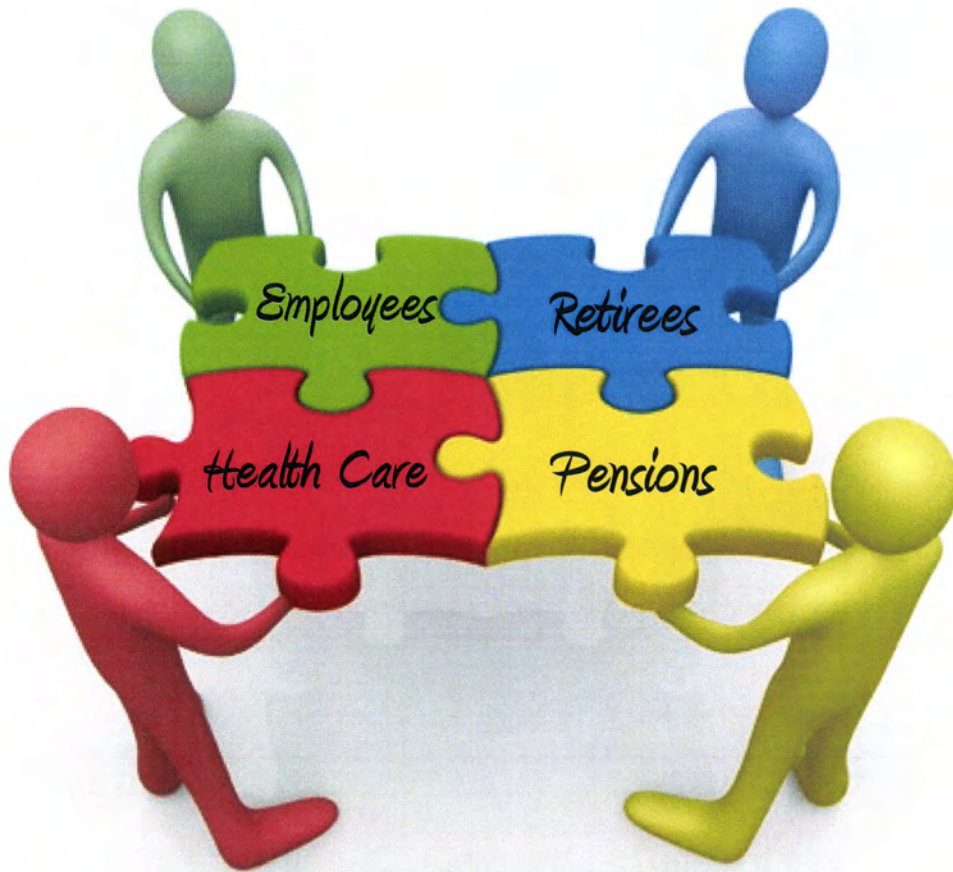


City of Detroit

OFFICE OF THE AUDITOR GENERAL OFFICE OF THE INSPECTOR GENERAL



**Emergency Manager Order No. 8
Initial 60 Day Report**

July 2011 – March 2013



Mark W. Lockridge, CPA
Auditor General

CITY OF DETROIT



James W. Heath, Esq.
Inspector General

MEMORANDUM

DATE: August 20, 2013
TO: Kevyn D. Orr, Emergency Manager
FROM: Mark Lockridge, Auditor General, CPA, CIA, CGAP
James Heath, Esq., Inspector General
RE: Emergency Manager Order No. 8 Initial 60 Day Report
CC: Mayor Dave Bing
Honorable City Council

Attached for your review is the Initial 60 Day Report in accordance with the Emergency Manager Order No. 8 issued on June 20, 2013, to conduct a joint investigation into possible waste, abuse, fraud, and corruption associated with the City's employee benefit programs.

The initial scope of this investigation includes:

- The Detroit General Retirement System
- The Detroit Police & Fire Retirement System
- Health Care Benefits
- Unemployment Benefits

Pursuant to Section 141.1550, Section 10 (1):

An emergency manager shall issue to the appropriate local elected and appointed officials and employees, agents, and contractors of the local government the orders the emergency manager considers necessary to accomplish the purposes of this act...to enable the orderly accomplishment of the financial and operating plan. Local elected and appointed officials and employees, agents, and contractors of the local government shall take and direct those actions that are necessary and advisable to maintain compliance with the financial and operating plan.

Copies of the Office of the Auditor General reports can be found on our website at <http://www.detroitmi.gov/CityCouncil/LegislativeAgencies/AuditorGeneral/tabid/2517/Default.aspx> and
Copies of the Office of the Inspector General reports can be found on our website at <http://www.detroitmi.gov/DepartmentsandAgencies/OfficeofInspectorGeneral.aspx>.

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EXECUTIVE SUMMARY

Pursuant to Emergency Manager Order No. 8 (EMO8), the Auditor General (AG) and the Inspector General (IG) conducted a joint investigation into the City's pension and health care benefits offered to employees and retirees. The scope of this investigation was an independent review of the City's administration of employee benefits during the period of July 1, 2011 through March 31, 2013.

The initial phase of investigation involved reading relevant prior audit and consultants reports; reviewing the City Charter, Municipal Manual, DRMS reports, organization charts, policies, procedures, ordinances, and Finance Directives; gathering policies and procedures of core operations and other similar data; interviewing department personnel regarding the department's transactions, controls, functions, records, and personnel; and documenting and testing processes.

The following overall objectives were set for the initial investigation:

- Review the effectiveness and efficiency of the administration of the Pension and Benefit programs' operations and their compliance with policies, plans, procedures, laws and regulations regarding financial transactions;
- Assess control procedures for the administration of the benefit programs and to determine if any control weaknesses exist;
- Determine if unemployment benefits were only paid to eligible individuals and to assess if control procedures are in place to detect ineligible or fraudulent claims;
- Review program performance in delivery of services to meet the programs' stated goals and objectives.

Pensions Investments

Pension investments occur in five major categories - real estate, mortgages, bond, stocks, or other special investment accounts of a life insurance company. Our initial investigation focused on real estate investments since this is an area where individuals allegedly involved in fraudulent activity are currently being investigated by external authorities. Our investigation revealed that in the periods prior to the scope of this investigation, both the General Retirement and Police and Fire Retirement pension systems were heavily invested in real estate. However, the officers of both pension systems have taken measures to align the investment portfolios with asset allocations recommended by consultants and approved by the Board of Trustees' in January 2013. The recommendations will guide the pensions systems into compliance with Public Act 314 of 1965, which governs the allowable composition of government investment portfolios. During the next 60 days, we intend to look at the total composition of the individual pension systems investment portfolios.

Pensions Disbursements

During this initial investigation, we uncovered several inconsistencies in the General Retirement System (GRS), such as questionable interest rates applied to annuities, the probability of bonuses being included in annuity account holders balances and ultimately included in their refund/disbursement, and overtime pay included in their

average final compensation calculation. While City's Charter does not prohibit these items, we question the wisdom of these policies along with the fiduciary responsibility of the Pension Board of Trustees. We feel that further scrutiny of the annuity disbursements calculations and the inputs used to calculate the average final compensation of monthly pensions is warranted. Also, in the next phase of this investigation, we intend to perform similar analysis on the Police and Fire Pension System.

Health Care Benefit Administration

Our review of the City's administration of employee benefits for health care underscores published reports, in that the process is poorly documented, highly transactional and extremely labor intensive. Albeit, and even with these process inefficiencies, our limited testing did not find any errors in employee deductions for health care contributions. We did find several areas of concern and internal control weaknesses with respect to the review and reconciliation of the billings from our major medical service provider. During the next phase of our investigation we intend to conduct tests of billings and payments to all health care providers, and continue documenting the processes.

Transition of Payroll and Benefit Administration to a Managed Care Provider

In November 2012, the City entered into a five year contract with a third-party to assume the payroll and benefit administration functions. We have several concerns with the proposed transition because the final product does not address or eliminate the underlying structural inefficiencies built into our current human resource operations. We found an absence of a total cost/benefit analysis, a lack of adequate process flows, no documentation which focused on internal controls, and a high probability that the project as currently planned may not provide the financial cost-savings as projected. We recommend a new assessment of the project, including a complete cost/benefit analysis.

Unemployment Compensation

Our initial investigation into the City's unemployment compensation claims revealed that of the 1,484 claims processed during our review period, 13% (or 192) of the claims are likely fraudulent, and another 36% (or 536) of the claims are highly questionable and need additional investigation to determine if the recipients were eligible for compensation. We intend to conduct a forensic investigation into these claims, and document internal and external controls for unemployment claims processing that are both preventative and detective in nature.

Additionally, there are personal service contractors who are receiving unemployment compensation. There is potential additional exposure to the City if contractors are subsequently deemed as employees by the Internal Revenue Service. The general rule is you are not an independent contractor if you perform services that can be controlled by an employer (what will be done and how it will be done) and this applies even if you are given freedom of action.

BACKGROUND

On June 20, 2013, and pursuant to Michigan's Public Act 436 of 2012, Kevyn D. Orr, the Emergency Manager (EM) of the City of Detroit, issued Emergency Manager Order No. 8. The order reads in part:

In accordance with powers granted to the Inspector General (IG) and the Auditor General (AG) by the City Charter, the IG and the AG shall jointly conduct an investigation into any possible waste, abuse, fraud, or corruption, including, but not limited to, administrative misfeasance or other impropriety with respect to the administration, operation, or implementation of Benefit Programs.

The IG and the AG shall prepare and deliver a preliminary written report to the EM within 60 days of the date of this Order (the "60 Day Report") regarding the preliminary findings of the investigation and making recommendations regarding next steps, and any corrective, prospective, legal, additional investigatory or other action designed to address any waste, abuse, fraud, or corruption uncovered.

The IG and AG shall update and revise the 60 Day Report by providing additional written reports to the EM as necessary but no later than every 60 days after the issuance of the initial 60 Day Report, and such other reports as may be necessary from time to time.

See pages 32 through 34 of this report for the full Emergency Manager Order No. 8.

Employment Benefits

The City of Detroit offers a competitive and comprehensive employee benefit package including medical, dental, vision, life insurance, long-term disability insurance, vacation, sick leave, other leave policies, and retirement benefits. The City's benefits are administered by the:

- **Finance Department Retirement (Pension) Division**

The Retirement Division administers the Pension Systems for the City of Detroit. The Retirement Systems of the City of Detroit are comprised of two separate systems each governed by a Board of Trustees. The General Retirement System is for active and retired general City employees, and the Police and Fire Retirement System is for active and retired police officers and firefighters.

- **Human Resources**

The Mission of the Human Resources Department is to provide services and implement programs that attract, hire, retain, and support a qualified and talented workforce committed to providing timely, high quality services to City of Detroit employees and its citizens, in an environment that contributes to the City's objectives.

The following tables provide an overview of employees receiving retirement and health care benefits:

Number of Retirement Fund Participants

Retirement System	No. of Members*
General Retirement System	20,542
Police and Fire Retirement System	12,699

**Source: General Retirement System and Police and Fire Retirement System Financial Statements, June 30, 2012*

Number of Persons Receiving Health Care Benefits

Employment Status	No. of Employee Health Care Contracts*
Active	9,203
Retired	24,612

**Source: City of Detroit Finance Department's roster of billings and payments to health care carriers at December 2012.*

PENSIONS

Background

A General Retirement System (GRS) for the employees of the City of Detroit was established under the authority of the 1918 Detroit City Charter and is continued under City Ordinance Section 47-1-2 for the purpose of providing retirement and survivor benefits for eligible City employees and their beneficiaries. The effective date for the system was July 1, 1938. Section 47-1-3 created a Board of Trustees of the General Retirement System who is responsible for the general administration, management and responsibility for the proper operation of the System, and for making effective the provisions of Chapter 47 of the City Code.

The 1973 Defined Benefit/Defined Contribution Plan consists of a Defined Benefit Plan and a Defined Contribution (Annuity) Plan; participation with employee contributions to the annuity plan is optional.

The composition of the active employees to retired employees is depicted in the table below:

Breakdown of Retirement Fund Participants		
Description	General Retirement System	Police & Fire Retirement System
Active members	6,519	3,181
Members receiving benefits	11,790	9,323
Terminated plan members entitled to, but not yet receiving benefits	2,233	195
Total Members	20,542	12,699

Pension Payroll General Retirement System

We selected ten retirees to test the accuracy of the calculations used for the Annual Pension Allowance (APA). The APA consists of the Average Final Compensation (AFC), the Unused Sick Leave (USL) allowance, and an additional multiplier based on years of service. The AFC is the average of the highest wages earned in any consecutive 36 month period within the last 120 months of active employment. Employees have the option of including 25% of the balance of their USL to their AFC. The USL amount is derived by multiplying the hourly rate at the time of retirement by 25% of the total sick bank balance. The total sick bank balance includes the total hours of both the "current" and "reserve" sick time bank at the time of retirement. The sick leave policy for active employees prior to the implementation of the City Employment Terms (CET) effective July 1, 2012, stipulates that twelve days (96 hours) are added to your "current" sick bank each year on July 1st, and an additional five days (40 hours) are added to your reserve sick bank on July 1st if the employee works a minimum of 1600 hours in the previous fiscal year.

The retirement allowance calculation consists of the following three (3) inputs:

- A basic pension of \$12 per month for each full year of service, but not to exceed \$120;
- A pension allowance equal to the sum of 1.6% times your first 10 years of service, plus 1.8% times each year of service greater than 10 years up to 20 years, plus 2.0% times each year of service greater than 20 years up to 25 years, plus 2.2% times each year of service over 25 years; multiplied by the AFC:

Years of Service Multiplier	
0 - 10	1.6%
11 - 20	1.8%
21 - 25	2.0%
25 +	2.2%

- The annuity portion of the disbursement is calculated on the balance in the employee's account and the age of the employee upon retirement.

Typical Straight Life Monthly Calculation Table							
Average Final Comp.	Years of Service						
	10	15	20	25	30	35	40
\$24,000.00	\$330.00	\$ 510.00	\$ 690.00	\$ 890.00	\$1,110.00	\$1,330.00	\$1,550.00
26,000.00	356.67	551.67	746.67	963.33	1,201.67	1,440.00	1,678.33
28,000.00	383.33	593.33	803.33	1,036.67	1,293.33	1,550.00	1,806.67
30,000.00	410.00	635.00	860.00	1,110.00	1,385.00	1,660.00	1,935.00
32,000.00	436.67	676.67	916.67	1,183.33	1,476.67	1,770.00	2,063.33
34,000.00	463.33	718.33	973.33	1,256.67	1,568.33	1,880.00	2,191.67
36,000.00	490.00	760.00	1,030.00	1,330.00	1,660.00	1,990.00	2,320.00
38,000.00	516.67	801.67	1,086.67	1,403.33	1,751.67	2,100.00	2,448.33
40,000.00	543.33	843.33	1,143.33	1,476.67	1,843.33	2,210.00	2,576.67
42,000.00	570.00	885.00	1,200.00	1,550.00	1,935.00	2,320.00	2,705.00
44,000.00	596.67	926.67	1,256.67	1,623.33	2,026.67	2,430.00	2,833.33
46,000.00	623.33	968.33	1,313.33	1,696.67	2,118.33	2,540.00	2,961.67
48,000.00	650.00	1,010.00	1,370.00	1,770.00	2,210.00	2,650.00	3,090.00
50,000.00	676.67	1,051.67	1,426.67	1,843.33	2,301.67	2,760.00	3,218.33
52,000.00	703.33	1,093.33	1,483.33	1,916.67	2,393.33	2,870.00	3,346.67
54,000.00	730.00	1,135.00	1,540.00	1,990.00	2,485.00	2,980.00	3,475.00
56,000.00	756.67	1,176.67	1,596.67	2,063.33	2,576.67	3,090.00	3,603.33
58,000.00	783.33	1,218.33	1,653.33	2,136.67	2,668.33	3,200.00	3,731.67
60,000.00	810.00	1,260.00	1,710.00	2,210.00	2,760.00	3,310.00	\$3,860.00

Example: An employee who retires at ten years of service and whose average final compensation amount is \$24,000, will receive an annuity of \$330.00 per month. The calculation of select monthly annuities is presented in the following table:

Example of Monthly Annuity Calculations:		
AFC, Yrs of Service \$000's	Monthly Allowance Amount	Calculations/Formula Break-out
\$24k, 10yrs	\$ 330.00	= ((0.016*10*24000)+120)/12
\$50k, 15yrs	1,051.67	= (((0.016*10)+(0.018*5))*(50000)+120)/12
\$30k, 20yrs	860.00	= (((0.016*10)+(0.018*10))*(30000)+120)/12
\$60k, 25yrs	2,210.00	= (((((0.016*10)+(0.018*10)+(0.02*5))*(60000))+120)/12
\$48k, 30yrs	2,210.00	= (((((0.016*10)+(0.018*10)+(0.02*5)+(0.022*5))*(48000))+120)/12
\$36k, 35yrs	1,990.00	= (((((0.016*10)+(0.018*10)+(0.02*5)+(0.022*10))*(36000))+120)/12
\$58k, 40yrs	3,731.67	= (((((0.016*10)+(0.018*10)+(0.02*5)+(0.022*15))*(58000))+120)/12

We collected supporting documentation independent of the General Retirement System (GRS) to verify the accuracy of the information used by GRS to compute the AFC.

Through our testing we determined the following:

- The 36 consecutive month wage calculations for retirees tested were consistent with the records kept by the HR Payroll Division;
- The 25% Unused Sick Bank allowance allocation included in the AFC computation had some inconsistencies when conducting the comparative analysis:
 - There were variations in the sick bank hours included in the AFC calculation recorded by HR Payroll when compared to the data recorded by GRS;
 - When comparing the sick bank hours:
 - GRS calculations were unclear;
 - Source documentation lacked continuity;
 - There was no direct interface between HR Payroll and the GRS system.
- The 36 consecutive month selection were all within the last 120 months of the retirees' active employment per policy guidelines;
- Additional documentation will be required from HR to determine if the years of service recorded by HR is consistent with the years of service included in the GRS AFC calculation. Since years of service input could not be validated, calculating the entire annual pension allowance for the sample set could not be done (Recommend performing this task in the next 60-days).

Other Concerns – Pension Payroll

- Human Resources have three (3) different systems used for payroll record keeping purposes: Payroll Personnel System (PPS), Oracle, and Workbrain. As a result, it was very difficult to obtain consistent bank time data from HR because employee data has been partially transitioned to different systems, or is maintained in multiple systems. We recommend further review to ascertain the accuracy of the unused sick bank data used to compute AFC in the test sample;
- For GRS, the AFC calculations included at least two calendar years of wages in the selected 36 consecutive months. When comparing the employee's W-2 earnings to the employee's actual annual salary, the W-2 data grossly exceeded the salary amount. This could be attributed to excessive overtime, perhaps a quantitative assessment will determine if savings could be realized if an employee's actual salary were used in the AFC calculations as opposed to the wages earned. We will expound on this theory in the next 60 days;
- There is a breakdown in communication between HR and the Pension Division which is evident by the lag time when completing the transition from active payroll to retirement payroll. This was acknowledged by Pension and Human Resource employees. We recommend that the retirement process be reevaluated to improve continuity for City employees.

Annuity Refunds

Based on our review of the GRS (only) annuity refunds, we plan to further investigate the policies that govern the annuity interest percentage and other credits. Analytics and sample testing are currently in progress. Based on our preliminary observations of the sample data we have found the following:

- Retirees received interest and credits which are in excess of the market rate earned by the retirement system in the following periods 1984-1986, 1995-2000, and 2005-2007, which is equivalent to an effective rate of return of over 20% for each fiscal year:
 - GRS has yet to deliver a policy that outlines how Trustees determined interest rate and dividend credits each year;
- Irregularities have been seen amongst annuity participants where interest dividend credits were given disproportionately to annuitant's;
- Annuity participants who contributed similar amounts over the course of their employment have received excessively disproportionate annuity refund amounts.

We developed a formula that gives an effective interest rate for each year of employees in the sample set by dividing the interest earned by the beginning balance to test for continuity amongst the sample set. The test revealed the following discrepancies:

- There was no consistent or direct relationship with the change in the balance of the net assets or the investment income earned by the fund in the respective fiscal year;

- The effective interest earned method revealed some discrepancies, however further analysis will need to be conducted to determine if there is actual partiality being given when allocating interest and dividend credits to annuitants.

In addition, upon review of the ledger detail of the sample set, we found that the beginning balance in fiscal year 2006 exceeded the ending balance of fiscal year 2005 by 13% in all cases.

Other Concerns and Recommendations

During the initial phase of this investigation, we had limited time to assess the root cause of the anomalies found thus far in our sample data set for GRS annuity disbursements. Therefore, in the next 60 days, we plan a focused review of the multiple dynamics used to offer interest and dividend credits to annuity account holders. We also will perform similar analysis of the PFRS annuity disbursements.

In addition to our concerns for GRS Pension Payroll and Annuity Refunds we also recommend reviewing the following areas for the GRS:

- Cash Receipts;
- Revenue generated from investments;
- Other expenses;
- Related policies and procedures.

Asset Allocation

Public Act 314 of 1965 states the pension boards “may invest in annuity investment contracts or participations in separate real estate, mortgage, bond, stock or other special investment accounts of a life insurance company authorized to do business in the states.” Furthermore, it outlines limitations related to the percentages of assets that can be invested in each of the categories. The Boards establish asset allocations to distribute the property between the categories in compliance with these limitations. The Board has not made any investments in separate real estate (i.e., direct investment outside of a pooled investment) over the last five years. The Investment Officer for the Pension Systems indicated that he has suggested to both Boards that no further investments in separate real estate occur in part because both systems have exceeded their asset allocation in this category.

Real Estate Investments

Public Act 314 of 1965 states that the systems can invest, “10% of a system's assets in publicly or privately issued real estate investment trusts or in real or personal property otherwise qualified.” The act further states that “an investment fiduciary of a system having assets of more than \$100,000,000.00 may” enter into other forms of investment related to real estate that should also not exceed 10% of the systems' assets. The Detroit General Retirement System (GRS) and Detroit Police and Fire Retirement System (PFRS) boards have established asset allocation policies in compliance with the state limitations in the public act. However, based on our review of 2010-11 and 2011-12 real estate asset allocations for each system, neither of the systems was in

compliance with the their self-imposed asset allocation limitations as follows:

Real Estate (Public or Private) Investment Percentages

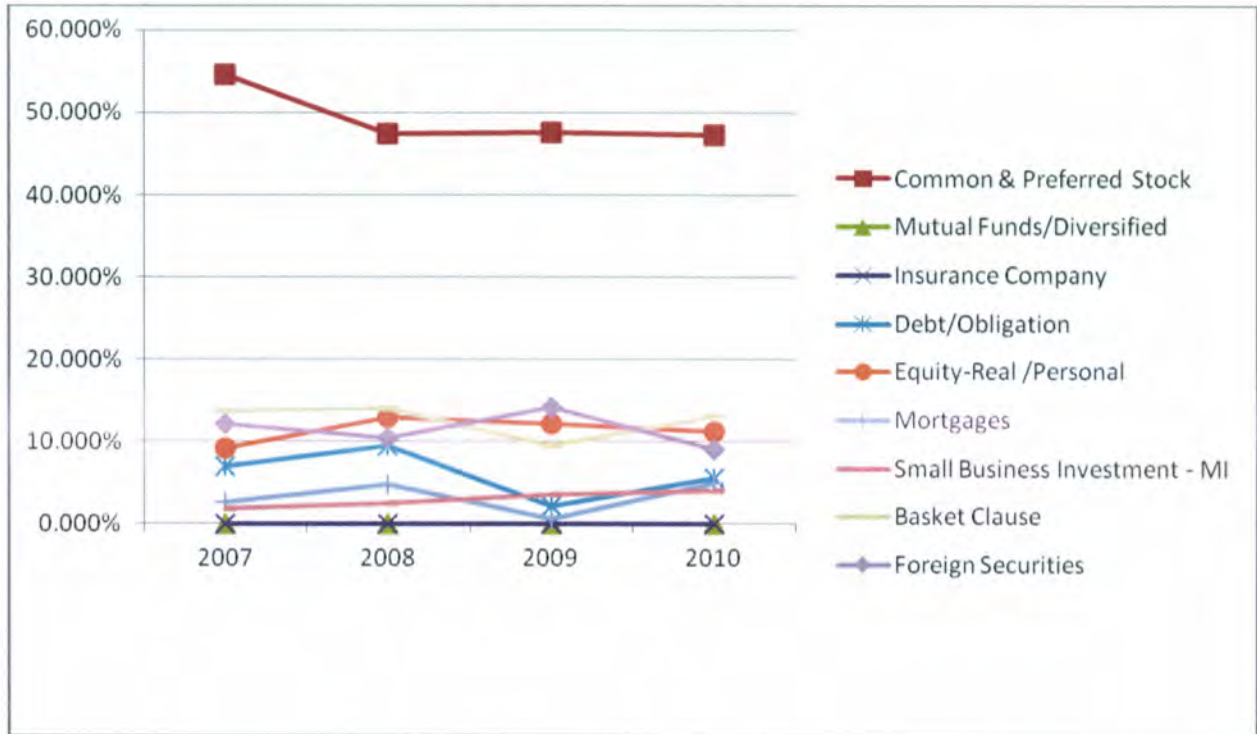
Retirement System	Policy Target	2010-11		2011-12	
		Allocation	Difference	Allocation	Difference
GRS	10.00%	12.22%	2.22%	13.99%	3.99%
PFRS	7.00% (2011)	14.33%	7.33%	12.60%	4.60%
	8.00% (2012)				

Source: Summary of Asset Allocation Reports GRS & PFRS August 31, 2011 & June 30, 2012

As indicated above, the GRS and PFRS system policy target percentages were in compliance with State of Michigan limitations. However, the actual percentages of assets allocated to real estate by the systems exceed the targets set by the retirement systems. The financial statements of each system include the statement that, the boards “has established asset allocation policies which are expected to deliver more than enough investment income over a very long period of time to satisfy the obligations to pay the benefits promised to the members of the Plan.” As of June 30, 2010 the GRS Annual Report documented a \$73,388,448 Net Realized/Unrealized Loss related to equity – real/personal. The PFRS Annual report for the same period documented a \$52,172,675 Net Realized Loss related to Equity Real Estate and a \$19,223,213 loss related to Equity – Real Estate Investment Trusts (REITs) & Pooled.

REITs are organizations that invest funds of multiple systems for shares of interest in real estate investments. Act 314 indicates real estate investments can be invested through REITs and therefore categorized outside of the 10% limitation. Furthermore, the act includes a section that would include “other” investments not specifically mentioned in the act. This category can include real estate investments as well. The Investment Officer for both systems stated direct real estate investments of the systems have been transferred and are now managed by REITs. Accordingly, the systems have taken advantage of the opportunity to reclassify investments in real estate in compliance with the statute to ensure asset allocations do not exceed state limitations. The Investment Officer also stated that, due to market fluctuations in recent years, the valuations of other investment categories decreased. This reduced the percentage of investment in other asset categories and increasing the investment in real estate (i.e., equity- real/personal).

Changes in General Retirement System Asset Value Percentages



As indicated in the graph above, the valuation of equity in real and personal property increased sharply in 2008, as did the valuations of debt obligations and mortgages. Meanwhile, the valuation of common and preferred stock and foreign securities sharply decreased. However, in addition to the percentage of change based on the makeup of the fund, the system entered into additional real estate investment during the 2008 fiscal year, after which no additional investments have been made. As of 2008, the percentage of investment in real estate has exceeded the systems' asset allocation provision. Other retirement systems, with similar participant levels, have the following real estate target levels and allocations for the 2012 fiscal year.

Asset Allocations of Retirement Systems with Similar Participant Levels

Retirement System	Participants	Real Estate Allocation	Long Term Target Allocation
Policemen's Annuity and Benefit Fund, Chicago, IL	25,523	4%	5%
Houston Municipal Employee Pension System	27,675	9.1%	12%
Los Angeles City Employee's Retirement System	42,646	6.1%	5%
Employee Retirement System of the City of Milwaukee	26,854	8.5	7.0%

Based on our research regarding other systems with similar participant levels, most other systems, have lower target levels ranging from 3% to 5% below that of the GRS and 1% to 3% below that of the PFRS. Furthermore, all have lower actual real estate allocation percentage levels ranging from 4.89% to 9.99% lower than the GRS and 3.5% to 8.6% lower than the PFRS. In regards to other pension systems within the State of Michigan, the largest systems had the following allocation rates for the 2011 fiscal year:

Asset Allocations of Other Michigan Retirement Systems

System	Participants	Real Estate Allocation	Long Term Target Allocation
Michigan Employee Retirement System	90,670	6.2%	7%
State Employee Retirement System	81,392	10.8%	9%

In addition, even though other retirement systems within the state of Michigan have larger participation levels than GRS and PFRS, their real estate allocation targets are 1% to 3% lower. The actual real estate allocations for the other Michigan systems are also 3.53% to 6.0% lower than those of GRS and PFRS. This suggests an industry standard of a conservative investment level in real estate.

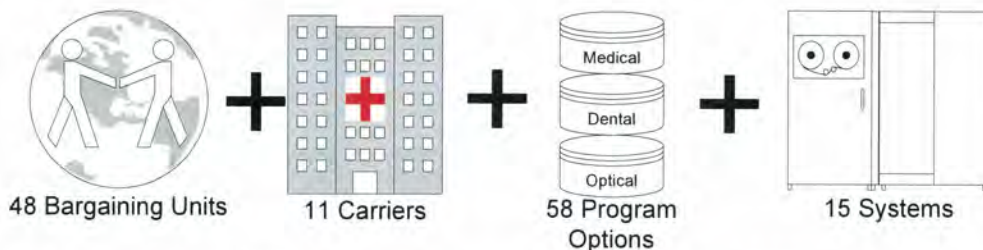
The current Investment Advisor for the systems has indicated that he has suggested to the boards that the asset investments, related to real estate, be reduced to meet the systems' established target amounts and the related allocations should be adjusted (i.e., lowered) to better diversify the investments of the funds. He also indicated the systems have recently initiated steps to liquidate real estate investments. The Boards of each system should continue to take whatever steps necessary and prudent to bring the real estate investments within their self-imposed targeted amounts. Additionally, the systems should ensure that; their investment policies outline the criteria for determining the categories in which real estate investment are presented in the financial statements, future transactions related to direct investments in real estate and all other asset categories are in compliance with Public Act 314 and the asset allocation targets.

HEALTH CARE

The City of Detroit offers a competitive and comprehensive employee benefit package which includes medical, dental, and vision health care benefits.

The Human Resources Department (HR) is responsible overall for the administration of employee health benefits. Its mission is to provide services and implement programs that attract, hire, retain, and support a qualified and talented workforce committed to providing timely, high quality services to City of Detroit employees and its citizens, in an environment that contributes to the City's objectives. The following divisions of HR administer health and other employee related benefits which are the:

- Central Services is responsible for centralized functions including Unemployment, Test Development and Administration, and Classification and Compensation;
- Employee Services (which includes Payroll) supports the management staff and employees of all City departments by providing consulting services which include employee relations, recruitment and selection, and employee certification. It is also responsible for processing employee payroll and facilitating human resources employee transactions;
- Labor Relations is primarily responsible for negotiating collective bargaining agreements and additional supplemental agreements in accordance with the City Charter and State Law. In addition, it conducts Special Conferences, Umpire hearings, Panel hearings, Arbitration hearings, and Pre-Arbitration grievance appeals. Labor Relations communicates and records all economic activities related to City of Detroit employees such as salaries, uniform allowances, rate changes, benefit changes, etc.:
 - The Benefits Administration Office (BAO) is a subdivision of Labor Relations and is responsible for administering, medical, dental, and optical, as well as supplemental life insurance benefits. According to benchmark studies, the office is grossly understaffed, and currently there are eight full time equivalents (FTE's) to handle the benefits of all the active and retired employees.



== Over 10,000 Medical Payroll Deduction Codes
== 40,000 Total Employee Payroll Deduction Codes
 Average of 56,000 Transactions Per Month

Two divisions of the Finance Department are involved with employee health care related benefits:

- Accounts Division - Accounting Section handles cash management, coordinates the preparation of the Comprehensive Annual Financial Report, and manages accounting information and grant programs;
- Retirement (Pension) Division administers the pension systems for the City of Detroit.

Also, within the Detroit Police Department, there are fifty or more police officers performing a timekeeping role and another twenty employees performing time capture and payroll processing roles.

The Retirement Systems for the City of Detroit (RSCD) is a separate organization and it performs the major activity of administering the General Retirement System (GRS) and the Police and Fire Retirement System (PFRS). The department is governed by two separate Boards of Trustees who oversee its operations and has its own accounting, payroll, and other benefit related activities.



Health Care Benefit Administration Major Processes



The City's Health Care Benefit Administration process is largely undocumented, extremely labor intensive, run on antiquated systems, and largely populated by manual processes. Based on interviews with representatives from HR, BAO, Pensions, and Finance, we compiled a flowchart depicting the process from the employee's initial selection of health care benefits to qualifying events such as layoff, termination, retirement or death (*See the Health Care Process Flowcharts on pages 35 and 36 of this report.*) Our review of the process underscores previous operational assessments performed by various consultants, and highlights areas of concern and internal control weaknesses. Listed below are the major processes with highlighted areas of concern. In addition, we have noted where additional testing or review should occur in the next phase of this investigation:

Health Care Administrative Processes

Department/Division	Process	Comments and Concerns Area of Concern Recommendation
Human Resources	Create city-wide employee and benefit deduction codes based on job codes, class codes, and bargaining units	<ul style="list-style-type: none"> • This process is driven by the number of benefit plans, options, and bargaining units resulting in a total of 40,000 deduction codes and over 10,000 medical codes <li style="background-color: yellow;">• 87.2% of medical plan participants are serviced by three carriers <li style="background-color: yellow;">• There are an additional five carriers who administer medical plans to only 12.8% of plan participants <li style="background-color: lightblue;">• We recommend testing of the creation of deduction codes
Human Resources	Add employee to the employee database (PPS or Oracle/HRMS): job code, class code, and bargaining unit	<ul style="list-style-type: none"> • We recommend testing updates to the employee database
Benefits Administration Office	Add employee to carrier systems: medical, dental, vision, and “carved-out” pharmacy	<ul style="list-style-type: none"> <li style="background-color: yellow;">• Requires at minimum, three updates per person for medical, dental, vision <li style="background-color: lightblue;">• We recommend independent verification of plan participation on the carrier systems
Benefits Administration Office	Assign deduction codes in employee database (PPS or Oracle/HRMS)	<ul style="list-style-type: none"> • Requires at minimum, three updates per person for medical, dental, vision, and “carved-out” pharmacy

Department/Division	Process	Comments and Concerns Area of Concern Recommendation
Benefits Administration Office	Qualifying event necessitates updates to deduction codes in employee database (PPS or Oracle/HRMS)	<ul style="list-style-type: none"> • Requires two to six updates per person for medical, dental, vision, and “carved-out” pharmacy; Have to delete current codes then re-add new codes • The laborious manual process is intensified due to the antiquated technology • Changes are tracked on a manual excel spreadsheet and reconciled against PPS and HRMS reports <div style="background-color: yellow; padding: 2px;"> <ul style="list-style-type: none"> • The same clerk that updates the database also prepares the list of changes and the reconciliation </div>
Benefits Administration Office	Supervisor Review Spreadsheet of Changes And Reconcile to PPS or HRMS	<div style="background-color: yellow; padding: 2px;"> <ul style="list-style-type: none"> • The supervisor relies on internal knowledge of all health related deduction codes • Handwritten reconciliation adjustments were not properly supported </div> <div style="background-color: lightblue; padding: 2px;"> <ul style="list-style-type: none"> • We recommend independent verification of changes to plan participation </div>
Benefits Administration Office	Calculation of Monthly Payments for Premium Based Carriers	<div style="background-color: yellow; padding: 2px;"> <ul style="list-style-type: none"> • Due to a lack of resources, payments to premium based carriers average 90 to 120 days in arrears </div> <div style="background-color: lightblue; padding: 2px;"> <ul style="list-style-type: none"> • We recommend verification of billings and payments </div>
Benefits Administration Office	Reconciliation of Self-Insured Based Medical Plans Billings	<div style="background-color: yellow; padding: 2px;"> <ul style="list-style-type: none"> • The BAO performs a limited review of the monthly billing from BC/BSM who service 64.7% of active and retired employees • A separate detailed claims audits is performed by third party vendors every three years; the last audit was 2010 </div>

Department/Division	Process	Comments and Concerns  Area of Concern  Recommendation
		<ul style="list-style-type: none"> • We recommend verification of billings and payments, and testing the accuracy of the BC/BSM billing (average billing is \$17 to \$18 million per month) • We recommend the third party detailed claims audit as soon as possible
Benefits Administration Office	Other Policies Relating to Health Care Costs (Medicare Eligibility, Spin-off of Divisions)	<ul style="list-style-type: none"> • Policy requiring employees who turn age 65 and must enroll in Medicare Parts A and B, and Medicare becomes the primary insurer • Limited policy on the process for tracking, determining, and paying or not paying legacy costs for units that we have spun off (DIA, Zoo, Historical Museum, Cobo Authority, Housing Authority, Fort Wayne, and the new PLA), specifically healthcare benefits, and pensions. <div style="background-color: yellow; padding: 2px;"> <ul style="list-style-type: none"> • A retiree must notify BAO when they reach age 65; also BAO receives notifications from other external sources when this qualifying event occurs • The City may be incurring improper legacy health care costs for spin-off divisions/activities </div> <ul style="list-style-type: none"> • We recommend verification that any retiree eligible for Medicare is enrolled in the system and the City becomes their secondary insurer • Investigate policies surrounding spin-off divisions as it relates to legacy health care costs
Finance	Wire transfer Payments to Carriers	<ul style="list-style-type: none"> • One FTE is primarily responsible processing all health care related costs

Department/Division	Process	Comments and Concerns  Area of Concern  Recommendation
		<ul style="list-style-type: none"> <li data-bbox="919 321 1386 394">• There are twenty wire transfers per month for payments <li data-bbox="919 401 1365 468">• We recommend verification of billings and payments
Pension	Process Retirement Application; Conduct Retirement Exit Interview; Calculate Pension	<ul style="list-style-type: none"> <li data-bbox="919 499 1419 680">• Notification to BAO of retirements is a manual process; Retirement benefit selection forms are put into a tray for BAO to retrieve and process <li data-bbox="919 686 1409 793">• There is a 2-3 month delay in processing plan changes relating to retirement <li data-bbox="919 800 1425 980">• We recommend independent evaluation of the time lag between the change in status from active to retired; assess the impact to health care costs

Benefit Plan Carriers, Billings, and Payments

Medical service providers (carriers) can be classified into two types based on the City's method of calculating and paying for services:

- Self-Insured – Costs are “as incurred” and payments are based on actual costs less the employee contribution; the billing is calculated by the carrier;
- Premium Based – The payment is calculated by the City (BAO) based on the number of enrollees in the plan times a flat rate premium; it is paid regardless of employee usage or non-usage. In some cases, advance payments are made to a carrier to cover their up-front costs. The advance payment is reconciled to the actual amount after the BAO calculates the correct premium based costs, resulting in adjustments to next month's payment.

Health Care Plan Options for Active Employees and Retirees 2012-2013

The City of Detroit's employee and retiree benefits plans are very complicated and stratified. The variety of plans offered, along with the numerous options available to each of the several bargaining units makes a comparable analysis difficult. Below you will find a summarization of the different types of plans, the different health care carriers (providers), and the range of costs for both active employees, retirees, and the City. Contribution rates listed in the tables below are the rate ranges for the period of December 2012; open enrollments that took place in the winter of 2013 may have changed both the employee and City rates.

Generally, there are three types of medical plans in the health care industry: **Health**

Maintenance Organizations, Preferred Provider Options, and Traditional Medical Plans.

Health Maintenance Organizations (HMO)

HMO plans manage and coordinate medical care. Plan participants select a primary care physician who provides the majority of medical services and coordinates other services, such as specialty care, hospital services, and diagnostic testing. The use of network providers is required. Because of this restriction, out-of-pocket expenses for covered benefits are usually lower than with other types of plans. It is important to note that employees and retirees who select an HMO plan must reside in the network services area of the HMO plan. If the employee or retiree moves outside of the service area, they are no longer eligible for the HMO plan and must switch to another plan. The following tables show the ranges of employee and employer contributions for various health care plans:

<u>Health Care Plan</u>	<u>Employee Contribution (Bi-weekly Range)</u>	<u>City Contribution (Bi-weekly Range)</u>
Blue Care Network HMO	\$40 - \$125	\$199 - \$501
Health Alliance Plan HMO	\$41 - \$157	\$196 - \$494
Total Health Care HMO	\$32 - \$91	\$160 - \$464

Preferred Provider Options (PPO)

PPO plans consist of a network of independent physicians, hospital and other health care providers who have agreed to accept a pre-approved amount as full payment for services provided to employees and members. Under this arrangement, out-of-pocket expenses are usually lower for covered benefits when network health care providers (rather than out of network providers) are used for services. Annual deductibles and co-pays are required for certain services.

<u>Health Care Plan</u>	<u>Employee Contribution (Bi-weekly Range)</u>	<u>City Contribution (Bi-weekly Range)</u>
Community Blue PPO	\$22 - \$102	\$174 - \$409
U.S. Health – C.O.P. S. Trust PPO	\$66 - \$165	\$215 - \$546

Traditional Medical Plans

Traditional plans allow members to receive services from virtually any health care provider nationwide. Because there are virtually no limitations placed on where and when services are received, and the providers are less restricted in the fees they

charge, out-of-pocket expenses and employee payroll contributions for medical coverage are higher under traditional plans.

<u>Health Care Plan</u>	<u>Employee Contribution (Bi-weekly Range)</u>	<u>City Contribution (Bi-weekly Range)</u>
Blue Cross Traditional	\$76 - \$396	\$210 - \$500
Blue Cross Comprehensive Major Medical	\$62 - \$145	\$225 - \$546

The information provided in the preceding tables and paragraphs is a simplified overview of the City's very complicated employee health care benefits. Some plans are only available to one or a few bargaining units and different bargaining units have varying benefits options available to them, as well as different employee contribution amounts. The following table details active employee and retirees plan participation by medical, dental, and vision carrier:

Overview of the Health Care Service Providers

The following tables document the variety of carriers and payment process and plan participation:

Health Care Carriers

Carrier	Type	Self-Insured	Premium Based	Advance Payment	Reconciled by Labor Relations
Blue Cross Blue Shield (BC/BS)	Medical Pharmacy	X			N, pay as billed
HAP	Medical Pharmacy		X		Y
COPS Trust United Healthcare (Police only)	Medical Dental Vision		X	X	Y
Total Health Care	Medical		X		Y
CVS Caremark	Pharmacy (only)	X			N pay as billed
Dentcap	Dental		X		Y
Golden Dental	Dental		X		Y
Co-op Optical (No longer offered)	Vision		X		Y
Heritage Optical	Vision		X		Y
US Alliance (Spectra) Available (Police only)	Vision		X	X	Y

Active and Retired Employees Receiving Health Care Benefits As of December 2012

Medical Carrier	BC/BSM Hospital		US Health	BCN	HAP	THC	BC/BS Option E	BC/BS Community Blue Option F	BC/BS CMM Option G Comprehensive Major	TOTAL Excl Census Count	% of Total
	12/2012 Schedule	Census 2011-12									
@ December 2012	Per Medical Monthly Report										
Active Police	1,952	2,116	410	53	104	15	-	-	-	2,534	7.5%
Active Fire (Incl EMS)	923	946	34	71	154	9	-	-	-	1,191	3.5%
Active Gen City (Incl DOT)	3,191	2,844	-	599	1,306	382	-	-	-	5,478	16.2%
Subtotal Active	6,066	5,906	444	723	1,564	406	-	-	-	9,203	27.2%
Retired Police	7,167	5,057	99	49	118	-	295	2,064	724	10,516	31.1%
Retired Fire (Incl EMS)	1,985	1,729	-	17	59	-	414	415	188	3,078	9.1%
Retired Gen City (Incl DOT)	6,674	7,053	-	714	2,210	-	253	1,151	-	11,002	32.5%
COBRA	-	-	1	1	5	-	-	-	-	7	0.0%
Early Retirees	-	-	-	1	8	-	-	-	-	9	0.0%
Sub Total Retirees	15,826	13,839	100	782	2,400	-	962	3,630	912	24,612	72.8%
Total No. of Employees Receiving Medical Benefits	21,892	19,745	544	1,505	3,964	406	962	3,630	912	33,815	100.0%
Percentage of Total By Carrier	64.7%	58.4%	1.6%	4.5%	11.7%	1.2%	2.8%	10.7%	2.7%	100.0%	

Medical Carrier	BC/BSM Hospital	US Health	BCN	HAP	THC	BC/BS Option E	BC/BS Community Blue Option F	BC/BS CMM Option G Comprehensive Major	TOTAL Excl Census Count	% of Total	
Total No. of Employees Receiving Dental Benefits @ 12/2012	Participants in these plans use the dental carriers offered by the City (Dencap and Golden Dental)	US Health Dental	Participants in these plans use the dental carriers offered by the City (Dencap and Golden Dental)							13,641	40.3%
Total No. of Employees Receiving Co-op Optical Benefits @ 12/2012	Participants in these plans use the dental carriers offered by the City (Dencap and Golden Dental)	US Health Optical	Participants in these plans use the optical carriers offered by the City (Heritage Optical, Co-op no longer offered)							58	0.2%
Pharmacy Benefits	BC/BS Pharmacy; CVS Caremark	Note: All of these plans include Pharmacy Benefits									

Note: The Census Count is based on the actual count as of June 30, 2012 and it is developed annually to support billings to the departments and the Comprehensive Annual Financial Report.

To summarize the plan participation by carrier:

- 85.5% of active and retired employees are serviced by a Blue Cross Blue Shield or Blue Care Network health plan product;
- 87.2% of employees are serviced by three medical plans, while the remaining 12.8% are serviced by five different carriers.

Listed below are additional areas of concern not covered in the preceding table:

- Currently, there are seven employees in the BAO to handle the benefits of over 30,000 active and retired employees; one of the two senior retiree specialists is on loan to the project development team for transitioning benefit administration to a third-party service provider;
- Written policies and procedures are very limited and do not adequately document the City's process for the administration of employee benefits. Instead, required tasks and processes are carried out by staff based solely on individual, internally retained employee knowledge. This puts the City at greater risk of properly administering benefits if these employees were to leave or miss work for an extended period of time.

Coalition of Public Safety Employees Health Trust

The "Coalition of Public Safety Employees Health Trust", also known as the "COPS Health Trust Fund", list themselves as a non-profit, statewide health and welfare fund established in 1994 by the Michigan Association of Police Officers (M.A.P.O.) The insurance plan is only available to police and fire employees. The COPS Trust Fund is the plan administrators for US Health/US Health Alliance Insurance.

As of December 2012, there were 410 active police personnel participating in the COPS plan. However, after the BAO completed the 2012 open enrollment, the number of plan participants increased by approximately 1,000 employees, to an approximate total of 1,410, which represents 55.6% of active police.

Regarding the validity of the trust fund, a manager with the State of Michigan's Department of Insurance and Financial Services (DIFS), Insurance Rate & Forms Division, provided the following information:

- "Coalition of Public Safety Employees Health Trust" or "C.O.P.S. Health Trust Fund" (hereinafter referred to as COPS) is not a licensee of DIFS, nor is it required to be a licensee of DIFS;
- It appears from their website that COPS allows its members/participants to join and enroll in coverage available through the Trust. The coverage is provided by US Health and Life Insurance Company with In-Network benefits provided by Cofinity PPO, which is a provider network;
- DIFS can confirm that US Health and Life Insurance Company are licensed to do business in Michigan as a life and health insurer;
- Cofinity is a PPO. A PPO is a group of doctors and/or other providers that band together to form a network. A PPO that does not pay claims or assumes any risk associated with the services it provides is not regulated by DIFS. These types of PPOs merely contract with licensed organizations at discounted fee-for-service rates.

DIFS suggested that the Corporations, Securities and Commercial Licensing would have a record of this Trust. However, the State of Michigan Department of Licensing and Regulatory Affairs, Corporations, Securities & Commercial Licensing Bureau confirmed that there is no record of an entity named either Coalition of Public Safety Employees Health Trust or C.O.P.S. Health Trust Fund on file with the Corporation Division.

Because we cannot confirm the existence of the COPS Health Trust Fund as a valid corporation or trust in the State of Michigan, coupled with their plan requiring the highest cost of contributions from the City, we recommend a cost/benefit analysis to justify continued use of offering this plan to a select and limited population of employees.

Testing of the Administration of Employee Health Care Benefits

We conducted a limited test of employee benefits contributions by selecting a small sample of ten active and ten retirees to determine if the payroll deductions were proper and properly recorded. We compared the employees' benefit selections with their payroll records for the last pay period in December 2012.

Through our testing we determined all of the payroll deductions for the employee contributions were correct. However, we did not test Dental and Vision deductions because the withholdings for these benefits are done monthly and not per pay period. The pay period selected for testing did not have dental and vision deductions.

While no errors were found in the employee deductions for health care contributions, it was found to be an extremely labor intensive process that lacks good documentation, uniformity of processes, and it is prone to errors for the following reasons:

- Due to the combination of job codes, class codes, and bargaining units, there are over 10,000 deduction codes for health benefit selections;
- In some cases, employees enrolled in the same health care plan had different deduction codes due to different bargaining units and departments; per BAO, this is required to segregate data for statistical reporting purposes;
- Changes in benefits selection requires between two to six updates to an employee's payroll deduction codes for any one change in healthcare plans or deductions;
- The codes in the system did not necessarily match the codes on the employee benefits enrollment forms because changes were made without using the standard form. In some cases, updates were made to employee deduction codes by the BAO in reaction to changes in health care plans on a bargaining unit or city wide basis;
- Active employees in six departments use the HRMS/Oracle system and their changes are processed through the online employee portal, and not through the standard paper forms;
- In an effort to confirm the appropriateness of the withholdings eleven different rate sheets were required. Rates vary greatly based on single, two-person, or family and bargaining unit, job code and time of employment;
- There is a lack of communication between Payroll, Pension, and Benefits Administration, which leads to a time lag of employees and retirees who become eligible for Medicare, transitioning from the City being their primary insurer to Medicare. This is a missed opportunity for the City to save on health care costs.

Transition of Payroll and Benefit Administration to a Managed Care Provider

On November 13, 2012, the Director of Human Resources presented to the Administration and City Council, the proposed transition of payroll and benefits administration to a managed service provider. The presentation focused primarily on the "highly manual, labor-intensive, and three to four times more costly payroll

processes.” It was noted that the City had selected Automatic Data Processing Incorporated (ADP) as the external service provider for payroll processing and benefit administration, with promises of improved service and reduced costs:

Projected Cost Savings	Millions
Labor Processing Costs Savings	\$4.7
Information Technology Costs Savings	4.5
Total Savings	\$9.2

The presentation listed other benefits such as:

- Re-deployment of fifty uniformed police officers from payroll to public safety;
- Significant improvements and improved controls over payroll and benefit administration processing;
- Dedicated Payroll and Benefits Call Center;
- Annual costs charged by ADP of \$5.5 million;
- One-time implementation costs of \$7.5 million.

Payroll cost savings were based on the results of a study conducted by Sourcing Analytics to quantify the total cost of ownership (TCO) of the payroll and benefit administration operations (April 2012). However, the cost of outsourcing Human Resources (HR) and Benefit Administration Operations (BAO) were not calculated or included in the summary of the City’s TCO:

City of Detroit Total Cost of Ownership per Employee

Activity	City Cost	Cost of Outsourcing	Average Cost	Comments
Payroll ^(A)	\$ 62	\$18	\$ 15	This was the only comparison referenced in the HR presentation
HR ^(B)	\$101	Not stated	\$ 76	HR and BAO will continue to provide oversight for the project and ongoing operations. However, the residual cost of these activities was not included in the total outsourced cost of this function
BAO ^(B)	\$ 60	Not Stated	\$156	
Total	\$223	Not Stated	\$247	

Sources ^(A) *City of Detroit Payroll & Benefits Administration, presented by Patrick Aquart, Human Resources Director, November 13, 2012.*

^(B) *Financial Analysis Tool Total Cost of Ownership Results, City of Detroit, April 2012, Sourcing Analytics.*

A representative of BAO stated that even with the shortage of staff and outdated computer systems, their current cost of operations is less than the average. It was also stated that a rate for outsourcing of BAO and HR was unavailable because ADP's "benefits administration module is new" so they could not quote or calculate the cost savings.

Contract Pricing Summary

The five year ADP contract was signed and approved by City Council in December 2012, for a total contract amount of \$32.3 million. In addition to one-time implementation fees of \$4.3 million, the contract includes monthly service fees of \$43 per employee per month, based on a minimum of 8,500 employees per month. The minimum service fee is payable regardless of whether the City's actual usage decreases below the minimum number of employees. Given, that the active employees with health care contracts was 9,203 (at December 2012) which is just 8% more than the minimum threshold, we could easily slip below the threshold if the City moves forward with plans to outsource or transfer operations of the Public Lighting Department, the Department of Public Works, Municipal Parking, the Detroit Department of Transportation, and the Detroit Water and Sewerage Department. An upper threshold on pricing is set based on 10,579 employees; services for those employees will be billed at higher rates.

The contract price structure includes incremental fees such as screening and selection services, pass through expenses such as payment of travel and related expenses, maintenance and development fees, change control fees, and other time and material services. With a new system, this pricing structure could result in a significant amount of additional costs.

Employee Benefit Operations

A main underlying cause of the complexity of the City's benefit administration is the vast number of employee deductions codes. As previously stated, there are over 40,000 employee deduction codes in one of our legacy systems. Approximately 10,000 of the deduction codes are needed for health care elections. The codes identify the deduction amount but do not accurately reflect the benefit plan associated with the employee, nor capture any dependent information.

Internal Controls and Process Documentation

The Transition Team Project Manager provided us with ADP's system workflows for Payroll and HR operations, but did not provide a flow for BAO. However, the workflows do not include work processes or points of internal controls. The Project Manager stated that the focus at this time is setting up the system and "once this is done and we determine what the system can and cannot do, and then we will set up processes to handle the gaps and design the internal controls. We may need to set up new manual processes to cover the gap areas."

Scheduled Target Completion

The project is scheduled for an April 2014 implementation. However this date may be at risk because the team is still waiting on the 2013-2014 health plans so they can be put into the system.

In conclusion, we recommend an independent, comprehensive cost analysis of the entire Payroll and Benefit Administration Project and the reviewer should provide an opinion as to whether the City should continue the project as a currently contracted or amend the project scope. The analysis should include accurately costing operations and processes that will remain with the City such as reconciliations and oversight, costs of implementing adequate internal controls, and the ongoing project management costs.

UNEMPLOYMENT COMPENSATION

Background

Unemployment Insurance is a form of social insurance administered in Michigan by the Unemployment Insurance Agency (UIA). It is designed to help individuals replace some of their income when they have become unemployed through no fault of their own. To qualify for benefits, a worker must be unemployed, have sufficient qualifying wages, and must be otherwise eligible for benefits. There are several reasons a worker would be ineligible for benefits, including discharge for misconduct and voluntarily leaving the position, which would require the worker to meet certain UIA standards to qualify for benefits. The employer handbook, provided by the UIA and available on their website, details the information above as well as any additional information necessary to determine unemployment requirements and eligibility.

In addition to services or benefits for unemployed workers, the UIA also offers benefits to workers who are underemployed, which means the individual is working part-time with earnings. These workers are paid a reduced weekly benefit amount based on UIA calculations. If a worker earns more than 1.6 times their benefit amount, they would not be eligible for benefits during that week. Under no circumstances is a full-time employee eligible for unemployment benefits.

The following steps usually occur when a worker files a claim for unemployment:

Unemployed Worker:

- Files an unemployment claim with UIA and supplies the required information.

Unemployment Insurance Agency:

- Obtains information from the employer to determine eligibility for benefits, including verification of employment history, reason for separation and wages;
- Makes a determination based on the information obtained and notifies the worker.

City of Detroit Human Resources Department (HR):

- HR Analyst at Central Services validates, contests, and maintains unemployment claims filed against the City of Detroit and ensures that the City is represented at related hearings;
- HR Analyst at Employee Services provides detailed information on employee separations and appears at unemployment hearings with appropriate witnesses and supporting documentation;
- A Principal Clerk prepares and maintains unemployment claim files and a claims database;
- The HR Manager compiles data and prepares quarterly/yearly unemployment reports.

The City is a reimbursing employer, and is liable for every dollar the UIA pays in

benefits to unemployed or underemployed City workers. It is imperative that HR conduct a timely review of the eligibility of claims as soon as they are notified by UIA that a claim has been filed. This communication is a crucial step in the process. It is in this phase where HR notifies UIA of events that would disqualify the worker for benefits, including leaving the position voluntarily, being discharged for misconduct, or if the worker is still employed and was never discharged from employment. If and when HR fails to provide this information timely, or fails to respond to UIA's requests for information, a determination is made based on the information provided by the worker. Unemployment compensation paid by UIA against ineligible claims, ultimately results in the City losing money due to fraud or waste.

According to the UIA, when questions regarding the City's unemployment claims were first raised by an anonymous tip (December 2011), HR was approximately 1.5 years behind in processing unemployment claims. In January 2012, a representative from HR also expressed concerns about some of the human resources staff collecting unemployment while being employed full time. It was stated that the 50% staff reductions in HR between fiscal years 2009 and 2013 negatively impacted the unemployment claims processing. This resulted in numerous workers being paid unemployment benefits that they were not eligible to receive.

Areas of Concern and Deficiencies

Our review of the Unemployment Claims Process found the following areas of concern and deficiencies:

- Processing of unemployment claims was inadequate and did not adhere to the established policy:
 - No one was processing unemployment claims in the Human Resources department creating a backlog;
 - There was no evidence of a database of unemployment claims being maintained;
 - There was no evidence of quarterly/yearly reports being prepared by HR Management;
 - The policy does not outline the steps taken in departments who do not utilize the centralized human resources function.
- A number of employees may have received unemployment benefits they were not eligible to receive. Quarterly billing reports from the UIA detailed the amount the City of Detroit owed to UIA for the reimbursement of benefits paid to individuals by quarter. We reviewed quarterly billing reports from the UIA as well as quarterly separation reports from the City of Detroit and found the following:
 - The City of Detroit paid unemployment claims for 1,484 individuals from July 1, 2011-March 31, 2013;
 - Of the 1,484 claims, only 756 appear to be claims related to lay-offs;
 - 536 of the claims need additional investigation to determine eligibility;

- 192 of the claims filed appear to be ineligible because the individuals were either full time employees or had no employment history with the City of Detroit.

The issue with these claims is a direct result of not following policy. If the City followed established policy, a number of the questionable claims would have been resolved prior to benefits being paid to the workers. The following provides detailed information about the unemployment claims filed against the City:

Unemployment Claims from July 1, 2011-March 31, 2013

Description	No. of Employees
Laid off due to a reduction in force	359
Laid off for seasonal reasons	95
Laid off voluntarily/other reasons	12
Laid off then rehired	302
Terminated/Discharged for various reasons	253
Resigned for various reason	64
Personal Services Contractors	65
Retired	49
Full-time, active employees who were not laid off	134*
Seasonal, active employees who were not laid off	60
No employment history with the City of Detroit	58*
Miscellaneous	33
Total	1,484

**Note: These two categories comprise the individual claims that make up the 192 persons that could be ineligible for unemployment compensation.*

- Lack of uniformity and timeliness in the responses provided to UIA. Both the UIA and the HR have known for over a year that some of the unemployment claims filed against the City were not valid. However, finding an appropriate resolution to this problem has been delayed due to the following:
 - Departments were setting their own policies for what is considered full time employment, causing confusion and delays with claims processing from UIA;
 - The terminology varied across departments, for example a furlough day in the Finance Department is an unpaid day, whereas a furlough day in the Police Department is treated as vacation leave;
 - Policies vary by department on paying for overtime; in some departments an employee could have worked 38 hours and received overtime and

another employee could have worked 44 hours with no overtime;

- Several departments, such as the Police and Fire Departments, maintain their employee time records separately from the remainder of the City, causing delays for HR to respond to UIA's requests for information.

Recommendations

In summary, based on our review of the unemployment claims, we recommend the following:

- Determine which of the 192 ineligible claims fall under intentional fraud and pursue prosecution;
- Initiate administrative action for the claims found to be ineligible but not fraudulent;
- Work with UIA to make a final determination on the eligibility of the 536 claims in question;
- Ensure employees who were laid off only collected unemployment during their eligible period;
- Quantify the total dollar amount lost due to the City paying for ineligible claims.

SUPPLEMENTAL INFORMATION

Emergency Manager Order No. 8



**EMERGENCY MANAGER
CITY OF DETROIT**

ORDER No. 8

**JOINT INVESTIGATION BY THE INSPECTOR GENERAL AND
AUDITOR GENERAL INTO POSSIBLE WASTE, ABUSE, FRAUD,
AND CORRUPTION ASSOCIATED WITH THE CITY'S
EMPLOYEE BENEFIT PROGRAMS**

BY THE AUTHORITY VESTED IN THE EMERGENCY MANAGER
FOR THE CITY OF DETROIT
PURSUANT TO MICHIGAN'S PUBLIC ACT 436 OF 2012,
KEVYN D. ORR, THE EMERGENCY MANAGER,
ISSUES THE FOLLOWING ORDER:

Whereas, on March 28, 2013, Michigan Public Act 436 of 2012 ("PA 436") became effective and Kevyn D. Orr became the Emergency Manager ("EM") for the City of Detroit (the "City") with all the powers and duties provided under PA 436; and

Pursuant to section 10(1) of PA 436, the EM may "issue to the appropriate local elected and appointed officials and employees, agents, and contractors of the local government the orders the emergency manager considers necessary to accomplish the purposes of this act;" and

Section 10(1) of PA 436 makes any such order "binding on the local elected and appointed officials and employees, agents, and contractors of the local government to whom it is issued;" and

Section 7.5-301 of the 2012 Charter for the City of Detroit ("City Charter") creates an independent Office of Inspector General and vests the City's Inspector General (the "IG") with the responsibility to "ensure honesty and integrity in City government by rooting out waste, abuse, fraud, and corruption;" and

SUPPLEMENTAL INFORMATION

Under Section 7.5-306(1) of the City Charter, the IG is charged with investigating “any Public Servant, city agency, program or official act . . . either in response to a complaint or on the Inspector General’s own initiative in order to detect and prevent waste, abuse, fraud and corruption;” and

Under Section 7.5-306 of the City Charter, the IG shall have “access to the financial and other records of all City agencies at any time;” and

Under Section 7.5-105(3) of the City Charter, the City’s Auditor General (the “AG”) is required to “[i]nvestigate the administration and operation of any city agency and report findings and recommendations to the City Council and the Mayor;” and

Section 7.5-105(1) of the City Charter grants the AG “access to all financial records, human resource records, and other records of city agencies necessary to perform his/her functions;” and

The IG and AG have authority under Sections 7.5-307 and 7.5-105(3) of the City Charter, respectively, to “subpoena witnesses, administer oaths, take testimony, require the production of evidence relevant to a matter under investigation, enter and inspect premises within the control of any city agency during regular business hours;” and

Section 7.5-310 of the City Charter provides that “[a]ny Public Servant who willfully and without justification or excuse obstructs an investigation of the Inspector General by withholding documents or testimony is subject to forfeiture of office, discipline, debarment or any other applicable penalty;” and

Section 7.5-308 of the City Charter provides that where the IG “has probable cause to believe that any Public Servant [as defined in the City Charter] or any person doing or seeking to do business with the City has committed or is committing an illegal act, then [the IG] shall promptly refer the matter to the appropriate prosecuting authorities;” and

The City provides various benefits to active City employees and their dependents, and retirees and their dependents, including, but not limited to, unemployment, disability, and health insurance and defined benefit and defined contribution pension plans (collectively, “Benefit Programs”); and

In furtherance of the City’s financial and operational restructuring, the EM has determined that it is necessary and appropriate for the IG and the AG to jointly investigate the administration, operation or implementation of Benefit Programs to identify any waste, abuse, fraud, or corruption, including, but not limited to, administrative misfeasance or other impropriety; and

The EM believes that any such waste, abuse, fraud, or corruption in the administration, operation or implementation of Benefit Programs harms the City and its residents, and that identifying and correcting such waste, abuse, fraud, or corruption is necessary and appropriate to carry out the purposes of PA 436.

SUPPLEMENTAL INFORMATION

It is hereby ordered that:

1. In accordance with the powers granted to the IG and the AG by the City Charter, the IG and the AG shall jointly conduct an investigation into any possible waste, abuse, fraud, or corruption, including, but not limited to, administrative misfeasance or other impropriety with respect to the administration, operation or implementation of Benefit Programs.
2. The IG and the AG shall prepare and deliver a preliminary written report to the EM within 60 days of the date of this Order (the "60 Day Report") regarding the preliminary findings of the investigation and making recommendations regarding next steps, and any corrective, prospective, legal, additional investigatory or other action designed to address any waste, abuse, fraud, or corruption uncovered.
3. The IG and AG shall update and revise the 60 Day Report by providing additional written reports to the EM as necessary, but no later than every 60 days after the issuance of the initial 60 Day Report, and such other reports as may be necessary from time to time.
4. All local elected and appointed officials, employees, agents, trustees, and contractors of the local government shall comply with this Order and any requests made by the IG or AG, either jointly or independently.
5. If any component of this Order is declared illegal, unenforceable, or ineffective by a court of competent jurisdiction, such component shall be deemed severable so that all other components contained in this Order shall remain valid and effective.
6. This Order is effective immediately upon the date of execution below.
7. This Order shall be distributed to the Mayor, City Council members, the IG, the AG, and all other City department directors.
8. The Emergency Manager may modify, rescind, or replace this Order at any time.

Dated: June 20th, 2013

By: 

Kevyn D. Orr
Emergency Manager
City of Detroit

cc: State of Michigan Department of Treasury
Mayor David Bing
Members of Detroit City Council

SUPPLEMENTAL INFORMATION

EMPLOYEE BENEFIT ADMINISTRATION: PROCESS FLOW HEALTH CARE BENEFITS

