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DEPARTMENT OF AUDITOR-CONTROLLER

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TO: Supervisor Don Knabe, Chairman
Supervisor Gloria Molina
Supervisor Yvonne B. Burke
Supervisor Zev Yaroslavsky
Supervisor Michael D. Antonovich

FROM: J. Tyler McCauley
Auditor-Controller

SUBJECT: **SHERIFF'S DEPARTMENT WORKERS' COMPENSATION COST AND BILLINGS**

At the request of Supervisor Antonovich, we have reviewed the County's method of allocating workers' compensation costs to the Sheriff's Department based on a three-year rolling average. The purpose of our review was to determine if the rolling average methodology has resulted in the Department paying more than their actual workers' compensation costs over the past eight years.

Our review included comparing the workers' compensation amounts billed to the Sheriff by the Chief Administrative Office (CAO) to the actual benefit payments made to Sheriff employees, plus workers' compensation administrative costs allocated to the Sheriff. In addition, we verified the CAO's rolling average calculations and analyzed the Sheriff's workers' compensation amounts reported to the Board during the May 2004 public hearings. We also reviewed the Sheriff's concerns that the CAO had billed the Department approximately $41 million more than its actual workers' compensation costs over a six year period.

Conclusion

Our review indicates the CAO accurately applied the County's three-year rolling average methodology in computing workers' compensation billings to the Sheriff's Department. However, for the past eight years, the rolling average methodology has resulted in the Sheriff's Department being billed a total of approximately $12 million (2%) more than their actual workers' compensation payments and administrative costs. This is because of a fairly recent trend of the Sheriff's percentage of the County's total payments dropping in relation to other County departments. If the current relationships remain constant, the rolling average methodology will automatically result in reduced future billings to the Sheriff's Department.

Because it is on a cash basis, the County's rolling average methodology is designed to allocate costs over a long-term basis. For example, the Sheriff may have a large number of unresolved cases and, in the year they would be paid, the Sheriff would be under billed. For certain subsequent periods, the Sheriff would be over billed to recover the prior under billings. The over billings that have recently occurred are, in all probability, indications that the Sheriff was under billed in the past. During the first two years of the analysis the Sheriff was in fact under billed. In addition, data obtained from the Department of Human Resources (DHR handled workers' compensation billings prior to the CAO) indicates the Sheriff was also under billed in the two years prior to our current study.

CAO managers told us they are considering re-evaluating the rolling average methodology. The following are the detailed findings of our review.

CAO Workers' Compensation Billings

The CAO bills departments for the benefits paid to their employees, plus related administrative costs. The CAO bills General Fund departments using a three-year rolling average of each department's workers' compensation costs as a percentage of the County's total workers' compensation costs. The average is computed based on each department's percentage of actual workers' compensation costs for the second, third, and fourth years prior to the current year. That percentage is then applied to the current year actual total County payments. The CAO then includes each department's distributive share of County administrative costs to arrive at each department's total billings.

The CAO uses the rolling average to smooth fluctuations in workers' compensation costs. Since workers' compensation costs are billed to State and Federal programs, the CAO obtained approval from the State for the rolling average methodology.

As shown in Attachment 1, over the last eight fiscal years, using the rolling average, the Sheriff has been billed approximately $548.6 million in workers' compensation benefits and administrative costs, while the Sheriff's actual costs for the same period were approximately $536.5 million. Therefore, using the rolling average, over the last eight years the Sheriff has been billed approximately $12.1 million (2%) more than their actual costs.

Based on data maintained by the CAO, the Sheriff's percentage of the County's actual total workers' compensation costs has decreased steadily from approximately 50% in Fiscal Year 1999-00 to approximately 45% in Fiscal Year 2002-03. Because the CAO bases the three-year rolling average on each department's percentages for the second, third, and fourth years prior to the current year, the Sheriff should realize most of the benefits of their relative reductions through reduced billings in future years.

Sheriff Workers' Compensation Report to the Board

During his May 12, 2004 budget hearing, the Sheriff reported being billed approximately $41 million more than their actual workers' compensation costs over a six year period. We noted that for four of the six years (1999-00 through 2002-03), the Sheriff's analysis is based on actual cost and substantially matches our analysis in Attachment 1. The Sheriff's and our analyses both conclude that due to the rolling average billing method, the Sheriff was billed approximately $12.7 million more than their actual cost over the four year period.

For Fiscal Years 2003-04 and 2004-05, the Sheriff projected costs and billings based on budgeted workers' compensation amounts and estimates. Using these estimates, the Sheriff projected that during Fiscal Years 2003-04 and 2004-05, the CAO will over bill workers' compensation costs to the Department by $12.9 million and $15.3 million, respectively.

We discussed the Sheriff's estimates with CAO Risk Management managers and reviewed actual Fiscal Year 2003-04 workers' compensation costs through March 2004 and billings through April 2004. Based on this data, we (and the CAO) project that the Sheriff's workers' compensation payments and administrative costs will be approximately $104 million and estimated actual billings will be $107 million. The $3 million in projected billings in excess of costs for Fiscal Year 2003-04 is due to the rolling average. While still a large amount, it is a reduction from the $5.7 million in billings over actual cost that occurred in Fiscal Year 2002-03. This indicates that the self-correcting aspect of the rolling average is beginning to take effect.

Based on historical data, the Sheriff's $15.3 million estimate of billings in excess of actual workers' compensation costs for Fiscal Year 2004-05 also appears to be overstated. If the Sheriff continues to have a lower percentage of the total County costs, the three-year rolling average will automatically result in reduced future billings. In addition, it should be noted that, because of the relatively small difference between historical billings and actual payments, and the uncertainty of the timing of payments, the actual difference may turn out to be an under billing. The actual difference cannot be determined until the latter part of Fiscal Year 2004-05.

If you have any questions or need additional information, please contact me or your staff may contact DeWitt Roberts at (626) 293-1101.

JTM:DR:MP

Attachment

c: David E. Janssen, Chief Administrative Officer
Leroy D. Baca, Sheriff
Violet Varona-Lukens, Executive Officer
Public Information Office
Audit Committee

SHERIFF'S DEPARTMENT
WORKERS' COMPENSATION COSTS - ACTUAL V. BILLED

EIGHT YEAR SUMMARY
FISCAL YEARS 1996-97 THROUGH 2003-04

	Actual Costs Incurred (1)	Amount Billed (2)	Difference (3)
Workers' compensation payments (4)	$ 485,045,075	$ 497,499,508	$ 12,454,433
Administrative Costs (5)	$ 53,174,923	$ 52,806,839	$ (368,084)
Credit For Providing Certain Health & Safety Services (6)	$ (1,686,307)	$ (1,686,307)	$ -
Total Workers' Compensation Costs - Eight Years	$ 536,533,691	$ 548,620,040	$ 12,086,349

FISCAL YEAR 2003-04 *ESTIMATED* (7)

	Actual Costs Incurred (1)	Amount Billed (2)	Difference (3)
Estimated Workers' compensation payments including Admin costs	$ 104,000,000	$ 107,000,000	$ 3,000,000
			-
			-
Total Workers' Compensation Costs	$ 104,000,000	$ 107,000,000	$ 3,000,000

FISCAL YEAR 2002-03

	Actual Costs Incurred (1)	Amount Billed (2)	Difference (3)
Workers' compensation payments (4)	$ 78,765,320	$ 84,452,403	$ 5,687,083
Administrative Costs (5)	10,121,898	10,121,898	-
Credit For Providing Certain Health & Safety Services (6)	(240,912)	(240,912)	-
Total Workers' Compensation Costs	$ 88,646,307	$ 94,333,390	$ 5,687,083

FISCAL YEAR 2001-02

	Actual Costs Incurred (1)	Amount Billed (2)	Difference (3)
Workers' compensation payments (4)	$ 68,208,448	$ 72,897,768	$ 4,689,321
Administrative Costs (5)	11,149,043	11,149,043	-
Credit For Providing Certain Health & Safety Services (6)	(240,912)	(240,912)	-
Total Workers' Compensation Costs	$ 79,116,579	$ 83,805,900	$ 4,689,321

FISCAL YEAR 2000-01

	Actual Costs Incurred (1)	Amount Billed (2)	Difference (3)
Workers' compensation payments (4)	$ 57,399,475	$ 60,185,354	$ 2,785,879
Administrative Costs (5)	7,403,021	7,479,073	76,052
Credit For Providing Certain Health & Safety Services (6)	(240,912)	(240,912)	-
Total Workers' Compensation Costs	$ 64,561,584	$ 67,423,515	$ 2,861,931

FISCAL YEAR 1999-00

	Actual Costs Incurred (1)	Amount Billed (2)	Difference (3)
Workers' compensation payments (4)	$ 53,158,180	$ 52,527,856	$ (630,324)
Administrative Costs (5)	7,525,078	7,666,288	141,210
Credit For Providing Certain Health & Safety Services (6)	(240,836)	(240,836)	-
Total Workers' Compensation Costs	$ 60,442,422	$ 59,953,308	$ (489,114)

FISCAL YEAR 1998-99

	Actual Costs Incurred (1)	Amount Billed (2)	Difference (3)
Workers' compensation payments (4)	$ 44,151,206	$ 45,321,402	$ 1,170,196
Administrative Costs (5)	5,578,224	5,603,734	25,510
Credit For Providing Certain Health & Safety Services (6)	(240,912)	(240,912)	-
Total Workers' Compensation Costs	$ 49,488,518	$ 50,684,224	$ 1,195,706

FISCAL YEAR 1997-98

	Actual Costs Incurred (1)	Amount Billed (2)	Difference (3)
Workers' compensation payments (4)	$ 42,652,032	$ 40,372,939	$ (2,279,093)
Administrative Costs (5)	5,768,399	5,751,498	(16,901)
Credit For Providing Certain Health & Safety Services (6)	(240,912)	(240,912)	-
Total Workers' Compensation Costs	$ 48,179,519	$ 45,883,525	$ (2,295,994)

FISCAL YEAR 1996-97

	Actual Costs Incurred (1)	Amount Billed (2)	Difference (3)
Workers' compensation payments (4)	$ 36,710,414	$ 34,741,785	$ (1,968,629)
Administrative Costs (5)	5,629,260	5,035,305	(593,955)
Credit For Providing Certain Health & Safety Services (6)	(240,912)	(240,912)	-
Total Workers' Compensation Costs	$ 42,098,762	$ 39,536,178	$ (2,562,584)

Footnote explanations are included on page 2 of this attachment.

SHERIFF'S DEPARTMENT
WORKERS' COMPENSATION COSTS

FOOTNOTE EXPLANATIONS
SEVEN YEAR SUMMARY

(1) This column represents the CAO's actual workers' compensation payments made to Sheriff Department employees during each fiscal year. Also shown are the CAO's administrative costs that are allocated to the Sheriff's Department. These administrative costs are allocated based on the Sheriff's percentage of total workers' compensation payments made to all participants during the year (without using the rolling average discussed in footnote 2 below).

(2) This column represents the amount the CAO billed the Sheriff's Department for workers' compensation costs. The CAO applies a three year rolling average to the County's total workers' compensation cost. This rolling average was implemented to smooth the effect of fluctuations that occur between years. Since workers' compensation costs can be billed to State programs, the CAO obtained State approval for the rolling average methodology.

The CAO calculates the "rolling average" percentage by dividing the total workers' compensation payments made by the CAO for the Sheriff's employees during the prior second, third, and fourth years by the total workers' compensation payments made by the CAO for all participating departments during those same years. The CAO then multiplies the County's total actual workers' compensation benefit payments for all employees by each department's rolling average percentage to determine each department's share of total workers' compensation benefit costs.

(3) Due to the rolling average calculation used by the CAO (discussed in footnote 2), there will always be a difference between actual and billed costs.

(4) Workers' compensation payments include medical payments, temporary disability payments, permanent disability payments, and other settlement payments.

(5) Administrative costs represent the Sheriff's Department's distributed share of overhead including: CAO administrative costs, Third Party Administrator Costs, budget services, Auditor-Controller warrant services, County Counsel legal services, litigation services and supplies, Registrar-Recorder Death Certificates, workers' compensation payments made where the case cannot be traced to a department, and miscellaneous other costs incurred by the CAO.

(6) This amount represents a credit to the Sheriff's Department for assisting the CAO with the workers' compensation process.

(7) The 2003-04 estimates are based on actual cost data through March 2004 and actual billing data through April 2004. These amounts were then annualized.