



Lexington-Fayette Urban County Government  
OFFICE OF INTERNAL AUDIT

## **INTERNAL AUDIT REPORT**

DATE: December 5, 2014

TO: Jim Gray, Mayor

CC: Sally Hamilton, Chief Administrative Officer  
Glenn Brown, Deputy Chief Administrative Officer  
Aldona Valicenti, Chief Information Officer  
Janet Graham, Commissioner of Law  
William O'Mara, Commissioner of Finance and Administration  
Phyllis Cooper, Director of Accounting  
Susan Straub, Communications Director  
Urban County Council Members  
Internal Audit Board Members

FROM: Bruce Sahli, CIA, CFE, Director of Internal Audit

RE: Employees Workers' Compensation Sick Pay Match Audit

### **Background**

Workers' compensation is covered under the Kentucky Workers' Compensation Act and provides certain benefits to employees injured in job-related accidents and to those who contract or develop diseases due to workplace exposure. Benefits include partial wage replacement, payment of medical treatment, and restoring the injured worker to suitable employment. If death occurs, a lump sum payment is made to the employee's estate and includes burial expense. Additionally, income benefits are extended to the surviving spouse and other dependents. The complete law (Act) is found in Chapter 342 of the Kentucky Revised Statutes and in Chapter 25 of Title 803 of the Kentucky Administrative Regulations.

Workers' Compensation will pay 66 2/3% of an eligible employee's average weekly wage/salary (calculated using the highest wages paid in a thirteen week period in the year before the injury occurred) up to a defined maximum amount. For 2012, 2013 and 2014, those maximum amounts were \$736.19, \$752.69 and \$769.06 respectively. LFUCG also elected to cover the difference between what an employee receives via workers' compensation and what the employee would normally receive through the use of disability leave as established in an Ordinance approved several years ago. These two combined components cover 100% of the eligible employee's salary.

In addition, disability leave will cover lost time an employee may incur for doctor's visits or medical treatment because workers' compensation does not consider this lost time from work. For most employees, disability leave is exhausted after one year from date of accident. For employees with collective bargaining agreements, disability leave can be extended an additional year or one-half year depending on the language in the agreement. Once disability leave is exhausted, the employee will continue to receive the workers' compensation amount only (66 2/3% of average weekly wage/salary) directly through a voucher payment made by the Division of Accounting.

Kentucky employers are required to carry workers' compensation insurance or be self-insured. Since 1985, LFUCG has chosen to be self-insured. The Property and Casualty Claims Fund, an LFUCG internal service fund, accounts for the Government's self-insurance programs, including workers' compensation. A contracted Third Party Administrator (TPA) actually handles the workers' compensation claims. The TPA receives and processes completed workers' compensation forms, including doctor reports stating the dates employees are to be excused from work and when affected employees can return to work.

### **Scope and Objectives**

The general control objective for the audit was to provide reasonable assurance that:

- Employees who received worker's compensation payments were not also receiving sick leave or other types of wages during the same pay period, which would result in excess compensation

Audit results are based on observations, inquiries, transaction examinations, and the examination of other audit evidence on a test basis and provide reasonable, but not absolute, assurance controls are in place and are effective. In addition, effective controls

in place during an audit may subsequently become ineffective as a result of technology changes or reduced standards of performance on the part of management.

The scope of our audit included employees who received worker's compensation during Calendar year 2012, 2013, and 2014 (through June 30, 2014).

### **Statement of Auditing Standards**

We conducted our audit in accordance with the International Standards for the Professional Practice of Internal Auditing. Those standards require that we plan and perform the audit to afford a reasonable basis for our judgments and conclusions regarding the organization, program, activity, or function under audit. An audit also includes assessments of applicable internal controls and compliance with requirements of laws and regulations when necessary to satisfy the audit objectives. We believe that our audit provides a reasonable basis for our conclusions.

### **Audit Opinion**

In our opinion, the controls and procedures provide reasonable assurance that the general control objective was being met. Opportunities to enhance controls are included in the Summary of Audit Findings.

### **Priority Rating Process**

To assist management in its evaluation, the findings have been assigned a qualitative assessment of the need for corrective action. Each item is assessed a high, moderate, or low priority as follows:

High - Represents a finding requiring immediate action by management to mitigate risks associated with the process being audited.

Moderate – Represents a finding requiring timely action by management to mitigate risks associated with the process being audited.

Low - Represents a finding for consideration by management for correction or implementation associated with the process being audited.

## SUMMARY OF AUDIT FINDINGS

### **Finding #1: Approved Policies, Procedures, and Training Needed for the Workers' Compensation Reporting and Payment Process**

**Priority Rating: High**

#### **Condition:**

We were informed that written policies and procedures regarding the workers' compensation reporting and payment process were drafted in October 2012. However, these policies and procedures have never been officially approved by the Department of Law. We were also informed that related training for LFUCG personnel responsible for reporting and paying workers' compensation claims has not been conducted in several years.

#### **Effect:**

The absence of approved written procedures could result in LFUCG personnel being inconsistent in the proper reporting and payment of workers' compensation claims, and in complying with management's performance expectations. The absence of approved procedures also makes it more difficult to train employees and hold them accountable for proper implementation of their training.

#### **Recommendation:**

Up to date policies and procedures regarding the workers' compensation reporting and payment process should be developed and approved by the Department of Law. Once this process has been completed, sufficient communication of and training on the policies and procedures should be provided to all payroll coordinators, insurance coordinators, and other necessary personnel in each Division responsible for reporting and paying workers' compensation claims.

#### **Commissioner of Law Response:**

I appreciate Internal Audit's review of this part of LFUCG's workers' compensation system and its finding that the controls and procedures related to same provide reasonable assurance that the general control objective is being met. As indicated above, workers' compensation is largely controlled by state law. Locally, LFUCG's policy and procedure has been adopted via ordinance (section 21-39 of the Code of Ordinances). Law will review what has been drafted, along with Human Resources and Accounting, to determine if better or additional guidance can be given beyond the ordinance. I agree that training in this area should be provided to appropriate personnel. By the end of the current fiscal year, appropriate written policies/guidance will be implemented and training provided to the appropriate personnel.

**Finding #2: Duplicate Payments of Benefits Noted**  
**Priority Rating: High**

**Condition:**

Our testing identified three employees who received workers' compensation and disability leave benefits paid by LFUCG Payroll while also receiving workers' compensation payments through vouchers paid by Accounting. Workers' compensation voucher payments are made once an employee exhausts his or her disability leave (disability leave is paid through LFUCG Payroll). For two of the employees, the overlap occurred during the first period covered by the voucher (after disability leave was exhausted) in July/August 2012. For the third employee, the overlap occurred over a period of several months.

Our testing also identified three employees who received payment of leave time through LFUCG Payroll while also receiving workers' compensation payments through vouchers paid by Accounting. Workers' compensation voucher payments are made once an employee exhausts his or her disability leave (disability leave is paid through LFUCG Payroll). For each of the employees, the overlap occurred during the time also covered by the voucher payment. Each employee was paid a full week of leave time through the payroll process for each week also covered by workers' compensation voucher payments. One of these three employees exhausted all his leave time prior to the workers' compensation voucher payments ending.

**Effect:**

The exceptions noted above indicate the overpayment of benefits to these employees.

**Recommendation:**

The Third Party Administrator should provide the Payroll Manager a report of all employees receiving workers' compensation benefits through voucher payment. This report should be provided on at least a monthly basis. The Payroll Manager should compare this report to a payroll report of employees receiving benefit payments through the payroll process to detect and correct such duplicate payments. Senior management should consider seeking reimbursement of the overpaid benefits from these employees.

**Commissioner of Law Response:**

I agree that duplicate payments should not be made to employees. Our estimates indicate that, on average, approximately 730 workers' comp payments are made per fiscal year. For the years reviewed, it appears that payments were made to approximately 250 employees. Improved communication among the personnel involved should prevent this limited number of duplicate payments. To that end, the Third Party Administrator will be asked to provide a report, at least monthly, as suggested by Internal Audit. The training

that will be provided will also stress the importance of reviewing employees who are receiving workers comp payments, including review by not just payroll coordinators but also supervisory personnel.

**Director of Accounting Response:**

The Third Party Administrator (TPA) will provide Payroll a monthly report listing worker's compensation payments made. Payroll will compare the TPA report to PeopleSoft time & labor reports to ensure there are no duplicate payments.

**Commissioner of Finance & Administration Response:**

The Commissioner concurs with the Director of Accounting's response.

**Finding #3: Employee Leave Balances Were Not Reinstated After Workers' Compensation Lost Time Claim Was Approved**

**Priority Rating: High**

**Condition:**

Our testing identified two employees that correctly used leave time while their claim was in review since the workers' compensation law requires a seven day waiting period before an employee is entitled to temporary total disability. After the claim was approved, the employee's timesheets should have been adjusted to reflect workers' compensation time since both were entitled to workers' compensation from the day of incident. The timesheets were not corrected at that time. This was reported to management during audit fieldwork. Leave balance reinstatement has been recently submitted for these two employees, and is in the review process.

**Effect:**

When employee leave balances are not reinstated, the employee cannot receive the future benefit of leave time they are entitled to. When timesheets are not properly adjusted, they do not provide a correct record of time reporting activity.

**Recommendation:**

The appropriate leave balances for these two employees should be reinstated. The Claims Manager should coordinate with the Division insurance coordinators and payroll coordinators to ensure the correct adjusting time report entries.

**Commissioner of Law Response:**

I agree that appropriate leave balances should be reinstated.

**Finding #4: A Division's Payroll Expense Was Not Reimbursed For an Employee's Workers' Compensation Payment**  
**Priority Rating: High**

**Condition:**

Our testing identified one Division whose payroll account was not properly reimbursed for workers' compensation the Division had previously paid to one of their employees through the payroll process. The Claims Manager has alerted the Third Party Administrator about this employee and the necessary steps have been taken to correct this.

We also identified seven additional employees that may require reimbursement of their Division's payroll for workers' compensation the Divisions had previously paid. However, further review is needed by the Claims Manager to determine if incorrect time coding may have created false positives. The information regarding these seven employees will be passed on to the Claims Manager for evaluation.

**Effect:**

When a Division's payroll account is not properly reimbursed, its payroll expense is overstated the amount previously paid for the employees workers' compensation benefits, and the Property and Casualty Claims Fund expense is understated.

**Recommendation:**

The affected Division's payroll account and the Property and Casualty Claims Fund should be adjusted to correct the error. The Claims Manager should also monitor workers' compensation benefits paid through LFUCG Payroll as provided to him on the PPE Spreadsheet by the Payroll Manager. He should then review the Risk Master program for evidence the Third Party Administrator has posted the proper coding in Risk Master that provides the support for the Division of Accounting to post journal entries reimbursing the Divisions payroll accounts and charging the expense to the Property and Casualty Claims Fund.

**Commissioner of Law Response:**

The Claims Manager will review this issue and appropriate adjustments will be made. The Claims Manager will also continue to review and monitor as suggested so that appropriate reimbursements are made to payroll accounts.

**Finding #5: Improper Time Codes May Have Been Used in Reporting Workers' Compensation**

**Priority Rating: High**

**Condition:**

Our testing identified four employees who used the workers' compensation time code but were not included on the lost time claims list provided by the Third Party Administrator. This indicates the use of the workers' compensation time code may have been incorrect.

**Effect:**

Timesheets may include incorrect time reporting codes, and the employee leave balances may be overstated if the employee took time off but incorrectly charged it to workers' compensation.

**Recommendation:**

The Claims Manager and Payroll Manager should investigate these anomalies to determine if proper time coding was posted and ensure any necessary corrections are made. If the employees in question did accurately charge the time to workers' compensation, journal entries will need to be made to reimburse their Divisions for the workers' compensation benefit paid by the Divisions.

**Commissioner of Law Response:**

The Claims Manager will investigate as suggested and process any necessary corrections.

**Director of Accounting Response:**

The Division of Human Resources and Payroll have begun quarterly Payroll Coordinator training. Time card auditing will be included on a routine basis. In addition, the worker's compensation training beginning in February can address time card coding issues.

**Commissioner of Finance & Administration Response:**

The Commissioner concurs with the Director of Accounting's response.