



# OFFICE OF THE CITY AUDITOR COLORADO SPRINGS, COLORADO

Denny L. Nester, City Auditor  
MBA CPA CIA CFE CGFM CGAP

## 17-14 City of Colorado Springs and Colorado Springs Utilities Liability Claims and Workers' Compensation Reserve Funds Audit

April 2017

### **Purpose**

The purpose of this audit was to review the Liability Claims and Workers' Compensation Reserve – Self Insurance Funds, as required by City Code (Code). The City Auditor's Office is required at least once every four years to determine that proper underwriting techniques, sound funding procedures, loss reserves, claims procedures, and accounting practices are being followed.

### **Highlights**

We conclude that proper underwriting techniques, claims procedures, and accounting practices were followed in the management and operation of the Liability Claims and Workers' Compensation Reserve Funds.

Funding procedures were considered adequate for Colorado Springs Utilities. The City of Colorado Springs (City) Liability Claims and Workers' Compensation funding was not considered adequate because December 31, 2015 fund balances were not sufficient to cover an average year's claims. However, the City General Fund was considered a backstop funding source for any claims that exceeded reserve balances. During this audit, we identified five recommendations for improvement.

The City and Colorado Springs Utilities (Utilities) were self-insured for Liability Claims and Workers' Compensation. Liability Claims included general, property, and automobile claims against the City and Utilities. The City and Utilities have purchased insurance from commercial carriers to mitigate potential losses from large Workers' Compensation and Liability Claims. Once a claim exceeded deductible thresholds, the claim was reimbursable under these policies.

Per Code, both City and Utilities reserve funds were required for Workers' Compensation claims. Code also required the City to maintain a reserve fund for liability claims. However, Code did not require Utilities to create a reserve fund for liability claims.

An annual actuarial study was performed to determine the estimated liability to be recorded for current and potential claims. Annual funding was recommended by City Administration and approved by City Council. Actual funding and reserve balances were reported in the Comprehensive Annual Financial Report.

### **Management Response**

Management was in agreement with our recommendations.

### **Recommendations**

1. City and Utilities management should propose updates of City Code Sections 1.5.502 and 1.5.602 to clearly specify fund reserve requirements.
2. City management should fund contributions to the Claims Liability Reserve Fund in accordance with updated City Code (See Recommendation 1 in this report).
3. City management should fund contributions to the City's Workers' Compensation Reserve Fund in accordance with updated City Code (See Recommendation 1 in this report).
4. An information technology issue was observed during our audit. (See additional information on page 3 of this report).
5. Management should propose removing several references of Colorado Revised Statute related to the "Colorado Auto Accident Reparations Act" in Code as the statute was repealed in 2003.

# 17-14 CITY OF COLORADO SPRINGS AND COLORADO SPRINGS UTILITIES LIABILITY CLAIMS AND WORKERS' COMPENSATION RESERVE FUNDS AUDIT

## **Observation 1**

The City Code (Code) Sections 1.5.502 and 1.5.602 contained ambiguous language. The requirement for adequate funding of Liability Claims and Workers' Compensation Reserve Funds was not well-defined. Additionally, the requirement for City Auditor to review loss reserves was not well defined.

Annual funding was recommended by City Administration and approved by City Council. Actual funding and reserve balances were reported in the Comprehensive Annual Financial Report.

Code did not specify criteria for the City Auditor's required review of loss reserves. Therefore, our office could not specifically determine compliance.

## **Management Response**

**City**—Management agrees with the recommendation. In 2016, the Finance Department, City Attorney's Office and Risk Management participated in a team Code Scrub effort to identify provisions of this Chapter of City Code which required updating. Proposed revisions are currently on hold. Management will prioritize this section of City Code for further review, building upon the work that has already been done. Estimated date for proposed revisions is Fall 2017. Management will coordinate efforts with Colorado Springs Utilities.

**Utilities**—We agree with the recommendation and will work with City management on proposed revisions.

## **Recommendation**

City and Utilities management should propose Code updates to City Council to clarify Sections 1.5.502 and 1.5.602.

Proposed Code revisions should clearly specify fund reserve and audit requirements for both the City and Colorado Springs Utilities.

## **Observation 2**

Since City Code funding requirements were not clear, the City Auditor defined adequate funding as current year contributions sufficient to pay current year expenditures. Under this definition, the City's Claims Liability Reserve Fund was not adequately funded.

Without considering IBNR (incurred but not reported) claims, funding was as follows:

- The fund has reported a deficit balance since 2013.
- A deficit balance of (\$328,362) for 2015.
- Our office projected a deficit of at least (\$300,000) for 2016.

When needed, claims payments were made from the City's General Fund.

## **Management Response**

Management agrees with the recommendation and has proposed transfers of fund balance from the General Fund to the Claims Liability Reserve Fund in the 2016 budget, but the transfer was not approved by City Council. Management will again request a transfer from the General Fund to the Claims Liability Reserve Fund, subject to City Council approval and appropriation. Management will note that the General Fund is the "back-stop" for all of the City's funds and therefore the General Fund reserves can be used for extraordinary claims settlements or judgments and has been used for this purpose in recent years.

## **Recommendation**

City management should fund contributions to the Claims Liability Reserve Fund in accordance with updated City Code (See Recommendation 1 in this report).

# 17-14 CITY OF COLORADO SPRINGS AND COLORADO SPRINGS UTILITIES LIABILITY CLAIMS AND WORKERS' COMPENSATION RESERVE FUNDS AUDIT

## **Observation 3**

Since City Code funding requirements were not clearly specified, the City Auditor defined adequate funding for City and Utilities Workers' Compensation Reserve Funds as current year contributions sufficient to pay current year expenditures.

Under this definition, the City Workers' Compensation Reserve Fund was not adequately funded. Fund expenditures exceeded contributions for every year from 2012 through 2016. Fund balance declined by \$1,718,578 from 2012 through 2015. Current funding levels were as follows:

- The 2015 fund had a deficit balance without IBNR of (\$398,471).
- Our office estimated the 2016 Fund balance without IBNR to have a deficit of at least (\$550,000).

## **Management Response**

Management agrees with the recommendation and has proposed transfers of fund balance from the General Fund to the City Workers' Compensation Reserve Fund in the 2016 budget, but the transfer was not approved by City Council. Management will again request a transfer from the General Fund to the City Workers' Compensation Reserve Fund, subject to City Council approval and appropriation. Management will note that the General Fund is the "back-stop" for all of the City's funds and therefore, the General Fund reserves can be used for extraordinary claims settlements or judgments and has been used for this purpose in recent years.

## **Recommendation**

City management should fund contributions to the City's Workers' Compensation Reserve Fund in accordance with updated City Code (See Recommendation 1 in this report).

## **Observation 4**

An issue related to Information Technology was observed during our audit. This issue was discussed with City of Colorado Springs Department of Information Technology.

We are not including details concerning any potential vulnerabilities (or strengths) related to the security of these City of Colorado Springs facilities/functions. Disclosure of this information to the public would be contrary to the public interest in improving or maintaining secure information technology systems for the City of Colorado Springs. The details of this audit are not required to be released to the public per C.R.S. § 24-72-204(2)(a)(VII)(A)

## **Management Response**

Management has agreed to address the issue. We will follow up on management's action midyear 2018.

## 17-14 CITY OF COLORADO SPRINGS AND COLORADO SPRINGS UTILITIES LIABILITY CLAIMS AND WORKERS' COMPENSATION RESERVE FUND AUDIT

### ***Observation 5***

City Code includes references to a statute that has been repealed. Colorado Revised Statute Title 10, Article 4, Part 726, "Colorado Auto Accident Reparations Act," was referenced in Code Sections 1.5.502 and 1.5.503.

### ***Recommendation***

City management should propose to City Council removing references to the "Colorado Auto Accident Reparations Act" in Code Sections 1.5.502 and 1.5.503.

### ***Management Response***

Management agrees with the recommendation; In 2016, the Finance Department, City Attorney's Office and Risk Management participated in a team Code Scrub effort to identify provisions of this Chapter of City Code which required updating and to propose updates. Proposed updates include removal of these repealed sections. Presentation of an ordinance making the changes are on hold. It should also be noted that the last significant code update was done in 2001. The more recent amendments in 2010 were focused almost entirely on the change in form of government (FOG).