2) an authorization form does not display the authorized dollar levels by the title of the required authority for each signature line; and (3) there is a lack of reconciliation between STARS and the COFRS system.

Segregation of Duties

An effective system of internal controls for claims processing ensures that key functions—such as inputting claim information, authorizing settlement of claims, generating warrant requests, and approving warrant requests—are not performed by the same person. Segregation of these activities is important because it provides assurance that claims processed are not fraudulent and are free from errors. When these duties cannot be separated due to small staff size, a detailed supervisory review of related activities is required as a compensating control. Segregation of duties is a deterrent to fraud and errors. When it takes more than one person to perpetrate a fraudulent act, such an act is less likely to occur.

In our review of ORM's processing of liability claims, we found that from September 2009 until April 2010 the ORM Assistant Claims manager was able to input claim information, authorize the settlement of claims, generate a warrant request, and approve the warrant request for all claims between $5,000 and $25,000. Accordingly, there was a risk during this period that a fraudulent or erroneous payment request that appeared to have the proper approvals could have been submitted and approved for payment by the same person. We found that as a mitigating factor to this risk, payment checks were reviewed by someone in the Department of Personnel and Administration accounting department prior to issuance. However, this person would not likely have had sufficient knowledge of a claim to be able to identify errors or fraud.

According to ORM, the Assistant Claims Manager was entering claims because of three vacancies, including the administrative assistant position responsible for entering claims. By April 2010, two of the vacant positions, including the administrative assistant position, were filled and that position now enters claims. Although this problem may have been temporary in nature, it is important that when staff vacancies occur, ORM takes appropriate steps to maintain the systems of internal control. In this case, appropriate internal controls could have been maintained by one of the following actions: (a) all warrant requests could have been approved by the Risk Manager; or (b) another employee could have been trained as a back-up to input claims and generate warrant requests. To ensure all payments made during the vacancy were appropriate, ORM should conduct an audit of a sample of claims processed between September 2009 and April 2010 to make sure all claims were properly approved and paid.

Settlement Authorization

A hierarchy for approving claims for settlement is set forth in statute [Section 24-30-1515, C.R.S.]. An ORM claims adjuster is authorized to settle liability claims in an amount not to exceed $5,000. The Assistant Claims Manager is authorized to settle claims exceeding $5,000 but not greater than $25,000. The State Risk Manager is authorized to settle claims not exceeding $50,000 and the Department of Personnel and Administration's Executive Director is authorized to settle claims from $50,000 to $100,000. The State Claims Board must settle all claims over $100,000. The Claims Board was created by statute [Section 24-30-1508, C.R.S.] to settle claims in excess of $100,000 and comprises the Executive Director of the Department of Personnel and Administration as well as the Treasurer and Attorney General of the State.

We found that the authorization form used by ORM to obtain approvals for settlements exceeding $5,000 does not display the authorized dollar levels by the title of the required authority for each signature line. As a result, it is possible that an unauthorized person may approve a settlement payment and a warrant request may be processed without the proper authorization. The authorization form should be amended to identify the dollar amounts each signor is authorized to approve.

Reconciliation Between STARS and COFRS

ORM maintains an internal database to track its property, liability, and workers' compensation claims. The system is known as the STARS system. Liability and property claims data are entered by ORM and contract staff, while workers' compensation claims data are provided by Pinnacol. Payment requests are also entered into and tracked through the STARS system. ORM staff print a summary of all payment requests from the STARS system, determine what amounts should be paid, and submit a hard copy request along with supporting documentation to the program accountant for payment processing through the State's accounting system, COFRS.

Reconciling claims paid according to STARS with claims paid according to COFRS is an important control to ensure the accuracy of claims payments, the integrity of the claims database, and to ensure that the State's financial statements are presented fairly. Reconciliation is also important because claims recorded in STARS may reflect amounts that are recoverable from insurance carriers or other parties. Currently these recoverable amounts are not recorded as receivables in the COFRS system, and as a result, the State does not have a means of tracking accounts receivable or ensuring that all amounts owed to the State by other insurance carriers are collected.

We reviewed ORM's process for reconciling STARS to COFRS and found that although the 2004 audit recommended that the Department of Personnel and Administration conduct reconciliations between STARS and COFRS, the Department of Personnel and Administration has not yet implemented the 2004 audit recommendation.

Completeness and accuracy of the claims data in STARS and COFRS is an important part of accountability for claims payments, for ensuring that the State's financial statements are properly stated, and to ensure the integrity of the data in STARS. Without reconciliation, an inappropriate expense may be charged to the claims account code and not be detected by ORM. Further, ORM cannot ensure that recoverable claim amounts are collected from other insurance carriers.

ORM should work with the Department of Personnel and Administration accounting office to develop reporting and reconciliation procedures that ensure claim payments in COFRS are reconciled to payments posted in STARS. Also, consideration should be given to posting outstanding reserves, or liabilities, to COFRS and periodically comparing the information to the expected reserves as estimated by the actuary with whom ORM contracts. Finally, consideration should be given to posting any expected recoveries to COFRS and periodically monitoring the status of each recovery. Specifically, ORM should submit an action form to the Department of Personnel and Administration accounting office to record a receivable when a claim has an amount that is recoverable from another insurer.

Recommendation No. 5:

The Office of Risk Management should strengthen controls over claims processing by:

a. Establishing policies and procedures to ensure segregation of duties is maintained. Additionally, ORM should conduct an audit of the claims processed between September 2009 and April 2010 to ensure payments were approved and paid appropriately.

b. Amending the settlement authorization form to specify the dollar amount, as well as the title, for each required signor.

c. Working with the Department of Personnel and Administration to reconcile claims information in STARS with payment information in COFRS on an ongoing basis. The reconciliation process should include recording and reconciling payments, outstanding liabilities, and amounts recoverable from other parties.

Office of Risk Management Response:

Agree, subject to available resources and system functionality. Implementation Date: June 2011.

The Division of Human Resources, Office of Risk Management will establish procedures ensuring segregation of duties and update the settlement authorization form as identified. The Office of Risk Management will work with the Department Controller to conduct an audit of the claims entered and payments processed between September 2009 and April 2010. Further, the Office of Risk Management will work with the Department Controller to establish a procedure to reconcile the risk management information system (RMIS) claim information with COFRS payment information. The current risk information system, STARS, does not track outstanding liabilities and amounts receivable from other parties on a claim-by-claim basis. As indicated above, once a new RMIS is selected we will determine if the selected system will facilitate the recommended tracking and determine if additional reconciliation processes are needed.

Risk Management Information System

Chapter 6

The State's risk management information system, STARS, is a web-based product that is used by ORM and department staff to manage information for all lines of risk. As mentioned in Chapter 5, liability and property claims data are entered into STARS by ORM and contract staff, while workers' compensation claims data are provided by Pinnacol. Payment requests are also entered into and tracked through STARS.

We reviewed the operations, performance, maintenance, and utilization of STARS, including all of its screens and many of the reports it generates. We found that there are opportunities for improving the current operation of STARS as well as opportunities for expanding the list of functions it can perform, as discussed below.

Improving the Current Operation of STARS

We identified three areas where there are opportunities for improving the operation of STARS. First, ORM needs to take steps to improve the completeness of the workers' compensation claims information contained in STARS. Second, ORM needs to develop consistent protocols and reports for departments to use when accessing STARS claims information. Finally, ORM needs to work with the STARS vendor to address problems with system performance and slow response time.

Workers' Compensation Claims Data

As the administrator of workers' compensation claims, Pinnacol uses its own proprietary system rather than STARS to manage claims information. Most of the workers' compensation information contained in the Pinnacol system is uploaded to STARS on a daily basis. The two systems are reconciled on a regular basis. Reports generated by each system are reviewed and specific discrepancies are addressed. We identified two areas where claims information uploaded by Pinnacol to STARS is problematic. First, we found that claims notes, a critical component to managing claims information in the Pinnacol claims system, are not uploaded to STARS. ORM and department staff currently have to access the Pinnacol system, in addition to STARS, to view claims notes. This means that staff must receive training, maintain user identifications and passwords, and understand the mechanics of two different claims systems in order to perform their duties.

Second, we found that STARS does not calculate "reserve takedowns" correctly. Each time a claim is processed, a claim adjuster establishes a claim reserve based on the amount that will likely be paid on the claim. This reserve is established to ensure that funds are available to pay the claim. This reserve amount is increased or decreased as the claim goes through processing, and claim liabilities are decreased as payments are made. A "reserve takedown" is the reduction of reserve amounts as payments on claims are made. We found that both the Pinnacol system and STARS each calculate reserve takedowns independently, with the result that payments and outstanding reserve amounts are often recorded twice for each claim when viewed within STARS and on reports generated by STARS. Users must understand the problem with the reserve takedown and make adjusting calculations in order to correctly determine the current outstanding reserve amounts when looking at reports from the STARS system. If users are not aware of the problem, they may make incorrect assumptions regarding the loss amounts. Reports must also use a work-around to correctly display outstanding reserves and incurred losses. These activities unnecessarily use valuable time and resources.

Department Customization of STARS

We identified two areas where improvements are needed to ensure STARS provides departments with useful information while also providing assurance that information obtained from STARS is accurate. Further these improvements are necessary to ensure that getting information into STARS via the individual department user interfaces is efficient, appropriate, and available to all departments who might wish to take advantage of such interfaces.

First, we found that reports in STARS should be standardized. Department staff have over the years created a large number of customized reports using STARS. This has resulted in multiple versions of similar reports, duplication of effort, and an excessive amount of staff time spent in report creation across state government. Flexibility in report generation may be needed in order to respond to department-specific requests for information. However, all users should have access to standardized information products that are consistent and accurate. A tiered reporting system is needed, consisting of the following: a core set of interdepartmental reports centrally created, validated, and made available to all users; a set of department reports created by selected department staff that can be used in individual departments; and additional reporting capabilities given to a limited number of users for responding to ad-hoc requests for information.

Second, ORM should do more to manage department customization of the STARS user interface. Each department has a user interface with the STARS system that allows the department to upload information on claims into STARS. We found that departments were able to customize these interfaces, within certain parameters, to better suit their needs. For example, the Department of Transportation has made a number of changes that allow the Department of Transportation to upload employment information for an individual involved in a claim from its internal information system directly to the STARS claims database rather than re-entering employment information manually. This type of change may have potential benefit to other departments as well, yet other departments are not aware of these changes or their potential benefits. Also, if individual departments extensively customize the system for their own use, it will make it more difficult over time for ORM to report on risk management information across all departments. Customizations should be managed in order to minimize cost, ensure success, and maximize benefit for the greatest number of users.

System Maintenance and Performance

In our review of the maintenance and performance of STARS we found two problems. First, we found that ORM should do more routine system maintenance to ensure that agencies or sections that are no longer in existence are moved and accounted for differently on reports. We found that agencies that were no longer in existence continue to be maintained within the STARS database and continue to be listed on reports. As a result, the lists must be manually evaluated and adjusted, making reporting more complicated. Resources are needed to spend additional time modifying existing reports to account for reorganized or discontinued agencies or sections.

The second problem is that STARS has experienced ongoing problems with poor performance. Both the report designer interface and the display of large sets of information can be slow and unresponsive. Additionally, for a period of months, STARS had to be rebooted each day during working hours between 11:45 AM and noon to avoid additional performance problems. Waiting for a slow and unresponsive system wastes time, causes staff frustration, and limits productivity. ORM should continue to work diligently with the STARS vendor to correct performance problems.

Recommendation No. 6:

The Office of Risk Management should enhance the availability, accuracy, and effectiveness of the information available to guide the State's risk management efforts. Specifically, ORM should take steps to address the deficiencies in the current operation of STARS, to include:

a. Improving management of workers' compensation claims data by uploading claims notes from the Pinnacol system into STARS. Further, ORM should ensure that reserve take downs are not recorded twice when claims are uploaded from Pinnacol to STARS so that users of COFRS and STARS reports do not have to make additional calculations to determine the remaining amount of a claim reserve.

b. Establishing greater control over customization of STARS, including department customization of reports and the STARS user interface.

c. Performing routine system maintenance to clean up discontinued agency files and ensure that STARS reports do not need to be manually adjusted to account for discontinued agencies. Further, ORM should continue to work with the STARS vendor to resolve any system performance problems.

Office of Risk Management Response:

Agree, subject to system functionality. Implementation Date: December 2011.

The Division of Human Resource, Office of Risk Management has already implemented changes in STARS to address the reserve takedown issue and the system currently calculates claim reserve correctly. Additionally, the Office of Risk Management is currently working to clean up the data associated with discontinued agency files and continues to work with STARS to address performance issues. As earlier noted, the Department is currently in the Request for Proposal (RFP) process for a Risk Management Information System (RMIS). Once a final decision is made regarding the RMIS, we will determine if the selected system will have the ability to bring over the notes from Pinnacol. If not, the Office of Risk Management will investigate the financial feasibility of modifying the system to do so. In addition, the Office of Risk Management will institute procedures to control customization of the newly implemented information system and ensure appropriate system performance levels.

Enhancing STARS Functionality

The State has made a significant investment in STARS. The initial cost to the State for STARS was $312,850 over a five year period. STARS is a comprehensive information system, but more could be done to maximize the value of STARS as a risk management tool. STARS can provide many additional functions, but these capabilities are dependent on the data being retained within the system or integrated with it. Specifically, a number of very useful risk-related information management applications could be created with relative ease using integrated information from external systems and data sources.

- **Incident recording—**ORM is not currently recording “incidents” within STARS. An incident refers to a problematic event that did not result in a claim, but could expose a vulnerability that might give rise to future claims. For example, an employee may have slipped on a wet floor but did not get injured. STARS currently offers the capability to track and manage incidents. As part of loss control activities, department users could analyze incident data to identify concerns that, if addressed, could give system users opportunities to make changes in the workplace that could result in fewer claims.

- **Property information management—**As we discussed in Chapter 4 of this report, the individual departments maintain their own separate systems and processes for managing properties, sometimes using Excel spreadsheets, while ORM uses STARS to manage properties (and their values) for risk management needs. Thus, there are now multiple systems with redundant information resulting in the need for duplicate data entry and the possibility of inconsistencies between the systems. Additional time and effort is required by ORM and department staff to maintain property information both in STARS and in the standalone spreadsheets and to keep them consistent over time.

In addition to the two examples cited above, there are other potential applications whereby STARS could provide substantial benefit to the State's risk management efforts. These include: employee risk profiles; demographic reporting; combining property information with loss and exposure information; and combining training histories with loss and exposure information. Also, STARS offers an audit module that is used for performing environmental health and safety audits. ORM could benefit from the use of the audit module by tracking specific safety concerns, changes in the environment, property improvements, and follow-up actions.

Recommendation No. 7:

The Office of Risk Management should perform a needs assessment and return on investment analysis to determine if additional STARS applications should be developed and implemented.

Office of Risk Management Response:

Agree. Implementation Date: June 2011.

Once a final decision is made regarding the Risk Management Information System Request for Proposal, the Office of Risk Management will perform a needs assessment and if appropriate, return on investment analysis, to determine if additional applications should be developed for the new risk management information system.

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Contract Management

Chapter 7

ORM contracts with the following vendors for risk management services:

- **Marsh USA, Inc**.—the insurance broker responsible for placing the State's property and casualty insurance coverage.

- **Pinnacol Assurance**—the third party administrator responsible for adjusting the State's workers' compensation claims. Pinnacol also provides loss control services.

- **GAB Robbins North America, Inc**.—the contractor responsible for adjusting the State's liability and property claims.

- **McMillan Claim Service**—the contractor responsible for adjusting the State's liability claims.

We reviewed both the pricing of the contracts with these vendors and ORM's management oversight of the vendor contracts. Generally, we found that these contracts are reasonably priced. The 2004 risk management audit found that the fees charged under the contract with Pinnacol were excessive. We reviewed the fee structure for the Pinnacol contract that was recommended in the 2004 audit and found that the recommended structure was appropriate. We compared the current fee structure and found that it is even less than the recommended structure, thereby achieving an estimated annual savings to the State of over $380,000 when compared to the 2004 recommended rates.

We also found that overall, ORM is effectively procuring its contracted services. We found that competitive bids are obtained every five years, that there is appropriate ongoing communication between ORM and the vendors, and that the claims procedures used by the vendors generally meet best practices guidelines. However, we identified some problems with ORM's contract monitoring. Specifically, we found that ORM has not held two of its vendors, Marsh and Pinnacol, accountable for providing important information that would be helpful in managing the State's risk management program.

Information Not Provided by Marsh

The contract with Marsh requires Marsh to provide ORM with a stewardship report and a cost of risk analysis each year. The contract also requires Marsh to deliver insurance policies to ORM within 30 days of receipt of correct policies from insurers. We found that Marsh did not provide ORM with the following information:

- **The annual stewardship report—**It is customary for a broker to prepare a stewardship report no less than four months prior to the time of policy renewal. The stewardship report outlines the broker's service plan for the year, identifies accomplishments in the prior year, describes changes in the insurance market since the last renewal, and identifies a strategy for upcoming renewals. A meeting with the client is then customarily held to go over the report. This meeting provides an opportunity for the client to communicate its needs, to influence insurance market choices, to propose insurance limit and retention options, and to provide feedback on the client's satisfaction with services received. According to Marsh, a stewardship report was not provided in 2009 because a new account executive had been assigned to the State's account and the State's risk manager position was vacant. Neither Marsh nor ORM was able to determine if reports prior to 2009 had been issued. As of the time of our review, a report for 2010 had not yet been prepared, although insurance renewals were only two and one-half months away. A stewardship report is a critical tool, affecting the State's ability to manage its insurance renewal process and measure the broker's performance according to the service plan. Without reliance on this tool, ORM is hampered in its ability to assess how the current year is proceeding and plan for the succeeding year. The 2004 audit of risk management emphasized the importance of ORM receiving a stewardship report from its broker in a timely manner. The 2004 recommendation was not implemented.

- **The annual cost of risk analysis—**The cost of risk analysis is a tabulation of an entity's insurance premiums, retained losses, and risk management administration costs. It is a useful tool to evaluate risk management performance from year to year and to compare performance to that of other similarly situated entities. Marsh indicates that a cost of risk analysis may not have been provided because Marsh did not receive loss information from ORM.

- **Two insurance policies—**The crime policy and one of the property policies were issued July 1, 2009, but had not been received by ORM as of March 2010. Carriers can be slow to issue policies, requiring continued reminders from the insured or broker. In the event of a loss, without a policy, the terms of coverage are not defined, making the State's recovery potentially more difficult. In addition, if ORM were to identify problems with policies delivered late in the year, its leverage to negotiate changes to the policy would be substantially impaired.

Information Not Provided by Pinnacol

In addition to serving as the third party administrator responsible for adjusting the State's workers' compensation claims, Pinnacol also provides 2,000 hours of loss control services annually. Pinnacol meets at least quarterly with the six departments that incur the most workers' compensation losses. The six departments are Corrections, Transportation, Human Services, Judicial, Public Safety, and Natural Resources. The more problematic claims (e.g., a claim that involves difficulty getting an employee back to work after a temporary disability) are reviewed at these meetings. Information provided by Pinnacol includes work status, paid/reserve information, and medical provider feedback. Pinnacol also provides safety training to state employees, attends safety committees, conducts safety inspection of facilities and operations upon request, and conducts ergonomic evaluations of state employee work stations.

Additionally, Pinnacol provides ORM monthly reports of loss control services and the hours logged. These reports are required by the State's contract with Pinnacol and they allow ORM to monitor loss control service delivery. However, the Pinnacol reports do not break out the services by department. Also, codes identifying the type of service provided (named on the report as "RM Visit Type Code") are not defined.

A summary of the year-to-date allocation of hours by department would more readily enable ORM to direct loss control services to the departments with the greatest need. Definitions for the service codes reported monthly would permit ORM to conclude whether services delivered are targeted to the areas of high loss cost.

Recommendation No. 8:

The Office of Risk Management should ensure that contractors provide information required by contract necessary to support management decisions by:

a. Requiring that Marsh provide it with a stewardship report annually but no later than March 1. ORM should use the stewardship report and accompanying meeting to verify the status of policy issuance. ORM should also ensure that Marsh provides it with a cost of risk analysis no later than 90 days following the end of each fiscal year.

b. Requesting that Pinnacol modify its monthly loss prevention reports to indicate loss control services by department and define codes to identify the specific type of services provided.

Office of Risk Management Response:

Agree. Implementation Date: December 2010.

The Division of Human Resources Office of Risk Management will require the insurance broker to provide a stewardship report no later than March 1 of each year and the cost of risk analysis no later than 90 days following the end of the fiscal year. The Office of Risk Management will use the stewardship report and the accompanying meeting to verify the status of policy issuance. The monthly loss prevention reports from Pinnacol have already been modified as indicated in the audit report.

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