Office of Risk Management
Division of Administration
State of Louisiana

Management Letter
Issued January 23, 2013

LOUISIANA LEGISLATIVE AUDITOR
1600 NORTH THIRD STREET
POST OFFICE BOX 94397
BATON ROUGE, LOUISIANA 70804-9397

Under the provisions of state law, this report is a public document. A copy of this report has been submitted to the Governor, to the Attorney General, and to other public officials as required by state law. A copy of this report has been made available for public inspection at the Baton Rouge office of the Legislative Auditor.

This document is produced by the Legislative Auditor, State of Louisiana, Post Office Box 94397, Baton Rouge, Louisiana 70804-9397 in accordance with Louisiana Revised Statute 24:513. One copy of this public document was produced at an approximate cost of $4.17. This material was produced in accordance with the standards for state agencies established pursuant to R.S. 43:31. This report is available on the Legislative Auditor's Web site at www.lla.la.gov. When contacting the office, you may refer to Agency ID No. 8402 or Report ID No. 80120072 for additional information.

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EXECUTIVE SUMMARY

We conducted certain procedures at the Office of Risk Management (ORM) as part of the audit of the state's Comprehensive Annual Financial Report for the fiscal year ended June 30, 2012, and to evaluate ORM's accountability over public funds.

We considered ORM's controls, compliance with laws, and financial reporting relating to current and long-term claims liability, claims and litigation handled by ORM, annuities, claims liability for state risk programs, and ORM's monitoring controls over the third-party administrator, F.A. Richard & Associates (FARA), who manages over 70% of ORM's lines of insurance. Our procedures disclosed the following:

- In a test of 10 claim reserves managed by FARA that exceed $100,000, five (50%) were not approved by ORM as required. Failure to adequately monitor and approve claim reserves and payments processed by FARA increases the risk of fraud and/or errors and could result in the misstatement of the estimated claims liability reported in the state's financial statements.

- In a separate analysis addressed in a performance audit report dated July 18, 2012, we noted that ORM has not implemented an effective quality assurance (QA) function to perform QA reviews of FARA or to review internal QA reviews performed by FARA, as required by the contract. Furthermore, ORM has not implemented an effective method to track the resolution of issues noted in its random file reviews of FARA-approved claim files.

- In an analysis of total net reserve balances by lines of insurance, we noted that Workers' Compensation claims comprise over 50% of the total net reserves at June 30, 2012.

This report is a public report and has been distributed to state officials. We appreciate ORM's assistance in the successful completion of our work.

LOUISIANA LEGISLATIVE AUDITOR
DARYL G. PURPERA, CPA, CFE

December 13, 2012

OFFICE OF RISK MANAGEMENT
DIVISION OF ADMINISTRATION
STATE OF LOUISIANA
Baton Rouge, Louisiana

As required by Louisiana Revised Statute 24:513 and as a part of our audit of the State of Louisiana's financial statements for the fiscal year ended June 30, 2012, we conducted certain procedures at the Office of Risk Management (ORM) for the period from July 1, 2011, through June 30, 2012.

- Our auditors obtained and documented an understanding of the ORM operations and system of internal controls through inquiry, observation, and review of its policies and procedures, including a review of the laws and regulations applicable to ORM.

- Our auditors performed analytical procedures consisting of a comparison of the most current and prior year financial activity using ORM's annual fiscal reports and/or system-generated reports and obtained explanations from ORM management of any significant variances. We also scheduled the components of total net reserve balances at June 30, 2012, by lines of insurance for informational purposes.

- Our auditors reviewed the status of a finding identified in our prior year report on ORM, dated January 4, 2012, relating to weaknesses in controls over claim reserves. That finding has not been resolved and is addressed again in this letter.

- Our auditors considered internal control over financial reporting; examined evidence supporting ORM's current and long-term claims liability, claims and litigation handled by ORM, annuities, and claims liability for state risk programs; and tested ORM's compliance with laws and regulations that could have a direct and material effect on the State of Louisiana's financial statements, as part of our audit of the state's Comprehensive Annual Financial Report for the fiscal year ended June 30, 2012, in accordance with *Government Auditing Standards*.

1600 NORTH THIRD STREET • POST OFFICE BOX 94397 • BATON ROUGE, LOUISIANA 70804-9397
WWW.LLA.LA.GOV • PHONE: 225-339-3800 • FAX: 225-339-3870

The Annual Fiscal Report of ORM was not audited or reviewed by us, and, accordingly, we do not express an opinion on that report. ORM's accounts are an integral part of the State of Louisiana financial statements, upon which the Louisiana Legislative Auditor expresses opinions.

Based on the application of the procedures referred to previously, the following significant finding is included in this letter for management's consideration.

Weaknesses in Controls over Monitoring the Third-Party Administrator

In a test of claim reserves that exceed $100,000 established by F.A. Richard & Associates (FARA), the third-party administrator responsible for processing certain claims, ORM did not provide required approvals for five of the 10 (50%) claim reserves tested. In addition, ORM has not performed effective monitoring reviews over FARA. Failure to adequately monitor and approve claim reserves and payments processed by FARA increases the risk of fraud and/or errors and could result in the misstatement of the estimated claims liability reported in the state's financial statements.

In a separate analysis, we noted certain additional weaknesses in controls over monitoring FARA, which were also addressed in a performance audit report dated July 18, 2012, (Privatization by FARA), as follows:

- ORM has not implemented an effective quality assurance (QA) function to perform QA reviews of FARA or to review internal QA reviews performed by FARA, as required by the contract. Although ORM has weekly meetings with FARA management to discuss performance-related issues, no formal QA process has been established to monitor and document FARA's performance.

- ORM has not implemented an effective method to track the resolution of issues noted in its random file reviews of FARA-approved claim files. Although random file reviews have identified insufficient documentation, miscalculations, overpayments, and untimely benefit payments, ORM has not established procedures for analyzing these results to assess the overall effectiveness of the performance of FARA.

ORM's written procedures require (1) its approval of claim reserves managed by FARA that exceed $100,000 and (2) adjusters to periodically review claims managed by FARA to determine the adequacy of reserves and payments. However, management has not identified all reserves managed by FARA that exceed $100,000 for approval and has not adequately designed procedures that will provide for the tracking and timely resolution of issues noted in its review of claims managed by FARA.

ORM's management should identify all reserves managed by FARA that exceed $100,000 and ensure that the adjusters and supervisors follow established procedures for monitoring, adjusting, and approving claim reserves. In addition, management should implement procedures to perform QA reviews and review internal QA reviews performed by FARA and should design an effective method to track the resolution of issues noted in its review of claims managed by FARA so that meaningful analysis can be reached on FARA's performance. Management partially concurred with the finding and outlined a plan of corrective action (see Appendix A).

The recommendations in this letter represent, in our judgment, those most likely to bring about beneficial improvements to the operations of ORM. The nature of the recommendations, their implementation cost, and their potential impact on the operations of ORM should be considered in reaching decisions on courses of action.

This letter is intended for the information and use of ORM and its management, others within the entity, and the Louisiana Legislature and is not intended to be, and should not be, used by anyone other than these specified parties. Under Louisiana Revised Statute 24:513, this letter is a public document, and it has been distributed to appropriate public officials.

Respectfully submitted,

Daryl G. Purpera, CPA, CFE
Legislative Auditor

MMG:CRV:BQD:THC:dl

ORM 2012

Management's Corrective Action Plan and Response to the Finding and Recommendations

BOBBY JINDAL
GOVERNOR

[illegible]
COMMISSIONER OF ADMINISTRATION

State of Louisiana

Division of Administration
Office of Risk Management

December 6, 2012

Mr. Daryl G. Purpera, CPA
Legislative Auditor
Office of the Legislative Auditor
State of Louisiana
P. O. Box 94397
Baton Rouge, LA 70804-9397

Dear Mr. Purpera:

Finding: Weaknesses in Controls Over Monitoring the Third Party Administrator

The Office of Risk Management (ORM) concurs with the noted weakness in controls over approval of claim reserves that exceed $100,000.

The ORM Claims Unit has procedures in place for approval of total claims reserves exceeding $100,000. The procedures are noted in the Client Instructions and have been provided to the third party administrator (TPA) as each line has transitioned. TPA claim adjustors request reserve changes via email, providing justification for the increase. The request is reviewed and approved by the appropriate ORM claims personnel, then noted on a Reserve Log maintained by the claims unit involved. At the end of each month a reserve report is produced using the TPA's iCE risk management information (RMIS) system. This reserve report is compared to the Reserve Log to identify differences.

What we have found is that the report is not matching what we have listed on our logs. In reviewing differences, it was discovered that the iCE system automatically creates certain reserve adjustments, or "system generated reserves". For example, expense reserves are being automatically increased if the outstanding reserve is insufficient when a payment is made. This occurs most often when the Louisiana Office of the Attorney General, Division of Risk Litigation (DOJ-RL) legal expenses paid monthly by ORM are received and saved to the iCE system. This has been brought to the attention of FARA and they are working to resolve the problem. Also, we have noted this issue on the FARA Issues Log.

To provide information that will assist the TPA's adjustors to establish realistic reserves for legal fees and minimize the impact of "system generated reserves", we have implemented a new procedure with the DOJ-RL staff attorneys, effective November 1, 2012. The DOJ-RL defense attorneys will submit legal budgets to the adjusters noting an estimation of the hours and tasks necessary to defend the claim.

ORM's management staff will continue to check reserves as part of their claim reviews. We will continue working with the TPA to improve the reporting and approval of required reserve changes.

The contact person for the weakness in controls over approval of claim reserves is Ann Wax, State Risk Administrator – Claims.

The Office of Risk Management (ORM) partially concurs with other noted weaknesses in controls relating to monitoring of the TPA.

ORM has completed a formal Quality Assurance (QA) Plan relating to the Workers' Compensation program and anticipates full implementation early in calendar year 2013. The QA plan identifies the monitoring procedures necessary for the program to be effective, most of which have been in place since the program transitioned to the TPA. As in the past, all findings from the file review processes will be logged and reported monthly to the TPA. The log will include an indicator of whether follow-up is appropriate. It should be noted that follow-up on identified monitoring deficiencies is most often not appropriate, i.e. because a monitoring issue relates to an error that cannot be corrected or the issue relates to a judgment of the TPA that differs from that of the ORM employee that completed the claim review.

Statistics are being compiled by ORM claim managers to reflect the type of errors found, and will be reported to ORM management on a quarterly basis. Management will compare the statistics to targets to identify areas requiring improvement. ORM will work with the TPA to improve procedures, provide training, etc. in order to achieve improvements in the areas identified. ORM will periodically verify that the TPA is utilizing an internal QA process in managing state claims, using self-defined processes.

The contact person for the other noted weaknesses in controls relating to monitoring of the TPA is Patti Gonzalez, Assistant State Risk Director.

Sincerely,

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