



**A Report to the
Audit Committee**

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**Audit of the Department of Law
Claims Process**

September 10, 2014

Metropolitan
Nashville
Office of
Internal Audit

EXECUTIVE SUMMARY

September 10, 2014



Why We Did This Audit

The audit was initiated based on the number of years that have elapsed since the last audit was conducted by this office.

What We Recommend

The Department of Law should enhance controls related to the handling of checks received, mail opening procedures, and the software application which supports the claims process. Efforts should be made to ensure the recording and deposits of receipts conform to Metropolitan Nashville financial policies.

AUDIT OF THE DEPARTMENT OF LAW CLAIM'S PROCESS

BACKGROUND

The responsibilities of the Department of Law were organized into three main areas: legal services, claims, and insurance. The focus of this engagement pertained to the claims and insurance processes. Injury-on-duty claims and other controls such as the safety program and contractual risk transference were not reviewed.

OBJECTIVES AND SCOPE

Key objectives of the audit were to determine:

- Citizens had fair and accessible means to address claims.
- Claims reserve amounts and insurance coverage were methodically determined.
- Controls ensured subrogation amounts and/or insurance claims were identified, investigated, and collected.

During the 30 month audit scope between July 1, 2011, and December 31, 2013, the Department of Law processed \$3.9 million in payments related to claims and received claims proceeds of \$2.6 million.

Self-Insurance and Claims Fund Balance

As of August 13, 2014	
Self-Insured Property Loss	\$ 3,519,281
Metro Self-Insured Liability	4,349,594
Police Professional Liability	2,823,730
Judgments and Losses	2,956,994
Schools Self-Insured Liability	2,230,477
Employee Blanket Bond	647,876
Total	\$16,527,952

Source: Metropolitan Nashville Council Analysis Report, August 19, 2014

WHAT WE FOUND

The Department of Law had defined processes in place for handling claims. This process was supported by a knowledgeable, veteran staff. Moreover, a robust management review process existed to ensure claims were properly processed. An actuarial firm was employed to assist in determining the reasonableness of reserve amounts.

GOVERNANCE

The Department of Law is led by the director of law who is appointed by the Mayor. The primary governance of the claims process is handled by an insurance manager and a group, referred to as the Settlement Committee, of management staff who must review all claims over an established threshold amount. The Settlement Committee consists of the director of law, the deputy director of law, two attorneys, and another member of management. Moreover, in some cases, claim amounts must be reviewed and approved by either the Metropolitan Nashville Council or the Metropolitan Nashville Board of Education.

OBJECTIVES AND CONCLUSIONS

1. *Did citizens have a fair and accessible means to address claims against the Metropolitan Nashville Government?*

Yes. The Department of Law has multiple policies and procedures to ensure that citizens have a fair and accessible means to address claims. Claims can be communicated in a variety of ways such as completing an online form, and calling/visiting the Department of Law directly. The Department of Law also had a very robust review process involving knowledgeable staff to ensure that settlements or the rejection thereof were reasonable and fair. Ultimately, claimants may appeal any settlement offer by seeking remedy with the courts. In these situations, Metropolitan Nashville Government attorneys would also be involved in the investigation process. Any modified settlement proposal would also be subjected to a robust review process. If a settlement cannot be reached, a judge will determine what is fair and reasonable.

2. *Were claim payments paid in accordance with Department of Finance policies, claim stipulations, and the Governmental Tort Liability Act?*

Yes. The Department of Law followed applicable Department of Finance policies and departmental guidelines when processing payables related to claims. Moreover, payables conformed to claim stipulations and the Governmental Tort Liability Act.

3. *Were self-insurance and claims reserve amounts and insurance coverage methodically determined?*

Yes. The Department of Law procured the services of an actuary to assist in predicting future liability and the reasonableness of current funding levels. Management also routinely and methodically monitored funding levels for adequacy. Also, a property insurance policy was procured to cover property losses, in excess of \$1 million per occurrence with a \$3 million aggregate, caused by a covered peril. Once the aggregate is exhausted, a \$50,000 per occurrence deductible applies for each and every covered loss. The property schedule is updated throughout the year as well as during the renewal process annually. Properties are added and/or deleted accordingly to accurately reflect the current schedule. However, as an added protection, the property insurance policy also includes \$10,000,000 coverage for miscellaneous unnamed locations, 90 days to add a newly acquired location as well as errors and omissions coverage to cover locations not named by an unintentional failure to include a location at the inception of the policy or an unintentional failure to report a newly acquired property. Surety bonds have also been secured to cover selected government officials. (See Observations G.)

4. *Were controls in place to ensure that subrogation amounts and/or insurance claims were identified, investigated, and collected?*

Generally yes. Controls pertaining designed to ensure that subrogation amounts and/or insurance claims are being identified, investigated, and collected to reduce taxpayer burden are in existence and operating as designed. However, opportunities to enhance cash handling tasks exist. (See Observations A, B, C, D, and E.)

5. *Were computer general and application controls for the Corporate Legal Management System adequately designed and operating as intended?*

Generally Yes. The Corporate Legal Management System controls supported the claims process. However, additional computer controls for monitoring changes and deletions to claim records along with hardening of application security would strengthen the integrity of information stored in the system. (See Observation F.)

AUDIT OBSERVATIONS

The Committee of Sponsoring Organizations of the Treadway Commission, *Internal Control – Integrated Framework*, Control Environment component recommends management and the board of directors establish mechanisms to communicate and hold individuals accountable for performance of internal control responsibilities and implement corrective action as necessary. The audit observations listed are offered to assist management in fulfilling their internal control responsibilities.

Observation A- Segregation of Duties for Payments Received

Incompatible cash collections tasks and functions were concentrated with one employee resulting in undue risk of timely detection of errors or misplaced funds.

The Law Department’s mail opening system was designed with one person receiving and opening the incoming mail. Incoming mail that may contain checks, money orders or correspondence relating to payments represents a significant risk area. The staff member assigned this task will note on a Microsoft Word document when a payment is received, the amount, the appropriate case or litigation number, the date received and to which party the payment was forwarded to.

The Department of Law’s applicable claim’s investigator receives all relevant checks from the office support specialist. The claims investigator generates a related payment memo and then forwards the check, via the insurance manager to the administrative assistant who handles claims related activities. This administrative assistant then prepares a deposit slip, ensures the deposit is properly recorded with the bank, prepares the journal entry for the general ledger as well as documents the payment within the Corporate Legal Management System.

Another administrative assistant within the Department of Law receives all non-claims related incoming checks from the office support specialist. This person was responsible for notifying the appropriate attorney, sometimes documenting the payment within the Corporate Legal Management System, preparing the deposit slip, recording the journal entry into the general ledger and ensuring the deposit was properly recorded in the bank. This administrative assistant also had administrative rights to the Corporate Legal Management System.

Criteria

The Committee of Sponsoring Organizations of the Treadway Commission, *Internal Control – Integrated Framework*, Control Activities, Principle 10.

Recommendation for the management of the Department of Law to:

1. Assign one employee to open the mail and an additional employee to witness and log all payments received. The log should be signed each day to note agreement on the amount of payments received. Additionally, all checks received should be stamped immediately as “For Metropolitan Government of Nashville and Davidson County Deposit Only”.
2. Ensure a separate employee is responsible for the custody of a payment and the record keeping of a payment. Those with record keeping responsibilities should not have access to the payments.
3. Ensure a separate employee is responsible for the custody of a payment and an additional employee responsible for reconciling deposits to the general ledger system.

Observation B - Documentation of Asset Custody and Transfer

Accountability for handling of payments received was diminished because employee acknowledgement (sign-offs) of amounts exchanged between employees was not practiced. This practice existed for both claims and subrogation checks handled by various staff.

Criteria

The Committee of Sponsoring Organizations of the Treadway Commission, *Internal Control – Integrated Framework*, Control Activities, Principle 10.

Recommendation for the management of the Department of Law to:

Create a log which documents any transfer of payments between various staff members. The log should specify the amount and the person who is taking custody of the check, the time period this custody occurred, the party the payment is eventually transferred too, and signatures of the person transferring the payment and receiving the payment to verify the amount and existence of the custody change.

Observation C - Enhancement of Reconciliations

Reconciliation procedures did not exist to ensure subrogation payments were properly deposited into the bank as well as recorded in the systems of record (Case Law Management System and EnterpriseOne). The office support specialist maintained a log of all incoming payments received in the mail. An entry was also entered into the Case Law Management System and the EnterpriseOne system by other employees.

Criteria

The Committee of Sponsoring Organizations of the Treadway Commission, *Internal Control – Integrated Framework*, Control Activities, Principle 10.

Recommendation for the management of the Department of Law to:

1. An employee not involved with the custody or record keeping of payments should periodically reconcile and ascertain that all payments recorded on the office support specialist log was entered into the Case Law Management System and EnterpriseOne Systems. Discrepancies should be investigated.
2. These reconciliations should be reviewed and approved by a member of management.
3. The log maintained by the office support specialist should be secured so that only this staff member can access and modify the contents of the log.

Observation D - Enhancement to the Monitoring of Receivables

Collection agency claims receivable balances were not monitored to ensure amounts due to the Department of Law were remitted. For non-collection agency matters, the Department of Law periodically generated reports from the Case Law Management System which list all open cases. The Department had established procedures whereby parties were notified of outstanding balances. These reports included any amounts due.

The Department of Law did not have any similar system in place regarding monitoring receivables submitted to the collection agency.

Criteria

The Committee of Sponsoring Organizations of the Treadway Commission, *Internal Control – Integrated Framework*, Control Activities, Principle 10.

Recommendation for the management of the Department of Law to:

Develop a monitoring system for receivable balances. Specifically, listings provided by the collection agency should be sent to the insurance manager who can reconcile the listings to the Case Law Management System and EnterpriseOne systems.

Observation E – Deposits and Postings to the General Ledger

Payments received for subrogation claims were not deposited or posted to the general ledger timely. The Claims Division receives payments in response to subrogation claims resulting from damage to Metropolitan Nashville Government owned property by third parties. A review of a random sample of 50 payments showed that 30 out of 50 payments were not deposited into a bank account within one business day of receiving the payment. Additionally, 30 out of 50 payments were not posted to the general ledger within two days of the deposit.

Criteria

Metropolitan Nashville Government’s Department of Finance, Treasury Policy #9 Cash Deposits

Recommendation for the management of the Department of Law to:

Deposit all payments within one day of receipt and post all payments to the general ledger within two days of deposit.

Observation F – Enhancement to Corporate Legal Management System

General and application controls within the Corporate Legal Management System should be enhanced to strengthen the overall control environment of the Claim's Process. Specific areas of concern were:

- Critical fields had not been identified and adequately secured. A strength related to the Case Law Management System was the ability to delete records and cases within the system were limited to only two specific employees. However, specific fields within Corporate Legal Management System can be modified by any staff member. Fields such as "Payment Amount" and "Date Closed" are critical to fields in that all tracking/monitoring reports pertaining to payables and receivables are driven by these two fields. If the "Date Closed" field is populated incorrectly, a pending receivable or payable would not show up on tracking/monitoring reports. Similarly, changes to the "Payment Amount" field were not monitored.
- The process for deleting records was informal. Periodically, records were deleted, primarily due to a duplicate entry. In these cases, emails were sent to the two staff members who performed the delete request.
- A report of modifications to critical fields was not available. Audit trails to monitor activities at the application and database level were not implemented.
- The potential of staff bypassing application protocol and directly updating tables within the SQL database that supports Corporate Legal Management System exist.

Criteria

The Committee of Sponsoring Organizations of the Treadway Commission, *Internal Control – Integrated Framework*, Control Activities, Principle 11.

Recommendation for the management of the Department of Law to:

1. Identify critical fields within the Corporate Legal Law Management System which, if incorrectly modified or deleted, could have a significant impact on the Claims Process. Secure these fields so that only designated employees who are not involved in the processing of any payments or receivables may execute the modification.
2. Formalize the process whereby all modifications and deletions are approved by management and retained as supporting documentation.
3. Establish database and application level audit trails to capture sensitive and critical activities. Procedures should be established to systematically review audit results, document any anomalies, and record investigation results.
4. Implement steps to ensure that staff does not have direct update access to the SQL database.

Observation G - Uniform Policy on Assets Covered by Property Insurance

A uniform policy to help determine the criteria for properties to be scheduled for insurance coverage was not available. Properties that should be covered by property insurance and excluded from the property listing could expose Metropolitan Nashville to material risk of loss.

The Department of Law procures an insurance broker to provide insurance coverage for select Metropolitan Nashville Government buildings and properties. Department heads will list the properties

under their span of control to be included and communicate these properties to the Department of Law. The departments will also include the applicable replacement cost of each property or building. Based on this listing, the insurance broker will calculate the applicable premium.

Criteria

The Committee of Sponsoring Organizations of the Treadway Commission, Internal Control – Integrated Framework, Control Activities, Principle 12

Recommendation for the management of the Department of Law to:

Work with the Department of Finance and/or Mayor’s office to develop and implement uniform guidelines and requirements for which properties should be included in property insurance coverage.

GOVERNMENT AUDITING STANDARDS COMPLIANCE

We conducted this compliance 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 observations and conclusions based on our audit objectives.

METHODOLOGY

To accomplish our audit objectives, we performed the following steps:

- Interviewed key personnel within the Department of Law Office.
- Reviewed and analyzed documentation for compliance with the Tennessee Code Annotated, Metropolitan Nashville Code of Laws, and other applicable laws, regulations, and policies.
- Evaluated internal controls currently in place.
- Considered risk of fraud, waste, and abuse.
- Considered information technology risks.

AUDIT TEAM

Mark Swann, CPA, CIA, CISA, ACDA, Metropolitan Auditor

Bill Walker, CPA, CIA, In Charge Auditor

Seth Hatfield, CPA, CIA, Auditor



METROPOLITAN GOVERNMENT OF NASHVILLE AND DAVIDSON COUNTY

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September 5, 2014

Mr. Mark Swann
Metropolitan Auditor
Office of Internal Audit
1417 Murfreesboro Road
Nashville, TN 37217

Re: Audit – Claims Division
Department of Law

Dear Mr. Swann:

This letter acknowledges the Department of Law's receipt of the Draft Audit Report of its Claims Division. We have reviewed the findings and recommendations and have incorporated our responses in Appendix A to the report.

In addition to the referenced response, you will also find enclosed a suggested rewording of Item #3 under "Objectives and Conclusions." This wording is being offered because it is felt that the property insurance that is purchased on behalf of the Metropolitan Government has not been accurately reflected. We will be happy to provide any further explanation that is requested.

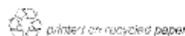
We appreciate the work that your department has performed to help us improve our Claims Division processes, and the professionalism of the Internal Audit staff in conducting the work.

Sincerely,

A handwritten signature in cursive script that reads "Saul Solomon".

Saul Solomon
Director of Law

Attachments



APPENDIX A – MANAGEMENT RESPONSE AND CORRECTIVE ACTION PLAN

We believe that operational management is in a unique position to best understand their operations and may be able to identify more innovative and effective approaches and we encourage them to do so when providing their response to our recommendations.

Recommendation	Concurrence and Corrective Action Plan	Proposed Completion Date
<p>A.1 Assign one employee to open the mail and an additional employee to witness and log all payments received. The log should be signed each day to note agreement on the amount of payments received. Additionally, all checks received should be stamped immediately as “For Metropolitan Government of Nashville and Davidson County Deposit Only”.</p>	<p>Disagree. The Department of Law agrees that a two-person mail opening system would be desirable. However, limited staff to devote to this duty, and the lack of necessary funds to employ additional staff to perform this function, prevents implementation of this recommendation. The Department of Law stamps all checks received with the wording required by the Department of Finance, ie: " Pay To The Order Of, First Tennessee, Nashville TN, For Deposit Only, Metro Nashville Check and Case Depository, Legal (Dept #), Account #)."</p>	<p>None</p>
<p>A.2 Ensure a separate employee is responsible for the custody of a payment and the record keeping of a payment. Those with record keeping responsibilities should not have access to the payments.</p>	<p>Agree. The revised process will include opening of the mail by an employee who will create a daily spreadsheet showing each payment and the CLMS number associated with it, email the spreadsheet to the claims representatives and manager, then transfer received checks to a second employee along with a signed physical copy of the spreadsheet. The second employee will also sign the spreadsheet to acknowledge receipt of the listed payments, then email scanned copies of the checks to the claims representatives and manager. After reconciling the checks with the information in the spreadsheet, the claims representatives will email the first and second employees to approve posting of the payments into the appropriate CLMS matter and deposit of the checks. The first employee will have sole custody of the daily spreadsheets and will keep them in a secure location until reviewed by management and reconciled with the information shown in EnterpriseOne.</p>	<p>10/15/2014</p>

APPENDIX A – MANAGEMENT RESPONSE AND CORRECTIVE ACTION PLAN

Recommendation	Concurrence and Corrective Action Plan	Proposed Completion Date
A.3 Ensure a separate employee is responsible for the custody of a payment and an additional employee responsible for reconciling deposits to the general ledger system.	Agree. Management will be responsible for monthly reconciliation.	10/15/2014
B. Create a log which documents any transfer of payments between various staff members. The log should specify the amount and the person who is taking custody of the check, the time period this custody occurred, the party the payment is eventually transferred too, and signatures of the person transferring the payment and receiving the payment to verify the amount and existence of the custody change.	Agree. The current log system will be updated to meet all suggestions.	10/15/2014
C.1 An employee not involved with the custody or record keeping of payments should periodically reconcile and ascertain that all payments recorded on the office support specialist log was entered into the Case Law Management System and EnterpriseOne Systems. Discrepancies should be investigated.	Agree. Management will be responsible for monthly reconciliation.	10/15/2014
C.2 These reconciliations should be reviewed and approved by a member of management.	Agree. Management will be responsible for monthly reconciliation.	10/15/2014
C.3 The log maintained by the office support specialist should be secured so that only this staff member can access and modify the contents of the log.	Agree. The log will be secured by the office support specialist.	10/15/2014
D. Develop a monitoring system for receivable balances. Specifically, listings provided by the collection agency should be sent to the insurance manager who can reconcile the listings to the Case Law Management System and EnterpriseOne systems.	Partially Agree. This recommendation has already been implemented except receivable balances cannot practically be posted and/or monitored in EBS.	Current
E. Deposit all payments within one day of receipt and post all payments to the general ledger within two days of deposit.	Agree. This recommendation has already been implemented	Current
F.1 Identify critical fields within the Corporate Legal Law Management System which, if incorrectly modified or deleted, could have a significant impact on the Claims Process. Secure these fields so that only designated employees who are not involved in the processing of any payments or receivables may execute the modification.	Partially Agree. Although it is acknowledged that this recommendation could be beneficial in securing the Claims process, we are unable to implement this under our current software management system (CLMS). Efforts are currently underway to procure a new software case management system. As this is being done, efforts will be taken to determine whether this recommendation can be implemented.	Within the next 12-18 months

APPENDIX A – MANAGEMENT RESPONSE AND CORRECTIVE ACTION PLAN

Recommendation	Concurrence and Corrective Action Plan	Proposed Completion Date
<p>F.2 Formalize the process whereby all modifications and deletions are approved by management and retained as supporting documentation.</p>	<p>Partially Agree. Although it is acknowledged that this recommendation could be beneficial in securing the Claims process, we are unable to implement this under our current software management system (CLMS). Efforts are currently underway to procure a new software case management system. As this is being done, efforts will be taken to determine whether this recommendation can be implemented.</p>	<p>Within the next 12-18 months</p>
<p>F.3 Establish database and application level audit trails to capture sensitive and critical activities. Procedures should be established to systematically review audit results, document any anomalies, and record investigation results.</p>	<p>Partially Agree. Although it is acknowledged that this recommendation could be beneficial in securing the Claims process, we are unable to implement this under our current software management system (CLMS). Efforts are currently underway to procure a new software case management system. As this is being done, efforts will be taken to determine whether this recommendation can be implemented.</p>	<p>Within the next 12-18 months</p>
<p>F.4 Implement steps to ensure that staff does not have direct update access to the SQL database.</p>	<p>Partially Agree. Although it is acknowledged that this recommendation could be beneficial in securing the Claims process, we are unable to implement this under our current software management system (CLMS). Efforts are currently underway to procure a new software case management system. As this is being done, efforts will be taken to determine whether this recommendation can be implemented.</p>	<p>Within the next 12-18 months</p>
<p>G. Work with the Department of Finance and/or Mayor’s office to develop and implement uniform guidelines and requirements for which properties should be included in property insurance coverage.</p>	<p>Disagree. The Department of Law believes that an appropriate process is already in place to identify all properties that should be included in property insurance coverage.</p>	<p>Current</p>

APPENDIX B – THE FIVE COMPONENTS OF INTERNAL CONTROL AND RELATED PRINCIPLES

Source: The Committee of Sponsoring Organizations of the Treadway Commission, *Internal Control – Integrated Framework (2013 Framework)*

