



March 8, 2023

To: Finance and Administration Committee

From: Darrell E. Johnson, Chief Executive Officer

Janet Sutter, Executive Director
Internal Audit Department

Subject: Workers' Compensation Program, Internal Audit Report
No. 23-501

Overview

The Internal Audit Department of the Orange County Transportation Authority has completed an audit of the workers' compensation program, including activities of the third-party administrator. Based on the audit, procurement of the third-party administrator was handled in accordance with procurement policies and procedures, and selected contractual requirements were met by the third-party administrator. However, subcontractors have not been identified in the contract, and weaknesses were identified in the third-party administrator's calculation of benefits and management's monitoring of third-party administrator activities. Four recommendations for improvement were made.

Recommendation

Direct staff to implement four recommendations provided in Workers' Compensation Program, Internal Audit Report No. 23-501.

Background

The State of California (State) requires each employer to secure payment for workers' compensation as provided in Section 3700 of the Labor Code. The Orange County Transportation Authority (OCTA) has received approval from the State's Director of the Industrial Relations Department to self-insure and self-administer its workers' compensation claims. The workers' compensation benefits are medical treatment, temporary disability benefit payments, permanent disability benefit payments, supplemental job displacement benefit vouchers, and death benefit payments.

OCTA entered into Agreement No. C-0-2202 (contract) with Intercare Holdings Insurance Services, Inc. (Intercare), to provide claims administration for the self-insured workers' compensation program. The contract is effective November 1, 2020, and continues through October 31, 2025, with a maximum obligation of \$2,445,559.00. The contract provides fixed annual fees for the five years. Intercare submits two monthly invoices to OCTA. The first invoice bills OCTA for the firm-fixed fees under the contract. The second invoice is a request to replenish the bank account Intercare has established for the benefit of OCTA and uses to pay the following: medical billing audit, utilization review services, and medical case management services performed by its sister company Intermed; amounts paid to employees; and fees paid to medical providers, lawyers, investigators, interpreters, etc. Every month, the Risk Management Department (management) selects ten percent of the payments against this account and requests and reviews the check copies, bills, and other supporting documentation.

Discussion

The contract requires that OCTA consent to subcontracting portions of the scope of work and approve any subcontractors. Internal Audit identified billings by multiple service providers that should be identified as subcontractors, with rates and fees identified in the contract. Disability consulting professionals, investigators, legal service providers, Medicare set-aside professionals, and court reporters that provide dedicated claims services substantive to the contract scope of work, are currently being treated as vendors. Payments to these service providers are significant in dollar value, averaging around \$41,000 per month. Internal Audit recommended these providers be added to the contract as subcontractors, with rates and fees identified, and that management implement controls to ensure rates invoiced by these providers conform to contracted rates. Management agreed and committed to working with Intercare and Contracts Administration and Materials Management staff to amend the contract and will implement a review process to ensure charges conform to contracted rates.

Intercare uses a bank account it holds for the benefit of OCTA to make payments to injured workers and service providers and then requests OCTA to replenish the account every month for all checks issued, including checks not yet cashed. While Intercare sends the monthly bank account details and reconciliations to management, the reports are not being reviewed. Internal Audit recommended that management implement a process to ensure adequate review and monitoring of the monthly bank account details and reconciliations. Management agreed and committed to working with Finance staff to implement the recommendation.

Management's monthly reviews of Intercare's check payments do not include a review of temporary disability benefit calculations with supporting wage statements or settlement calculations with supporting documentation. Monthly reviews also do not include a review of paper transactions that add to the check register, and to the amount replenished to the bank account by OCTA. In addition, when management reviews payments to the pharmacy benefit manager, supporting documentation is not provided. Finally, there is no procedure to reconcile Intercare's listing of checks sent to OCTA to what has been received and deposited. Internal Audit recommended management enhance their review of activities, implement a process to reconcile checks sent to OCTA to those received, and ensure timely deposit of checks received. Management agreed to implement the recommendations.

Intercare's calculation and payment of temporary disability payments are not always accurate, and methodologies are inconsistent. Intercare overpaid temporary partial disability benefits to two injured workers by not deducting light-duty and holiday pay and overpaid another injured worker's temporary partial disability benefits. Intercare also reissued a \$1,533.60 stale-dated check for temporary disability benefits to an injured worker, even though the employee had returned to work and was not due the benefits. Internal Audit recommended management instruct Intercare on the calculation of benefits, standardize the calculations, and recover the identified overpayment. Management agreed to implement the recommendations.

Summary

Internal Audit has completed an audit of the workers' compensation program and has offered four recommendations, which management has agreed to implement.

Attachment

A. Workers' Compensation Program, Internal Audit Report No. 23-501

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Workers' Compensation Program

Internal Audit Report No. 23-501

February 28, 2023



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Conclusion

The Internal Audit Department (Internal Audit) of the Orange County Transportation Authority (OCTA) has completed an audit of OCTA's workers' compensation program, including activities of the third-party administrator (TPA) providing administration of the program. Based on the audit, procurement of the TPA, Intercare Holdings Insurance Services, Inc. (Intercare), was handled in accordance with OCTA procurement policies and procedures, and selected contractual requirements were met by Intercare. However, subcontractors have not been identified in the contract, as required, and weaknesses were identified in Intercare's calculation of benefits and OCTA's monitoring of Intercare activities. Four recommendations for improvement were made.

Background

The State of California (State) requires each employer to secure payment for workers' compensation as provided in Section 3700 of the Labor Code. An employer may be insured through an insurance company or be permissibly self-insured, with self-insurers required to submit an employer's annual report to the State. OCTA has received approval from the State's Director of the Industrial Relations Department to self-insure and self-administer its workers' compensation claims.

The workers' compensation benefits are:

- Prompt and effective medical treatment;
- Temporary disability benefit payments if employee cannot work while recovering, with payment of two-thirds of the average weekly earnings for temporary total disability and two-thirds of the weekly loss in wages for temporary partial disability;
- Permanent disability benefit payments if employee does not recover completely;
- Supplemental job displacement benefit vouchers to help pay for retraining or skill enhancement if employee does not recover completely and does not return to work; and
- Death benefit payments for employee's children or other dependents if employee dies from a job injury or illness.

OCTA entered into Agreement No. C-0-2202 (contract) with Intercare to provide claims administration for the self-insured workers' compensation program. The contract is effective November 1, 2020, and continues through October 31, 2025, with a maximum obligation of \$2,445,559.00. The contract provides fixed annual fees for the five-year term. The contract also identifies time-and-expense rates for medical billing audit, utilization review services—nurse level (up to three modalities), utilization review—peer review, and medical case management services. These are paid by Intercare off the claim file as allocated loss adjustment expenses and are subject to a two percent increase each year. The contract requires Intercare to secure a fidelity bond under which OCTA is paid up to \$500,000 for losses caused to or sustained by OCTA through acts or omissions of

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any of Intercare's employees and/or officers whether acting alone or in collusion with others. The contract also requires submission of monthly reports of claims, settlement awards, subrogation, monthly loss run, etc.

Intercare submits two monthly invoices to OCTA. The first invoice bills OCTA for the firm-fixed fees under the contract. The second invoice is a request to replenish the bank account Intercare uses to pay the following: medical billing audit, utilization review services, and medical case management services performed by its sister company, Intermed; amounts paid to employees; and fees paid to medical providers, lawyers, investigators, interpreters, etc. The medical billing audit, utilization review services, and medical case management services should be billed in accordance with the rates identified in the contract. Payments to medical providers are based on amounts recommended by the medical billing audit. All other payments are supported by cost documentation. Every month, the Risk Management Department (Risk Management) selects ten percent of the payments against the account and requests and reviews the check copies, bills, and other supporting documentation. Risk Management also sends monthly workers' compensation reports to OCTA bus base management.

Every year, Intercare submits a System and Organization Controls (SOC) 1 report on management's description of a service organization's system to Risk Management.

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Objectives, Scope, and Methodology

The objectives were to assess and test internal controls related to administration of workers' compensation claims, including oversight of the TPA, Intercare.

According to Generally Accepted Government Auditing Standards (GAGAS), internal control is the system of processes that an entity's oversight body, management, and other personnel implement to provide reasonable assurance that the organization will achieve its operational, reporting, and compliance objectives. The five components are control environment, risk assessment, control activities, information and communication, and monitoring.¹ The components and principles that were evaluated as part of this audit are:

- Control Environment
 - OCTA demonstrates a commitment to attract, develop, and retain competent individuals in alignment with objectives.
- Control Activities
 - OCTA selects and develops control activities that contribute to the mitigation of risks to the achievement of objectives to acceptable levels.
- Information and Communication
 - OCTA obtains or generates and uses relevant, quality information to support the functioning of internal control.

The methodology consisted of testing compliance with selected procurement policies and procedures, testing compliance with the Intercare contracts bond and reporting requirements, confirming if Risk Management reviewed Intercare's SOC 1 reports, testing all payments made against the Intercare contract for contract compliance, assessing Risk Management's monthly review of Intercare check payments and testing a sample of such payments for adequate support and contract compliance, when applicable, and testing a sample of claims for compliance with regulations, policies, and procedures.

The scope is limited to workers' compensation and excludes other claims. The scope includes the SOC 1 reports and employer's annual reports for 2020 and 2021, a haphazard sample of six months of Risk Management's monthly reporting to the bases, and a judgmental sample of five months of Intercare's monthly reporting to Risk Management with a bias towards even distribution during the last two years. The scope also includes a judgmental sample of 40 claims with a bias towards more recent claims. Finally, the scope includes all invoices paid on the Intercare contract from inception to September 2022, a judgmental sample of eight of Risk Management's monthly reviews of Intercare check payments with a bias towards even coverage throughout the last two years, as well as a judgmental sample of 40 Intercare check payments with a bias towards

¹ See U.S. Government Accountability Office publication, "Standards for Internal Control in the Federal Government," available at <http://www.gao.gov/products/GAO-14-704G>, for more information.

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more recent checks. Since the samples are non-statistical, any conclusions are limited to the sample items tested.

We conducted this performance audit in accordance with GAGAS. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

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Audit Comments, Recommendations, and Management Responses

Identification of Subcontractors in the Contract with Intercare

The contract with Intercare requires that OCTA consent to subcontracting portions of the scope of work and approval of the subcontractors. While no subcontractors have been identified in the contract, Internal Audit identified billings by multiple service providers that Intercare is currently treating as vendors. Disability consulting professionals, investigators, legal service providers, Medicare set-aside professionals, and court reporters are all treated as vendors, when many of them should be identified as subcontractors, as they provide dedicated claims services substantive to the contract scope of work. Rates and fees for these subcontractors should be identified in the contract and subject to contractual requirements such as insurance coverage. Payments to these service providers are significant in dollar value, averaging around \$41,000 per month.

Recommendation 1:

Internal Audit recommends that these providers be added to the contract as subcontractors with rates and fees identified in the contract. Once added as subcontractors, insurance and other contractual requirements should apply. In addition, once rates are identified in the contract, management should implement controls to ensure rates invoiced by the subcontractors agree to the contract rates.

Management Response (Risk Management):

Management agrees and will work with Intercare and Contracts Administration and Material Management to amend Intercare's contract, adding these providers and their rates / fees to it, and subsequently reviewing charges to ensure rates invoiced by them are consistent with the contract rates.

Monitoring of Bank Account Activities

Intercare makes payments to service providers and injured workers using a bank account held by Intercare for the benefit of OCTA. Intercare requests OCTA replenish the account on a monthly basis for all checks issued, including checks that have not yet been cashed. Intercare sends monthly bank account details and reconciliations to Risk Management; however, these reports are not currently being reviewed.

Recommendation 2:

Internal Audit recommends management implement a process to ensure adequate review and monitoring of monthly bank account details and reconciliations.

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Management Response (Risk Management):

Management agrees and will work with Finance to ensure adequate review and monitoring of monthly bank account details and reconciliations.

Risk Management's Monthly Reviews of Intercare Activities

Risk Management's monthly reviews of Intercare's check payments do not include a review of temporary disability benefit calculations with supporting wage statements or settlement calculations with supporting documentation. Internal Audit's review identified two temporary partial disability payments and one settlement payment that were incorrectly calculated, resulting in underpayments to the workers.

Monthly reviews also do not include a review of paper transactions that add to the check register total replenished by OCTA. Two paper transactions were added to the check register total as corrections to earlier credits of refund checks sent to OCTA for deposit; however, one check for \$200, payable to Intercare, was never sent to OCTA and was not logged on Intercare's listing of checks sent to OCTA for deposit. As of the audit, Intercare is still researching the status and/or location of this check. The second check, for \$2,753.61, was sent directly to OCTA but was not deposited for almost four months. Further, there is no procedure in place to reconcile Intercare's listing of checks sent to OCTA to what is received and deposited.

Finally, when Risk Management reviews payments to the pharmacy benefit manager Express Scripts, supporting documentation of the charges is not provided.

Recommendation 3:

Internal Audit recommends management enhance their monthly reviews of Intercare's check payments to include review of temporary benefit calculations and settlement calculations with supporting documentation. Management should also perform reviews of paper transactions that add to the check register for the account funded by OCTA. In addition, management should reconcile Intercare's listing of checks sent to OCTA to what has been received and deposited. Checks received by OCTA should be deposited in a timely manner. Finally, management should request Intercare provide a detailed invoice from Express Scripts to support payments.

Management Response (Risk Management):

Management agrees and will:

- Enhance its monthly reviews of Intercare's check payments, to include review of temporary benefit calculations and settlement calculations and supporting documentation.

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- Review paper transactions added to the check register.
- Reconcile Intercare's listing of checks sent to OCTA to what has been received and deposited.
- Request Intercare provide detailed information to support Express Scripts payments.

Intercare's Temporary Disability Calculations and Payments

Intercare's calculation and payment of temporary disability benefits are not always accurate, and methodologies are not consistent. Internal Audit recalculated temporary disability benefits that differed from Intercare's calculations in 13 instances. The differences were due to Intercare using too many days in its calculation of annual wages, excluding minor amounts of pay from annual wages, or dividing annual wage by too many weeks of pay, as well as a formula error and other minor discrepancies with wage statements. Additionally, Intercare overpaid temporary partial disability to two injured workers when they didn't deduct light-duty and holiday pay and overpaid another injured worker when they didn't follow their usual calculation methodology for temporary partial disability. Finally, Intercare reissued a \$1,533.60 stale-dated check for temporary disability benefits to an injured worker, despite the fact that the employee had returned to work and was not due the benefits.

Recommendation 4:

Internal Audit recommends management request that Intercare standardize the calculation of temporary disability benefits, including temporary partial disability benefits. Intercare should instruct adjustors to use the first day of the beginning payroll period, instead of the pay period end date, in tallying the number of days of pay. Adjustors should also be instructed to consistently check for payment of light-duty and holidays before calculating temporary disability benefits. Finally, management should request Intercare recover the \$1,553.60 overpayment.

Management Response (Risk Management):

Management agrees and will:

- Request Intercare to standardize the calculation of temporary disability benefits, including temporary partial disability benefits.
- Request Intercare to instruct its adjustors to affirm the pay period start and end dates when determining the number of days of pay.
- Request that Intercare instruct adjustors to consistently check for payment of light duty and holidays before calculating temporary disability benefits.
- Request Intercare to recover the \$1,553.60 overpayment.