DIVISION OF ADMINISTRATION, OFFICE OF RISK MANAGEMENT PRIVATIZATION BY FARA

PERFORMANCE AUDIT
ISSUED JULY 18, 2012

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LOUISIANA LEGISLATIVE AUDITOR
DARYL G. PURPERA, CPA, CFE

July 18, 2012

The Honorable John A. Alario, Jr.,
President of the Senate
The Honorable Charles E. "Chuck" Kleckley,
Speaker of the House of Representatives

Dear Senator Alario and Representative Kleckley:

This report provides the results of our performance audit on the Division of Administration's Office of Risk Management (ORM) and the privatization of the state's lines of insurance and associated services by F.A. Richard & Associates.

The report contains our findings, conclusions, and recommendations. Appendix A contains ORM's response to this report. I hope this report will benefit you in your legislative decision-making process.

We would like to express our appreciation to the management and staff of ORM for their assistance during this audit.

Sincerely,

Daryl G. Purpera, CPA, CFE
Legislative Auditor

DGP/ch

ORM 2012

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Louisiana Legislative Auditor
Daryl G. Purpera, CPA, CFE

Division of Administration, Office of Risk Management Privatization by FARA

July 2012

Audit Control # 40120004

Executive Summary

This report provides the results of our performance audit of the Division of Administration's (DOA) Office of Risk Management (ORM) and focuses on the privatization of the state's lines of insurance and associated services by F.A. Richard & Associates (FARA). The purpose of this audit is to provide a chronology and the current status of ORM's contract with FARA and an update on the status of the cost savings from the FARA contract as of June 30, 2011. This audit also evaluates ORM's current monitoring of FARA's performance under the contract with regards to claims administration and loss prevention services. The audit objectives and results of our work are as follows:

Objective 1: What is the chronology and current status of ORM's contract with FARA?

Results: In 2009, DOA consulted with the Reason Foundation to determine which of ORM's services could potentially be provided by the private sector. One key privatization opportunity identified by the study was the claims processing function. In November 2009, ORM issued a Request for Proposal (RFP) for its claims administration and loss prevention services. ORM received 10 proposals from eight vendors with contract costs varying from approximately $65.2 million to $106.2 million. DOA developed an evaluation committee to review and rank the RFPs to determine the vendor.

Based on the evaluation committee's results, ORM awarded FARA a contract in June 2010 to privatize the state's lines of insurance and associated services. The transfer of ORM's nine lines of insurance and associated services to FARA was to be done in four phases, which began in July 2010. The original contract amount was approximately $68.1 million over a five-year period from July 1, 2010, through June 30, 2015. FARA guarantees $50 million in *claims and litigation payment savings*[1] per this contract.

In April 2011, ORM increased the contract amount by approximately $6.8 million (10%), from $68.1 million to approximately $74.9 million. According to ORM, the agency requested the amendment to accelerate the transfer of General Liability and any other lines of insurance that needed to be transferred earlier to FARA. The implementation date for General Liability was moved up from January 1, 2013, to July 1, 2011, because of the high turnover of ORM employees and the subsequent high cost of temporary contract workers.

[1] According to the contract, the guaranteed savings include payment savings in the categories of Claims and Related, Division of Risk Litigation, and Contract Litigation.

Objective 2: What are the projected cost savings of the FARA contract and what is the status of these cost savings as of June 30, 2011?

Results: ORM projects net program savings of $22 million as a result of the FARA contract. Net program savings consist of *claims and litigation payment savings* and *administrative and other cost savings* over the course of the entire contract, versus the cost of the contract. A breakdown and the status of savings are as follows:

- **Claims and Litigation Payment Savings.** FARA guarantees $50 million in *claims and litigation payment savings* to the state during the five-year term of its contract with ORM. As of June 30, 2011, ORM estimated that FARA had achieved approximately $6.0 million (12%) of the $50 million in payment savings. We obtained and analyzed the reasonableness of ORM's methodology, calculations, and resulting estimate based on comparisons of actual budget expenditures for fiscal years 2010 and 2011. These savings are ahead of schedule for fiscal year 2011 based on ORM's projections.

- **Administrative and Other Cost Savings.** In addition to the $50 million in *claims and litigation payment savings* guaranteed by the contract, ORM will need $40 million in *administrative and other cost savings* to achieve its projection of $22 million in net program savings. As of June 30, 2011, ORM had achieved approximately $2.5 million (6.3%) of the $40 million in *administrative and other cost savings* it needs to achieve its projection. Therefore, ORM has four years to achieve the remaining $37.5 million (93.7%).

- **Net Program Savings.** Based on the year-one contract costs ($7.1 million), *claims and litigation payment savings* ($6.0 million), and *administrative and other cost savings* ($2.5 million), ORM estimated net program savings of approximately $1.4 million as of June 30, 2011. This amount is approximately 6.4% of the $22 million ORM projects in net program savings over the five-year contract period. ORM had originally estimated additional program costs of approximately $659,000 for year one of the FARA contract. Therefore, net program savings are ahead of schedule for fiscal year 2011 based on ORM's projections.

Objective 3: Is ORM effectively monitoring the performance of FARA?

Results: ORM needs to improve its current monitoring process to ensure that it is effectively monitoring FARA's performance. According to the contract, ORM is responsible for monitoring services provided by FARA and the expenditure of funds under the contract. ORM's monitoring is to include activities such as internal audits, invoice reviews, random file reviews, quality assurance (QA) reviews, and customer satisfaction surveys. However, we found that ORM has not started conducting QA reviews of FARA or reviewing FARA's internal QA reviews.

In addition, we identified two areas where ORM could improve the effectiveness of the monitoring it is providing. Specifically, ORM should begin analyzing issues it is detecting in its file reviews of FARA's approved claims to determine the pattern and magnitude of these issues (e.g., insufficient documentation and the miscalculation, overpayment, and delay of benefits). ORM should also continue to monitor the trend in customer satisfaction since FARA took over the state's claims administration and loss prevention services and further examine the overall reasons if decreases in customer satisfaction continue.

Background

Louisiana Revised Statute (R.S.) 39:1528 created the Office of Risk Management (ORM) within the Division of Administration (DOA) to provide a comprehensive risk management system for the state. ORM provides workers' compensation coverage to all state employees. ORM also provides coverage for property, employee bonds, crime, automobile liability and physical damage, comprehensive general liability, personal injury liability, boiler and machinery, medical malpractice, road hazards, and miscellaneous coverage for those claims not otherwise covered.

Privatization of ORM's Services. In June 2010, ORM awarded F.A. Richard & Associates (FARA) a five-year contract to provide claims administration and loss prevention services for all of the state's lines of insurance and associated services. Based on the contract, ORM is to pay FARA approximately $68.1 million over five years, beginning July 1, 2010, and ending on June 30, 2015, with approval to increase the contract amount to approximately $74.9 million if needed. ORM projects net program savings of $22 million as a result of the FARA contract. This includes, in part, FARA's guarantee of $50 million in *claims and litigation payment savings*[2] for the state, as required by the contract.

As of March 30, 2012, FARA is administering six of the state's nine lines of insurance and associated services including General Liability, Loss Prevention Services, Property, Second Injury Fund Recovery, Subrogation Recovery, and Workers' Compensation. Exhibit 1 describes all lines of insurance and associated services that will be privatized to FARA.

Exhibit 1
ORM's Lines of Insurance and Associated Services

Line of Insurance/Service	Description
Auto Liability/Physical Damage	Provides coverage for the state against bodily injury and/or property damage from the ownership or operation of licensed vehicles that are owned, used by, or leased to the state. Provides coverage for physical damage to licensed state vehicles.
General Liability*	Provides coverage for third-party losses where the state is legally liable.
Loss Prevention Services*	Services include conducting "Workplace Safety" classes for all state agencies and appraising all state-owned and leased buildings for replacement costs.
Medical Malpractice	Provides coverage for all state health care facilities.
Property*	Provides coverage for losses to state buildings and state-insured contents.
Road Hazard	Provides coverage for claims against the Louisiana Department of Transportation and Development for damages resulting from the design of any state bridge, tunnel, dam, street, road, highway, or expressway.

[2] According to the contract, the guaranteed savings include payment savings in the categories of Claims and Related, Division of Risk Litigation, and Contract Litigation.

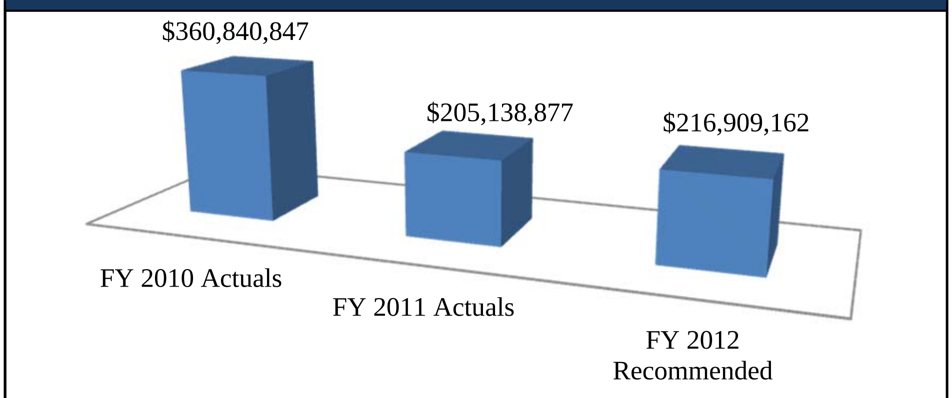
Exhibit 1 (Cont.) ORM's Lines of Insurance and Associated Services	
Line of Insurance/Service	**Description**
Second Injury Fund Recovery*	Services recover reimbursements to the state for a portion of workers' compensation claim costs when an employee with a preexisting permanent partial disability sustains a subsequent job-related injury.
Subrogation Recovery*	Services recover expenses for a claim paid out when another party should have been responsible for paying at least a portion of the claim.
Workers' Compensation*	Provides coverage for lost wages and medical expenses of employees that have been injured while working.

*Lines of insurance and associated services administered by FARA as of May 2012.
Source: Prepared by legislative auditor's staff using information provided by ORM.

Operating Costs. ORM is funded primarily through premiums paid by state agencies for coverage provided by the various lines of insurance. In fiscal year 2010, ORM's actual operating costs were approximately $361 million. In fiscal year 2011, ORM's actual operating costs were approximately $205 million, a reduction of 43% from the previous year. According to ORM, operating costs were reduced primarily because a large amount of Hurricane Gustav claims were paid in fiscal year 2010.

ORM's recommended budget for fiscal year 2012 was approximately $217 million. This budget was developed in the fall of fiscal year 2011, and therefore does not reflect any cost savings resulting from the privatization of certain lines of insurance and associated services by FARA. According to ORM, its budget is primarily based on premiums developed using actuarial principles and there is a lag between reduced claims costs and the resulting lower premiums and budget. Therefore, it will take several years for any decrease in *claims and litigation payments* resulting from privatization to have a noticeable impact on ORM's premiums and budget. Exhibit 2 is a comparison of actual operating costs for ORM for fiscal years 2010 and 2011, and the recommended budget for fiscal year 2012.

Exhibit 2
ORM's Operating Costs
Fiscal Years 2010 through 2012



Source: Prepared by legislative auditor's staff using information provided by the executive budget.

Staffing. As of May 2012, ORM reduced its staff from 140[3] to 88 employees, a reduction of 52 employees (37.1%) from fiscal year 2010. According to ORM, once all of its lines of insurance and associated services have transferred to FARA, its staff will be further reduced to approximately 50 employees,[4] a decrease of approximately 90 (64.3%) employees from fiscal year 2010. The contract requires that FARA offer employment to all ORM employees displaced by privatization for at least one year. According to ORM, of the 52 employees that have left ORM, 27 (51.9%) have accepted positions with FARA. The remaining 25 (48.1%) employees transferred to other state agencies, accepted jobs in the private sector, or retired.

Contract Monitoring. According to the contract, ORM is responsible for monitoring services provided by FARA and the expenditure of funds under the contract. Specifically, ORM's monitoring of FARA's performance is to include the following:

- Reviewing system reports to ensure that all requirements are being met
- Performing random file reviews of claims handled by FARA
- Performing periodic quality assurance (QA) reviews as well as reviewing FARA's QA reviews
- Performing internal audits and reviewing FARA initiated and independent audits
- Performing surveys to determine customer satisfaction
- Reviewing FARA's average payout, closing ratios and development patterns, final payout/reserve ratio, and expense management
- Verifying monthly FARA invoices to determine if billing for work completed is accurate

[3] According to ISIS, ORM had 140 employees in fiscal year 2010, including full-time and part-time employees and student workers.
[4] The remaining 50 employees will staff ORM's legal, underwriting, information technology, contracts, accounting, and administrative functions.

Objective 1: What is the chronology and current status of ORM's contract with FARA?

In 2009, DOA consulted with the Reason Foundation to determine which of ORM's services could potentially be provided by the private sector.[5] In September 2009, the Reason Foundation presented its study to the Commission on Streamlining Government. One key privatization opportunity identified by the study was the claims processing function of ORM. In November 2009, ORM issued a Request for Proposal (RFP) for its claims administration and loss prevention services.

RFP Process. ORM received 10 proposals from eight vendors with costs varying from approximately $65.2 million to $106.2 million. DOA developed an evaluation committee to review and rank the RFPs to determine the entity with which ORM should contract. Exhibit 3 shows the eight vendors that bid on the proposal and their proposed costs.

Exhibit 3
Proposals Received by ORM in Response to Privatization RFP

Vendor	Proposed Cost
Gallagher Bassett*	$65,227,694
FARA	$68,118,971
Avizent	$69,016,777
Corvel**	1. $70,067,948
	2. $71,512,948
Crawford and Company	$70,878,332
Tristar	$74,999,016
MCI**	1. $99,896,640
	2. $101,832,065
CCMSI	$106,211,712

*Gallagher Bassett's proposal was eliminated because it did not include all necessary costs for required services and it would not confirm with ORM that it would stand by the total cost originally proposed.
**Corvel and MCI submitted two proposals each containing alternate implementation schedules from the RFP that ORM evaluated separately.
Source: Prepared by legislative auditor's staff using information provided by ORM.

Based on the evaluation committee's results, ORM awarded FARA a contract in June 2010 to provide claims administration and loss prevention services for the state's lines of insurance and associated services. According to ORM, it selected FARA based on the following factors:

- Estimated savings of $50 million in *claims and litigation payments* over five years
- Instant access to technology improvements

[5] This study was conducted free of charge to the state.

- Greater program flexibility
- Reduction of state employees
- Competitive contract cost

Contract. The contract between ORM and FARA is for approximately $68.1 million over a five-year period from July 1, 2010, through June 30, 2015, and guarantees $50 million in *claims and litigation payment savings*. The transfer of ORM's nine lines of insurance and associated services to FARA will be done in four phases, as shown in Exhibit 4.

<table>
<tr><th colspan="4">Exhibit 4
Implementation Schedule
As of May 2012</th></tr>
<tr><th>Phase</th><th>Line of Insurance or Service</th><th>Original Contract Implementation Date</th><th>Actual and Revised Implementation Date</th></tr>
<tr><td rowspan="4">I</td><td>• Loss Prevention Services</td><td rowspan="4">9/1/2010</td><td>7/2/2010</td></tr>
<tr><td>• Workers' Compensation</td><td>9/1/2010</td></tr>
<tr><td>• Subrogation Recovery</td><td>9/1/2010</td></tr>
<tr><td>• Second Injury Fund Recovery</td><td>9/1/2010</td></tr>
<tr><td>II</td><td>• Property</td><td>1/1/2012</td><td>1/16/2012</td></tr>
<tr><td rowspan="2">III</td><td>• Medical Malpractice</td><td rowspan="2">1/1/2013</td><td>8/1/2012*</td></tr>
<tr><td>• General Liability</td><td>07/01/2011</td></tr>
<tr><td>IV</td><td>• Road Hazard
• Auto Liability/Physical Damage</td><td>11/01/2013</td><td>Has not yet transferred.</td></tr>
<tr><td colspan="4">*ORM plans to accelerate the transfer of Medical Malpractice to FARA on this date.
Source: Prepared by legislative auditor's staff using information in the FARA contract and provided by ORM.</td></tr>
</table>

Contract Amendment. In April 2011, ORM increased the contract amount by approximately $6.8 million (10%), from $68.1 million to approximately $74.9 million. According to ORM, it requested the increase to accelerate the transfer of General Liability and any other lines of insurance that in the future may need to be transferred earlier to FARA. The implementation date for General Liability was moved up from January 1, 2013, to July 1, 2011, because of the high turnover of ORM employees and the subsequent high cost of temporary contract workers. The accelerated transfer of General Liability cost approximately $1.9 million (27.9%) of the $6.8 million contract amendment. According to ORM, the remaining $4.9 million (72.1%) of the contract amendment will only be utilized if and when additional lines of insurance are accelerated. Exhibit 5 shows a detailed chronology of the privatization of ORM's lines of insurance and associated services to FARA from September 2009 through June 2015.

Exhibit 5 Chronology of the Privatization of ORM's Lines of Insurance and Associated Services September 2009 through June 2015	
Date	**Description**
September 2009	In 2009, DOA consults with the Reason Foundation to determine which of ORM's services could potentially be provided by the private sector. On September 2, 2009, the Reason Foundation presents to the Streamlining Commission that DOA has a key privatization opportunity with the claims processing function of ORM.
November 2009	On November 13, 2009, ORM issues a RFP for claims administration and loss prevention services.
March 2010	On March 15, 2010, the evaluation committee completes its final evaluations and the Commissioner of Administration selects FARA to privatize ORM's lines of insurance and associated services.
May 2010	On May 19, 2010, ORM justifies the privatization of its lines of insurance and associated services to the Joint Legislative Committee on the Budget (JLCB), including the advantages of privatization, the estimated cost savings, and the reduction of 85 ORM employees over 40 months. Since the RFP was for a five-year contract, ORM has to obtain JLCB's approval per R.S. 39:1514(D). On May 27, 2010, ORM presents the results of the evaluation committee's selection of FARA to the JLCB.
June 2010	On June 8, 2010, ORM awards FARA a contract to privatize the state's lines of insurance and associated services for a total of $68,118,971 over five years.
July 2010	On July 2, 2010, ORM accelerates the transfer of Loss Prevention over to FARA from the original implementation date of September 1, 2010, because of the high turnover of ORM employees. (PHASE I) Per the contract, FARA is required to offer employment to all ORM employees displaced by the implementation of the contract for a minimum of one year.
September 2010	On September 1, 2010, Workers' Compensation, Subrogation Recovery, and Second Injury Fund Recovery transfer over to FARA. (PHASE I)
April 2011	On April 7, 2011, ORM amends the contract amount from $68,118,971 to $74,930,868 (an increase of 10%) for the acceleration of the transfer of General Liability and any additional lines of insurance to FARA.
May 2011	On May 10, 2011, the House Appropriations Committee meets to discuss the performance of FARA and the 10% amendment. On May 20, 2011, Avizent acquires FARA; however, ORM states that this acquisition will not affect operations. FARA continues to employ Louisiana-based employees for the ORM contract.
July 2011	On July 1, 2011, ORM accelerates the transfer of General Liability over to FARA from the original implementation date of January 1, 2013, because of the high turnover of ORM employees. (PHASE III)
December 2011	On December 20, 2011, York Services Group acquires Avizent; however, ORM states that this acquisition will not affect operations. FARA continues to employ Louisiana-based employees for the ORM contract.
January 2012	On January 16, 2012, ORM transfers Property over to FARA. The original implementation date of January 1, 2012, was delayed to allow for additional time for testing and data conversion. (PHASE II)

Exhibit 5 (Cont.)
Chronology of the Privatization of ORM's Lines of Insurance and Associated Services
September 2009 through June 2015

Date	Description
April 2012	As of April 30, 2012, FARA employs 55 Louisiana-based employees in three offices for the ORM contract.
August 2012	On August 1, 2012, ORM plans to transfer Medical Malpractice over to FARA, accelerating the original implementation date of January 1, 2013. (PHASE III)
November 2013	FARA is scheduled to implement Road Hazard and Auto Liability/Physical Damage by November 1, 2013. (PHASE IV)
June 2015	The contract with FARA ends on June 30, 2015. According to ORM, it will create a new RFP for a third-party administrator to administer the state's lines of insurance and loss prevention services prior to this date.

Source: Prepared by legislative auditor's staff using information provided by ORM.

Objective 2: What are the projected cost savings of the FARA contract and what is the status of these cost savings as of June 30, 2011?

ORM projects net program savings of $22 million as a result of the FARA contract. Net program savings consist of *claims and litigation payment savings* and *administrative and other cost savings* versus contract costs.

FARA guarantees $50 million in *claims and litigation payment savings* to the state during the five-year term of its contract with ORM. As of June 30, 2011, ORM estimated that FARA had achieved approximately $6.0 million (12%) of the $50 million in savings. In addition to this $50 million in savings, ORM will need $40 million in *administrative and other cost savings* to achieve its projection of $22 million in net program savings. As of June 30, 2011, ORM had achieved approximately $2.5 million (6.3%) of the *administrative and other cost savings* it needs to achieve its projection. Therefore, ORM has four years to achieve the remaining $37.5 million (93.7%).

Based on the contract costs to date ($7.1 million), *claims and litigation payment savings* ($6.0 million), and *administrative and other cost savings* ($2.5 million), ORM estimated net program savings of approximately $1.4 million as of June 30, 2011. This amount is approximately 6.4% of the $22 million ORM projects in net program savings over the five-year contract period.

FARA has achieved $6.0 million (12%) of the $50 million in *claims and litigation payment savings* guaranteed by the contract as of June 30, 2011.

ORM's contract with FARA guarantees $50 million in *claims and litigation payment savings* over the five-year term of the contract. As of June 30, 2011, ORM estimated[6] that FARA had reduced *claims and litigation payments* by approximately $6.0 million (12%) of the $50 million in payment savings the contract guarantees. These savings are ahead of schedule for fiscal year 2011 based on ORM's projections. ORM had projected contract savings of approximately $4.8 million for fiscal year 2011, as shown in Appendix C.

If FARA does not achieve the $50 million in *claims and litigation payment savings*, it must refund the state 3% of the shortfall, up to $1.5 million, which is approximately 2% of the $68.1 million contract.[7] If FARA exceeds the $50 million in savings, the state will pay an

[6] ORM's estimations were based on comparisons between fiscal year 2010 and fiscal year 2011 budget actuals, which we reviewed for reasonableness.

[7] Savings measurement will include adjustments for material changes which are beyond FARA's control, such as changes in law, natural disasters, disruption in the planned contract term, etc.

additional 3% of the savings greater than $50 million, up to $1.5 million or the maximum of the contract, whichever is less.

According to FARA, it based its guarantee of $50 million in savings on data from the Workers' Compensation Research Institute, which determines an average comparison of workers' compensation claims for different states. Exhibit 6 summarizes the actions FARA will take to achieve the projected $50 million in *claims and litigation payment savings* during the five-year contract.

Exhibit 6
Breakdown of FARA's Estimated $50 Million Claims and Litigation Payments Savings
July 1, 2010, through June 30, 2015

Actions/Results	Estimated Savings
Loss prevention resulting in 200 fewer paid indemnity claims annually through loss prevention actions and security investigative services	$10.2 million
Lower overall indemnity claim costs as a result of the following: • Decreased litigation rates • Reduced durations of disability • Reduced treatment durations	$7.5 million
3% improvement in bill review savings and a 20% reduction in prescription spending by using FARA's bill review system and engaging in FARA's Pharmacy Benefit Management	$11.1 million
Savings from all other lines of coverage by reducing litigation, the duration a claim is open, and faster settlements by completing early investigations and loss prevention efforts	$21.2 million
Total	**$50 million**

Source: Prepared by legislative auditor's staff using information provided by FARA.

The risk exists that FARA could falsify its performance by not paying claims or by denying claims to increase perceived savings. However, ORM has safeguards in place to reduce this risk. For example, if FARA fails to pay a valid claim, the claimant can file a "Failure to Pay" complaint with ORM (Form 1008), which will result in legal action by the claimant and penalties assessed to FARA. Also, the contract states that ORM must review all claims that FARA denies, so this reduces the risk that FARA denies valid claims to exaggerate claims payment savings. In addition, ORM states that it purposely requested a five-year contract period to more accurately monitor FARA's performance and associated claims and litigation payment savings over a realistic, longer term.

In addition to the savings guaranteed by the contract, ORM will need $40 million in *administrative and other cost savings* to achieve its projected net program savings of $22 million.

ORM projects that the FARA contract will result in net program savings (including *claims and litigation payment savings* and *administrative and other cost savings*) of approximately $22 million. The original cost of the FARA contract (approximately $68 million) minus the guaranteed *claims and litigation payment savings* ($50 million) leaves a deficit of approximately $18 million. Therefore, to achieve its estimation of approximately $22 million in net program savings, ORM would have to realize approximately $40 million in *administrative and other cost savings*. According to ORM, it will not adjust this estimation based on the $6.8 million (10% increase) contract amendment in April 2011 because it does not know how much of the increase it will actually spend on the contract.

According to ORM, the $40 million in *administrative and other cost savings* will come from reductions in budget items such as contract costs, salaries and benefits, office rent, telecommunications, software licenses, etc. As of June 30, 2011, ORM has achieved approximately $2.5 million (6.3%) of the $40 million in *administrative and other cost savings* it needs to realize a net program savings of approximately $22 million by the end of the contract period. Therefore, ORM has four years to achieve the remaining $37.5 million (93.7%). See Appendix C for a summary of ORM's and FARA's estimated total program costs and resulting net program savings.

ORM estimated net program savings of approximately $1.4 million in year one of FARA contract.

As of June 30, 2011, ORM estimated net program savings (*claims and litigation payment savings* and *administrative and other cost savings*) of approximately $1.4 million. This amount is approximately 6.4% of the $22 million ORM projects in net program savings over the five-year contract period. ORM had originally estimated additional program costs of approximately $659,000 for year one of the FARA contract. Therefore, net program savings are ahead of schedule for fiscal year 2011 based on ORM's projections, as shown in Appendix C.

As stated previously, FARA reduced claims and litigation payments by approximately $6.0 million as of June 30, 2011. In addition, according to ORM, administrative and other costs were also reduced by approximately $2.5 million during this timeframe. Taking into account that ORM has paid FARA approximately $7.1 million (10.4%) towards the original contract cost of $68.1 million, the net program savings to the state during year one of the FARA contract is approximately $1.4 million. The calculation is as follows:

Year One Contract Cost ($7.1 million) - Administrative and Other Cost Savings ($2.5 million) - Claims and Litigation Payment Savings ($6.0 million)
*= **$1.4 million Net Program Savings***

Appendix D summarizes the cost savings resulting from the contract as of June 30, 2011.

Objective 3: Is ORM effectively monitoring the performance of FARA?

ORM needs to improve its current monitoring process to ensure that it is effectively monitoring FARA's performance. According to the contract, ORM is responsible for monitoring services provided by FARA and the expenditure of funds under the contract. As outlined in the background section of the report, ORM's monitoring is to include activities such as internal audits, invoice reviews, random file reviews, quality assurance (QA) reviews, and customer satisfaction surveys. However, we found that ORM has not started conducting QA reviews of FARA or reviewing FARA's internal QA reviews.

In addition, we identified two areas where ORM could improve the effectiveness of the monitoring it is providing. Specifically, ORM should begin analyzing issues it is detecting in its file reviews of FARA's approved claims to determine the pattern and magnitude of these issues (e.g., insufficient documentation, and the miscalculation, overpayment, and delay of benefits). ORM should also continue to monitor the trend in customer satisfaction since FARA took over the state's claims administration and loss prevention services and further examine the overall reasons if decreases in customer satisfaction continue.

ORM has not started conducting QA reviews of FARA or reviewing FARA's internal QA reviews.

According to the contract, ORM is responsible for performing periodic QA reviews of FARA's performance. In addition, FARA is to conduct its own periodic QA reviews and report its findings to ORM along with actions it will take to resolve any issues. However, we found that ORM has not formally begun conducting QA reviews of FARA nor has it reviewed any of FARA's internal QA reviews. In addition, the contract does not specify criteria for these required reviews performed of and by FARA.

According to ORM officials, staff meets with FARA management weekly to discuss any issues related to FARA's performance and maintains a log of information technology-related issues discussed. However, ORM has not developed a formal QA process by which to monitor and document FARA's performance. FARA started conducting its own QA reviews on the Workers' Compensation line in July 2011 and on the General Liability line in January 2012. However, ORM has not yet requested the results of these QA reviews from FARA to review. Once all lines of insurance are successfully transferred over to FARA, ORM officials stated that they will begin performing QA reviews of FARA and monitoring FARA's internal QA reviews. However, if ORM waits until the implementation schedule is completed, it may miss opportunities to recognize and proactively address issues related to FARA's performance in a timely manner.

Recommendation 1: ORM should establish quantifiable and verifiable criteria for QA reviews performed of and by FARA to ensure consistent and thorough assurance of FARA's performance.

Summary of Management's Response: ORM partially agrees with this recommendation. ORM states that it agrees that quantifiable and verifiable criteria for QA reviews of FARA should be established and has begun planning updates to the QA review process that has been utilized during the transition period. However, ORM disagrees with the statement that it should establish criteria for QA reviews performed by FARA. ORM's contract with FARA does not provide for a FARA QA process defined by ORM. QA reviews performed by FARA are internal and are based on processes that have evolved through the contractor's 34 years of claims management experience as a third-party administrator.

LLA Additional Comments: ORM's contract with FARA states that ORM will monitor FARA's performance by reviewing FARA's QA reviews. By providing FARA with quantifiable and verifiable criteria for its QA reviews, ORM can help ensure that FARA is consistently and thoroughly assessing its own performance and providing ORM assurance of this performance.

Recommendation 2: ORM should begin performing periodic QA reviews of FARA's performance in accordance with the contract monitoring plan.

Summary of Management's Response: ORM partially agrees with this recommendation. ORM states that it has been planning for a formal QA review process for the workers' compensation line of insurance, to be initiated around July 1, 2012. Most of the components of the QA review process have been in place since the transition of this line began on September 1, 2010. ORM has utilized a flexible, informal, and ongoing method of QA review during the transition period that has provided management with assurances of FARA's acceptable performance under the contract. Because of the phased implementation of the contract, only the workers' compensation line is at the appropriate stage to allow a full formal QA review. As each line reaches maturity with FARA, ORM will move from a flexible, informal, ongoing QA monitoring process to a formal annual QA review process.

Recommendation 3: ORM should ensure that FARA is performing required periodic QA reviews and reporting the results to ORM, as well as actions to be taken to resolve issues, in accordance with the contract monitoring plan.

Summary of Management's Response: ORM agrees with this recommendation. Procedures should be in place to ensure that FARA is performing required periodic QA reviews and reporting the results.

ORM has not started analyzing the results of its random file reviews, which could help identify issues in FARA's administration of claims services.

One of the performance measures in the FARA contract requires ORM to measure the accuracy of FARA's staff in administering claims services. To accomplish this, ORM's claims staff performs daily reviews on a random selection of 5% of FARA's approved claims files to ensure the accuracy of the claims, as provided in the contract monitoring plan. These random file reviews are in addition to the QA reviews, which are meant to be a more comprehensive review of FARA's performance.

According to ORM, its random file reviews have identified instances of FARA not providing sufficient documentation as well as miscalculating, overpaying, and delaying payment of benefits. However, ORM has not begun analyzing the magnitude or frequency of errors it detects to potentially improve processes or prevent future errors. For example, according to the contract FARA is responsible for paying workers' compensation penalties assessed to ORM as a result of FARA's failure to pay claims timely.[8] ORM reports that FARA was assessed $12,000 in workers' compensation penalties for fiscal year 2011, and $90,691 as of December 31, 2011, for fiscal year 2012. Although ORM could provide these amounts, it currently is not monitoring the reasons FARA was assessed these penalties to determine any trends in why FARA is not paying claims timely.

According to ORM, it has plans to analyze these instances to look for trends in FARA's performance that may warrant action on ORM's part and to establish a baseline for future comparison of FARA's performance. Until ORM begins reviewing such data, however, it is missing opportunities to improve FARA's processes and prevent future errors.

Recommendation 4: ORM should begin analyzing the results of its random file reviews so that it can determine trends in FARA's performance that may require improvement to prevent future errors.

Summary of Management's Response: ORM partially agrees with this recommendation. ORM states that it has been analyzing the results of random file reviews so that detailed feedback can be provided to FARA. ORM agrees that sufficient time has now passed for trends to be meaningful for the workers' compensation line. ORM will begin to expand its evaluation of FARA's performance to include a statistical review of critical factors.

Recommendation 5: ORM should monitor workers' compensation penalties assessed to FARA so that it can monitor trends in FARA's performance in paying claims timely.

[8] Penalties are assessed, in accordance with R.S. 23:1201, by the Louisiana Office of Workers' Compensation Administration within the Louisiana Workforce Commission.

Summary of Management's Response: ORM agrees with this recommendation. ORM states that it is already monitoring penalties assessed to FARA, but now that the number of penalties assessed to FARA has increased, ORM agrees that a different type of analysis of penalties should be conducted to more easily identify trends and causative factors.

LLA Additional Comments: During the audit, ORM's monitoring of workers' compensation penalties involved tracking the amount of penalties assessed to FARA, but not the reasons that FARA was assessed these penalties.

ORM surveys show a decrease in customer satisfaction since the transition to FARA.

According to the contract monitoring plan, ORM is required to conduct customer satisfaction surveys to obtain feedback on how claims are handled by FARA. According to ORM, it randomly surveys claimants monthly and state agencies semi-annually to evaluate direct contact and experience with FARA. ORM generates survey results on a monthly basis and forwards them to the appropriate ORM and FARA managers for awareness and resolution of any issues with the claims process. All negative responses are sent to the ORM Claims Director, the ORM Claims Manager, and the relative FARA contact. In addition, the responses are also discussed at meetings held every two weeks between ORM and FARA, with FARA notifying ORM when the negative issues have been resolved.

Exhibit 7 compares cumulative customer satisfaction survey results for ORM and FARA on customers' overall contact and experience for claims administration and loss prevention services. Based on most recent customer satisfaction survey results, claimants are less satisfied with the services they are receiving since ORM contracted with FARA. As a result, it is important that ORM continue to monitor the trend in customer satisfaction and further examine the overall reasons if decreases in customer satisfaction continue as the contract progresses. This will assist ORM to proactively identify and address issues with FARA's performance.

Exhibit 7
Comparison of Customer Satisfaction Survey Results

	ORM Results* March 2010 through June 2010 (714 Total Responses)		FARA Results* October 2011 through March 2012 (322 Total Responses)	
Survey Question	**Agree or Strongly Agree**	**Disagree or Strongly Disagree**	**Agree or Strongly Agree**	**Disagree or Strongly Disagree**
I was able to easily contact an ORM/FARA representative.	82.1%	6.3%	72.1%	9.9%
I received a prompt response to my voicemail or e-mail.	75.3%	7.3%	68.3%	11.5%

Exhibit 7 (Cont.) Comparison of Customer Satisfaction Survey Results				
	ORM Results* March 2010 through June 2010 (714 Total Responses)		**FARA Results* October 2011 through March 2012 (322 Total Responses)**	
Survey Question	**Agree or Strongly Agree**	**Disagree or Strongly Disagree**	**Agree or Strongly Agree**	**Disagree or Strongly Disagree**
The ORM/FARA representative was courteous.	87.1%	2.5%	80.1%	4.0%
I was satisfied with the services and/or information I received.	82.1%	4.4%	73.3%	10.6%
My overall experience was positive.	82.8%	4.2%	74.2%	8.7%

***Totals do not add up to 100% because of the "Neutral" and "N/A" responses.
Source: Prepared by legislative auditor's staff using survey results provided by ORM.

Recommendation 6: ORM should continue to monitor the trend in customer satisfaction levels and further examine the overall reasons if decreases in customer satisfaction continue.

Summary of Management's Response: ORM agrees with this recommendation. Surveys conducted in early contract implementation stages show a slight decrease in customer satisfaction. This outcome was anticipated by ORM management because of the changes with outsourcing the claims administration services to FARA.

APPENDIX A: MANAGEMENT'S RESPONSE

Bobby Jindal
GOVERNOR

Paul W. Rainwater
COMMISSIONER OF ADMINISTRATION

State of Louisiana

Division of Administration
Office of Risk Management

June 13, 2012

Mr. Daryl Purpera, CPA
Legislative Auditor
1600 North Third Street
Post Office Box 94397
Baton Rouge, LA 70804-9397

Re: Response to Performance Audit Report on the FARA Contract Administered by Division of Administration Office of Risk Management

Dear Mr. Purpera:

The State of Louisiana Division of Administration (DOA) would like to thank you and your staff for conducting a performance audit of DOA Office of Risk Management (ORM), focusing on the privatization of the state's claims management and loss prevention services by F.A. Richard & Associates (FARA).

When ORM began the privatization of claims administration of its lines of insurance, the goal was to harness instant access to technology improvements and program flexibility to provide continued quality of service while achieving taxpayer savings. I am happy to see that your report confirms that the results to date have already exceeded expectations. As you can see from ORM's timeline of expected savings estimates made prior to the privatization (Appendix C in the report), while we originally expected the implementation period of the first year of the contract (Fiscal Year 2011) to result in claims savings of $4.8 million, or 9.5 percent of the guaranteed amount under the contract, in actuality the first year achieved claims savings of $6 million, or 12 percent of the anticipated total. The $6 million in actual first-year claims savings exceeded our own original expectations by $1.2 million, or 25 percent.

Similarly, ORM originally anticipated none of the total 5-year net program savings would be achieved in the first year of the contract, and in fact anticipated a net increase of about $659,000 in costs the first year. The actual results of the first year achieved $1.4 million in net program savings, or 6.4 percent of the anticipated total. The $1.4 million in actual first-year net program savings exceeded our own original expectations by more than $2 million, or 312%.

The sections of ORM's fiscal year 2012 operating budget that include claims costs and administrative costs reflects the net savings produced by third-party administration; savings that are not only recurring, but expected to increase. In addition, while ORM's budget is primarily reflective of premiums that are based on actuarial concepts, by pursuing claims savings through the expanded resources, technological capacity, and more aggressive methods of the TPA, ORM does expect to realize additional savings from lower premiums over time that would not have been available otherwise.

I also appreciate the report's recommendations concerning performance monitoring of the FARA contract – almost all of which are already being phased in or have already been implemented We have reviewed the recommendations and offer the following comments:

1. *ORM should establish quantifiable and verifiable criteria for QA reviews performed of and by FARA to ensure consistent and thorough assurance of FARA's performance.*

   Response: ORM partially agrees with this recommendation. ORM agrees that quantifiable and verifiable criteria for QA reviews of FARA should be established. When ORM implements all aspects of its QA process, quantifiable and verifiable criteria will be incorporated. ORM has begun planning updates to the QA review process that has been utilized during the transition period. ORM management will select quantifiable and verifiable criteria to incorporate in its formalized annual QA review.

   ORM disagrees with the statement it should establish criteria for QA reviews performed by FARA. ORM's contract with FARA does not provide for a FARA QA process defined by ORM. QA reviews performed by FARA are internal and are based on processes that have evolved through the contractor's 34 years of claims management experience as a third party administrator (TPA).

2. *ORM should begin performing periodic QA reviews of FARA's performance in accordance with the contract monitoring plan.*

   Response: ORM partially agrees with this recommendation. ORM has been planning for a formal QA review process for the workers' compensation line of insurance, to be initiated around July 1, 2012. Most of the components of the QA review process have been in place since the transition of this line began September 1, 2010. ORM has utilized a flexible, informal and ongoing method of QA review of FARA during the transition period that has provided management with assurances of the TPA's acceptable performance under the contract. Because of the phased implementation of the contract, only the workers' compensation line is at the appropriate stage to allow a full formal QA review. As each line reaches maturity with FARA, ORM will move from a flexible, informal, ongoing QA monitoring process to a formal annual QA review process.

3. *ORM should ensure that FARA is performing required periodic QA reviews and reporting the results to ORM, as well as actions to be taken to resolve issues, in accordance with the contract monitoring plan.*

   Response: ORM agrees that procedures should be in place to ensure that FARA is performing required periodic QA reviews and reporting the results. FARA's QA program is comprised of two separate components that focus on timeliness and quality of work product. These components are used in the process of evaluating and reviewing staff. Ongoing internal QA reviews are required of FARA as a component of ORM's contract monitoring plan.

4. *ORM should begin analyzing the results of its random file reviews so that it can determine trends in FARA's performance that may require improvement to prevent future errors.*

   Response: ORM partially agrees with this recommendation. ORM has been analyzing the results of random file reviews so that detailed feedback can be provided to FARA. ORM agrees that sufficient time has now passed for trends to be meaningful for the workers' compensation line. ORM will begin to expand its evaluation of FARA's performance to include a statistical review of critical factors.

5. *ORM should monitor workers' compensation penalties assessed to FARA so that it can monitor trends in FARA's performance in paying claims timely.*

   Response: ORM is already monitoring penalties assessed to FARA; therefore agrees that workers' compensation penalties assessed to FARA should be monitored so that trends in FARA's performance can be identified.

   The assessment of workers' compensation penalties generally takes place quite some time after the claim incident occurs. Accordingly, ORM management accurately anticipated that penalties assessed to FARA during the transition phase would be minimal. During Fiscal Year 2011, only 4.7% of the penalties paid by ORM were determined to be FARA's responsibility. Now that the number of penalties assessed to FARA has increased, ORM agrees that a different type of analysis of penalties should be conducted to more easily identify trends and causative factors.

6. *ORM should continue to monitor the trend in customer satisfaction levels and further examine the overall reasons if decreases in customer satisfaction continue.*

   Response: ORM agrees that the trend in customer satisfaction levels should continue to be evaluated and monitored. Surveys conducted in early contract implementation stages show a slight decrease in customer satisfaction. This outcome was anticipated by ORM management, because of the changes with outsourcing the claims administration services to FARA.

We appreciate the efforts of your office to make recommendations for improving the operations of state government, and we will carefully consider the recommendations for opportunities to improve the monitoring FARA's performance under the contract.

Sincerely,

J. S. "Bud" Thompson, Jr.
State Risk Director

CC: Paul W. Rainwater
Patti Gonzalez
Marsha Guedry
Ann Wax
Marsha Pemble
Steven Procopio
Ray Stockstill
Michael DiResto

ORM Response to LLA Performance Audit – FARA – 6-12-2012 FINAL(2).docx

APPENDIX B: SCOPE AND METHODOLOGY

We conducted this performance audit under the provisions of Title 24 of the Louisiana Revised Statutes of 1950, as amended. We conducted this audit in response to legislative interest. Our audit focused on the privatization of ORM and the outsourcing of its services to FARA. Our audit scope covered the time period from November 2009 through March 2012. The audit objectives were to answer the following questions:

1. What is the chronology and current status of ORM's contract with FARA?
2. What are the projected cost savings of the FARA contract and what is the status of these cost savings as of June 30, 2011?
3. Is ORM effectively monitoring the performance of FARA?

To answer the audit objectives, we reviewed internal controls relevant to the audit objectives and performed the following procedures:

- Researched and reviewed federal and state laws on workers' compensation
- Researched and reviewed ORM's internal policies and procedures
- Interviewed various ORM and FARA staff to develop an understanding of program operations and determine the chronology of the privatization of ORM's lines of insurance and associated services
- Obtained and analyzed the reasonableness of ORM's estimated cost savings methodology and analysis based on comparisons of actual expenditures for fiscal year 2010 and fiscal year 2011
- Tested a sample of ORM's calculations of estimated cost savings from independent expenditure documentation for fiscal year 2010 and fiscal year 2011
- Obtained and reviewed FARA's methodology for projecting $50 million in *claims and litigation payment savings* to the State of Louisiana
- Recreated ORM's contract costs with ISIS data
- Contacted officials from Kentucky for best practices with the privatization of workers' compensation and the monitoring of the third-party administrator
- Listened to ORM's testimony to the House Appropriation Committee and the Joint Legislative Committee on the Budget on privatization

We conducted this performance audit in accordance with generally accepted government auditing standards issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide reasonable basis for our findings and conclusions based on our audit objectives. We believe the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

APPENDIX C: ESTIMATED TOTAL PROGRAM COSTS AND NET SAVINGS FISCAL YEAR 2011 THROUGH FISCAL YEAR 2015

		FY10-11	FY11-12	FY12-13	FY13-14	FY14-15	5 Year Total
ORM In-house	Administration	$13,455,132	$13,719,609	$14,170,188	$14,662,661	$15,242,043	$71,249,633
	Claims and Related	260,741,997	211,499,667	224,812,818	239,457,094	255,565,607	1,192,077,183
	Division of Risk Litigation	17,311,747	17,588,735	17,870,154	18,156,077	18,446,574	89,373,287
	Contract Litigation	13,967,380	14,190,858	14,417,912	14,648,598	14,882,976	72,107,724
	Less savings from planned improvements - Subrogation Recovery Contract	(450,000)	(900,000)	(900,000)	(900,000)	(900,000)	(4,050,000)
	Less savings from planned improvements - Pharmacy Benefit Manager	(562,500)	(750,000)	(750,000)	(750,000)	(750,000)	(3,562,500)
	TOTAL PROGRAM COST	**$304,463,756**	**$255,348,869**	**$269,621,072**	**$285,274,430**	**$302,487,200**	**$1,417,195,327**
FARA - savings per vendor	Original Contract cost*	$10,002,833	$11,216,448	$14,070,715	$16,261,603	$16,567,373	$68,118,972
	Plus estimated ORM costs - Admin	10,658,786	9,921,349	8,419,292	6,894,600	6,845,560	42,739,587
	Plus estimated ORM costs - Claims & Related	257,996,997	208,205,167	220,963,868	235,048,249	251,090,877	1,173,305,158
	Plus estimated ORM costs - Division of Risk Litigation	17,311,747	17,588,735	17,870,154	18,156,077	18,446,574	89,373,287
	Plus estimated ORM costs - Contract Litigation	13,967,380	14,190,858	14,417,912	14,648,598	14,882,976	72,107,724
	Less proposed savings - Claims	(4,815,000)	(11,159,000)	(11,419,000)	(11,666,000)	(11,611,000)	(50,670,000)
	TOTAL PROGRAM COST	**$305,122,743**	**$249,963,557**	**$264,322,941**	**$279,343,127**	**$296,222,360**	**$1,394,974,728**
	Net Program Cost/(Savings)	$658,987	($5,385,312)	($5,298,131)	($5,931,303)	($6,264,840)	**($22,220,599)**

*****ORM based all cost savings estimations on the original contract cost and did not re-estimate based on the 10% increase approved in April 2010.
Source: Prepared by legislative auditor's staff using information provided by ORM.

APPENDIX D: NET COSTS/SAVINGS GENERATED FROM IMPLEMENTATION OF FARA CONTRACT AS OF JUNE 30, 2011

	FY 2010 (ORM)	FY 2011 (FARA)	Difference	Description
Administrative Program				
A. Operating Services	$1,049,122	$760,508	($288,614)	Includes reduced costs from FY10 to FY11 for travel, building and equipment rentals, licensing and software maintenance, postage, internet provider services, telephone, dues and subscription, and office and automobile supplies.
B. Professional Services	95,095	20,330	(74,765)	Includes the elimination of the contract for AssetWorks, Inc. for building appraisals. This service is now being provided by FARA.
C. Interagency Transfers	1,204,337	1,046,482	(157,855)	Includes reduced cost from FY10 to FY11 for Interagency Transfer services. Includes reduced costs of interagency transfers for computing services, rental and maintenance of office space, telephone services, and postage and mailing services.
D. Personnel Services	n/a	n/a	(1,964,590)	Includes calculated FY11 salary and related benefit costs for positions eliminated because of the outsourcing of Workers' Compensation, Loss Prevention, and Subrogation Recovery.
E. Total Administrative Program Savings (rows A, B, C, and D)				**($2,485,824)**
Other Claims Related Program				
F. Professional Services	$1,537,089	$703,045	($834,044)	Includes savings generated by the reduction in Workers' Compensation medical management, rehabilitation services, and investigative/surveillance services. These services are now paid as part of the service fee (medical management/rehab) or are paid through the FARA contract.

	FY 2010 (ORM)	FY 2011 (FARA)	Difference	Description
Other Claims Related Program (Cont.)				
G. Other Charges	n/a	n/a	($105,800)*	Includes savings generated by the reduction from FY10 to FY11 of outside adjusting contracts and contracts for expert services. The overall costs for these contracts were reduced or eliminated by the outsourcing of the Workers' Compensation line of insurance.
H. Claims - Loss Payments, Net of Recoveries	48,086,265	42,996,838	(5,089,427)	Includes overall savings from FY10 to FY11 of total Workers' Compensation claims cost.
I. Total in Other Claims Related Program Savings (rows F, G, and H)				**($6,029,271)**
Total Savings Generated from FARA Contract (rows E and I)				**($8,515,095)**
Total FARA Contract Costs in FY 2010-2011				**$7,089,225**
NET COST/(SAVINGS) IN FY 2010-2011				**($1,425,870)**

*ORM calculated these savings by dividing a contract payment of approximately $525,000 over five years ($105,800 per year).
Source: Prepared by legislative auditor's staff using information provided by ORM.