City Council Report

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File #: 2016-01501 | December 6, 2016 | **Discussion Item 21**

Title: City Auditor's Audit of the City's Risk Management Division

Recommendation: Pass a Motion approving the Audit of the City's Risk Management Division.

Location: Citywide

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Department: Mayor/Council**,** Office of the City Auditor

Attachments:
1-Description/Analysis
2- Audit of the City's Risk Management Division

Description/Analysis

Issue Detail: This audit was approved as part of the 2015/2016 Audit Plan. According to City Code Chapter 2.18, the City Council should be kept apprised of the City Auditor's work. This report documents the *Audit of the City's Risk Management Division.*

Policy Considerations: The City Auditor's presentation of the *Audit of the City's Risk Management Division* is consistent with the Mayor and City Council's intent to have an independent audit function for the City of Sacramento.

Economic Impacts: None.

Environmental Considerations: None.

Sustainability: None.

Commission/Committee Action: The Budget and Audit Committee unanimously accepted this audit on November 1, 2016 and forwarded it to the full City Council for approval.

Rationale for Recommendation: This staff report includes three findings and makes seventeen recommendations aimed at improving City operations.

Financial Considerations: The cost of the Audit of the City's Risk Management Division was funded out of the 2015/2016 Office of the City Auditor Budget.

Local Business Enterprise (LBE): None.

An Audit of the City's Risk Management Division

Report # 2016-05|November, 2016

Some Transactions in the Two Risk Management Funds May be Inconsistent with Proposition 218 Requirements

Actuarial Funding Levels Have Outpaced the City's Increase in Contributions to the General Liability and Auto Liability Fund

The City May Reduce Risk and Liability by Making Improvements to Some Programs and Policies

City of SACRAMENTO

Office of the City Auditor

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Whistleblower Hotline

In the interest of public accountability and being responsible stewards of public funds, the City has established a whistleblower hotline. The hotline protects the anonymity of those leaving tips to the extent permitted by law. The service is available 24 hours a day, 7 days week, 365 days per year. Through this service, all phone calls and emails will be received anonymously by third party staff.

Report online at https://www.reportlineweb.com/cityofsacramento or call toll-free: 888-245-8859.

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City of SACRAMENTO
Office of the City Auditor

AUDIT FACT SHEET

Audit of the City's Risk Management Division

November, 2016 2016-05

BACKGROUND

The Human Resources Department's Risk Management Division is responsible for protecting City employees and assets through effective loss prevention administration of claims made by the public or City employees. The objective of our audit was to assess how well the Risk Management Division is handling, accounting for, and reporting public liability and loss recovery.

FINDINGS

Some Transactions in the Two Risk Management Funds May be Inconsistent with Proposition 218 Requirements

The City's other funds contribute to the two Risk Management Division Funds including property-related enterprise funds such as the Department of Utilities' Water, Wastewater, and Storm Drainage Funds. Property-related enterprise funds must comply with California's Proposition 218, which states that these funds "shall not be used for any purpose other than that for which the fee or charge was imposed." Specifically, we found:

- The General Liability and Auto Liability Fund subsidized nearly $158,000 in employee health benefit costs during fiscal year 2014/15;
- The Workers' Compensation Fund has missed out on over $375,000 in interest income due to interest-free loans;
- The Public Works Department was over-reimbursed by more than $262,000 in fiscal year 2014/15 from the General Liability and Auto Liability Fund; and
- Nearly $1 million in salaries for employees not in the Risk Management Division were paid out of the General Liability and Auto Liability Fund during fiscal year 2014/15.

Actuarial Funding Levels Have Outpaced the City's Increase in Contributions to the General Liability and Auto Liability Fund

The Risk Management Division contracts with an actuarial firm, Bickmore Risk Services, to estimate the amount to budget for claim costs and expenses that will occur in the coming fiscal year and the program's liability for outstanding claims. Our review found that although contributions from the General Fund and other funds have increased, the GL&AL Fund is still underfunded as Bickmore's funding levels have outpaced the City's increase in contributions.

The City May Reduce Risk and Liability by Making Improvements to Some Programs and Policies

The Risk Management Division currently has a number of programs and policies in place to reduce the City's risk and liability. However, our review found improvements to some existing programs and policies may further reduce City risk and liability. More specifically, we found:

- The Sacramento Regional Drivers Training Facility could be better used by nonemergency personnel;
- The Risk Management Funds' *Extraordinary Loss* accounts could be better managed;
- The Risk Management Division currently only monitors drivers' licenses of commercial drivers;
- The City would benefit from establishing limitations on employee work-related physical fitness;
- The City could reduce the risk of hiring undesirable applicants by establishing additional pre-employment screenings; and
- The City does not have a mechanism to ensure compliance with the insurance requirements of the Transportation Policy.

RECOMMENDATIONS

We made the following recommendations to various departments and division to reduce the City's risk and liability:

1. Continue to develop a system to reconcile health benefit premium invoices to actual amounts deducted in payroll to ensure the General Liability and Auto Liability (GL&AL) Fund does not subsidize health benefit costs.
2. Work with the health benefits vendors to attempt to recoup any overpayments that may have been made.
3. Determine if reimbursements to the GL&AL Fund from other City funds are necessary.
4. Ensure loans made out of the Risk Management Funds are documented in a written agreement and receive a reasonable rate of interest.
5. Work towards repaying the Workers' Compensation (WC) Funds' golf operating loan including interest accrued.
6. Consider pursuing reimbursement of the overpayment from the GL&AL Fund to the Public Works Department to ensure compliance with Proposition 218 requirements and the Property Claims Processing/ Risk Fund Reimbursement Procedure.
7. Work with the Public Works Department to establish a process to ensure property claim reimbursements are approved prior to posting to the GL&AL Fund and are in compliance with the Property Claims Processing/Risk Fund Reimbursement Procedure.
8. Review positions paid by the GL&AL Fund not in the Risk Management Division and determine if they are inconsistent with Proposition 218. If payments of the positions conflict with Proposition 218, the department should consider whether repayment to the GL&AL Fund for at least the portion of the positions paid by restricted enterprise funds is required.
9. Develop policies and procedures that outline the types of expenditures that can be made out of the two Risk Management Funds to limit payments not directly related to risk management programs.
10. Increase contributions at a greater rate than currently planned until the actuarially calculated contribution amounts for each fund can be made each fiscal year.
11. Develop policies and procedures that establish guidelines on which employees should take drivers' training at the SRDTF and a reasonable timeline for completing the training.
12. Document guidance for the use of the *Extraordinary Loss* accounts and review expenditures in the accounts for appropriateness.
13. Consider monitoring the drivers' licenses of all employees that drive City vehicles or receive City vehicle allowances.
14. Establish reasonable limits on the types of activities allowed to reduce the City's liability when an employee is injured off-duty.
15. Continue to pursue establishing pre-employment screenings for all classifications in the City to reduce the risk of hiring undesirable applicants.
16. Continue to work towards implementing the updated draft of the Transportation Policy to increase the insurance requirement of employees driving their personal vehicles for City business.
17. Develop a monitoring mechanism to ensure employees maintain the required minimum insurance coverage when receiving a vehicle allowance.

Introduction

In accordance with the City Auditor's fiscal year (FY) 2014/15 Audit Plan, we have completed the *Audit of the City's Risk Management Division*. We conducted this performance audit in accordance with Generally Accepted Government Auditing Standards. 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.

The City Auditor's Office would like to thank the Human Resources and Finance Departments for their time and cooperation during the audit process.

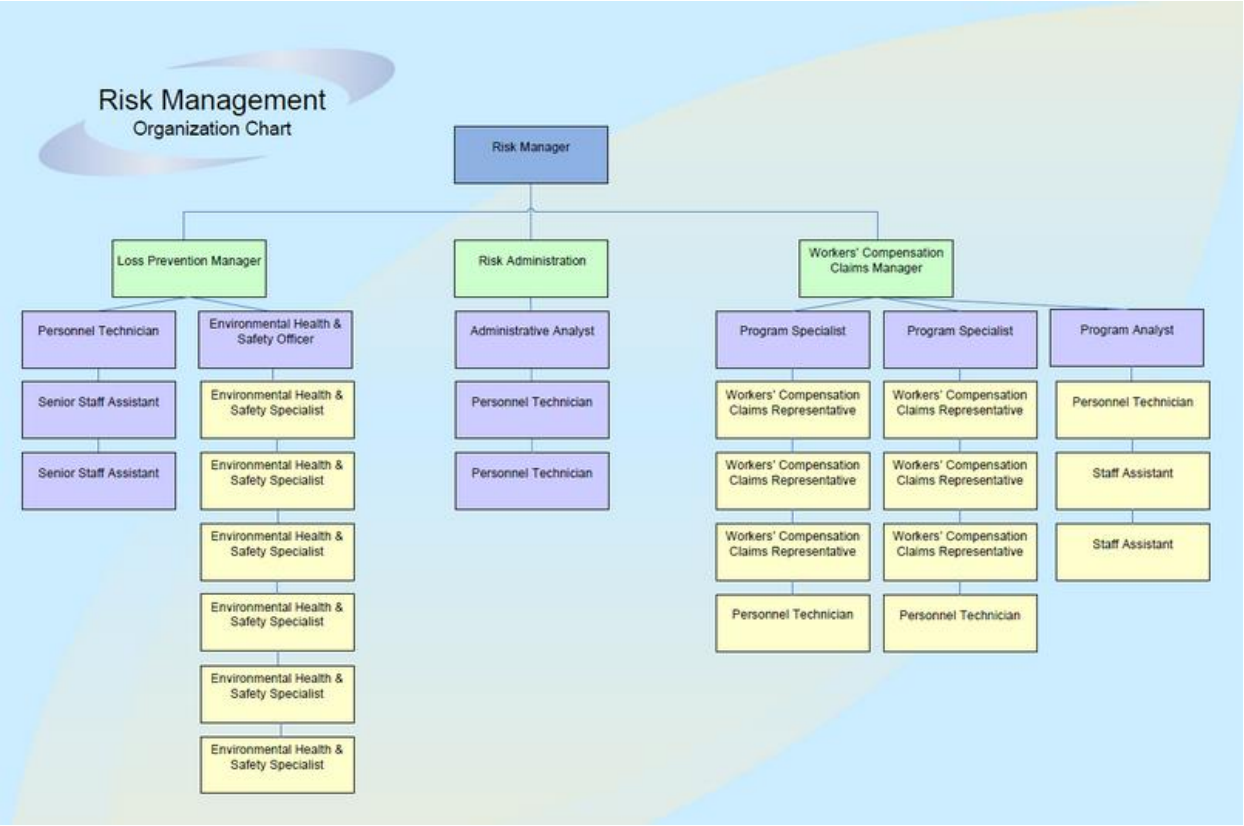
Background

Risk Management Division

The City of Sacramento is exposed to various types of risks and liabilities such as employee injuries and damage to private property. The Human Resources Department's Risk Management Division is responsible for protecting City employees and assets through effective loss prevention and administration of claims made by the public or City employees. The Risk Management Division consists of three operational units: Loss Prevention, Workers' Compensation, and Risk Administration. The units are detailed in the organizational chart below.

The Risk Management Division consists of three operational units: Loss Prevention, Workers' Compensation and Risk Administration.

Figure 1: Risk Management Organizational Chart



Source: Risk Management Division's internal City website.

The Risk Management Division compiles an annual report for the City Council and management that outlines the division's services and provides summaries of workers' compensation, general liability, and auto liability losses for the fiscal year. The three most recent annual reports are available on the City's website at http://www.cityofsacramento.org/HR/Divisions/Risk-Management/Risk-Administration.

Loss Prevention Unit

According to the Risk Management Division, the primary goal of the Loss Prevention Unit is to reduce the number and severity of injuries and accidents to minimize employee injuries and claim costs. The City's loss prevention activities, which are intended to prevent accidents before they occur, include the following: training, vehicle safety, consultation, employee recognition, environmental compliance, and support services. There are six Environmental Health and Safety Specialists who are assigned to consult with each City of Sacramento department on workplace health and environmental issues.

The Loss Prevention Unit coordinates training to reduce losses to the City. Coordinated trainings include sexual harassment prevention and awareness, CPR/first aid certifications, confined space entry, workplace violence

prevention, illness and injury prevention, and others. The unit also supports the Sacramento Regional Drivers Training Facility (SRDTF). SRDTF classes include initial, refresher, and remedial driver training for City employees, law enforcement academy recruits, external agency employees and members of the public. The unit also provides administrative support for the Vehicle Review Committee in which management from departments that use City vehicles meet every quarter to review City vehicle collision statistics compiled by the unit. According to the Risk Management Division, the City's collision frequency rate--the number of chargeable collisions divided by million miles driven--has decreased substantially since FY 2005/06; most recently, it decreased five percent between FY 2013/14 and FY 2014/15. Figure 2 below identifies the City vehicle miles driven, number of collisions, number of collisions that were chargeable[1], collision frequency rate, and the number of liability claims filed against the City between FY 2011/12 to 2014/15.

Figure 2: Vehicle Collision Incidents

Year	Miles Driven	Total Collisions	Chargeable Collisions[1]	Collision Frequency Rate	Liability Claims Filed
FY 2014/15	15,213,936	394	141	9.3	94
FY 2013/14	13,977,224	355	136	9.7	104
FY 2012/13	14,256,310	353	141	9.9	98
FY 2011/12	13,270,465	304	136	10.2	123

Source: Auditor compiled based on reports provided by the Loss Prevention Unit of the Risk Management Division.
Note: The numbers in this table have not been audited.

The Loss Prevention Unit also provides consulting services to City departments to maintain a safe and healthy work environment. Consulting services include ergonomic evaluations, commercial drivers' license monitoring, random drug and alcohol testing of employees who drive City commercial vehicles (excluding Fire Department drivers), personal protective equipment assessments, coordinating hearing tests, and more. The unit also conducts environmental regulatory compliance activities such as supporting environmental remediation projects, coordinating hazardous and bio-hazardous waste clean-up and disposal, and completing asbestos and lead sampling citywide as requested by the Facilities Division. In addition, the unit provides support services to City departments, such as administering pre-employment and preventative medical programs.

[1] A chargeable collision is one in which the City employee is determined to be at fault. Chargeable collisions which resulted in less than $750 in property damage to City assets are excluded.

Workers' Compensation Unit

The City of Sacramento has self-insured and self-administered workers' compensation claims since 1981. Workers' Compensation Claims Representatives assist employees injured on the job by providing benefits such as indemnity benefits, salary continuation, and medical benefits in accordance with the California Labor Code and City Charter.

Prior to August 2015, the Workers' Compensation Unit used the GenSource software program to manage and process workers' compensation claims. In August 2015, the unit changed to the paperless Systema software program, also known as SIMS. Due to this change, most documents uploaded in the GenSource software program are unavailable in the new Systema program. As of June 2016, the Risk Management Division was working with the City Attorney's Office to regain access to the documents from the GenSource vendor.

Risk Administration Unit

The Risk Administration Unit is managed by the Risk Management Division Manager and provides support services such as contractual risk transfers; monitoring compliance with City contract insurance requirements for City contractors and vendors; and providing support for the special events insurance program, insurance renewals, and liability claims administration. The Risk Administration Unit also performs oversight of liability claims and is responsible for the Risk Management Division's two funds, Workers' Compensation Fund and General Liability and Auto Liability Fund, which provide risk financing and support services related to the workers' compensation and general and automobile liability programs, respectively. For public reporting purposes, these two funds are combined and called the Risk Management Internal Service Fund.

Liability Claims

The City of Sacramento has contracted with York Risk Services Group (York), a third-party administrator, to handle liability claims filed against the City. Claims are divided into two categories: automobile and general liability. General liability claims include all claims other than automobile accidents. Litigated claims are primarily handled in-house by the Sacramento City Attorney's Office. General liability claim costs vary dramatically each year as one or two large claims can skew the results. Figure 3 below, summarizes the number of claims and the amounts incurred during FY 2012/13, 2013/14, and 2014/15.

The City of Sacramento has contracted with York Risk Services, a third-party administrator, to handle liability claims filed against the City.

Figure 3: Amount and Cost of Claims by Type and Fiscal Year

	FY 2012/13		FY 2013/14		FY 2014/15	
Claim Type	Number of Claims	Amount Incurred	Number of Claims	Amount Incurred	Number of Claims	Amount Incurred
Bodily Injury - Auto	17	$ 3,806,141	33	$ 4,983,214	10	$ 78,300
Bodily Injury - General	110	$ 2,265,588	126	$ 5,093,545	126	$ 632,910
Property Damage - Auto	104	$ 175,509	96	$ 186,477	96	$ 158,948
Property Damage - General	280	$ 867,398	229	$ 781,355	289	$ 350,739
Sexual Harassment	3	$ 105,750	2	$ 47,320	1	$ 19,981
Police Liability	6	$ 129,587	6	$ 31	1	$ -
Employment Practices	6	$ 125,500	1	$ 169,110	0	$ -
Collision	4	$ 2,273	1	$ 1,850	0	$ -
Personal/Advert Injury	1	$ -	1	$ 8,448	0	$ -
Public Officials	0	$ -	1	$ 5,000	0	$ -
TOTAL	**531**	**$ 7,477,746**	**496**	**$ 11,276,350**	**523**	**$ 1,240,878**

Source: Auditor compiled based on reports from York Risk Services' Claim Reporting software

Some of the claims that contributed to high costs in FY 2012/13 and 2013/14 include allegations of dangerous condition of public property, property damage from water main breaks, and liability from Parks and Recreation, Police and Fire actions. Figure 4 below, summarizes the same claim information and amounts by department during FY 2012/13, 2013/14, and 2014/15.

Figure 4: Amount and Cost of Claims by Department and Fiscal Year

	FY 2012/13		FY 2013/14		FY 2014/15	
Department	Number of Claims	Amount Incurred	Number of Claims	Amount Incurred	Number of Claims	Amount Incurred
Community Development	11	$ 3,086,994	7	$ 98,040	15	$ 56,211
Police	103	$ 1,614,099	126	$ 2,951,501	102	$ 531,419
Utilities	166	$ 1,250,017	94	$ 2,231,695	105	$ 230,915
Fire	22	$ 705,767	13	$ 440,859	12	$ 15,988
Public Works	146	$ 415,866	162	$ 1,738,125	206	$ 323,755
General Services	1	$ 210,240	1	$ -	6	$ 4,980
Parks and Recreation	14	$ 162,220	23	$ 3,111,517	12	$ 48,414
Human Resources	2	$ 20,198	0	$ -	0	$ -
Mayor/Council	3	$ 10,248	3	$ 47,328	1	$ 10,240
Information Technology	1	$ 1,276	1	$ 11,609	2	$ -
Convention, Culture, and Leisure	6	$ 579	9	$ 33,437	5	$ 16
Non City/Non-Jurisdictional	55	$ 243	54	$ 18,846	57	$ 18,942
Finance	1	$ -	0	$ -	0	$ -
City Attorney	0	$ -	2	$ 593,395	0	$ -
City Manager	0	$ -	1	$ -	0	$ -
TOTAL	**531**	**$ 7,477,746**	**496**	**$ 11,276,350**	**523**	**$ 1,240,878**

Source: Auditor compiled based on reports from York Risk Services' Claim Reporting software

Subrogation Claims

York also handles subrogation claims for the City by attempting to recover funds from third parties for damage to City assets. The City pays York $335 on each claim they collect; if the collection is under $500, York receives 20 percent of the amount. Recoveries usually range from $200,000 to $300,000 per fiscal year. The City paid York about $30,000 during FY 2014/15 for collections on subrogation claims. If York Risk Services is unable to collect from a third party, the case is referred to the City's Revenue Collections Division of the Finance Department. If Revenue Collections is also unable to collect the money owed to the City, it is referred to the City's contracted collection agency, Financial Credit

Network (FCN). Figure 5 identifies the amounts recovered in the last three fiscal years.

Figure 5: Subrogation Collections by Fiscal Year

Fiscal Year	Estimated Revenue	Recognized Revenue[2]	Collected Revenue[2]	York Payment
FY 2014/15	$ 250,000	$ 227,251	$ 293,765	$ 30,050
FY 2013/14	$ 250,000	$ 244,754	$ 371,128	$ 30,870
FY 2012/13	$ 250,000	$ 302,875	$ 273,865	$ 20,780

Source: Auditor compiled using eCAPS Budget Overview Revenue Reports and York Risk Services Invoices

According to the Risk Manager, beginning September 2016, York will no longer be processing the City's subrogation claims. The Risk Management Division will work directly with the Finance Department's Revenue Division to attempt to collect from the third parties, as they now have the staffing to take on the additional work and are better equipped to maximize recoveries.

Actuarial Report

An actuarial report is prepared each fiscal year for the City of Sacramento's self-insured workers' compensation and general and automobile liability programs by Bickmore Risk Services, a professional actuarial firm experienced in self-insured public entity program analysis. The actuarial report provides two key pieces of information: the amount to budget for claim costs and expenses that will occur in the coming fiscal year, and the program's liability for outstanding claims. Outstanding claims represent the ultimate value of losses less any amounts already paid. The estimated outstanding liability for all claims increased 12 percent, or $7,583,000, in FY 2014/15 to $70,683,000. According to the Risk Management Division, increases occurred primarily in liability claims from adverse losses in automobile and general liability claims.

Risk Management Budget

All City Departments are charged for the Risk Management Division's costs based on the actuary's estimate of the amount required to pay the costs of workers' compensation, general liability and automobile liability claims as well as the operational costs of the Risk Management Division. The Risk Management Division has two different funds to track its income and expenditures. The Workers Compensation (WC) Fund is used to track income and expenditures related to the Division's workers' compensation unit. The General Liability and Auto Liability (GL&AL) Fund is used to track all other income and expenditures for the Division. For financial reporting purposes, the

[2] Recognized revenue is the amount due, including invoices that are outstanding, while collected revenue is the actual amount collected during each fiscal year. Collected Revenue only includes the amount collected by York and does not include the amount collected by the Revenue Division or FCN.

two funds are combined and identified as the Risk Management Internal Service Fund.

Prior to each fiscal year, the Finance Department uses the actuarial estimates to budget for the following year, including identifying the amount of money each of the City's funds will contribute to the Risk Management funds. For the GL&AL and the WC Funds, the Finance Department utilizes the actuary's cost allocation at the 80 percent loss experience and 20 percent exposure level. This means that the calculated amounts should be sufficient to cover the fiscal year's costs for the funds 80 percent of the time.

Prior to each fiscal year, the Finance Department uses the actuarial estimates to budget for the following year.

The actuary estimates the cost of the Risk Management programs including losses due to claims and operational costs such as employee services, insurance premiums, and services and supplies. Figure 6 below identifies the actual income and expenditures for the two funds managed by the Risk Management Division during FY 2012/13, 2013/14, and 2014/15.

Figure 6: Risk Management Funds Income and Expenditures

Income and Expenditures

(in thousands)

	General Liability and Auto Liability Fund (6502)			Workers Compensation Fund (6504)		
Fiscal Year	**2012/13**	**2013/14**	**2014/15**	**2012/13**	**2013/14**	**2014/15**
Beginning Balance	$ (3,231)	$ (7,778)	$ 5,641[3]	$ 48,374	$ 48,478	$ 27,243[3]
Income						
Charges for Services	$ 14,062	$ 13,801	$ 14,923	$ 9,582	$ 9,823	$ 9,818
Expenditures						
Employee services	$ 1,910	$ 2,069	$ 2,130	$ 1,498	$ 1,521	$ 1,570
Services and supplies	$ 5,790	$ 5,978	$ 5,803	$ 838	$ 903	$ 930
Insurance premiums	$ 2,493	$ 2,681	$ 2,846	$ 382	$ 375	$ 437
Claims and judgments	$ 8,763	$ 9,077	$ 11,873	$ 7,682	$ 6,392	$ 7,323
Other	$ (345)	$ (323)	$ (450)	$ (922)	$ (1,107)	$ (596)
Total Expenditures	**$ 18,611**	**$ 19,482**	**$ 22,202**	**$ 9,478**	**$ 8,084**	**$ 9,664**
Transfers In/(Out)	$ 2	$ 21,261	$ -	$ -	$ (21,271)	$ -
Ending Balance (deficit)	**$ (7,778)**	**$ 7,802**	**$ (1,638)**	**$ 48,478**	**$ 28,946**	**$ 27,397**

Source: Auditor created based on reports provided by the City of Sacramento Finance Department.

As shown in Figure 6, the WC Fund has a relatively higher fund balance and the GL&AL Fund ended FY 2014/15 with a negative fund balance, even after over $21 million was transferred from the WC Fund to the GL&AL Fund in FY 2013/14.

Insurance Premiums

The City of Sacramento has entered into an agreement with Alliant Insurance Services (Alliant) to provide insurance brokerage services such as marketing and soliciting quotations for insurance policies. Alliant also places and services insurance policies for the City. The City of Sacramento purchases excess liability, property, excess workers' compensation, fine arts, aircraft, airport liability, crime, pollution legal liability, and bounce house liability insurance. Total

[3] The financial statements for the beginning balance in FY 2014/15 were restated due to new Governmental Accounting Standards Board pronouncements related to pension liability. Therefore, the beginning balance in FY 2014/15 is not equal to the ending balance in FY 2013/14.

insurance premium costs increased five percent in FY 2014/15 to $3,179,125, primarily driven by increases in property, excess liability, and excess workers' compensation insurance. Figure 7 below identifies the cost of insurance premiums from FY 2013/14 to 2016/17.

Figure 7: Annual Insurance Premium Costs

Fiscal Year	Insurance Premium Costs	Percent Increase from Prior Year
2013/14	$ 3,016,709	8%
2014/15	$ 3,179,125	5%
2015/16	$ 3,207,266	1%
2016/17	$ 4,056,102	26%

Source: Auditor compiled based on data provided by the Risk Management Division

Other Audits

The State of California Department of Industrial Relations, Division of Workers' Compensation (DWC), conducts audits of workers' compensation claim handling every five years to make certain injured workers receive accurate and prompt compensation to which they are entitled. The DWC's most recent audit score for the City of Sacramento was 0.66074, the lowest or best score received by a public self-insured entity for the audit year, meaning appropriate benefits were being paid to injured workers.

The California State Association of Counties (CSAC) also audits the Workers Compensation Unit every two years for the excess insurance purchased through CSAC. The CSAC audit focuses on claim handling procedures and includes:

- Reviewing the overall management of claims;
- Reviewing a sample of claims thoroughly, including any prescription medications;
- Reviewing high dollar claims; and
- Assessing if claims processing best practices are being followed. CSAC provides these best practices to the City as part of the excess insurance agreement.

The latest CSAC audit from FY 2014/15 gave the City a final combined score of 87 percent, below CSAC's expectation of an overall 95 percent compliance standard. The CSAC audit made a number of recommendations related to case review and documentation, fiscal handling, three-point contact, compensability, payments, reserves, and subrogation. According to the Risk Management Division, the CSAC audit score is a guideline and lower than expected scores do not affect the City of Sacramento.

Objective, Scope and Methodology

The objective of this audit was to assess how well the City's Risk Management Division is handling, accounting for and reporting public liability and loss recovery. The scope of our audit included FY 2014/15 workers' compensation, general liability, auto liability, and subrogation claims. The audit scope also included current processes and procedures in place in the Risk Management Division for minimizing, handling, accounting for, and reporting public liability and loss recovery.

In conducting our audit, we met with various Risk Management Division staff to gain a better understanding of the various roles and responsibilities of employees in the division. In addition, we reviewed the methodology for funding the two Risk Management Funds and payments made out of the two funds in FY 2012/13, 2013/14, and 2014/15. We also reviewed a sample of general liability, auto liability, and subrogation claims for appropriate processing. Due to the complex nature of the workers' compensation bill review program, we relied on the biennial audits conducted by CSAC and did not test the worker's compensation claims. We also reviewed the process for monitoring employee drivers' licenses and providing training to employees at the Sacramento Regional Drivers Training Facility (SRDTF). We reviewed the types and amounts of various insurance retained by the City. We identified the amount and type of pre-employment screening performed by the City for various classifications and departments. We also reviewed the types of user role access, the purpose, and the users with each type of access for the division's workers' compensation claims system.

Finding 1: Some Transactions in the Two Risk Management Funds May be Inconsistent with Proposition 218 Requirements

As previously stated, the Finance Department determines the amounts each of the City's funds will contribute to the two Risk Management Division funds. City funds that contribute to the division's funds include property-related enterprise funds such as the Department of Utilities' Water, Wastewater, and Storm Drainage Funds. Property-related enterprise funds must comply with California's Proposition 218, which states that these funds may not be used to finance programs unrelated to the property-related service. While it is appropriate that the enterprise funds subject to Proposition 218 contribute their proportionate share of the costs associated with workers' compensation, general liability, and auto liability, our review of fiscal year (FY) 2014/15 payments found some transactions in the two funds that may be inconsistent with Proposition 218 requirements. More specifically, we found:

- The General Liability and Auto Liability Fund subsidized nearly $158,000 in employee health benefit costs during fiscal year 2014/15;
- The Workers' Compensation Fund has missed out on over $375,000 in interest income due to interest-free loans;
- The Public Works Department was over-reimbursed by more than $262,000 in fiscal year 2014/15 from the General Liability and Auto Liability fund; and
- Nearly $1 million in salaries for employees not in the Risk Management Division were paid out of the General Liability and Auto Liability Fund during fiscal year 2014/15.

Considering that enterprise funds subject to Proposition 218 contribute to the Risk Management Division's funds, care should be taken to ensure transactions made out of the two funds are appropriate. Questionable transactions should be reviewed prior to being made out of the funds to ensure they do not violate Proposition 218 requirements. In our opinion, if it is confirmed that transactions did not comply with Proposition 218, the Risk Management Funds should be reimbursed.

The General Liability and Auto Liability Fund Subsidized Nearly $158,000 in Employee Health Benefit Costs During Fiscal Year 2014/15

The City offers employees health benefits such as medical, dental, and vision. The General Liability and Auto Liability (GL&AL) Fund is used to collect City and employee contributions for health benefits and pay vendors for insurance

coverage. During FY 2014/15, the City paid over $63 million to insurance carriers for health benefits. Given the high cost of health benefits, it is important that the amounts collected from City departments and employees and paid to vendors are accurate. However, the City currently does not have processes in place to reconcile medical vendors' invoices with the amounts contributed by the City and its employees. As a result, the City cannot ensure the amounts paid to insurance carriers are only for the health benefits costs of benefit-eligible City employees. If invoices are more than City and employee contributions, the GL&AL Fund covers the costs and pays the vendors despite having no reconciliation to confirm the amount. This practice may be inconsistent with Proposition 218 requirements, as enterprise funds subject to Proposition 218 requirements contribute to the GL&AL Fund.

Given the high cost of health benefits, it is important that the amounts collected from City departments and employees and paid to vendors are accurate.

The City contributes a portion of the cost of employee health benefits, and employees may contribute a portion through payroll based on amounts negotiated in the labor agreements with the City's various labor unions. Both the City's contribution and employees' contributions are deposited into the GL&AL Fund and used to pay health premiums to the City's vendors, such as Kaiser Permanente and Delta Dental. With no reconciliation of the amounts collected with the payments made to the vendors, the City is at risk of under-collecting for health benefits and leaving the GL&AL Fund to subsidize the cost. Our office first uncovered this issue in our *Audit of Employee Health and Pension Benefits* which was released in April 2011. The *Audit of Employee Health and Pension Benefits* made a recommendation to the Human Resources Department to develop a system to reconcile billed health premiums to actual amounts deducted in payroll. As of June 2016, this recommendation had not yet been implemented. According to the Finance Department, from FY 2010/11 to FY 2015/16, the GL&AL Fund covered over $620,000 in health benefit premiums. Figure 8 below identifies the amount of health benefit premiums paid by the GL&AL Fund each fiscal year.

Figure 8: Health Benefits Premiums Paid by the General Liability and Auto Liability Fund

Fiscal Year (FY)	City & Employee Contributions	Payments Made to Insurance Carriers	Gains or (Losses) in GL&AL Fund
FY 2010/11	$ 55,626,491	$ (56,155,906)	$ (529,415)
FY 2011/12	$ 58,578,269	$ (58,326,300)	$ 251,969
FY 2012/13	$ 60,930,478	$ (61,046,103)	$ (115,625)
FY 2013/14	$ 63,566,858	$ (63,637,121)	$ (70,263)
FY 2014/15	$ 62,879,912	$ (63,037,543)	$ (157,631)
Grand Total	**$ 301,582,009**	**$ (302,202,974)**	**$ (620,965)**

Source: City of Sacramento Finance Department

The Human Resources Department's failure to implement a recommendation made in 2011 has cost the GL&AL Fund an additional $620,000 since the recommendation was made; further, these costs may be inconsistent with Proposition 218 requirements. The Human Resources Department informed us that they are currently developing a process for reconciling health benefits premiums and addressing the recommendation.

Recommendations

We recommend the Human Resources Department:

1. Continue to develop a system to reconcile health benefit premium invoices to actual amounts deducted in payroll to ensure the General Liability and Auto Liability Fund does not subsidize health benefit costs.
2. Work with the health benefits vendors to attempt to recoup any overpayments that may have been made.
3. Determine if reimbursements to the General Liability and Auto Liability Fund from other City funds are necessary.

The Workers' Compensation Fund Has Missed Out on Over $375,000 in Interest Income Due to Interest-Free Loans

Proposition 218 seeks to reduce possible abuses of assessments and property-related fees to pay for general governmental services. The California Constitution's Article 13D regarding Proposition 218 states that revenue derived from property-related fees and charges "shall not be used for any purpose other than that for which the fee or charge was imposed." In addition, the California Government Code Section 66013, which imposes requirements on sewer and water connection fees and charges, states that interfund loans from such capital facilities funds "shall include the date on which the loan will be repaid, and the rate of interest that the fund will receive on the loan." Considering funds subject to Proposition 218 contribute to the two Risk Management Funds, care should

Proposition 218 seeks to reduce possible abuses of assessments and property-related fess to pay for general governmental services.

be taken to ensure the funds are used for the purpose for which they were collected. Further, if loans are made from funds that may be subject to Proposition 218, in our opinion, interest paid on the loan should at least be equal to what otherwise would have been earned in the fund if the money had not been lent out. Risk Management Funds typically earn interest from investments. However, we found that the WC Fund was used to make loans in which the interest was later forgiven or was not charged. Had the loans not been made and the money was still in the WC Fund, it could have earned at least the accounts' interest rate. By not collecting interest on loans, the WC Fund has not recovered the interest income it could have accrued and may be inconsistent with Proposition 218.

In FY 2013/14, the City Council approved a short-term, interest-free loan of up to $12 million to ArenaCo to cover application, impact, permit and other fees that ArenaCo must pay to the City or other governmental or quasi-governmental entities for the design, development, and construction of the Golden1 Arena. During fiscal year 2015, the City loaned over $3.1 million to ArenaCo from the WC Fund. The interest-free loan was paid back in less than four months. During the months the loan was made, the City Treasurer's Office reported average earned interest yield of 0.95 percent for other City investments. If the loan terms had included at least this interest rate, the WC Fund would have received about $8,200 in interest income.

The WC Fund has also been used to make loans to other City funds, including five loans totaling $6.2 million to cover capital improvements and bridge the gap between revenues and expenditures in the City's Golf Special Revenue Fund. In October 2011, the City entered into a public/private partnership with Morton Golf, LLC to maintain the City's golf courses. As of June 2016, there were two existing loans to the Golf Special Revenue Fund from Risk Management's WC Fund; one for capital, and one for operations. According to the Finance Department, the capital loan has a current balance of $3.7 million and is being paid from Morton Golf, LLC revenue. The operating loan has a current balance of $4.7 million, including interest through June of 2011; at that time, the City Council voted to stop accruing interest on this loan. No payments are currently being made to the WC Fund for this loan. According to the Finance Department, when interest stopped accruing in 2011 to the Golf Special Revenue Fund, the General Fund should have picked up the interest portion of the payment. The Finance Department estimates the accrued interest since 2011 to be approximately $367,000 as of June 2016 (at 1.5 percent interest per year) and is reviewing options for repayment of the golf operating loan.

As enterprise funds subject to Proposition 218 contribute to the Risk Management Funds, waiving interest for loans made from the funds may be

inconsistent with Proposition 218 requirements. During FY 2014/15, funds subject to Proposition 218 contributed nearly 11 percent of the more than $9.5 million contributed to the WC Fund. Using the FY 2014/15 contribution rates, more than $40,000[4] (11 percent of the $367,000 in accrued interest for the golf operating loan) of the accrued interest is associated with funds restricted by Proposition 218. Although the accrued interest for the ArenaCo loan is minor when compared to the Golf loan, in our opinion, a similar plan in which the General Fund picks up at least the interest rate on the City's other investments should have been developed for the loan to ensure that revenues from the enterprise funds subject to Proposition 218 receive a reasonable rate of interest.

We believe City Council should not take action to forgive interest or provide interest-free loans on funds subject to Proposition 218. In our opinion, given that the Risk Management Funds receive money from such restricted funds, loans made from the Risk Management Funds should be limited. In instances that require a loan to be made from the funds, care should be taken to ensure loan terms are in a written agreement with the principal, interest, term, and schedule of repayment documented.

Recommendations

We recommend the Finance and Human Resources Departments:

4. Ensure loans made out of the Risk Management Funds are documented in a written agreement and receive a reasonable rate of interest.
5. Work towards repaying the Workers' Compensation Fund's golf operating loan including interest accrued.

The Public Works Department was Over-Reimbursed by More Than $262,000 in Fiscal Year 2014/2015 From the General Liability and Auto Liability Fund

Because the City is self-insured, the Risk Management Division receives funding from other City departments and acts as the insurance company for these departments. All claims against the City, including WC and GL&AL claims, are then paid and managed by the Risk Management Division. The Risk Management Division has excess property insurance for claims greater than $100,000. However, property claims less than $100,000 are paid for by the Risk Management Division's GL&AL Fund. The Property Claims Processing/Risk Fund Reimbursement Procedure outlines the process for reporting and receiving reimbursement for property losses. During our audit, the Risk Management

The Property Claims Processing/ Risk Fund Reimbursement Procedure outlines the process for reporting and receiving reimbursement for property losses.

[4] This is a simplified calculation to demonstrate the risk to the fund if interest-free loans are determined to be inconsistent with Proposition 218.

Division informed us that the Public Works Department had not complied with the Procedure, which led to an overpayment of more than $262,000 by the GL&AL Fund.

When departments experience a loss to property, they submit a claim for reimbursement to the Risk Management Division by submitting an Incident/Loss Report (or Vehicle Accident Report if the incident involved a motor vehicle). Similar to an insurance company, the Risk Management Division has established a property deductible for $1,000 that is applied to each self-insured claim reimbursement. The City's Public Works Department repairs many assets in the City, such as streets, pavements, signs, signals and lighting; as such, the Risk Management Division has allowed the Public Works Division to receive reimbursement for property losses without completing an Incident/Loss Report for each claim. During FY 2014/15, the Public Works Department received nearly $800,000 in property claim reimbursements from the GL&AL Fund. We found that the Public Works Department did not pay the $1,000 deductible for the claims it submitted, and received reimbursements for the full amount of claims submitted to the Risk Management Division.

We found that the Public Works Department did not pay the $1,000 deductible for the claims it submitted, and received reimbursements for the full amount of claims submitted to the Risk Management Division.

During FY 2014/15, the Human Resources Department began reviewing the transactions and found the Public Works Department's noncompliance with the $1,000 deductible requirement resulted in more than $262,000 overpaid by the GL&AL Fund during FY 2014/15. The Public Works Department was able to avoid the $1,000 deductible because they submitted the Risk Management Division's reimbursement claims with a monthly citywide journal that also charged other City departments for work done by the Public Works Department. The monthly citywide journals are approved by the Public Works Department and sent to the Finance Department for approval and posting. This does not provide the Risk Management Division a sufficient amount of time to review and approve the reimbursement claims prior to payment.

The Property Claims Processing/Risk Fund Reimbursement Procedure also prohibits the reimbursement for indirect costs (such as labor compensation other than base salary) incurred and states that claims will be reimbursed based on actual cash valuation, not the replacement cost of the property. According to the Human Resources Department, the Public Works Department also did not comply with these aspects of the Procedure. However, the Human Resources Department was not able to determine the extent of the overpayments for this noncompliance.

Because funds restricted by Proposition 218 contribute to the GL&AL Fund, the overpayment by the GL&AL Fund may be inconsistent with the Proposition's requirement that restricted funds cannot be used for a purpose other than that

for which they were intended. Restricted enterprise funds contributed 21 percent of the funding for the GL&AL Fund during FY 2014/15. Therefore, $55,000 of the $262,000 may be restricted funding subject to Proposition 218. In our opinion, the Human Resources Department should pursue reimbursement of the overpayment from the Public Works Department to ensure compliance with Proposition 218 requirements and the Property Claims Processing/Risk Fund Reimbursement Procedure. In addition, the Risk Management Division should work with the Public Works Department to establish a process in which claim reimbursements are approved prior to being sent to the Finance Department and posted to the GL&AL Fund.

Recommendations

We recommend the Human Resources Department:

6. Consider pursuing reimbursement of the overpayment from the GL&AL Fund to the Public Works Department to ensure compliance with Proposition 218 requirements and the Property Claims Processing/Risk Fund Reimbursement Procedure.
7. Work with the Public Works Department to establish a process to ensure property claim reimbursements are approved prior to posting to the GL&AL Fund and are in compliance with the Property Claims Processing/Risk Fund Reimbursement Procedure.

Nearly $1 Million in Salaries for Employees Not in the Risk Management Division were Paid Out of the General Liability and Auto Liability Fund During Fiscal Year 2014/15

As previously stated, Proposition 218 seeks to reduce possible abuses in the use of assessments and property-related fees to pay for general governmental services. As funds that are subject to Proposition 218 contribute to the Risk Management Funds, care should be taken to ensure only expenditures directly related to risk management are paid out of the Risk Management Funds. Our review of the expenditures in the Risk Management Funds found that the GL&AL Fund paid nearly $1 million in salaries of employees not in the Risk Management Division during FY 2014/15. The Human Resources Department should be cautious in allowing personnel costs to be paid for by the GL&AL Fund as it could affect the actuary's annual estimates. To calculate the amount of money required in the two Risk Management Funds each fiscal year, the actuary utilizes historical data regarding claim costs and operational costs for each program. Therefore, payments for salaries of employees not in the Risk Management Division increases the actuary's calculation of the amount of money required in the fund and increases each of the City funds' contribution

Our review found that the GL&AL Fund paid nearly $1 million in salaries of employees not in the Risk Management Division during FY 2014/15.

amounts. This includes increases in the contribution amounts of funds subject to Proposition 218.

Until the FY 2016/17 budget, a number of positions in the Human Resources Department were paid out of the GL&AL Fund. During FY 2014/15, this cost the GL&AL Fund nearly $600,0000. The GL&AL Fund was also contributing $333,000 towards the City Auditor's budget. For FY 2016/17, the contribution to the City's Auditor's budget has been cut in half and the Finance Department informed us that in the following years, the GL&AL Fund will no longer contribute to the City Auditor's budget. Because the Auditor's Office and some of the Human Resources positions may be performing work for enterprise funds subject to Proposition 218, a more thorough review of the positions paid by the GL&AL Fund should be done to determine whether these payments out of the Fund are consistent with Proposition 218 requirements.

We also found the GL&AL Fund was reimbursing the Convention & Cultural Services Department nearly $50,000 annually for security guards at the City's historic cemetery. Although it can be argued that having security guards in the cemetery may reduce the risk that the cemetery will be vandalized, it does not appear to be directly related to risk management. During our audit, the Risk Management Division informed us that they will discontinue paying for the cemetery guard after FY 2016/17.

Costs such as those described above are taken into account by the actuary when calculating the funding levels, which could lead to a higher funding requirement for each fiscal year. The higher funding requirement requires each of the City's funds to contribute more to the GL&AL Fund than it costs for expenditures directly related to risk management. Personnel costs paid by the Risk Management Funds should be reviewed to ensure they are directly related to risk management. In our opinion, if the payments are inconsistent with Proposition 218 requirements, the City should consider ways to reimburse the GL&AL Fund for the portion of the positions paid by restricted enterprise funds.

The Risk Management Division currently does not have any policies or procedures in place to provide guidance on the types of expenditures that can be made out of its two funds. Therefore, transactions that may be inconsistent with Proposition 218 may be made in the two funds. In our opinion, expenses paid out of the Risk Management Funds should be reviewed for appropriateness and compliance with Proposition 218. Policies and procedures should be developed to outline the types of expenditures that can be made out of the two Risk Management Funds to limit payments not directly related to risk management programs and expenditures should be reviewed for appropriateness before approval.

The Risk Management Division currently does not have any policies or procedures in place to provide guidance on the types of expenditures that can be made out of its two funds.

Recommendations

We recommend the Human Resources and Finance Departments:

8. Review positions paid by the GL&AL Fund not in the Risk Management Division and determine if they are inconsistent with Proposition 218. If payments of the positions conflict with Proposition 218, the department should consider whether repayment to the GL&AL Fund for at least the portion of the positions paid by restricted enterprise funds is required.

We recommend the Human Resources Department:

9. Develop policies and procedures that outline the types of expenditures that can be made out of the two Risk Management Funds to limit payments not directly related to risk management programs.

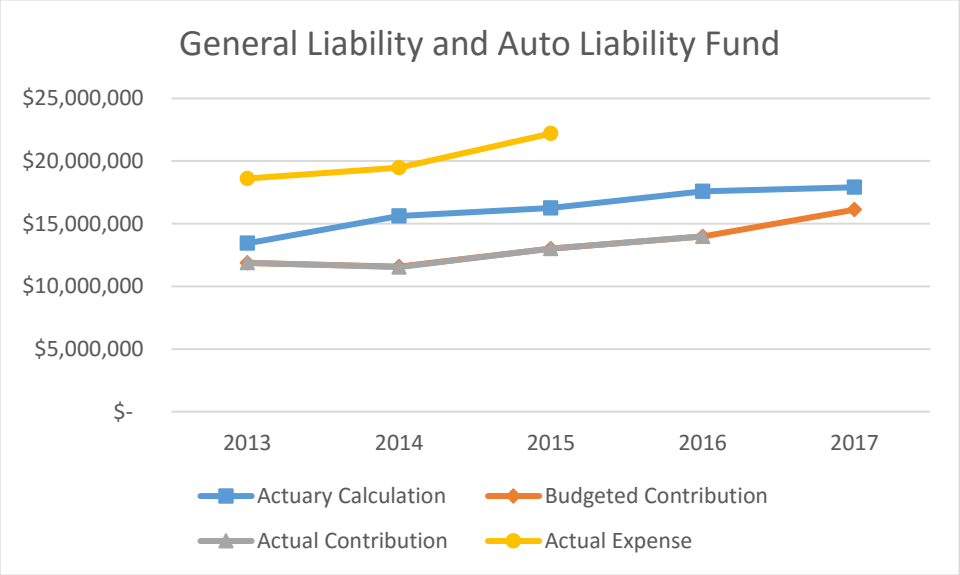
Finding 2: Actuarial Funding Levels Have Outpaced the City's Increase in Contributions to the General Liability & Auto Liability Fund

The Risk Management Division contracts with an actuarial firm, Bickmore Risk Services (Bickmore), to estimate the amount to budget for claim costs and expenses that will occur in the coming fiscal year and the program's liability for outstanding claims. Bickmore utilizes historical City loss data to forecast the upcoming fiscal year's cost of claims and expenses at various confidence levels. The City's Finance Department receives a copy of the actuary's report and uses it to create the coming fiscal year's budget for all City funds. The City utilizes the actuary's forecast at the recommended 80 percent confidence level when budgeting for claim costs and expenses. This means that the calculated amounts should be sufficient to cover the fiscal year costs for the Workers' Compensation (WC) and General Liability and Auto Liability (GL&AL) Funds 80 percent of the time. Our review of the funding levels for fiscal years (FY) 2012/13, 2013/14, and 2014/15 found that the City has been allocating less than the actuary's recommended levels for the GL&AL Fund, while expenses in the Fund have been more than Bickmore had calculated. This has contributed to the low or negative fund balances in the GL&AL Fund and the need to transfer funds from the WC Fund to pay for claim and operating expenses.

Bickmore's estimate of the GL&AL Fund claim costs and expenses that will occur each fiscal year has increased between FY 2012/13 and 2016/17. The Finance Department has attempted to increase contributions from the General Fund to eventually contribute at Bickmore's estimated levels. Our review found that although contributions from the General Fund and other funds have increased, the GL&AL Fund is still underfunded as Bickmore's funding levels have outpaced the City's increase in contributions. In addition, we found annual expenses in the GL&AL Fund were higher than the actuary's calculation for FY 2012/13 through 2014/15. Figure 9 below identifies the actuary's calculated annual claim costs and expenses, the actual or budgeted allocated amounts from the City's funds, and the actual claim costs and expenses in the GL&AL Fund from FY 2012/13 through 2016/17.

Bickmore's estimate of the GL&AL Fund claim costs and expenses that will occur each fiscal year has increased between FY 2012/13 and 2016/17.

Figure 9: General Liability and Auto Liability Fund Allocations and Expenses



Source: Auditor compiled from annual actuarial reports and eCAPS reports.

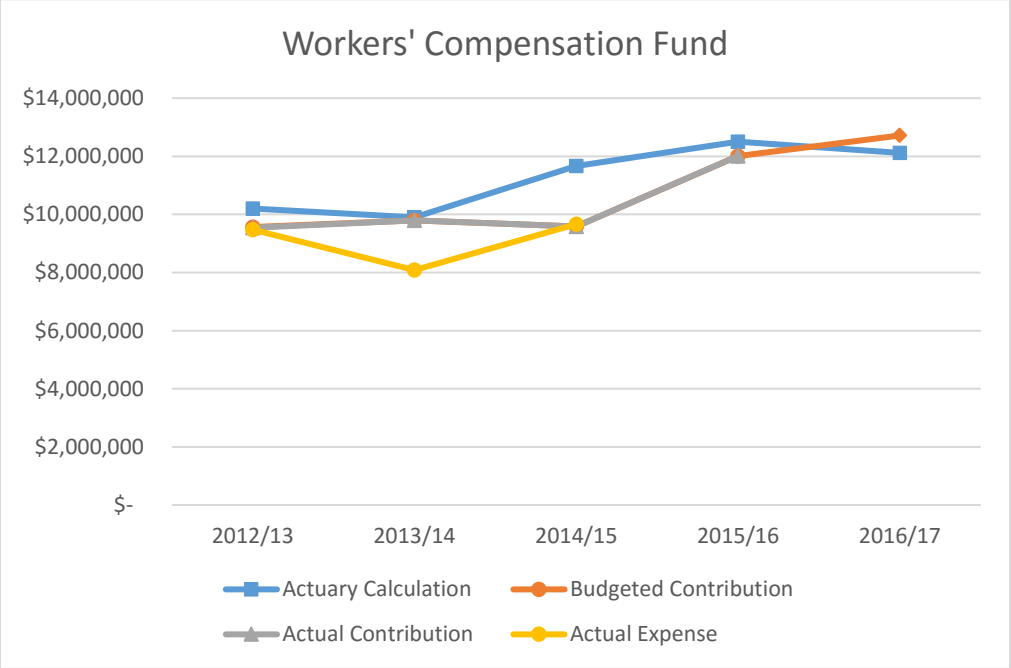
As shown in Figure 9 above, while the City's contribution to the GL&AL Fund has increased in the last few years, the actuary's funding levels have also increased, leaving the GL&AL Fund underfunded each fiscal year. Bickmore's September 22, 2015 *Actuarial Review of the Self-Insured Liability Program* warned the City that if it funds at a low level,

> "the chances are much greater that future events will prove that additional contributions should have been made for current claims. The additional contributions for years by that time long past may be required at the same time that costs are increasing dramatically on then-current claims. The additional burden of funding increases on past years as well as current years may well be prohibitive."

This appears to be the situation the City is currently facing in the GL&AL Fund. The Risk Management Division informed us that annual expenses in the funds normally have ebbs and flows. However, expenses in the GL&AL Fund have continually increased in the past few years which led to a negative balance in the fund. Due to the deficit, in their report *Actuarial Review of the Self-Insured General Liability Program* dated September 6, 2013, Bickmore recommended "the City transfer assets from the City's workers' compensation program to equalize the confidence level of each program, without bringing the workers' compensation program below the target 80% confidence level." The City transferred $21 million from the WC Fund to the GL&AL Fund during FY 2013/14. While a few claims with large payouts were filed in the past few years, underfunding the GL&AL Fund and making payments unrelated to risk from the Fund, as discussed in Finding 1, also appears to have contributed to the deficit.

An analysis of the WC Fund in Figure 10 below shows that the Fund has been doing better, as the City's contribution into the Fund is closer to Bickmore's estimated funding level and the actual expenses in the Fund have been less than the actuary's calculation. This had led to a positive fund balance in the WC Fund which has allowed the City to transfer $21 million from this Fund to the GL&AL Fund in FY 2013/14.

Figure 10: Workers' Compensation Fund Allocations and Expenses



Source: Auditor compiled from annual actuarial reports and eCAPS reports.

The Finance Department is aware of the GL&AL funding issue and has developed a plan to increase the General Fund's contribution in each coming fiscal year. Figure 11 below identifies the Finance Department's planned increase in contributions to the GL&AL Fund from the General Fund.

Figure 11: Planned Increases in Contribution to the GL&AL Fund from the General Fund

Fiscal Year	Planned Increase in General Fund Contribution
2017/18	$ 500,000
2018/19	$ 1,000,000
2019/20	$ 1,500,000
2020/21	$ 2,000,000
2021/22	$ 2,500,000

Source: Finance Department

It appears that even the planned increases from the General Fund over the next few fiscal years may not address the funding issues in the GL&AL Fund because, as Bickmore had warned, the required funding levels appear to increase each fiscal year as well. The Finance Department is attempting to increase contributions from the General Fund at a greater rate than currently planned to close the gap and ensure that the actuarially calculated contribution amounts are funded in each fiscal year's budget. In addition, to ensure the two Risk Management Division Funds maintain adequate reserves, the Finance Department implemented the Risk Management Funding and Reserve Policy in May 2015. The policy outlines the annual funding level for the WC and GL&AL Funds and provides guidance on how excess reserves or shortfalls will be balanced. As part of the FY 2015/16 year-end process, the Finance Department used the City's General Fund expenditure savings to fully fund the General Fund's contribution to the GL&AL Fund in FY 2015/16 per the actuarial recommendation.

To ensure the two Risk Management Division Funds maintain adequate reserves, the Finance Department implemented the Risk Management Funding and Reserve Policy in May 2015.

In our opinion, to ensure there is sufficient funding levels in the GL&AL Fund to pay annual claims and expenses, the Finance Department should increase contributions at a greater rate than currently planned until the actuarially calculated contribution amounts for each fund can be made each fiscal year. If the trend shown in Figure 9 above continues, the GL&AL Fund will have an increasing negative fund balance each fiscal year and will no longer be able to cover its annual expenses. In addition, as the fund balance in the WC Fund is depleted from previous transfers to the GL&AL Fund, the ability to transfer from the WC Fund in the future may also be limited.

Recommendation

We recommend the Finance Department:

10. Increase contributions at a greater rate than currently planned until the actuarially calculated contribution amounts for each fund can be made each fiscal year.

Finding 3: The City May Reduce Risk and Liability by Making Improvements to Some Programs and Policies

The Risk Management Division currently has a number of programs and policies in place to reduce the City's risk and liability. For example, drivers' training is provided to employees at the Sacramento Regional Drivers Training Facility; drivers' licenses of commercial drivers are monitored; and injury and illness prevention programs and policies have been developed. Our review of the Human Resources Department and Risk Management Division's programs found improvements to some existing programs and policies may further reduce City risk and liability. More specifically, we found:

- The Sacramento Regional Drivers Training Facility could be better used by nonemergency personnel;
- The Risk Management Funds' *Extraordinary Loss* accounts could be better managed;
- The Risk Management Division currently only monitors drivers' licenses of commercial drivers;
- The City would benefit from establishing limitations on employee work-related physical fitness;
- The City could reduce the risk of hiring undesirable applicants by establishing additional pre-employment screenings; and
- The City does not have a mechanism to ensure compliance with the insurance requirements of the Transportation Policy.

We believe the City may further reduce risk and liability by expanding drivers training and drivers' license monitoring to all employees that drive vehicles on City business. In addition, the City may also reduce risk by improving policies and procedures and establishing pre-employment screening.

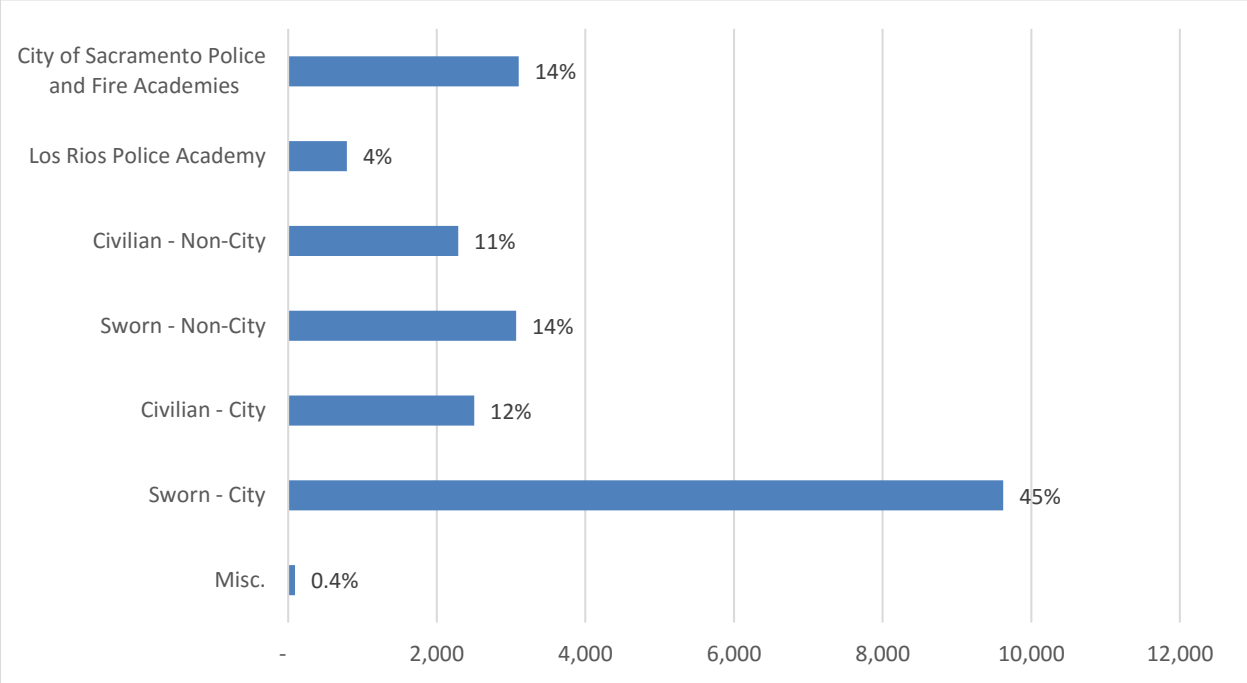
The Sacramento Regional Drivers Training Facility Could be Better Used by Nonemergency Personnel

The City has many employees that spend many of their work hours driving in City vehicles, such as police officers, firefighters, and sanitation workers. To ensure employees are driving safely and the liability to the City is minimized, the Risk Management Division provides funding to run the Sacramento Regional Drivers Training Facility (SRDTF). The SRDTF is a joint operation between the City and County of Sacramento and was established to reduce employee vehicle accidents. Although many City departments drive a large number of miles in City vehicles for City business, we found there are no policies and procedures requiring nonemergency personnel to take drivers' training. In addition, it

appears many departments are not taking advantage of training provided at the SRDTF to improve driver safety and reduce City liability.

The City's Police and Fire Departments are currently the primary users of the SRDTF; Police and Fire Department employees have mandatory drivers' training requirements on an annual or biennial basis. The Police and Fire Departments also provide drivers safety training courses for other City employees, outside entities, and the general public. Figure 12 below identifies the hours of use by each type of training provided by the City at the SRDTF during fiscal year (FY) 2014/15.

Figure 12: City of Sacramento's SRDTF Fiscal Year 2015 Hours of Use by Training Type



Source: Auditor created from Risk Management Division SRDTF Monthly Statistical Report

As shown in figure 12 above, the City had over 21,000 hours of training at the SRDTF during FY 2014/15, 77 percent of these hours were spent by internal and external emergency services personnel. According to the Risk Management Division, at capacity, the City can provide 32,000 hours of training at the SRDTF. As the facility is currently not being used at capacity, we believe additional nonemergency personnel may benefit from drivers' training courses offered at SRDTF.

Many City job classifications, such as parking enforcement and code enforcement officers, drive City vehicles. Figure 13 below identifies the number of City vehicle miles driven, total collisions, chargeable collisions and the collision frequency rate by department during FY 2014/15.

Figure 13: Fiscal Year 2014/15 City Vehicle Miles Driven and Collisions by Department

Department	Miles Driven	Total Collisions	Chargeable Collisions	Collision Frequency Rate
Police	6,680,746	150	61	9.1
Public Works	3,436,252	95	28	8.1
Utilities	2,039,423	37	18	8.8
Fire	1,701,588	75	19	11.2
Parks & Recreation	725,489	26	11	15.2
Community Development	621,374	11	4	6.4
Convention and Cultural Services	5,684	0	0	0.0
Charter Offices	3,380	0	0	0.0
Grand Total	**15,213,936**	**394**	**141**	**9.3**

Source: Auditor compiled from report provided by the Risk Management Division of the Human Resources Department

As shown in Figure 13 above, City departments such as Public Works and Utilities also drive City vehicles and have experienced a number of collisions. Although some employees from other departments, such as Public Works' Solid Waste employees, take drivers' training courses at the SRDTF, there are currently no policies requiring them to take courses before driving for City business. Given the risk and liability the City is exposed to by these departments, City management should consider whether nonemergency personnel would benefit from taking drivers' training courses at the SRDTF.

In addition to providing drivers' training courses to employees driving City vehicles, the City should consider training employees driving personal vehicles on City business. During calendar year 2015 the City spent approximately $700,000 to provide nearly 400 employees vehicle allowances for driving their personal vehicle on City business. These employees may also benefit from taking drivers' training courses at the SRDTF.

Although the SRDTF is currently not being used at capacity, nonemergency personnel that drive City vehicles or drive their own vehicles on City business are not required to take drivers' training courses at the SRDTF. This increases the risk that employees driving either City vehicles or their personal vehicles for City business may not be properly trained in safe and defensive driving techniques. In our opinion, the City may reduce risk and liability by encouraging all employees, including those that drive nonemergency City vehicles and those that receive a vehicle allowance, to take drivers training courses at the SRDTF.

Recommendation

We recommend the Risk Management Division:

11. Develop policies and procedures that establish guidelines on which employees should take drivers' training at the SRDTF and a reasonable timeline for completing the training.

The Risk Management Funds' *Extraordinary Loss* Accounts Could be Better Managed

The Risk Management Division is responsible for protecting City employees and assets through effective loss prevention and administration of claims made by the public or City employees. Within each of the two Risk Management Funds, about $50,000 is set aside in an *Extraordinary Loss* account each fiscal year. According to the Risk Management Division's Loss Prevention Manager, the money is used to pay for risk-related items that departments do not have the money in their budgets to cover, and are intended to help incentivize departments to reduce losses. However, there are no policies or procedures outlining the intended purpose of the *Extraordinary Loss* account. Our review of the two funds during FY 2012/13, 2013/14, and 2014/15 found the *Extraordinary Loss* accounts in the two Risk Management Funds could be better managed to improve equality in the distribution of the funds and reduce the risk of it being used for unintended purposes.

Within each of the two Risk Management Funds, about $50,000 is set aside in an* Extraordinary Loss *account each fiscal year.

Our review of the payments made out of the two *Extraordinary Loss* accounts found there may be inequality in the distribution of the funds, as a large amount of the money in the accounts was spent on public safety transactions. For example, we found that between $17,000 and $20,000 was paid from the General Liability and Auto Liability (GL&AL) Fund each fiscal year for Police canine training. In addition, $20,000 was paid to the Fire Department from the Workers' Compensation (WC) Fund in FY 2014/2015 to pay for the purchase of Stryker Power Load Lift Systems, a device used by Emergency Medical Services to load and unload cots in the ambulances. We also found payments for equipment such as police vests, hearing protectors, and helmets and seat cushions for a City helicopter. As there are currently no policies or procedures outlining what the Risk Management Funds may be used for, we asked the Human Resources Director about some of the transactions described above. Although the transactions may arguably be risk-related, the director stated that some of these transactions are not typically paid out of the Risk Management Funds. The intent of the *Extraordinary Loss* account should be documented and guidance should be provided on the appropriate use of the account. In addition, the accounts should be made known to all departments, as the infrequent use of the *Extraordinary Loss* accounts by other departments may be due to lack of

knowledge about the money available to help pay for loss prevention efforts. In our opinion, by better managing the *Extraordinary Loss* accounts, equality in the distribution of the funds will be improved and the risk of it being used for unintended purposes will be minimized.

Recommendation

We recommend the Human Resources Department:

12. Document guidance for the use of the *Extraordinary Loss* accounts and review expenditures in the accounts for appropriateness.

The Risk Management Division Currently Only Monitors Drivers' Licenses of Commercial Drivers

Some City positions require employees to maintain a commercial drivers' license governed by the State Department of Motor Vehicles (DMV). These positions include Recycling and Solid Waste Drivers and Fire Department employees who drive fire engines. The Risk Management Division uses an online software through a company called A-Check to monitor their drivers' licenses for suspended or expired licenses and expired medical reviews[5]. When the A-Check software identifies an employee whose drivers' license is not current and valid with the DMV, the Risk Management Division sends a letter to the employee's department and the City's Labor Relations Division to inform them of the status of the employee's drivers' license. It is the department's responsibility to ensure their employee does not drive until the drivers' license issue is corrected.

The Risk Management Division currently monitors the drivers' licenses of about 500 City employees from the Utilities, Fire, and Public Works Departments. However, there are many other City employees that drive City vehicles or their personal vehicles for City business whose drivers' licenses are currently not monitored. As a result, there may be employees with expired or suspended drivers' licenses driving on City business that could increase the City's potential liability. Although there is not a requirement for these employees to have their drivers' license information monitored, the City could benefit from reviewing the employees' drivers' license status to ensure employee licenses are valid. The California Department of Motor Vehicles requires employers to obtain authorization from employees for the release of driver record information before employers can monitor employee drivers' licenses. In 2006 the Risk Management Division provided a proposal to begin drivers' license monitoring

The Risk Management Division currently monitors the drivers' licenses of about 500 City employees from the Utilities, Fire, and Public Works Departments.

[5] Commercial drivers have required medical reviews to be conducted with the DMV up to every two years depending on whether the driver has medical issues.

of frequent City drivers to promote driver safety and reduce potential liability. However, according to the Risk Management Division, they did not receive authorization to move forward with the proposal.

To reduce the City's potential liability, the City should work towards obtaining the authorization forms from employees and consider monitoring the drivers' licenses of all City employees that drive City or personal vehicles for City business through A-Check, as there would be no additional cost to the City for adding additional drivers' licenses in the A-Check system for monitoring.

Recommendation

We recommend the Risk Management Division:

13. Consider monitoring the drivers' licenses of all employees that drive City vehicles or receive City vehicle allowances.

The City Would Benefit from Establishing Limitations on Employee Work-Related Physical Fitness

The City's sworn Police and Fire Department employees have more intensive physical requirements than other City departments. For example, the State of California's Peace Officer Standards and Training set physical requirements for Police Officers. To ensure they maintain the appropriate physical fitness level, employees may exercise with sports such as basketball, running, biking, and hiking. However, without clear guidelines to define what constitutes work-related exercises, the City is at risk of paying workers' compensation claims for off-duty injuries that may not necessarily be the City's responsibility. The Police Department currently has a policy regarding their Physical Fitness Program that outlines appropriate on-duty workout activity. However, the City currently does not have policies and procedures in place regarding off-duty physical fitness and analyzes these types of claims on a case-by-case basis to determine what, if anything, is compensable. Therefore, there is a potential for City liability if a Police or Fire Department employee is injured while performing any type of off-duty exercise, as the employee can claim workers' compensation and argue that the City received a benefit from the employee's exercising.

Without clear guidelines to define what constitutes work-related exercises, the City is at risk of paying workers' compensation claims for off-duty injuries that may not necessarily be the City's responsibility.

During FY 2015/16, the City received 1,166 workers' compensation claims, 52 of which were for injuries due to on-duty or off-duty exercise by Police and Fire Department employees. As of September 2016, nearly $49,000 had been paid out in workers' compensation benefits on these claims and an additional $64,000 is expected to be paid by the time they are all closed. To minimize the City's exposure regarding off-duty exercise, the City may benefit from establishing limitations on employee physical fitness programs.

We found that other cities have addressed this issue to limit liability. The City of Vacaville, for example, has taken measures to define what types of off-duty exercises they allow. Specifically, Vacaville put reasonable limits on the types of activities covered under an employee's physical fitness plan. The limits state that "off-road cross country type running is not authorized" and that "all running, jogging, and walking must be performed on a sidewalk, city park, school athletic field or treadmill". This policy protected the City when an employee submitted a workers' compensation claim after he was injured while hiking with his dog. Vacaville denied the employee's claim and the employee appealed the denial with the State's Workers' Compensation Appeals Board (WCAB). The WCAB believed the employer's limitations were reasonable and upheld the City of Vacaville's decision. In our opinion, the City of Sacramento could also benefit by establishing similar limitations on employee physical fitness.

Recommendation

We recommend the Risk Management Division:

14. Establish reasonable limits on the types of activities allowed to reduce the City's liability when an employee is injured off-duty.

The City Could Reduce the Risk of Hiring Undesirable Applicants by Establishing Additional Pre-Employment Screenings

According to the State of California Department of Justice's Office of the Attorney General, "securing a criminal background check prior to employment, licensure, or certification provides a hiring or licensing authority an important resource, which aids in the evaluation of the applicant." As of June 2015, the City had over 4,100 full-time equivalent employees. To gain an understanding of the City's onboarding process, we discussed the City's pre-employment screening process for potential employees with the Human Resource's Employment Services Manager. We found that some level of pre-employment screenings are performed for certain classifications such as all Police Department employees, sworn Fire Department employees, Animal Control Officers, Park Rangers, Department Directors, and anyone working with children in the Parks and Recreation Department. For most other classifications, applicants simply answer a conviction questionnaire that is not investigated and no additional pre-employment screenings are performed.

The Employment Services Manager informed us that they are currently looking into implementing pre-employment screenings for all potential employees. The City would require all potential employees to complete Live Scan fingerprinting where electronic fingerprints of an individual are taken by a certified fingerprint

roller or qualified law enforcement personnel. The fingerprint images and personal information of the individual are then sent to the Department of Justice and searched against all other fingerprint images in the fingerprint database. If the fingerprints of the individual match an existing fingerprint in the database, it is reviewed to determine if there is a criminal history associated with the individual. The Department of Justice also allows organizations to receive subsequent arrest information on its employees in which the Department of Justice would inform the City if an employee is arrested in California during the course of employment with the City. The Employment Services Manager stated that Live Scan fingerprinting would have to be negotiated with the labor unions before it can be implemented in the City. Other Cities have already implemented pre-employment screenings for all potential employees. We found the City of Citrus Heights requires a Live Scan for all positions and the City of Long Beach requires both a Live Scan and physical for all new hires.

The State's Office of the Attorney General warns "entrusting applicants with the responsibility of the position prior to a criminal background check potentially jeopardizes the safety and integrity of the workplace and may leave some individuals exposed to unnecessary harm." While it appears the City does their due diligence for some classifications, it relies on the honesty of the applicants for many of the classifications in the City. By not performing pre-employment screenings as a part of the hiring process, the City is at risk of hiring undesirable applicants. We found an instance where a City employee had lied about a criminal conviction on their employment application by stating that he had not been convicted of a felony on his conviction questionnaire. The lie was uncovered when we had the Labor Relations Division of the Human Resources Department conduct a background check on the individual as part of a whistleblower allegation we were investigating.

By not performing pre-employment screenings as a part of the hiring process, the City is at risk of hiring undesirable applicants.

The Risk Management Division worked with other City staff to produce a draft pre-employment background check policy in 2009. According to the Risk Management Division, the draft policy was approved by the City's executive team but was never implemented. In our opinion, the City should continue to pursue pre-employment screenings for all potential new employees and employees receiving promotions as it could reduce the risk of hiring undesirable applicants and ensure a safe workplace.

Recommendation

We recommend the Human Resources Department:

15. Continue to pursue establishing pre-employment screenings for all classifications in the City to reduce the risk of hiring undesirable applicants.

The City Does Not Have a Mechanism to Ensure Compliance with the Insurance Requirements of the Transportation Policy

As previously mentioned, the City provides some employees a vehicle allowance for using their personal vehicles to conduct City business. During calendar year 2015, the City provided nearly $700,000 to employees for vehicle allowances and as of December 11, 2015, 378 City employees were receiving the allowance. The Public Works Department's Fleet Management Division currently has a City Employee's Transportation Policy (also known as API #29) that requires employees using their privately owned vehicles for official City business to have public liability and property damage insurance coverage of at least $15,000 for one injury, $30,000 for all injuries and $5,000 for property damage. Employees receiving a vehicle allowance are required to complete an Insurance Certification form certifying that they meet the insurance requirement. In the event an employee is in an auto accident in their personal vehicles while on City business, the employee's personal insurance will be the primary insurer and the City would be the secondary insurer if the loss exceeds the employee's insurance coverage limits. However, the City currently does not have processes in place to ensure employees are in compliance with the policy.

The City currently does not have processes in place to ensure employees are in compliance with the Transportation Policy.

During our audit, the Loss Prevention Manager provided us with an updated draft of the Transportation Policy that outlines the policies and procedures regarding the use of City vehicles and personal vehicles for City business. More specifically, for the use of privately owned vehicles, the policy states the employee's insurance will be the primary insurance for losses and that the employee "shall maintain public liability and property damage insurance with limits of at least $100,000 for one injury, $300,000 for all injuries and $50,000 for property damage." The draft Transportation Policy also requires employees using their personal vehicles for City business to provide their supervisors with an Insurance Certification form stating that they meet the insurance requirement.

While the updated Transportation Policy would help reduce the City's liability in regards to employees driving their personal vehicles for City business, the policy has been in draft form for two years and has yet to be implemented. In our opinion, the City should implement the updated Transportation Policy to reduce

the City's liability as the secondary insurer of employees driving their personal vehicles for official City business. In addition, a method for monitoring compliance with the policy should be established to ensure employees maintain the increased insurance coverage amounts when receiving a vehicle allowance.

Recommendations

We recommend the Fleet Management Division:

16. Continue to work towards implementing the updated draft of the Transportation Policy to increase the insurance requirement of employees driving their personal vehicles for City business.

We recommend the Risk Management and Fleet Management Divisions:

17. Work together to develop a monitoring mechanism to ensure employees maintain the required minimum insurance coverage when receiving a vehicle allowance.

City of SACRAMENTO
Department of Human Resources

MEMORANDUM

DATE: October 14, 2016

TO: Jorge Oseguera, City Auditor

FROM: Patrick Flaherty, Risk Manager

SUBJECT: City's Risk Management Division Audit

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1. This memorandum is in response to the City Auditor's Audit of the City's Risk Management Division.

2. The Human Resources Department ("HR"), Risk Management Division, and the Finance Department acknowledge receipt and concur with the recommendations from the City Auditor's draft report.

3. Corrective actions are actively being taken. In addition, internal operating procedures are being updated and staff training has begun to ensure implementation of the recommendations.

4. I would like to take this opportunity to thank the City Auditor and staff for their efforts in identifying process improvements in this audit. Please feel free to contact me directly should you have any questions.

5. Below is the response of the named departments to the 17 audit recommendations identified in the audit report:

AUDIT RECOMMENDATIONS AND DEPARTMENTAL RESPONSE

1. Continue to develop a system to reconcile health premium invoices to actual amounts deducted in payroll to ensure the General Liability and Auto Liability fund does not subsidize health benefit costs.

Response: The Human Resources Benefits division is currently working on health insurance billing reconciliation. The process will be in place by the end of FY2016/17.

Risk Management Division
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Sacramento, CA 95814-2604
916-808-5278

2. **Work with the health benefits vendors to attempt to recoup any overpayments that may have been made.**

   Response: The City is currently working with vendors to receive refunds, for the time frames allowable under the contracts.

3. **Determine if reimbursements to the General Liability and Auto Liability Fund from other City funds are necessary.**

   Response: It is impossible to determine exactly what funding sources and the amount charged to each fund to reimburse the Risk Fund. The City will be charging the appropriate funding sources as we move forward.

4. **Ensure loans made out of the Risk Management funds are documented in a written agreement and receive a reasonable rate of interest.**

   Response: The Finance Department presented an Interfund Loan Policy to the Budget and Audit Committee and City Council. The policy as presented requires City Council approval of all interfund loans, except for short-term working capital loans. This policy was adopted by Council on June 9, 2016 (Motion Order 2015-0141).

5. **Work towards repaying the WC Fund's golf operating loan including interest accrued.**

   Response: The Finance Department included a detailed explanation of the golf operating loan, waiver of interest and potential for loan repayment in the FY2016/17 Approved Budget. Options for repaying this loan, including accrued interest, will be included in the FY2016/17 Midyear Budget for Council consideration.

6. **Consider pursuing reimbursement of the overpayment from the GL&AL Fund to the Public Works Department to ensure compliance with Proposition 218 requirements and the Property Claims Processing/Risk Fund Reimbursement Procedure.**

   Response: HR Staff will meet with Finance staff to determine the appropriate course of action.

7. **Work with the Public Works Division to establish a process to ensure property claim reimbursements are approved prior to posting to the GL&AL Fund and are in compliance with the Property Claims Processing/Risk Fund Reimbursement Procedure.**

   Response: HR staff will meet with the Public Works Department to establish a section in the Risk Fund Reimbursement Procedure specifically for Public Works losses by November 30, 2016 to ensure compliance with the Self-Insured Property Claim Reimbursement Policy. This procedure will include removing the Self-Insured Claim Reimbursements from the citywide journal process

and the HR Department receiving stand-alone journals to review and approve prior to being sent to Accounting for posting.

8. **Review positions paid by the GL&AL Fund not in the Risk Management Division and determine if they are inconsistent with Proposition 218. If payments of the positions conflict with Proposition 218, the department should consider whether repayment to the GL&AL Fund for at least the portion of the positions paid by restricted enterprise funds is required.**

   Response: Human Resources and Finance staff reviewed all GL&AL funded positions in the Risk Division during the development of the FY2016/17 Proposed Budget. The review identified five positions not directly associated with Risk Management operations. These positions were moved to the General Fund in the Human Resources Department in the FY2016/17 Approved Budget.

9. **Develop policies and procedures that outline the types of expenditures that can be made out of the two Risk Management funds to limit payments not directly related to risk management programs.**

   Response: The HR Department will develop policies and procedures that outline the types of expenditures that can be made out of the two Risk Management funds by June 30, 2017.

10. **Increase contributions at a greater rate than currently planned until the actuarially calculated contribution amounts for each fund can be made each fiscal year.**

    Response: A review of the Risk Funds (GL&AL and Workers' Compensation) by Human Resources and Finance Department staff in 2013 determined that General Fund contributions to the GL&AL Fund needed to be increased. In FY2013/14 the Finance Department built a plan into the General Fund 5-year forecast to increase contributions over time to ensure that the General Fund was contributing the actuarially determined amount.

    Furthermore, the Finance Department developed a Risk Management Funding and Reserve Policy (Policy) which was adopted by the City Council on May 5, 2015 (Motion 2015-0094). This policy recommends that when there are excess claims the City will increase contributions over a one to three-year period. General Fund contributions have increased by $3.5 million since FY2013/14, however, the cost of claims has outpaced the annual funding and as such, the Finance Department will continue to include additional contributions in order to meet actuarially recommended levels.

    In FY2015/16 resources were available at year-end in the General Fund, so the required contribution to the GL&AL fund was made. The FY2016/17 General Fund budget for GL&AL contributions is $12 million, however, the actuarially determined contribution is $13.6 million. If resources are available at the end of FY2016/17 an additional $1.6 million in General Fund resources will be transferred to meet the required contribution. As stated above, the Finance

Department will include the full funding of the GL&AL by fund in the FY2017/18 Proposed Budget and in future five-year forecasts consistent with the adopted policy.

The Finance Department will review the existing Policy as part of the FY2017/18 budget development process and return to Council with any changes necessary to address these audit findings.

11. Develop policies and procedures that establish guidelines on which employees should take drivers' training at the SRDTF and a reasonable timeline for completing the training.

Response: HR Risk Management Division staff will present a proposal for driver training guidelines at the January 2017 Vehicle Review Committee meeting with intent to finalize the Committee's recommendation at the May 2017 meeting. Implementation date is dependent upon the process required for city wide adoption of the Vehicle Review Committee's recommendation.

12. Document guidance for the use of the *Extraordinary Loss* accounts and review expenditures in the accounts for appropriateness.

Response: The extraordinary loss accounts has been used to fund prevention projects based on departmental needs to minimize exposures to employee injuries and liability claims. Loss prevention projects have been reviewed for appropriateness by the Risk Manager and HR Director on an annual basis. The HR Risk Management Division will document guidance for use of these funds and submit it for approval by the HR Director by December 31, 2016.

13. Consider monitoring the drivers' licenses of all employees that drive City vehicles or receive City vehicle allowances.

Response: All employees who operate commercial vehicles are currently enrolled in the California Department of Motor Vehicles (CA DMV) drivers' license pull notice system. The draft Transportation Policy includes the following requirement for non-commercial drivers. "Employees who drive at least weekly on City business, with a class C license, will be enrolled in CA DMV pull notice at the time of hire or in accordance with terms of collective bargaining agreements." The HR Risk Management Division will implement pull notice monitoring for these non-commercial drivers upon adoption of the Transportation Policy.

14. Establish reasonable limits on the types of activities allowed to reduce the City's liability when an employee is injured off-duty.

Response: HR Risk Management staff will provide a recommendation by December 31, 2016, to limit workers' compensation liability regarding safety personnel's off-duty exercise. Included will be a survey of other California entities similar to the City of Sacramento and their related policies.

15. **Continue to pursue establishing pre-employment screenings for all classifications in the City to reduce the risk of hiring undesirable applicants.**

    Response: HR is in the process of setting up a pre-employment policy that includes fingerprinting and appropriate pre-employment screenings based on position.

16. **Continue to work towards implementing the updated draft of the Transportation Policy to increase the insurance requirement of employees driving their personal vehicles for City business.**

    Response: HR will continue to work towards implementing the updated draft of the Transportation Policy.

17. **Work together to develop a monitoring mechanism to ensure employees maintain the required minimum insurance coverage when receiving a vehicle allowance.**

    Response: Public Works Fleet Management and HR Risk Management staff recommend conducting a 25% random sample annually to verify that requirements for maintaining automobile insurance are met by employees who receive mileage reimbursements or automobile allowances. HR Risk Management staff will implement this verification process upon adoption of the $100,000/$300,000/$50,000 insurance limits recommended in the draft Transportation Policy.