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Office of the State Auditor**

**Department of the Treasury
Division of Risk Management**

July 1, 2009 to December 31, 2011

**Stephen M. Eells
State Auditor**



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Enclosed is our report on the audit of the Department of the Treasury, Division of Risk Management for the period of July 1, 2009 to December 31, 2011. If you would like a personal briefing, please call me at (609) 847-3470.

Stephen M. Eells
State Auditor
June 5, 2012

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Scope

We have completed an audit of the Department of the Treasury, Division of Risk Management for the period July 1, 2009 to December 31, 2011. Our audit included financial activities accounted for in the state's General Fund.

Expenditures of the division during fiscal year 2011 were \$95.6 million. The primary responsibility of the division is to reduce the impact of catastrophic pure loss on state operations and budgets through a combination of risk management and loss prevention techniques. The division administers the self funding of losses involving workers' compensation, tort liability, auto liability, subrogation of property damage, and foster parent liability. We excluded the activity of the UMDNJ Self-Insurance Reserve Fund which is administered by the Office of the Attorney General and the Department of the Treasury, Division of Administration. We also excluded the activity of the Tort Claims Liability Fund since the majority of these expenditures are incurred and controlled by the Department of Law and Public Safety, Division of Law. The audit also did not include payroll and operating expenses of the division as they are included in our audit of the Department of the Treasury, Division of Administration. Revenues of the division were \$1.2 million during fiscal year 2011. The major component of revenue is a percentage of subrogation receipts which are accounted for in the division's operating account.

Objectives

The objectives of our audit were to determine whether the division has adequate controls in place to ensure the workers' compensation program for state employees is administered in accordance with state regulations, claims filed against the state are administered effectively, and risks and losses to the state are reduced. In addition, we determined whether financial transactions were related to the division's programs, were reasonable, and were recorded properly in the accounting systems. We also tested for resolution of the significant conditions noted in our prior report dated December 22, 2004.

This audit was conducted pursuant to the State Auditor's responsibilities as set forth in Article VII, Section I, Paragraph 6 of the State Constitution and Title 52 of the New Jersey Statutes.

Methodology

Our audit was conducted in accordance with *Government Auditing Standards*, issued by the Comptroller General of the United States.

In preparation for our testing, we studied legislation, the administrative code, circular letters promulgated by the Department of the Treasury, and policies of the division. Provisions we considered significant were documented and compliance with those requirements was verified by interview, observation, and through our testing of financial transactions. We also read the budget messages, reviewed financial trends, and interviewed division personnel to obtain an understanding of the programs and the internal controls.

A nonstatistical sampling approach was used. Our samples of financial transactions were designed to provide conclusions about the validity of transactions, as well as internal control and compliance attributes. Sample populations were sorted and transactions were judgmentally selected for testing.

To ascertain the status of findings included in our prior report, we identified corrective action, if any, taken by the division and walked through or performed tests on the system to determine if the corrective action was effective.

Conclusions

We found the division has adequate controls to ensure the workers' compensation program for state employees is administered in accordance with state regulations, claims filed against the state are administered effectively, and risks and losses to the state are reduced. We also found the financial transactions included in our testing were related to the division's programs, were reasonable, and were recorded properly in the accounting systems. However, in making these determinations, we noted certain internal control weaknesses related to the workers' compensation program meriting management's attention. We also found that the division has not fully resolved the significant issues noted in our prior report regarding subrogation, Risk Management Information System internal controls, and coordination of benefits. These issues have been updated in our current report.

Workers' Compensation

The Division of Risk Management administers the workers' compensation program which is governed by N.J.S.A. 34:15-1 et. seq. and provides medical treatment for all state employees injured while working and nontaxable compensation to those who are eligible. Through workers' compensation, employees may receive temporary compensation and/or permanent awards. The division receives approximately 6,800 new claims per year. The cost of the program for fiscal year 2011 totaled \$87.9 million. Temporary compensation is awarded at a rate of 70 percent of the employee's wages at the time of injury up to a weekly maximum (\$792 for calendar year 2011) as determined by the Commissioner of Labor. Medical providers in coordination with division investigators establish the length of leave time for temporary compensation. Awards can be made for a maximum of 400 weeks. Division investigators determine the amount of the award. Permanent awards are determined by a workers' compensation court judgment. The division accounts for claim activity in the Risk Management Information System (RMIS). Our review of the workers' compensation program noted the following issues.

Workers' Compensation Procedures

The division should establish formal written procedures for the workers' compensation function.

The division does not have formal written procedures for the workers' compensation function. Written procedures are an essential element in the overall internal control system. They establish accountability, responsibility, and consistency in procedures throughout the organization. Written procedures would provide standardization to workers' compensation investigators for the administration and investigation of claims.

Secondary Employment

The division should perform periodic matches to wage data.

Based on the workers' compensation fraud statute, N.J.S.A. 34:15-57.4, the division has taken the position that an employee cannot work and receive temporary compensation at the same time without its approval. An injured employee is required to notify the division of any secondary employment. Upon notification, the investigator will obtain pay stubs and a job description, and the division will determine if the employee can work a secondary job. The investigators also have access to the Department of Labor and Workforce Development's (DLWD) Wage Record System. According to management, investigators use system access to identify injured employees with secondary employment on a sample basis.

Using computer-aided audit techniques, we performed a match to determine if employees collected temporary compensation while earning wages from secondary employment during calendar year 2010. We noted 15 individuals that appeared to be collecting temporary compensation while earning wages from an employer other than the State of New Jersey. We

reviewed the claim files for these individuals and found only four instances where secondary employment was noted in the file. One of these instances noted secondary employment on a medical assessment but it did not appear to be included in the claim investigation. In another instance, the system diary noted that a phone call was made to the employer and a voice mail was left; however, there was no documentation in the file that indicated that the investigator followed up on this matter. There was no documentation in the files indicating a final disposition on secondary employment for any of these 15 instances. All of the instances noted were provided to the workers' compensation unit for further investigation. The division should obtain wage data periodically from DLWD to match against temporary compensation benefits paid to identify possible overpayments or potential instances of fraud. The division could then use on-line system access to review additional quarters if deemed necessary.

Overlap

The division should monitor overlapping payments and recoup overpayments.

We performed a match of state payroll and temporary compensation payment data for the period July 2009 through May 2011 to determine if employees received temporary compensation while collecting their regular wages for an entire pay period. We identified 60 employees who were paid temporary compensation totaling \$126,300 while receiving regular wages involving a total of 89 pay periods. Based on our review of division records, temporary compensation payments totaling \$41,300 were voided or refunded. In regards to the remaining \$85,000, we noted 12 claimants who were paid temporary compensation totaling \$39,500 for the same period Sick Leave Injury (SLI) was paid by their employing state agency. Some of these instances were due to SLI being later approved for the same temporary compensation period. These employing agencies are responsible to reimburse the division for temporary compensation paid during the approved SLI period by reducing the employee's SLI payment. The remaining 27 claimants received \$45,500 of temporary compensation for the same period that regular payroll was processed by their employing state agency and paid to the claimant. This was primarily caused by communication issues between the division and agency human resource units. A periodic match of temporary compensation payments to state payroll data and enhanced communication with agency human resource units could provide the division with the added control measure to ensure payments do not overlap.

It should be noted that we focused on overlapping instances where both temporary compensation and regular wages were paid for the entire pay period and that other instances of overlap could exist based on the total number of temporary compensation and regular payroll days that were paid during a pay period. The following summary of our analysis includes all potential instances of overlapping payments; however, we did not verify whether any of these instances were voided or refunded.

Description	# of Employees	Total Payroll	Total Temporary Compensation
Full Payroll/Partial Temporary Compensation	114	\$ 274,239	\$ 63,124
Full Temporary Compensation/Partial Payroll	89	\$ 104,591	\$ 137,282
Partial Payroll/Partial Temporary Compensation*	49	\$ 24,409	\$ 10,595

* Payroll and temporary compensation amounts prorated for overlapping days.

Overpayments

Internal controls should be enhanced to prevent overpayments.

We performed an analysis of temporary compensation payments for the period July 1, 2009 to May 20, 2011 to determine if any payments exceeded the statutorily mandated maximum weekly compensation. We identified 232 instances totaling \$18,740 where payments exceeded the maximum rate and selected the 36 highest overpayments for testing. In four instances totaling \$2,900, the division offset subsequent payments and recovered \$1,100. We noted 29 of the overpayments totaling \$4,400 occurred because the maximum weekly rate for a different year was used rather than the year of the injury. The remaining three overpayments were immediately voided by the division. The division relies on human detection to identify these overpayments and RMIS does not contain edits that would restrict these improper amounts from being paid.

We performed an additional test of 63 claims to determine if the correct salary was used to calculate the weekly temporary compensation benefit amount. We noted seven claims where an improper salary was used to calculate the weekly benefit amount instead of the claimant's salary at the time of injury as required by statute. This resulted in overpayments totaling \$38,000, including one claim paid at the incorrect rate for five years amounting to an overpayment of \$30,000. Recently, upper management obtained access to the state's Personnel Management Information System. The investigators may benefit from having inquiry access to this system to verify salaries at the time of injury.

Recommendation

We recommend the division:

- Develop written procedures that outline the entire claim investigation process and include topics regarding the death of a claimant, secondary employment determinations, and calculating and applying temporary compensation rates.
- Periodically obtain the wage reporting database from the Department of Labor and Workforce Development to match against temporary compensation benefits paid to identify potential overpayments or possible instances of fraud. Additionally, claim files should contain documentation that identifies the outcome of all investigations of secondary employment.

- Periodically match temporary compensation payments to state payroll data to identify overlaps, enhance communication with agency human resource units, and recoup any overpayments.
- Modify the Risk Management Information System to flag instances where the maximum rate is exceeded and where the rate for the year of injury differs from the rate entered for payment. The division should also obtain inquiry access to the Personnel Management Information System for the claim investigators so they can manually verify and correct discrepancies.

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Third Party Settlements

Monitoring of third party settlements should be improved.

Pursuant to N.J.S.A. 34:15-40, the division may only be responsible for up to one-third of workers' compensation benefits and medical expenses for employees who were injured by and have received a settlement from a third party. If the settlement received from a third party exceeds the lien established by the division for costs incurred up to the date of settlement, a cushion is created where subsequent payments on the employee's claim should be reduced. We tested nine claims where a third party settlement was received and a cushion was established. Payments for five of these claims were not reduced to the appropriate amount resulting in an overpayment of \$134,000. When this issue was brought to the division's attention, they identified nine additional claims with a cushion; three of these claims were overpaid \$150,000. The other six claims did not have activity after the settlement date; however, these claims should be monitored to ensure any future activity is paid at the appropriate rate. The division currently does not have a mechanism to track the cushion and ensure that subsequent expenses are paid at the reduced rate.

Recommendation

We recommend the division ensure that subsequent expenses for third party claims where a cushion is established are paid at the appropriate rate. The division should also recoup any overpayments.

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Maximizing Subrogation Collections

The division should enhance subrogation collection efforts.

The division's subrogation unit is responsible for the administration and recovery of claims on behalf of the state against other responsible parties for damages to the state, its employees, and property. Over the past six fiscal years, the subrogation unit has compiled \$5.1 million in

outstanding open and closed claims with no recoveries. We identified the following factors which contribute to the loss of potential revenue for the division.

The time from when an accident occurs to when the division receives notification from the applicable state agency is lengthy. Our analysis of 2,700 claims found that, on average, it takes over five months for the reporting agency to forward the proper documentation to the division. This time lag could lead to a loss of potential recoveries.

Additionally, we tested 30 open claims and noted 20 instances where the investigator waited from 5 to 21 months before sending a second notice of damages to the responsible party. While the division's operating procedures state that cases should be closed within four to six months, this passive approach contributes to the subrogation balance that remains uncollectible.

Recommendation

We recommend the division continue outreach efforts to further improve its cooperation and coordination with outside agencies in order to reduce the time it takes to collect and submit claim information to the subrogation unit. We also recommend the investigators take a more aggressive approach when seeking restitution of damages.



Business Continuity and Data Recovery

The division has not tested its business continuity plan.

During our audit, it was noted that the business continuity plan was out-of-date and untested. The division, however, took immediate action and updated the plan. Industry best practices require periodic testing of the business continuity plan to ensure adequate controls are in place and functioning to minimize the loss of data if a disruption were to occur. Testing is also important because it measures the feasibility of the plan and identifies any modifications that may be required because of noted weaknesses. We also noted that the daily back-up data is not periodically tested for integrity.

Recommendation

We recommend the division periodically test both the business continuity plan and the daily data back-ups.





State of New Jersey

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May 30, 2012

RE: **Division of Risk Management Audit Report**

Dear Mr. Termyna:

Thank you for your audit report of the Department of Treasury Division of Risk Management. The Division finds the report to be accurate and helpful in terms of improving the Divisions internal controls. We offer responses to each of your findings below:

Workers' Compensation Procedure

The Division should establish formal written procedures for workers' compensation function.

The Division of Risk Management is currently assembling and updating written procedures for workers' compensation function. Many of the procedures were written as a result of the December, 2004 audit findings, but were never finalized and assembled into a finished document. The Division began the process of finalizing the procedures in 2012, and anticipates having the final written procedures in place by the beginning of FY 2013.

Secondary Employment

The Division should perform periodic matches to wage data.

The Division of Risk Management has scheduled investigator re-training sessions to encourage the proper use of Department of Labor and Workforce Development system to identify temporary compensation benefit recipients that receive wages from secondary employment in New Jersey. The Division tried unsuccessfully to gain access to the federal system in order to identify secondary wages earned in other states. The Division is precluded from the data base by federal law. As a compromise, the Division sought and was recently granted limited access to social media site Facebook as a tool to investigate secondary employment that is not reported to the DLWD system. Additionally, the Division is working on procedure for a quarterly cross matching of temporary benefit recipients with DLWD wage earners to confirm that investigators

have identified all of the potential secondary wage earners and have properly modified temporary workers' compensation benefits.

The audit uncovered 15 claimants that were employed in other jobs while receiving temporary compensation benefits, and the Division identified 2 other cases. Of those 17 cases, investigation reveals that 6 of the cases did not have overlapping payments, 1 case was successfully prosecuted for fraud, and 10 are currently assigned to Deputy Attorneys General for resolution. Files are appropriately noted.

Overlap

The Division should monitor overlapping payments and recoup overpayments.

Until the Division was granted access to the Personnel Management Information System, investigators relied upon employing agencies to provide salary at the time of the loss. As noted in the audit report, the Division was recently granted limited PMIS access and now has access to timely and accurate data in determining temporary compensation benefits. The Division is now seeking supervisor level access to PMIS so the investigators are not reliant on a single person to respond to their payroll inquiries. Notwithstanding, the audit uncovered a situation involving a Senior Auditor and her trainees who were performing the calculation incorrectly, using current benefit limitations rather than limitations in effect at the time of the injury. The Division conducted additional training for the individuals involved. The RMIS system has automated benefit calculation functionality to avoid any occurrences of overpaying the benefit obligation. The Division is developing a quarterly report of manual overrides for workers' compensation investigator review and confirmation. Any instances of overlapping payments discovered during the quarterly review are assigned to the appropriate workers' compensation supervisor for resolution and recovery.

The examples cited in the audit report relate to overlaps caused by the employing agency granting Sick Leave Injury benefits that are not reported to Division of Risk Management. The reporting failures result in overlapping temporary compensation benefits. The Division consistently pursues recovery of the overlapping payments. With the elimination of SLI, the relevance of this issue diminishes. However, the fore mentioned PMIS access will aid the Division in coordinating leave time benefits with temporary compensation benefits.

Monitoring of third party settlements should be improved.

The Division has reset Horizon Casualty Services medical claims to a \$0 reserve for all claims with third party liens where the settlement exceeds the Division's lien. Claims cannot be paid from the Horizon system except from established reserves. Third party case management is now centralized under one person at the Division. That person monitors any activity for these so called "cushion" claims. Horizon obtains payment authorization from the Division's coordinator, who is then able to track and adjust the remaining cushion amount. It is worth noting that the Division has requested and Horizon has agreed that the 2/3 balance of claims costs that are paid from the claimant's settlement will be billed to the claimant at the State's discounted rate. The audit identifies claims that were overpaid, and the Division is in the process of recovering the

overpayments. All of the claims uncovered in the audit have been audited and a clear path identified for full recovery of overpayments.

The Division should enhance subrogation efforts.

The Division continues its' outreach to State agencies to timely notify the Division of subrogation opportunities. In addition, the Division established very specific procedures with timelines for the handling of subrogation claims. The supervisor of the subrogation unit has begun quarterly subrogation file audits to verify investigator compliance with guidelines. Results of the monthly audits are sent to the Division director for review and compilation. Of note, the audited files reflect past practices that have already been improved. They also reflect a period of time when the subrogation unit was short of staff due to medical leaves of absence. To avoid a similar situation, tort investigators, subrogation investigators and auto investigators have been cross trained in all three disciplines and all now handle each type of file. The Division continues its' outreach efforts to reporting agencies, and has recommended procedural changes to the circular letter dealing with automobile accident reporting that will enhance timely reporting of possible subrogation opportunities.

The Division has not tested its business continuity plan.

The Division is working with office of Treasury Technology to establish periodic plan testing and to establish off-site back up storage in West Trenton. We anticipate having a written plan for quarterly testing and have off-site storage established in the next 90 days.

The Treasury Division of Risk Management is grateful for the work that was done by the State Auditor's team. The audit team was extremely thorough, and patient with the process and with Division staff. Their courtesy, professionalism and respect for Division staff's time were very much appreciated. We agree with all of their findings and commit to adopting their recommendations. The audit team advanced the Division's processes, procedures and internal controls more quickly and comprehensively than we might accomplish without their guidance.

Sincerely,

A handwritten signature in cursive script that reads "William M Mayo".

William M. Mayo, Director, Treasury Division of Risk Management