PERFORMANCE AUDIT OF THE RISK MANAGEMENT PROGRAM

August 2004

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August 6, 2004 850-002

Legislative Audit Committee
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Office of the State Auditor
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PERFORMANCE AUDIT OF THE RISK MANAGEMENT PROGRAMS

This report presents the results of ARM Tech's audit of the risk management programs of the State of Colorado (State) done under contract with the Office of the State Auditor.

As part of this audit ARM Tech:

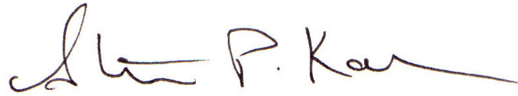
1. Reviewed insurance schedules, loss summaries, prior audit, and other pertinent data supplied by the Office of Risk Management.
2. Reviewed and analyzed the State's cost of risk, risk financing approach, cost allocation system, claims handling, and loss control program.
3. Interviewed the Risk Manager, Assistant Claims Manager, and Loss Control staff in the Office of Risk Management.
4. Interviewed risk liaisons in the Departments of Public Safety, Transportation, Corrections, Human Services, Law, and Colorado State University.
5. Interviewed the State's insurance broker and third-party administrators.

The review of internal controls was completed by James Marta, CPA. The balance of the analysis was completed by ARM Tech.

We appreciate the opportunity to assist the State with this project. We would be pleased to answer any questions you may have.

Respectfully submitted,

ARM TECH



By ________________________________

Steven P. Kahn, CPCU, ARM
Managing Director

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Risk Management Program
Department of Personnel & Administration
Performance Audit
August 2004

REPORT SUMMARY

AUTHORITY, PURPOSE, AND SCOPE

ARM Tech conducted this performance audit under contract with the Office of the State Auditor pursuant to Section 24-30-1513, C.R.S. This audit reviewed the Department of Personnel & Administration's statewide risk management program. The audit work was performed from April through June 2004. We acknowledge the assistance and cooperation extended by management and staff at the Department.

DESCRIPTION OF RISK MANAGEMENT

The Office of Risk Management (Risk Management), within the Department of Personnel & Administration, administers a comprehensive risk management program that serves all state agencies, excluding the University of Colorado. Risk Management supervises the investigation, adjustment, and legal defense of property, liability, and workers' compensation claims and administers loss control programs designed to decrease the State's liability, property, and workers' compensation losses. Risk Management also has financial responsibility for the State's workers' compensation, property, and liability risks. This includes determining how much risk the State should retain through self-insurance and how much should be covered with purchased insurance. In Fiscal Year 2004 Risk Management was appropriated about $52 million and 9.0 full-time equivalent employees.

SUMMARY OF AUDIT FINDINGS

Contract Management

We reviewed Risk Management's contract management practices with respect to its three claims administration firms (Pinnacol, McMillan, and GAB) and its insurance broker (Marsh) and found:

- **The State is paying almost $900,000 more for workers' compensation claims administration services than is necessary.** We reviewed the fees Pinnacol charges to administer the State's workers' compensation claims and compared them with the fees charged by other third-party administrators for

the same types of services. The State pays Pinnacol $500 per claim during the year a claim is reported, and then $250 per year for each year a claim remains open after the first year. With its current fee structure, we found that the State is saving almost $700,000 per year on indemnity claims compared with what other firms would charge, but is paying almost $1.8 million more than other firms would charge for medical and record only claims. The State should negotiate separate competitive per claim fees for indemnity, medical only, and record only claims, or negotiate a lower total fee for all types of claims.

- **Improvements are needed in Risk Management's contract with Pinnacol for loss control services.** Risk Management contracts with Pinnacol to provide 1,500 hours of loss control services annually to state agencies. We reviewed Risk Management's contracting process and contract provisions related to these services and found that (1) Risk Management may be paying more for loss control services than is necessary because it combines workers' compensation claims administration services and loss control in a single request for proposals, (2) the contract does not specify the cost of loss control services to be provided, and (3) Risk Management does not require Pinnacol to provide adequate reports on the loss control services actually provided.

- **Risk Management does not require its three claims administration firms (Pinnacol, McMillan, and GAB) to purchase sufficient insurance.** The firms must provide insurance to protect the State against any liabilities resulting from their employees' actions. We reviewed the current contract provisions related to administrator liability and found that Risk Management does not require its administrators to purchase sufficient automobile and general liability, professional liability, or employee dishonesty insurance.

Risk Financing

We reviewed the State's current risk financing program, which includes both self-insurance and purchased insurance, and found:

- **The State may be able to save up to $850,000 in insurance premiums by discontinuing many of its policies and self-insuring the losses associated with those policies.** Under its current risk financing program, the State purchases insurance for much of its large property claims and self-insures most of its workers' compensation claims and liability losses. Using industry guidelines for determining an organization's risk retention capacity, we estimate that the State can increase its risk retention capacity by about $25 million. This is in addition to the $55 million the State already expects to incur for self-insured losses. Considering the increased risk retention capacity, we found the State may be able to discontinue coverage for

automobile liability, automobile physical damage, and crime losses and still remain within its risk retention limits.

- **Risk Management needs to develop "run-off" agreements with higher education institutions.** With the passage of House Bill 04-1009, higher education institutions have the option of withdrawing from the statewide risk management program and deciding how to fund their own losses. We found that Risk Management needs to implement procedures for handling withdrawals that will ensure higher education institutions are responsible for claims they have incurred, but that remain unpaid at the time of their withdrawal. Specifically, Risk Management should require institutions that withdraw to take over their claim files and make their own payments after the withdrawal date or reimburse Risk Management for actual payments, plus the estimated cost of claims administration and legal services.

Loss Control

Risk Management is responsible for administering loss control programs that reduce the possibility losses will occur and reduce the severity of losses should they occur. We reviewed the State's loss control program and found:

- **Risk Management lacks data on the effectiveness of its loss control initiatives.** Further, Risk Management has not analyzed loss areas to determine if additional or more effective loss control initiatives are needed. As a result, Risk Management does not know if its efforts are helping to reduce the State's losses or if its loss control resources are directed in the appropriate areas.

- **Additional loss control incentives are needed.** Risk Management's current incentive program consists of awards for loss control efforts given at the annual Risk Management conference. We found that although these awards reinforce the general importance of loss control, they do not appear to motivate behavior at the agency level. We believe a risk management grant program that makes funding available to state agencies for innovative loss control initiatives would be a more effective motivator.

Claims

Risk Management staff process and administer liability and property claims with the assistance of its third-party administrators (McMillan and GAB). Pinnacol administers all workers' compensation claims for the State. Our review of the claims administration process noted the following issues:

- **Internal controls surrounding the STARS system need to be strengthened.** The STARS system is Risk Management's internal database

for tracking property, liability, and workers' compensation claims data. We found during our review of Risk Management's procedures surrounding the STARS system that (1) claims data are not reconciled between STARS and COFRS, (2) payments are not assigned unique identification numbers, (3) there is limited security over user access, (4) employment liability and civil rights claims are not coded separately, (5) claims do not receive timely follow up, and (6) claims data are entered twice by Risk Management and contract staff. As a result, this subjects the State to the risk of errors, irregularities, and fraud.

- **The employment claims reporting process could be improved.** Section 24-30-2504(1)(m), C.R.S., requires Risk Management to establish and administer a statewide database and uniform reporting system to track employment claims and the losses associated with those claims. Currently state agencies are required to report all employment claims to Risk Management when they are filed. We found that although agencies are reporting claims filed in state or federal court, they are not consistently reporting grievances handled administratively at the State Personnel Board level. As a result, Risk Management does not have complete employment claims data as required by statute.

- **Structured settlement criteria have not been established.** Structured settlements can help reduce claim costs because the State locks in a settlement amount which takes away the uncertainty associated with claims and the risk that costs will escalate over time. In our 2001 audit we recommended that Risk Management establish criteria for when structured settlements should be considered. We found that Risk Management has not implemented this recommendation.

Administration

Risk Management is responsible for administering the statewide risk management program with its 9.0 FTE, including a Risk Manager, Assistant Claims Manager, Contract Administrator, three loss control specialists, one and one-half accounting staff, and one and one-half administrative staff. We reviewed Risk Management's current organizational structure and found that Risk Management may not be using its resources as effectively or efficiently as possible. Specifically, we found that Risk Management needs to identify and prioritize its key functions, determine the skills required to manage those functions effectively, assess its available resources, and allocate staff accordingly.

Our recommendations and the responses of the Department of Personnel & Administration can be found in the Recommendation Locator.

A R M   T e c h

RECOMMENDATION LOCATOR

Agency Addressed: Department of Personnel & Administration

Rec. No.	Page No.	Recommendation Summary	Agency Response	Implementation Date
1	11	Negotiate separate competitive per claim fees for workers' compensation indemnity, medical only, and record only claims, or a lower total fee for all types of claims.	Agree	July 1, 2006
2	13	Solicit bids for loss control services separately from bids for workers' compensation claims administration services; establish the type and cost of loss control services to be provided; and require service provider to submit adequate reports.	Agree	July 1, 2006
3	15	Require third-party administrators to carry adequate insurance.	Agree	January 1, 2005
4	16	Require the insurance broker to submit the annual stewardship report no later than six months prior to coverage renewal and to assist with the annual cost of risk calculation.	Partially Agree	June 1, 2005
5	23	Evaluate the feasibility of self-insuring losses now insured by the automobile liability, automobile physical damage, and crime policies or increasing the deductible for property losses.	Agree	July 1, 2005
6	24	Require higher education institutions that withdraw from risk management programs to assume responsibility for paying claims they have incurred or reimburse Risk Management for all claim payments made on the institutions' behalf.	Agree	December 1, 2004
7	29	Develop a means of evaluating the effectiveness of loss control efforts, including identifying appropriate results- and activity-based performance measures.	Agree	July 1, 2005
8	30	Consider establishing a loss control grant program for state agencies.	Agree	July 1, 2005
9	33	Evaluate the feasibility of strengthening controls over the STARS system by developing reporting and reconciliation procedures with COFRS; assigning unique identification numbers to payment requests; implementing security controls over access to the system; implementing separate codes for employment liability and civil rights claims; using the electronic diary system to schedule follow up claims investigations; and requiring contractors to enter claims data directly into STARS.	Agree	July 1, 2005
10	36	Implement a new employment claims reporting process which may include monthly reports from the State Personnel Board and the Attorney General's Office.	Agree	July 1, 2005
11	37	Ensure the proper allocation of costs between state agencies by periodically evaluating claim reserve amounts and updating disposition plans on a quarterly basis.	Agree	December 31, 2004
12	38	Establish criteria for when structured settlements are to be considered when settling claims.	Agree	December 31, 2004
13	40	Increase the settlement authority limit for contract claims adjustors to the $5,000 allowed by statute.	Agree	December 31, 2004
14	41	Work with the Attorney General's Office to provide a litigation strategy for each claim.	Agree	July 1, 2005
15	44	Conduct a comprehensive evaluation of risk management key functions, determine the skills needed and resources available to accomplish those functions, and reallocate staff accordingly.	Agree	December 31, 2004

DESCRIPTION OF RISK MANAGEMENT

BACKGROUND

The State Office of Risk Management (Risk Management), within the Department of Personnel & Administration, administers a comprehensive risk management program that serves all state agencies, excluding the University of Colorado. Risk Management is responsible for supervising the investigation, adjustment, and legal defense of the following types of claims:

- **Property -** These are claims made by state agencies for damage to state property.
- **Liability -** These are claims made against the State by others for such things as automobile accidents and injury on state property.
- **Workers' Compensation** - These are claims arising out of injuries to state employees during the course of their employment.

In addition, Risk Management is responsible for administering loss-control programs that are designed to decrease the State's accidental losses and for assessing the overall risk to the State with regard to property, liability, and workers' compensation claims. This includes determining how much risk the State should retain through self-insurance and how much risk should be covered with purchased insurance. Currently the State's risk financing plan includes both self-insurance and purchased insurance.

STAFFING AND BUDGET

Risk management services are provided throughout the State by Risk Management's 9.0 FTE which includes a Risk Manager, Contract Administrator, Assistant Claims Manager, three loss control specialists, one and one-half accounting staff, and one and one-half administrative staff. In addition, Risk Management contracts with third-party administrators for workers' compensation claims administration and liability claims investigations. There are also 142 risk management coordinators located in state agencies who help conduct risk management activities for their agencies. These coordinators perform many risk management functions including risk identification, loss control, claims management, and evaluating the insurance requirements in contracts.

In Fiscal Year 2004 Risk Management was appropriated about $52 million. These funds are used to pay insurance premiums, Risk Management's general operating expenses, and self-insured property retention, liability, and workers' compensation losses. As the following table shows, the overall risk management budget has increased 42 percent over the past four years.

Risk Management Appropriations[1]
Fiscal Years 2001 Through 2004

Program Area	2001	2002	2003	2004	Percent Change FY 2001-2004
Liability	$6,263,390	$6,434,630	$9,644,260	$11,642,650	86%
Workers' Comp	$26,574,430	$19,015,360	$22,232,500	$30,053,740	13%
Property	$3,045,480	$4,419,330	$5,958,000	$10,019,130[2]	229%
Administrative Exp	$983,760	$793,290	$802,000	$769,860	-22%
Total	**$36,867,060**	**$30,662,610**	**$38,636,760**	**$52,485,380**	**42%**

Source: Department of Personnel & Administration Fiscal Year 2004 budget document.
Note:
[1] The appropriation amounts do not include funds carried over from prior years.
[2] According to the Department, the significant increase in property insurance premiums may be due in part to Colorado floods and fires.

PREMIUM ALLOCATIONS

Risk management expenses are allocated among state agencies. Property costs are allocated on the basis of each agency's property value compared to the total property values for the State. That is, property costs are prorated based on each agency's share of total building and content values. Workers' compensation and liability costs are allocated to agencies based on each agency's percent of total reported losses for the three most recent years. However, Risk Management has implemented a "cap" on the amount an agency's allocation can change each year. In general, agency allocations cannot be less than 70 percent or more than 110 percent of the prior year's allocation. Risk Management administrative costs including salaries, overhead, and audit expenses are funded primarily from the interest income earned on the risk management loss fund.

I. CONTRACT MANAGEMENT

BACKGROUND

Risk Management contracts with four third-party administrators to assist it in providing risk management services to the State. These firms include:

- **Pinnacol Assurance (Pinnacol).** Pinnacol administers the State's workers' compensation claims. This includes:
  - Receiving reports of employee injuries.
  - Confirming the claim arose out of employment.
  - Paying claimant and medical providers.
  - Taking other steps necessary to resolve claims.
- **GAB Robins North America, Inc. (GAB).** GAB administers the State's routine liability claims (e.g. those arising from auto accidents). This includes investigating, evaluating, and resolving claims assigned by Risk Management, and providing Risk Management with regular reports on the status of claims.
- **McMillan Claim Service (McMillan).** McMillan provides the same services as GAB on the State's more complex liability claims.
- **Marsh USA, Inc (Marsh).** Marsh is the State's property and casualty insurance broker. Marsh obtains necessary information from the State and negotiates insurance policy terms with insurers. Marsh also supplies the STARS claim management system to Risk Management. Marsh provides periodic system updates and is available to answer questions about system operation.

WORKERS' COMPENSATION FEES

As previously mentioned, Risk Management contracts with Pinnacol to administer its workers' compensation claims. Claims can be categorized as follows:

- **Indemnity claims.** These are claims where the employee injury results in lost time from work. These claims are the most costly to the State and the most time-consuming to administer.

- **Medical only claims.** These are claims where the employee receives medical treatment but does not lose work time. These claims are less costly to the State and require less time to administer.

- **Record only.** These are reports of incidents made by State agencies, but there is no lost time or medical treatment. These claims require very little time to administer because Pinnacol only has to record the incident in its system.

According to the terms of its contract, Risk Management pays Pinnacol the same amount to administer and process all three types of workers' compensation claims. This fee consists of:

- $500 per claim during the contract year in which the claim is reported, plus;

- $250 per year, for each year the claim remains open, after the first year.

To evaluate whether the current fee structure is advantageous to the State, we compared Pinnacol's fees with the average per claim fees charged by other third-party administrators (TPAs) for indemnity, medical only, and record only claims. We found the State is saving almost $700,000 per year on indemnity claims under Pinnacol's current fee structure compared with the average fees charged by other TPAs for these types of claims. However, we found that for medical and record only claims, the State is paying Pinnacol almost $1.8 million more than other firms would charge. As the following table shows, overall, the State is paying almost $900,000 more for workers' compensation claims administration than is necessary.

Workers' Compensation Claims Administration Fees Pinnacol vs. Other Third-Party Administrators			
Claim Types	**Pinnacol**	**Other TPAs**	**Difference**
Indemnity Claims	$832,500	$1,531,800	($699,300)
Medical Only Claims	1,700,000	339,900	1,360,100
Record Only Claims	518,500	82,960	435,540
Subtotal	$3,051,000	$1,954,660	$1,096,340
Less Loss Control Allowance[1]	$200,000	$0	$200,000
Total	**$2,851,000**	**$1,954,660**	**$896,340**

Source: ARM Tech's analysis of Department of Personnel & Administration and other third-party administrator data.
Notes:
1. Pinnacol's fee includes 1,500 hours of loss control services valued at $200,000 that must be subtracted from the total fee to compare Pinnacol with the other TPAs.
2. Fee comparison based on Colorado's average annual claims volume for Fiscal Years 1999-2002 of:
- 666 indemnity claims
- 3,399 medical only claims
- 1,037 record only claims

3. Fee comparison uses industry averages and assumes:
- Average indemnity claim is open for four years.
- Average medical only claim is open for the contract year only.

The State is paying more for workers' compensation claims than it should be, in part, because Risk Management negotiates one fee for all types of claims. By negotiating separate rates for the different types of claims or a lower total fee, the State could save a significant amount of money each year on workers' compensation claims administration.

Recommendation Number 1:

The Department of Personnel & Administration should attempt to negotiate separate competitive per claim fees for workers' compensation indemnity, medical only, and record only claims, or a lower total fee for all types of claims under its current contract with Pinnacol and as part of its bid process for future contracts.

Department of Personnel & Administration Response:

Agree. The current contract with Pinnacol does not expire until June 30, 2005 and is renewable for an additional year. The DPA/Office of Risk Management will attempt to renegotiate the Pinnacol contract based on the recommendation. In the event that a renegotiation of terms is not successful, DPA/Office of Risk Management will consider publishing an RFP that incorporates these options.

Implementation Date: July 1, 2006

LOSS CONTROL SERVICES

In addition to workers' compensation claims administration services, Risk Management contracts with Pinnacol to provide 1,500 hours of loss control services annually to state agencies. As we discuss in more detail in Chapter III, the purpose of loss control services is to reduce the possibility that losses will occur and reduce the severity of losses should they occur. We reviewed Risk Management's contracting process and contract provisions related to these services and noted the following issues:

- **Risk Management may be paying more for loss control services than is necessary.** We found that Risk Management included the loss control services in its most recent request for proposals issued to workers' compensation claims administration firms. Bundling claims administration and loss control in a single RFP prevents well-qualified firms that offer only loss control services from bidding. By obtaining separate competitive bids for loss control services, Risk Management may receive more bids from firms that offer a broader range of loss control services and potentially at a lower cost.

- **The Pinnacol contract does not specify the cost of loss control services to be provided.** The current contract does not separate the cost of loss control services from the cost of the claims administration services that Pinnacol also provides. Therefore, Risk Management does not know how much it is actually paying for loss control or claims administration services. By not specifying the cost of loss control services to be provided, Risk Management cannot determine if it is receiving appropriate services at the lowest cost.

- **Risk Management does not require Pinnacol to provide adequate reports on the loss control services provided.** The contract requires Pinnacol to provide "sufficient reports" and allows Risk Management to determine what reports are sufficient. At the time of our audit, Risk Management had not established what type of reports should be submitted.

Currently Pinnacol submits reports that distinguish between administrative, travel, and onsite hours. The reports, however, do not specify what services have been provided, which agencies received services, or which Pinnacol staff provided the services. Without this type of information, Risk Management cannot determine whether the loss control services provided by Pinnacol are directed at the conditions and agencies that are causing the greatest losses to the State. More detailed reports would allow Risk Management to evaluate the quality of the services provided and direct services to the appropriate areas.

Recommendation Number 2:

The Department of Personnel & Administration should solicit bids for loss control services separately from bids for workers' compensation claims administration services. The Department should also establish the type and cost of loss services to be provided in the contract and require its loss control service provider to submit reports that more fully describe the services provided, agencies contacted, and hours spent at each agency.

Department of Personnel & Administration Response:

Agree. When publishing the next RFP for workers' compensation administrative services, the DPA/Office of Risk Management agrees to solicit bids that allows the Department to compare bundled and unbundled loss control components. The DPA/Office of Risk Management further agrees to include in any contract for loss control services, that the provider will be required to submit reports that more fully describe the services provided, agencies contacted, and hours spent at each agency.

Implementation Date: July 1, 2006

THIRD-PARTY ADMINISTRATOR LIABILITY

When contracting with Risk Management, the three risk management third-party administrators (TPAs - Pinnacol, McMillan, and GAB) must provide insurance to protect the State against any liabilities resulting from their employees' actions in regards to resolving claims. We reviewed the current contract provisions related to TPA liability and noted the following areas for improvement:

- **TPAs should carry adequate automobile and general liability insurance.** In the course of their work for Risk Management, TPA employees operate motor vehicles and come in contact with claimants. This creates the possibility that an employee will injure a member of the public or a claimant. If an injury occurs, the injured party may sue both the TPA and the State. To

ensure the TPAs have sufficient funds to pay any resulting claims and to limit the State's liability, TPAs should be required to carry automobile liability insurance to pay claims arising from automobile accidents. They should also be required to carry general liability insurance to pay claims arising out of general operating activities. Currently Risk Management's contracts with McMillan and GAB require them to carry policies with a $600,000 limit. However, Pinnacol's contract does not require it to carry any automobile or general liability insurance. Typical industry practice is to require automobile and general liability insurance with limits not less than $1 million. Although Risk Management has indicated that its TPAs currently carry insurance that meets this limit, Risk Management needs to ensure the State is protected in the future by updating its TPA contracts to require them to purchase sufficient liability insurance.

- **TPAs should carry adequate professional liability insurance.** It is common industry practice to require TPAs to purchase professional liability insurance to ensure the TPAs have sufficient funds to pay costs the State may incur due to errors TPA employees make while providing professional services. For example, if Pinnacol does not thoroughly investigate a workers' compensation claim, it could fail to determine that a third party caused an employee injury. The State would then miss an opportunity to be reimbursed by the third party. Currently Risk Management's contracts with McMillan and GAB require them to purchase policies with a limit of $600,000 per claim and $1 million for all claims made during the year. However, Pinnacol is not required to carry any professional liability insurance. A standard professional liability insurance limit is $1 million per claim. Although Risk Management has indicated that its TPAs already carry insurance that meets this limit, Risk Management needs to ensure the State is protected in the future by updating its TPA contracts to require professional liability insurance with $1 million per claim limits.

- **TPAs should carry adequate employee dishonesty insurance.** The State is exposed to losses arising from dishonest acts by the employees of the three TPAs. For example, TPA employees may generate counterfeit claims and fraudulently bill the State for these claims. Significant dollars could be lost before these acts are discovered. To protect the State from these losses and ensure the TPAs have sufficient funds to cover any losses that might occur, the three TPAs should be required to carry employee dishonesty insurance. Standard limits typically range from $500,000 to $1 million. We believe a $1 million limit would be appropriate for an organization the size of the State. Although Risk Management has indicated that its TPAs carry insurance meeting this limit, Risk Management needs to ensure the State is protected in the future by updating its TPA contracts to require employee dishonesty insurance with a $1 million limit.

Recommendation Number 3:

The Department of Personnel & Administration should require its third-party administrators to carry adequate insurance. This should include:

a. Automobile and general liability insurance with limits not less than $1 million.

b. Professional liability insurance with a limit of $1 million per claim.

c. Employee dishonesty insurance with a limit of $1 million.

Department of Personnel & Administration Response:

Agree. The DPA/Office of Risk Management agrees to contractually require its third-party administrators to carry adequate insurance to include employee dishonesty insurance, automobile and general liability insurance, and professional liability insurance. At present, Pinnacol, the State's TPA for workers' compensation services, and the State's two adjusters, McMillan and GAB, carry the recommended insurance.

Implementation Date: January 1, 2005

REPORTING REQUIREMENTS

As the State's insurance broker, Marsh negotiates the purchase of the State's property and casualty insurance. According to the terms of its contract with Risk Management, Marsh is to provide an annual stewardship report to the State. The purpose of this report is to establish the timeline for the current year's service plan, discuss current insurance market trends, and provide recommendations for marketing the State's renewal coverages. In addition, the contract requires Marsh to assist Risk Management in calculating the State's annual cost of risk. As we discuss in Chapter II, the State's cost of risk is the sum of its retained losses (losses below deductibles or self-insured retentions), insurance premiums, and risk management administrative costs. The cost of risk is used to help develop the State's optimal risk financing plan which includes determining how much risk should be covered by purchased insurance and how much should be self-insured.

We reviewed Marsh's compliance with the contract terms and found that Marsh has not provided the stewardship report to Risk Management in a timely manner. Specifically, Marsh did not provide the report to Risk Management until June 1, 2004. This means that Risk Management received the report on how Marsh would handle the insurance renewals three months prior to September 1, 2004

when a majority of the renewals occur. For Risk Management to have sufficient time to review and act on these reports, they should be received at least six months prior to the renewal date. Currently the contract does not specify a date by which this report should be provided.

In addition, we found that Marsh has not provided Risk Management with assistance in calculating the State's annual cost of risk as required by the contract. According to Risk Management, it does work closely with Marsh to evaluate property, liability, and workers' compensation costs individually. However, the State does not prepare a formal cost of risk calculation and look at cost of risk as a percent of revenue. As we discuss in Chapter II, calculating cost of risk is important when determining how the State should finance its risk. Marsh can provide valuable benchmarking information to Risk Management related to how other states and organizations calculate their cost of risk. Therefore, Risk Management should enforce the contract requirement and work with Marsh to calculate the State's cost of risk.

Recommendation Number 4:

The Department of Personnel & Administration should require its insurance broker, Marsh, to provide the annual stewardship report at least six months prior to coverage renewal and to assist with the State's annual cost of risk calculation.

Department of Personnel & Administration Response:

Partially Agree. The DPA/Office of Risk Management will request the annual stewardship report be provided no later than three months prior to the coverage renewal. The DPA/Office of Risk Management believes that three months is adequate time to fully evaluate the State's insurance coverage options, while six months is too early and therefore, not as informative and beneficial. The DPA/Office of Risk Management currently works closely with Marsh U.S.A., the State's insurance broker, regarding the cost of risk and will formally document that process.

Implementation Date: June 1, 2005

II. RISK FINANCING

BACKGROUND

Risk financing encompasses methods for ensuring that funds will be available to pay for the accidental losses the State incurs. There are many risk financing techniques, but most fall into two broad categories:

1. **Self-insurance.** This means the State pays its own losses and arranges for loss adjusting services.

2. **Purchased insurance**. This means the State buys an insurance policy and the insurer adjusts the claim and pays the loss.

The ultimate goals of any risk financing plan are to minimize an entity's cost of risk (explained below) and to smooth year-to-year variations in cost to a tolerable level. These goals are achieved by having sound and effective loss control programs, good quality claims administration programs, and a prudent balance between the level of risk retained (self-insurance) and the amount of insurance purchased.

Generally, the ideal risk financing approach includes retaining smaller, predictable losses (self-insurance) and insuring catastrophic or unpredictable losses. Regardless of how much risk the State decides to retain, the decision should be soundly based and consistently applied.

COST OF RISK

As stated above, the goal of most risk financing programs is to obtain the lowest long-term cost of risk (COR) and maintain the desired degree of stability in the COR over time. COR is the sum of:

1. **Retained losses.** These are losses below deductibles or self-insured retentions in the State's insurance policies.

2. **Insurance premiums.** These are amounts the State pays to commercial insurers.

3. **Risk management administrative costs.** These are amounts the State pays to administer the risk management program and include Risk Management's operating expenses, amounts paid for claims administration, and Attorney General expenses for claims defense.

The above three elements must be balanced to keep the COR low and stable. If, for example, insurance policy deductibles are increased, insurance premiums will decrease. However, self-insured losses will increase and costs will likely become less predictable (i.e., less stable). In addition, if some of the State's low-deductible insurance policies are discontinued, insurance premiums will decrease and retained losses will likely increase. This is because the State will no longer have to pay premiums for the discontinued policies, but it will have to pay any losses incurred in the areas where the policies were discontinued. It is the Risk Manager's job to manage these interrelated costs to keep them low while not exposing the State to catastrophic uninsured losses.

We measured the State's COR in our 2001 Risk Management Audit and have measured it again in this audit. As the table shows, the State's cost of risk in 2004 was $67.4 million, or 0.46 percent of the State's total revenue.

Cost of Risk Calculations Fiscal Year 2000 and 2004			
Cost of Risk Component	**Cost of Risk 2000[1]**	**Cost of Risk 2004**	**Percent Change**
Insurance Premiums[2]			
Liability	$479,000	$782,460	63%
Workers' Compensation	225,000	491,800	119%
Property	1,767,000	6,841,600	287%
Subtotal, Insurance Premiums	$2,471,000	$8,115,860	228%
Retained Incurred Losses[3]			
Liability[4]	$7,250,000	$13,455,520	86%
Workers' Compensation[4]	27,882,220	38,486,960	38%
Property	1,912,360	3,662,750	92%
Subtotal, Retained Losses	$37,044,580	$55,605,230	50%
Administration[5]			
Risk Management	$958,000	$769,860	-20%
Claims Handling	3,336,000	2,950,750	-12%
Service Providers (Brokers)	202,000	Included	
Subtotal, Administration	$4,496,000	$3,720,610	-17%
Cost of Risk	**$44,011,580**	**$67,441,700**	**53%**
Total Revenue[6]	$12,547,345,000	$14,786,730,000	18%
Cost of Risk as a Percent of Revenue	**0.35%**	**0.46%**	**31%**

Source: ARM Tech's analysis of Department of Personnel & Administration actual expenditure and retained loss data. See Note 3 for definition of "retained loss."

Notes:

1. All 2000 amounts except liability and workers' compensation losses are from ARM Tech's 2001 Risk Management Audit.
2. Provided by Risk Management Office.
3. Retained losses are the total projected losses for the claims as determined by the State's actuary. This is the estimated total projected costs expected to be paid for the claims during the year. These amounts are not the actual expenses paid on the claims.
4. Taken from July 30, 2003 actuarial reports and include Attorney General's Office fees.
5. All 2004 amounts provided by Risk Management.
6. Department of Personnel & Administration data.

These cost increases highlight the need to carefully manage claims, closely monitor contract loss control services, purchase only the required insurance policies, and closely watch the COR computation Marsh is to provide. Most of the recommendations in this report are designed to help the State reduce its COR while not exposing the State to large uninsured losses.

RISK FINANCING APPROACH

From our experience, we have found that the optimum risk financing program will provide the lowest long-term cost (considering all elements of the cost of risk) and not commit the State to deductibles (i.e., risk retentions) larger than it can afford. In evaluating the State's risk financing program, we considered the size of the deductible the State can afford and the current insurance program. In addition, we evaluated the State's risk retention capacity. Generally, the larger the organization, the greater its risk retention capacity. To determine the dollar amount of accidental losses an organization can absorb, it must evaluate several subjective and objective factors, including:

a. Unencumbered retained income, reserves, or fund balances.

b. Certainty and amount of annual gross revenue.

c. Amount of operating and capital expenditures that could be canceled or deferred to meet short-term cash needs resulting from an accidental loss.

d. Legal and financial ability to issue debt.

e. Ability to increase taxes or otherwise raise revenue to finance accidental loss.

f. Existence of financial reserves designated for catastrophic loss payment.

g. Attitude of senior management toward risk (willingness of elected and appointed officials to face critics following a multimillion-dollar loss that may have been insured for a few hundred thousand dollars annually).

Traditional guidelines that relate to an organization's financial data are often used to aid in determining risk retention capacity. Two of these guidelines are:

a. **Percentage of expenditures.** This method suggests an appropriate risk retention capacity is indicated by an organization's expenditures. Underlying this guideline is the belief that if an organization has to finance unexpected losses, it will be able to temporarily reduce expenditures previously designated for other uses in an amount sufficient to pay the large loss. A reasonable range often used to establish the amount of funds that could be redirected is between 0.5% and 2.0% of expenditures.

b. **Percentage of unrestricted funds.** A retention amount may be selected based on the amount of an organization's surplus, not designated for another use. This guideline suggests that between 10% and 20% of the unrestricted surplus might be appropriate to use for financing unexpected losses.

Colorado has unique financing issues and, due to current budget constraints, may not be able to easily absorb substantial unexpected losses. However, after applying the industry guidelines described above and based our experience with other states, we conservatively estimate that the State may be able to absorb at least $25 million of unexpected losses in a single year and still meet major operating objectives. This is in addition to the $55 million the State expects to incur for self-insured losses. Therefore, we estimate that the State's total loss retention capacity is about $80 million.

We believe $80 million is a reasonably conservative annual loss retention level for an organization the size of the State, and under the State's current financial situation, should be the beginning point for constructing a risk financing program. The State can use this amount when determining how potential losses should be distributed among its various insurance policies considering its loss retention capacity. For example, entities ordinarily limit their per loss exposure to no more than 10% of the annual amount. This means that the State could self-insure up to $8 million per loss occurrence for any given insurance policy. Risk Management should use this as a guideline when establishing policy limits and deductibles. As discussed in the next section, however, the State needs to assess the costs and benefits associated with retaining more risk, as well as the State's ability to do so, before making any changes to its current program.

As we evaluated the State's insurance program, we considered whether each policy was insuring losses the State could afford to retain (i.e., self-insure) or whether the policy was providing protection against losses that are too large for the State to self-insure. The final retention selected in any single year's program is affected by the relative cost of insurance. When insurance pricing is aggressively low, the State should construct programs that retain less risk than is suggested by the above analysis. As a general rule, when the insurance market is more restrictive and the pricing is more expensive, higher retention levels should be considered.

RISK FINANCING PROGRAM

During the course of the audit, we obtained a schedule of the State's current insurance policies and the risk financing program. The State purchases insurance for much of its large property claims and some of its claims related to crimes and self-insures most of the costs associated with its workers' compensation and liability claims. The following table shows the premiums for each of the State's major coverage areas.

State of Colorado
Premium Amounts by Coverage Area
Fiscal Year 2004

Major Coverage Area	Premium
Automobile Liability	$758,160[1]
Automobile Physical Damage	$34,637
Crime	$50,330
Excess Workers' Compensation[2]	$491,800
Property	$6,841,600[3]
Aircraft	$63,201

Source: Department of Personnel & Administration data.
Notes:
[1] This amount does not include all liability coverages for the State, only those discussed in this section.
[2] Excess workers' compensation refers to coverage above the State's self-insured retentions.
[3] This is the annualized premium for a 14-month property policy.

We compared the State's risk retention capacity with the State's insurance policy deductibles and limits to determine whether the State could assume more risk and eliminate certain policies or increase some deductibles. The State now retains all general liability losses. However, we believe the State may have the capacity to retain other losses as well. As discussed in the previous section, we estimate that the State can consider increasing its risk retention capacity by about $25 million. When added to the $55 million the State already expects to incur for self-insured losses, we estimate the State has an $80 million risk retention capacity. Considering the increased risk retention capacity, we believe the State may be able to discontinue coverage for automobile liability, automobile physical damage, and crime losses and still remain within its risk retention capacity. By self-insuring, or retaining, these losses, we believe a significant portion of the almost $850,000 in premiums paid for these coverages could be saved. Increasing property insurance deductibles may also reduce costs.

To determine the feasibility of making these changes and the extent of any savings, the State's actuary should estimate losses that might be covered by these policies and then compare them with the insurance premiums. The difference between the insurance premiums and the losses would be the estimated annual savings. This information could then be used to determine if

coverages should be discontinued or deductibles raised considering the State's current fiscal situation.

Recommendation Number 5:

The Department of Personnel & Administration should evaluate the feasibility of self-insuring losses now insured by automobile liability, automobile physical damage, and crime policies. The next actuarial study should include an analysis of losses the State would retain if these policies were discontinued or if the deductible for property losses was increased.

Department of Personnel & Administration Response:

Agree. The DPA/Office of Risk Management currently performs this analysis in conjunction with Marsh U.S.A. and agrees to continue to evaluate the feasibility of self-insuring losses now insured by automobile liability, automobile physical damage, and crime policies. The process includes an analysis of losses the State would retain if these policies were discontinued or if the deductible for property losses was increased. The DPA/Office of Risk Management will formalize and document this process.

Implementation Date: July 1, 2005

HIGHER EDUCATION EXCLUSIONS

The Risk Management Act applies to all state agencies with the exception of the University of Colorado. With the passage of House Bill 04-1009 during the 2004 Legislative Session, other higher education institutions have been given the option of withdrawing from the statewide risk management program. Institutions opting out would be responsible for funding their own losses for workers' compensation, liability, and property coverage and deciding what insurance to purchase.

As part of its procedures for handling higher education institution withdrawals, Risk Management needs to develop "run-off" agreements with the institutions to protect itself against higher education liabilities. These agreements should address how higher education institutions that withdraw from the risk management system will assume responsibility for claims they have incurred, but that remain unpaid at the time of withdrawal. There are several ways to achieve this. We believe the best method would be for the institution to take over the claim files and make their own payments after the withdrawal date. Risk Management should then transfer to the institution the related liabilities and offsetting assets it has recorded for the respective institution. Alternatively, Risk Management could continue to make the payments and have the institution

reimburse Risk Management for actual payments, plus the estimated cost of claims administration and legal services. Although either alternative will ensure that higher education institutions take responsibility for their own claims, the first option would require less administrative time by Risk Management.

Recommendation Number 6:

The Department of Personnel & Administration should develop "run-off" agreements with higher education institutions that address how the institutions that withdraw from the statewide risk management program will assume responsibility for claims they have incurred, but that remain unpaid at the time of withdrawal. This could include having the institutions either assume responsibility for paying claims they have incurred or reimburse Risk Management for all expenses associated with claim payments Risk Management makes on the institutions' behalf.

Department of Personnel & Administration Response:

Agree. On June 30, 2004, the Executive Director of DPA promulgated emergency rules that require any higher education institution withdrawing from the statewide risk management program pursuant to HB04-1009 to assume responsibility for paying claims they have incurred or to request a claim waiver that would require the higher education institution to reimburse Risk Management for all expenses associated with claim payments. The final rules are expected to be adopted and effective December 1, 2004.

Implementation Date: December 1, 2004

III. LOSS CONTROL

BACKGROUND

As mentioned previously, Risk Management is responsible for administering a risk management program that includes supervising the investigation and adjustment of claims, providing legal defense for property, liability, and workers' compensation claims, and administering loss control programs. Loss control is a risk management technique that seeks to reduce the possibility that losses will occur and reduce the severity of losses should they occur. Loss control can include services such as employee safety training and ergonomic evaluations.

Risk Management's three loss control specialists serve 50 state agencies and higher education institutions. Each of the loss control specialists is assigned to a group of agencies. Forty agencies have full- or part-time personnel dedicated to safety. Of these 40 agencies, several of the larger agencies (e.g., Departments of Human Services and Transportation and Colorado State University) have full-time risk managers or several loss control staff and are therefore, less dependent on Risk Management. The remaining 10 agencies have property, liability, and/or workers' compensation liaisons whose duties include loss control. In addition, Risk Management contracts with Pinnacol to provide 1,500 hours of loss control services annually to state agencies.

As the following table shows, reported losses and premium allocations for state agencies increased substantially for property claims between Fiscal Years 2000 and 2003. The table also shows that liability losses for some departments (e.g., Departments of Corrections and Revenue) increased significantly during this time period. In contrast, the data show decreases in liability and workers' compensation losses for most of the departments. This is because many of the claims incurred in more recent years are still open and have not been settled. We expect the losses incurred as a result of these claims to increase as more facts about the claims emerge and as the claims are settled. Even so, the data indicate the need for Risk Management to look more closely at losses and loss control initiatives as we discuss in this chapter.

REPORTED LOSSES AND PREMIUM ALLOCATIONS by department FISCAL YEAR 2000 THROUGH 2003										
	2000		2001		2002		2003		Percent Change 2000-2003	
Department	Reported Losses[1]	Premium Allocations[2]	Reported Losses[1]	Premium Allocations[2]	Reported Losses[1]	Premium Allocations[2]	Reported Losses[1]	Premium Allocations[2]	Reported Losses[1]	Premium Allocations[2]
PROPERTY										
Corrections	$140,496	$304,080	$68,389	$321,866	$492,880	$549,504	$173,436	$693,849	23.4	128.2
Higher Ed	$73,264	$1,677,480	$38,241	$1,707,796	$727,460	$2,755,194	$61,694	$3,400,251	15.8	102.7
Human Services	$20,335	$217,840	$84,010	$204,294	$87,100	$322,839	$297,252	$302,969	1361.8	39.1
Judicial	$8,729	$30,520	$122,756	$28,574	$18,210	$28,897	$13,006	$28,923	49.0	-5.2
Natural Resources	$250,622	$84,000	$39,021	$78,053	$100,160	$135,457	$345,781	$145,820	38.0	73.6
Public Safety	$3,199	$20,160	$27,090	$19,491	$17,160	$31,607	$55,618	$32,222	1638.6	59.8
Revenue	$0	$20,160	$0	$19,384	$0	$37,476	$6,999	$45,163	6999.0	124.0
Transportation	$87,265	$140,280	$346,023	$133,465	$302,890	$209,958	$143,615	$333,292	64.6	137.6
Other	$1,328,722	$305,480	$626,089	$287,077	$117,200	$444,301	$4,003,345	$617,361	201.3	102.1
Total	**$1,912,632**	**$2,800,000**	**$1,351,619**	**$2,800,000**	**$1,863,060**	**$4,515,233**	**$5,100,746**	**$5,599,850**	**166.7**	**100.0**
LIABILITY										
Corrections	$177,225	$1,852,385	$1,952,590	$1,446,493	$447,200	$1,215,091	$3,587,355	$1,556,383	1924.2	-16.0
Higher Ed	$1,276,127	$1,782,593	$1,002,498	$1,701,035	$646,760	$1,428,913	$382,250	$1,575,893	-70.0	-11.6
Human Services	$571,714	$545,974	$1,184,635	$573,261	$211,880	$756,738	$503,007	$1,011,857	-12.0	85.3
Judicial	$227,578	$309,700	$304,842	$236,519	$66,520	$267,984	$49,968	$307,174	-78.0	-.8
Natural Resources	$481,547	$254,448	$271,846	$190,847	$40,710	$185,056	$142,213	$198,396	-70.5	-22.0
Public Safety	$104,172	$322,059	$74,525	$306,187	$183,730	$404,185	$151,675	$396,041	45.6	23.0
Revenue	$97,436	$182,476	$250,172	$179,080	$26,810	$207,346	$298,920	$203,168	206.8	11.3
Transportation	$61,623	$1,303,503	$57,720	$1,249,745	$789,850	$1,267,224	$42,672	$1,549,437	-30.8	18.9
Other	$764,514	$716,819	$1,000,568	$616,833	$3,197,960	$576,964	$830,883	$728,362	8.7	1.6
Total	**$3,761,936**	**$7,269,957**	**$6,099,396**	**$6,500,000**	**$5,611,420**	**$6,309,501**	**$5,988,943**	**$7,526,711**	**59.2**	**3.5**

REPORTED LOSSES AND PREMIUM ALLOCATIONS by department FISCAL YEAR 2000 THROUGH 2003										
	2000		2001		2002		2003		Percent Change 2000-2003	
Department	Reported Losses[1]	Premium Allocations[2]	Reported Losses[1]	Premium Allocations[2]	Reported Losses[1]	Premium Allocations[2]	Reported Losses[1]	Premium Allocations[2]	Reported Losses[1]	Premium Allocations[2]
WORKERS' COMPENSATION										
Corrections	$848,952	$3,871,548	$1,186,652	$3,642,047	$2,364,020	$2,926,504	$674,954	$3,751,220	-20.5	-3.1
Higher Ed	$3,619,203	$6,345,113	$3,252,257	$6,663,968	$4,233,970	$5,450,792	$1,893,331	$5,880,432	-47.7	-7.3
Human Services	$3,909,909	$5,659,667	$3,676,389	$5,691,710	$3,593,220	$4,537,649	$2,274,032	$4,763,981	-41.8	-15.8
Judicial	$414,268	$1,143,312	$882,863	$971,869	$428,700	$690,715	$442,533	$706,186	6.8	-38.2
Natural Resources	$1,539,090	$1,024,104	$1,179,315	$1,100,705	$1,880,080	$892,558	$946,216	$1,112,847	-38.5	8.7
Public Safety	$982,177	$1,419,658	$1,330,515	$1,206,776	$1,044,380	$844,739	$662,413	$959,012	-32.6	-32.4
Revenue	$652,469	$677,318	$909,431	$595,389	$249,500	$416,770	$379,659	$534,220	-41.8	-21.1
Transportation	$3,625,958	$4,475,716	$2,858,697	$4,667,897	$3,274,490	$3,267,512	$2,597,137	$3,396,602	-28.4	-24.1
Other	$2,756	$2,476,275	$1,185	$2,237,962	$1,495,140	$1,786,948	$4,148	$1,713,012	50.5	-30.8
Total	**$15,594,782**	**$27,092,711**	**$15,277,304**	**$26,778,323**	**$18,563,500**	**$20,814,187**	**$9,874,423**	**$22,817,512**	**-36.7**	**-15.8**
TOTAL	**$21,269,350**	**$37,162,668**	**$22,728,319**	**$36,078,323**	**$26,037,980**	**$31,638,921**	**$20,964,112**	**$35,944,073**	**-1.4**	**-3.3**

Source: Department of Personnel & Administration data.
Notes:
[1] The State purchases insurance to cover all property losses. Therefore, reported losses for property include the actual amount paid by insurance companies for losses incurred during the year, as well as the State's deductible. The State self-insures most liability and workers' compensation losses. Therefore, reported losses for liability and workers' compensation include the actual amount paid on these claims plus reserve amounts which reflect the adjustors' estimated future cost of the claims.

[2] The premium allocation amount for property represents the portion of the State's insurance premium allocated to each department. The premium allocation amounts for liability and workers' compensation represent the amounts billed to the departments to cover all of the costs associated with the claims such as third-party administrator fees, reported losses based on each agency's three-year loss history, Risk Management salaries, and any additional purchased insurance premiums.

LOSS CONTROL EVALUATION

We evaluated Risk Management's loss control efforts and found that its current initiatives include the following:

- **Identifying loss trends and setting loss control objectives.** Risk Management prepares an Annual Risk Management Report for each state agency. These reports provide a summary of the agency's loss information, identify loss trends, and provide recommendations for loss prevention.

- **Training.** Risk Management conducts an annual Risk Management Conference that is open to all state agencies and focuses primarily on employee safety and employment practices. In addition, Risk Management coordinates activities of the Statewide Risk Management Advisory Group. The group consists of agency representatives who meet monthly with Pinnacol staff who provide training on a particular safety topic. The meetings are also used as a forum for agencies to share solutions to common problems. Finally, Risk Management provides standard and customized training courses upon state agency request and maintains a video library for agencies to access.

- **Providing risk management assistance.** Risk Management's loss control specialists assist with accident investigations, research workplace safety standards, and provide more detailed loss analysis when requested to do so.

These loss control initiatives are similar to those implemented by other state governments. In our review, we found that Risk Management lacks data on whether these initiatives are effective. Further, Risk Management has not analyzed areas with significant losses, such as property claims, to determine if additional or more effective loss control initiatives are needed. As a result, Risk Management does not know if its efforts are helping to reduce the State's losses or if its loss control resources are directed in the appropriate areas. One way Risk Management could evaluate its loss control initiatives is to begin to regularly assess the effect of loss control initiatives through performance measures such as:

- **Results-Based Measures.** These measures examine claims frequency and cost trends to determine if initiatives are reducing losses. For example, Risk Management could calculate the number of property claims per $1 million of property values or the number of workers' compensation and liability claims per $1 million of payroll. In addition, Risk Management could evaluate cost trends by calculating total property losses per $100 of property values and liability and workers' compensation losses per $100 of payroll. We completed these analyses and found that the frequency of claims have either remained steady (property) or decreased (liability and workers' compensation) since

1999. However, total reported property losses per $100 of property value have increased 114.5 percent since 2000, while the estimated ultimate liability and workers' compensation losses per $100 of payroll have increased 64 and 27 percent respectively since 2000. Although a significant portion of the increase in property losses is due to a $3 million claim in 2003 filed by Colorado State University for a collapsed roof, the data indicate the need for further review by Risk Management.

- **Activity-Based Measures.** These measures look at the number of loss control activities occurring during a certain time period. For example, it is our understanding that many of the agency safety committees are inactive. One activity-based measure could be to encourage agencies to reestablish safety committees over the next year. Other measures could quantify in a 12-month period the number of safety committee meetings attended, loss control training sessions conducted, or onsite agency safety evaluations conducted.

There are limitations to assessing loss control initiatives through results-based measures only. For example, results-based measures can be significantly impacted by sudden and unexpected losses outside the State's control such as a tornado destroying a multi-million dollar state facility. In addition, it is sometimes difficult to determine if there is a correlation between loss control initiatives and statistical measures. Therefore, Risk Management should adopt a comprehensive set of results- and activity-based measures. Having both results- and activity-based measures will provide Risk Management with a better understanding of how well its loss control initiatives are working.

Recommendation Number 7:

The Department of Personnel & Administration should develop a means of evaluating the effectiveness of its loss control efforts. This should include identifying appropriate annual results- and activity-based loss control performance measures.

Department of Personnel & Administration Response:

Agree. The DPA/Office of Risk Management will develop a means of evaluating the effectiveness of its loss control efforts within the uncontrollable variables within the litigation environment. In developing the methodology to evaluate the effectiveness of its loss control efforts, the DPA/Office of Risk Management will consider applying annual results- or activity-based loss control performance measures.

Implementation Date: July 1, 2005

LOSS CONTROL INCENTIVES

Incentive programs offer rewards in an attempt to modify behavior to achieve a specific objective (e.g., fewer lost-time injuries). Properly structured incentive programs can be an effective tool to reduce losses. We reviewed Risk Management's current incentive program and found that it consists only of awards for loss control efforts given at the annual Risk Management conference. Awards are given to the department with an innovative loss control procedure producing positive results, an effective risk management program, and a program designed to save lives. Individuals can receive awards for facilitating the reduction of loss frequency and severity and for saving a life. Although these awards reinforce the general importance of loss control, they do not appear to motivate behavior at the agency level. The agency staff we interviewed were not familiar with each of the awards or their eligibility criteria.

In our experience, monetary rewards are a more effective motivator than recognition. To motivate loss control efforts at the agency level, we recommend Risk Management make funding for innovative loss control initiatives available through a risk management grant program. Annually, agencies could submit requests for funding to implement a specific loss control technique that targets an area of high frequency or severity. Risk Management can establish criteria to judge the merits of the submissions and award funding to the selected agency, or agencies. Typically, these types of grant programs require a minimum of $100,000 to provide a reasonable incentive to elicit the involvement of state agencies. Risk Management has indicated that sufficient funds are available in the risk management fund for this type of program, but statutory authority may be needed to use the funds for this purpose.

Recommendation Number 8:

The Department of Personnel & Administration should consider establishing a loss control grant program for state agencies. If necessary, the Department should propose statutory changes to allow it to use risk management funds for this purpose.

Department of Personnel & Administration Response:

Agree. The DPA/Office of Risk Management will consider to what extent the establishment of a loss control grant program is advisable. The evaluation will consider the appropriateness of such a program, given budgetary and spending authority issues, and any necessary statutory changes that would be required to effectuate such a program.

Implementation Date: July 1, 2005

IV. CLAIMS

BACKGROUND

Risk Management staff process and administer liability and property claims with the assistance of its third-party administrators (McMillan and GAB). Once a claim is reported, Risk Management staff decide if it should be denied, assigned to one of the State's third-party administrators, or turned over to the Attorney General's Office. All lawsuits and employment practice liability claims are directed to the Attorney General's Office for review and litigation. Risk Management relies on Pinnacol for workers' compensation claims handling and legal services.

The State receives important protection with respect to claims under the Colorado Governmental Immunity Act (CGIA). The CGIA limits the State's liability for claims brought in Colorado courts to $600,000 per occurrence. The CGIA, however, does not limit the State's liability for claims brought under federal or civil rights law.

STARS INTERNAL CONTROLS

Risk Management maintains an internal database to track its property, liability, and workers' compensation claims. The system is known as the STARS system. STARS, which was created by the State's insurance broker Marsh, consolidates and analyzes all of the claims information. Liability and property claims data are entered by Risk Management and contract staff, while workers' compensation claims data are provided by Pinnacol. Payment requests are also entered into and tracked through the STARS system. Risk Management staff print a summary of all payment requests, determine what amounts should be paid, and then submit a hard copy request along with supporting documentation to the program accountant for payment processing through the State's accounting system, COFRS. We reviewed Risk Management's procedures surrounding the STARS system and identified the following areas where controls could be strengthened:

- **Claims data are not reconciled between STARS and COFRS**. Reconciling claims data to the State's accounting system is an important control to ensure the accuracy of claims payments and the integrity of the claims database. Additionally, reconciliation can identify duplicate payment requests that may result because unique identification numbers are not assigned to each request as discussed below. We found there is no formal process for reconciling the transactions entered into the STARS system to COFRS.

Without a reconciliation, an inappropriate expense may be charged to the claims account code and not be detected by Risk Management. As a result, Risk Management cannot ensure that the information in the STARS system is accurate and complete or that claims paid through COFRS are valid. This subjects the State to the risk of errors, irregularities, and fraud. To assist with the reconciliation process, Risk Management should develop a file closing checklist to ensure closed claim files contain all of the appropriate documentation. Staff can then use the file when reconciling the information in COFRS to STARS.

- **Payments are not assigned unique identification numbers.** Claim numbers are used as an identifier when a payment request form is submitted through the STARS system. However, since multiple payments are typically made for each claim it is difficult to distinguish one payment request from another. Although there is a payment request review process, the lack of a unique identification number makes it difficult to track payment requests and ensure duplicate payments are not made. The STARS system was originally designed to be a claims management system, not a payment request system. As a result, it was not programmed to assign a unique payment identification number to each payment request. Unique payment identification numbers are recognized as a strong internal control over payments to ensure duplicate payments are not requested and made.

- **There is limited security over user access.** Security passwords and procedures for the STARS system are needed to ensure that access to privileged information is limited and the integrity of the claims database is maintained. We found the STARS security is not properly configured to limit access at the staff level. For example, we found that there are users with administrative rights that should probably only have general privileges; users with general privileges that should probably only have restricted access; user accounts for personnel that are no longer employees of Risk Management; and dummy accounts setup for training purposes that have full access to the STARS system. If security protocols are not established and maintained by management, users may be able to have inappropriate access or make improper changes to the claims information which could affect the integrity of the data and system reporting.

- **Employment liability and civil rights claims are not coded separately in STARS.** Risk Management currently uses the same codes for employment practices liability claims, civil rights claims, and general personal injury claims. To identify employment and civil rights claims, one would have to review the cause and location codes as well as description fields. It is important to be able to quickly identify these claims so that they can be monitored more closely than other types of claims. This is because the Colorado

Governmental Immunity Act may not limit the State's liability in these cases, which means the claims may result in much higher awards than other claims. Using a separate code for employment and civil rights claims would streamline identification and review of these claims by making it possible for the system to sort them electronically.

- **Claims do not receive timely follow up.** Risk Management has established a 30-day standard for follow up on claims after investigations are complete. Currently Risk Management maintains a manual calendar rather than the STARS electronic system to schedule follow up activities. We found, however, that there is no management control over this manual calendar. Therefore, follow up on some claims falls well outside of the 30-day time requirement. Specifically, we found that for 10 of the claims in our sample, follow up occurred between 58 and 110 days after investigation was complete. After investigations are completed, the estimated claim payment amount may change significantly. If this occurs, without timely follow up Risk Management will not be aware of the change and will not reserve sufficient funds to pay the claims. To ensure that follow up is timely, Risk Management should use the STARS electronic diary system to schedule follow up claims investigation, evaluation, and disposition activities. The Risk Manager would then be able to verify that follow ups are being completed on schedule and ensure claims are monitored appropriately.

- **Claims data are entered twice.** Currently contract adjustors enter claims-related data into their own databases. This information is e-mailed to Risk Management staff who must then enter the information into STARS. We found that this process is duplicative and inefficient. The STARS system is a web-based system that allows users at different sites to access claims data. This means that contractors can scan documentation into STARS and attach it to claims files. Therefore, there is no need for the contractors to maintain their own database. Instead, Risk Management should require contractors to enter all claims data directly into STARS. This would increase the efficiency of the claims administration process and be a better use of contractor resources as discussed in Chapter V.

Recommendation Number 9:

The Department of Personnel & Administration should evaluate the feasibility of implementing the following changes to strengthen its controls over the STARS claims management system by:

a. Developing reporting and reconciliation procedures that ensure claims payments agree with COFRS. This should include developing a file closing checklist that can be used in the reconciliation process.

b. Assigning a unique identification number to payment request forms.

c. Implementing security controls over access to the system. This should include defining user access levels and removing inactive and dummy user accounts.

d. Implementing separate codes for employment liability and civil rights claims.

e. Using the electronic diary system to schedule follow up claims investigation, evaluation, and disposition activities.

f. Requiring contract adjustors to enter claims data directly into STARS.

Department of Personnel & Administration Response:

Agree. The DPA/Office of Risk Management agrees to research the feasibility of modifying STARS in order to strengthen, to the extent feasible, the development of reporting and reconciliation procedures for payments processed through COFRS, assigning identification numbers to payment request forms, the implementation of system security codes, the implementation of separate codes for employment liability and civil rights claims, for using the electronic diary system to schedule follow up claims investigation, evaluation, and disposition activities, and the feasibility of adjustors entering claims directly into STARS.

Implementation Date: July 1, 2005

EMPLOYMENT PRACTICES CLAIMS

Section 24-30-1504(1)(m), C.R.S., requires Risk Management to establish and administer a statewide database and uniform reporting system to track employment claims brought against state agencies and the losses incurred as a result of those claims. This means that Risk Management must track information on all employment claims, including claims filed in state and federal court and grievances handled internally by the State Personnel Board. Claims can be filed in state court if they are related to issues outside of the CGIA and federal court if they arise under federal law. Grievances are claims related to employee termination, reinstatement, or back pay and must be handled administratively by the State Personnel Board before a claimant is permitted to pursue a case in state or federal court. The statutory reporting requirement was established as a result of the 1998 Risk Management audit which recommended that uniform reporting standards be established for all employment claims. At the time, there

was not a complete record of employment claims and the total costs associated with those claims. This made it difficult for Risk Management to monitor employment claims and focus loss control efforts in the appropriate areas.

The following table shows the employment practices liability claims reported to Risk Management over the past six years. Because many of the claims filed in more recent years are still open, we expect the number, as well as the costs associated with these claims, to increase as more facts about the claims emerge and as claims are actually settled. As the table shows, employment claims can result in significant costs to the State.

Employment Practices Liability Claims Reported to The Office of Risk Management (as of April 30, 2004)

Fiscal Year	Number of Claims	Reported Cost
2004	1	$25,150
2003	44	712,987
2002	32	795,597
2001	37	1,521,783
2000	42	1,514,179
1999	15	446,845

Source: Department of Personnel & Administration data.

We reviewed the current employment claims reporting process and found that it is not effective for capturing complete information. Currently state agencies are required to report all employment claims to Risk Management when they are filed. We found that agencies are reporting claims that are filed in state or federal court. However, we found that agencies are not consistently reporting grievances that are handled administratively at the State Personnel Board level. According to Risk Management staff, agencies are hesitant to report grievances because they do not know when the grievance is first filed whether it will result in a loss to the State. Therefore, Risk Management does not have complete employment claims data.

In order to ensure that it receives complete data, Risk Management needs to reevaluate its current reporting process. Instead of relying on state agencies to report grievances, Risk Management could obtain monthly reports from the State Personnel Board on all cases heard by the Board, judgments awarded, and attorneys' fees ordered. This information could be broken down by agency and include the cause of action. The Attorney General's Office could also provide a monthly report on attorneys' fees incurred as a result of State Personnel Board hearings. Risk Management could then incorporate this information into a database along with data on claims filed in state and federal court. This would

ensure that Risk Management tracks complete employment claims data. As we found in our prior audit and as the General Assembly recognized by implementing the statutory requirement, it is important for policymakers to have a complete record of employment claims costs. Without this information, policymakers do not know the full extent of employment claim costs to the State and it is difficult to identify ways to mitigate such losses in the future.

Recommendation Number 10:

The Department of Personnel & Administration should implement a new reporting process to help ensure that it obtains complete employment claims data. This process should include working with the State Personnel Board to obtain monthly reports listing all of the employment cases heard by the Board. The reports may include for each case the agency involved, cause of action, judgment awarded, and attorneys' fees ordered. In addition, Risk Management should work with the Attorney General's Office to obtain monthly reports on attorneys' fees incurred as a result of State Personnel Board hearings.

Department of Personnel & Administration Response:

Agree. The DPA/Office of Risk Management agrees to work with the State Personnel Board and the Office of the Attorney General to develop a new reporting process for employment claims as required by C.R.S. 24-30-1504(1)(m). This process may include periodic reports from the State Personnel Board that list all of the employment cases scheduled for hearing before the Board. The reports may include for each case the agency involved, cause of action, judgment awarded, and attorneys' fees ordered. In addition, DPA/Office of Risk Management will work with the Attorney General's Office to obtain regular reports on attorneys' fees incurred as a result of State Personnel Board hearings.

Implementation Date: July 1, 2005

CLAIM RESERVES

Risk Management is responsible for overseeing claim dispositions and ensuring state funds are spent appropriately. As part of this process, Risk Management must develop a disposition plan for each claim that includes identifying claims that may not be subject to the Colorado Governmental Immunity Act (CGIA) or those that will exceed the CGIA caps. Using case information, Risk Management must estimate the most probable payment amount for these claims. Once the estimated payment amount is determined, Risk Management reserves funds in

anticipation of payment. Reserve amounts are used when determining how costs should be allocated between state agencies.

We reviewed the claim reserve process and found that once reserves are set, Risk Management does not periodically review the reserve amounts to determine if they are still appropriate, considering the progression of a case. In addition, we found that Risk Management has established standard reserve amounts for all inmate and employee claims, regardless of the nature of the claims. Setting standard reserve amounts is an accepted industry practice for claims that are generally settled for a set amount. For example, Risk Management sets all inmate claim reserves at $1,000 and all employment practice liability claims at $25,000 based on the assumption that these claims will settle for these amounts. We found, however, that the settlement amounts for inmate and employment claims have varied significantly over the years. When settlement amounts vary from reserve amounts, it means that Risk Management's allocation of costs between state agencies will be incorrect and will require adjustment.

To prevent the misallocation of costs, Risk Management should evaluate reserves at quarterly intervals based on claim developments and update the disposition plan accordingly. This will help Risk Management to increase or decrease reserves as appropriate and will also alert the Risk Manager to more significant claims that require closer oversight.

Recommendation Number 11:

The Department of Personnel & Administration should ensure the proper allocation of costs between state agencies by periodically evaluating claim reserve amounts and updating disposition plans on a quarterly basis.

Department of Personnel & Administration Response:

Agree. The DPA/Office of Risk Management will institute a periodic review of claim reserve amounts and will update disposition plans. These data will continue to be considered in the allocation process utilized when determining liability and workers' compensation program costs to state agencies.

Implementation Date: December 31, 2004

STRUCTURED SETTLEMENTS

A structured settlement is when an injured party does not receive compensation for injuries in one lump sum or on a pay-when-benefits-become-due basis. Instead the State purchases an annuity from an insurance company to provide a stream of tax-free payments tailored to meet future agreed-upon medical expenses and indemnity benefits to the injured party on a scheduled basis. Structured settlements can be used in cases where the allegations are outside Colorado Governmental Immunity Act (CGIA) caps (e.g., automobile accident in another state) or where damages warrant using the CGIA cap to provide payments over a long period.

In our 2001 Risk Management audit we recommended that Risk Management establish criteria for when structured settlements are to be considered. At the time there were no criteria for staff to use when determining if a structured settlement was appropriate. During our current audit we found that Risk Management has not implemented this recommendation. We believe that it is still important that Risk Management establish these criteria. Structured settlements can help reduce claims costs because the State locks in a settlement amount. This takes away the uncertainty associated with claims and the risk that costs will escalate over time. In addition, the State can save money by closing the claim and saving handling costs. Structured settlements are also beneficial to claimants because they receive steady, tax free payments to meet ongoing economic needs related to their injuries.

Recommendation Number 12:

The Department of Personnel & Administration should establish criteria for when structured settlements are to be considered when settling claims.

Department of Personnel & Administration Response:

Agree. The DPA/Office of Risk Management will consult with the Office of the Attorney General with regard to developing criteria to be considered on a case-by-case basis for evaluating the feasibility and cost effectiveness of a structured settlement agreement.

Implementation Date: December 31, 2004

SETTLEMENT AUTHORIZATION LEVELS

When claims are filed, the State has the ability to settle them prior to litigation. Section 24-30-1515, C.R.S., establishes settlement authority limits for individuals authorized to settle claims for the State. This means that these individuals can only settle claims for amounts up to the limits listed below.

- Claims Adjustor — $5,000
- Claims Manager — $25,000
- Risk Manager — $50,000
- Executive Director — $100,000
- Claims Board — greater than $100,000
  (Attorney General, State Treasurer, and DPA Executive Director)

Since there is currently no Claims Manager position, the Claims Manager's $25,000 settlement authority has been delegated to the Assistant Claims Manager.

We reviewed the statutory settlement authorization levels and found them to be appropriate. However, our review found that Risk Management is not following the statutory limits for contract claims adjustors. These are individuals working for one of the State's third-party administrators (McMillan, GAB, or Pinnacol) who adjust claims. According to policies set up by the prior Risk Manager, contract claims adjustors are only authorized to settle claims up to $1,500, instead of $5,000 as specified in statute. This is an inefficient use of contract and staff resources. From Fiscal Years 1999 through 2003 there were 462 claims that were settled for amounts between $1,500 and $5,000. These claims required the contract claims adjustors to obtain settlement approval from the Assistant Claims Manager. For all of these claims the Assistant Claims Manager approved the contract claims adjustors' settlement recommendations.

By establishing a lower settlement authorization level for contract claims adjustors than statute allows, it means that the Assistant Claims Manager must spend a significant amount of time reviewing claims when the adjustors' settlement recommendations are always approved. It would be a more efficient use of resources to allow contract claims adjustors to approve settlements up to the $5,000 limit imposed by statute. Risk Management could then review claims settled for amounts between $1,500 and $5,000 on a sample basis to ensure claims are settled appropriately.

Recommendation Number 13:

The Department of Personnel & Administration should increase the settlement authority limit for contract claims adjustors to the $5,000 allowed by statute. Office of Risk Management staff should then review claims settled for amounts between $1,500 and $5,000 on a sample basis to ensure claims are settled appropriately.

Department of Personnel & Administration Response:

Agree. The DPA/Office of Risk Management will increase the settlement authority limit for contract claims adjustors to the $5,000 allowed by statute and will also, on a periodic and random basis, review claims settled for amounts between $1,500 and $5,000 to ensure settlements are being settled appropriately.

Implementation Date: December 31, 2004

LITIGATION MANAGEMENT

As mentioned previously, all lawsuits and employment practice liability claims are directed to the Attorney General's Office (AG) for review and litigation. If there is a conflict of interest or other reason the AG believes it should not defend the claim, an outside attorney is retained. Risk Management's Risk Manager is responsible for managing all of the claims submitted to the AG or outside counsel, including authorizing any settlement amounts. We found that there is not a standard process for the AG's Office to communicate claim status reports and litigation strategies to the Risk Manager. Currently the communication process between the two offices is very informal and is not applied consistently. As a result, the claim files do not contain complete information on the actions taken on a case. This makes it difficult for the Risk Manager to ensure that they are receiving sufficient information to effectively manage the litigated claims.

As we discuss in Chapter V, the Risk Manager is responsible for managing more than 460 litigated liability claims. Therefore, it is important that the AG provide the Risk Manager with adequate documentation to show what actions have been taken on a particular case and what it anticipates will happen in the future. Based on our experience with other state programs, we believe the Risk Manager needs a written litigation strategy in order to effectively manage claims. The strategy should include a summary of the evidence in the case, an estimate of the expected verdict range, and an assessment of the probability that the State will prevail should the claim be litigated in court. The Risk Manager could then use this information when deciding whether it is worthwhile to spend the State's

funds on proceeding to trial, considering the projected outcome and costs, or to negotiate a settlement prior to trial. We have found in other states that having this type of process in place makes it more likely that the risk management program will identify ways to save costs.

Recommendation Number 14:

The Department of Personnel & Administration should work with the Attorney General's Office to provide a litigation strategy for each claim that includes a summary of the evidence in the case, an estimate of the expected verdict range, and an assessment of the probability that the State will prevail should the claim be litigated in court.

Department of Personnel & Administration Response:

Agree. The DPA/Office of Risk Management will work with the Attorney General's Office to formalize the litigation strategy for each claim that includes a summary of evidence in the case, an estimate of the expected verdict range, and an assessment of the probability that the State will prevail should the claim be litigated in court.

Implementation Date: July 1, 2005

V. ADMINISTRATION

BACKGROUND

As mentioned previously, Risk Management has 9.0 FTE including a Risk Manager, Contract Administrator, Assistant Claims Manager, three loss control specialists, one and one-half accounting staff, and one and one-half administrative staff. At the time of the audit, all of the positions were staffed with the exception of the Contract Administrator position. In addition, Risk Management contracts with third-party administrators for loss control services, workers' compensation claims administration, and liability claims investigations. There are also risk management coordinators at state agencies who provide risk management functions such as risk identification, loss control, and claims management.

ORGANIZATIONAL STRUCTURE

We evaluated Risk Management's current organizational structure and found that Risk Management may not be using its resources as effectively or efficiently as possible. Specifically, we found that Risk Management needs to identify and prioritize its key functions, determine the skills required to manage those functions effectively, assess its available resources, and allocate staff accordingly.

Risk Management is responsible for three primary functions: claims management, loss control, and risk financing. Currently each staff member is assigned to one of these functions. During our review, however, we identified the following problems that have resulted from this method of allocating staff:

- **Backlogs.** Currently the Risk Manager, Assistant Claims Manager, and one of the administrative staff are responsible for investigating, evaluating, and resolving property and liability claims. The Risk Manager is managing 466 pending litigated liability claims, while the Assistant Claims Manager is managing 477 pending liability claims. In our experience with other governmental claims management units, a manageable pending claims volume is 250 claims per staff member. For the Risk Manager, 50 claims is a more reasonable amount because of the time required for other responsibilities. We have found that loss payments tend to increase when pending claims exceed 250. When backlogs increase, staff may take shortcuts when verifying and negotiating claims.

- **Staff resources may not be allocated as efficiently as possible.** We found that loss control staff spend too much time on indoor air quality issues and preparing annual reports. Currently staff spend about 500 hours on indoor air quality issues, when there are only 10 to 15 claims arising from this issue each year. In addition, there may be a duplication of efforts because Risk Management also pays an outside consultant to investigate all indoor air quality complaints. We also found that loss control staff spent on average 20 percent of their time last year preparing the annual loss control reports for agencies. This is a significant amount of staff time, especially considering that no follow up occurs to ensure the report recommendations are implemented.

- **Contractor resources may not be allocated as efficiently as possible.** As discussed in Chapter I, Risk Management contracts with Pinnacol to provide 1,500 hours of loss control services annually to state agencies. However, Risk Management has not established in the contract what services Pinnacol should be providing, nor does it require Pinnacol to report what services it is providing. As a result, Pinnacol may be duplicating services that are already being provided by Risk Management staff.

Risk Management needs to conduct a comprehensive evaluation of its key functions and the resources available to accomplish those functions as efficiently as possible. This should include assessing where Risk Management's efforts are producing the greatest results for the State and identifying areas where contractors can be used more effectively considering current resource limitations.

Recommendation Number 15:

The Department of Personnel & Administration should conduct a comprehensive evaluation of its key functions and determine the skills needed and the resources available, both internally and externally, to accomplish those functions. Using this information, the Department should prioritize its functions based on their benefit to the State and allocate responsibility for these functions to staff in the most efficient manner possible.

Department of Personnel & Administration Response:

Agree. The DPA continually evaluates its functions, required skills, and available staffing with the goal of allocating its limited resources in the most efficient manner. This is a normal business practice to allow the Department to accomplish its mission effectively. The Department will conduct a comprehensive evaluation of the Office of Risk Management's key functions and determine the skills needed and the resources available, both internally and externally, to accomplish those functions and will prioritize its functions based on their benefit to the State and allocate responsibility for these functions to staff in the most efficient manner possible.

Implementation Date: December 31, 2004

APPENDIX A

Summary of Progress in Implementing Prior Recommendations

Appendix A

SUMMARY OF PROGRESS IN IMPLEMENTING PRIOR AUDIT RECOMMENDATIONS

Following are the recommendations contained in the September 2001 audit by ARM Tech and the progress made in implementing them as of May 31, 2004

Rec. No.	Recommendation Summary	Status	Comment
1	Obtain quotes from insurance broker for excess liability coverage that protects the State from non-*Colorado Governmental Immunity Act* occurrences.	Implemented	Marsh U.S.A, the State's insurance broker did conduct an informal market survey of costs for excess liability coverage. Risk Management, in consultation with Marsh U.S.A., agreed that an informal market survey was the most cost efficient option given the program structure.
2	Increase the limits of coverage for aviation liability to at least $10 million.	Implemented	The policy limits for aviation liability were not increased because the agency financially responsible for the premium, the Colorado Department of Public Safety, decided it was cost prohibitive.
3	Consider purchasing limits of at least $10 million for both employee dishonesty and faithful performance coverage.	Implemented	Risk Management was provided with quotes for $10 million for both employee dishonesty and faithful performance coverage, but determined that the purchase was cost prohibitive and not necessary given the structure of the program.
4	Establish criteria for when structured settlements are to be considered.	Not implemented	Although Risk Management did not implement this recommendation, we believe it is still an important issue. See Rec. No. 13.
5	Work in conjunction with Pinnacol to establish formal workers compensation claims reporting procedures.	Implemented	Risk Management and Pinnacol established workers' compensation claims reporting procedures.
6	Seek alternative proposals from its current workers compensation TPA and other vendors.	Implemented	Risk Management issued an RFP for workers' compensation third-party administrator services. The decision was made to continue contracting with Pinnacol for these services. However, during the current audit we noted issues similar to those in the 2001 audit with respect to the fees paid to Pinnacol for claims administration services. See Rec. No. 1.
7	Submit liability claims exceeding $100,000 to the State Claims Board.	Implemented	Liability claims in excess of $100,000 are now submitted to the State Claims Board.

Rec. No.	Recommendation Summary	Status	Comment
8	Extend the employment claims database to all agencies that are not specifically excluded by statute.	Implemented	Although all agencies are subject to the reporting requirement, we found agencies are not consistently reporting complete information. See Rec. No. 11.
9	In the cost allocation plans, relate each department's loss experience to the department's relative size within the State, and cap individual claims to an amount that does not penalize a department for incurring a catastrophic claim.	Implemented	Risk Management caps changes in year-to-year premiums.
10	Develop a statewide safety policy statement.	Not implemented	Risk Management has not developed a statewide safety policy statement, but has indicated that it intends to do so.
11	Develop summarized data on an annual basis for the cost of risks, loss rates, and risk administration expenses.	Partially Implemented	Although Risk Management has not fully implemented this recommendation, it does conduct some analyses on a yearly basis with respect to cost of risk, loss rates, and risk administration expenses.

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