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Release Date MAR 19 1997

November 7, 1995

Mr. Frank Endom, General Counsel
Orleans Parish School Board
3510 General DeGaulle
New Orleans, Louisiana 70114

Re: Interim Draft Audit of Risk Management Department

Dear Mr. Endom:

KPMG Peat Marwick LLP (KPMG) and Bruno & Tervalon (B&T) have been retained by you on a consulting basis to enable you to render legal advice to the Orleans Parish School Board in connection with a draft Internal Audit Report dated September 1, 1995 regarding an audit of Risk Management and the subsequent response to that report by management in addition to Internal Audit's comments to management's response.

In performing our services, we have obtained supporting documents from both the Internal Audit Department and the Finance Department, and on November 2, 1995, have held separate status meetings with Mr. William Garibaldi and staff and Mr. James Henderson to confirm the facts as reported by each party and as observed by our staff during the course of performing our services.

The following summarizes the results of our work as related to each party's report/response and representations contained therein. Part I addresses the Internal Auditor's Report dated September 1, 1995 *(hereafter referred to as Internal Audit Report)*; Part III addresses Internal Auditor's comments relating to the Chief Financial Officer's response dated October 10, 1995 (hereafter referred to as Internal Audit Response). Part II addresses the Chief Financial Officer's response to the Internal Audit Report dated September 26, 1995 (hereafter referred to as Finance Response). Part IV contains a summary of our conclusions and recommendations.

Executive Summary

Our overall findings can be summarized as follows:

Findings #1 and #3:

- Charges to the Federal programs for unemployment compensation and worker's compensation insurance are in compliance with OMB Circular A-87.

- There are no violations of the False Claims Act resulting from overcharges to Federal programs from self-insurance funds.

- While not in violation of OMB Circular A-87, the 1993-94 premium for worker's compensation should be charged to the General Fund; the charge could be amortized over a period of up to five years.

Finding #2:

- Periodic evaluations of unemployment compensation insurance should be performed by staff.
- The financial analysis of the profitability of the contract with UCCS is incomplete.

Finding #4:

- The financial statements including the insurance internal service funds are properly presented in accordance with governmental generally accepted accounting principles (GASB 10) for fiscal years ended June 30, 1995 and 1994.

The remainder of our report details our findings and conclusions in detail.

Part I - Internal Audit Report

Internal Audit Report - Finding #1

Unemployment Compensation Insurance Billings should be allocated and billed to Special Revenue and Food Service Programs in accordance with Federal and State Cost Principles [Government GAAP - GASB 10 and OMB Circular A-87, Cost Principles for State and Local Governments - (Circular A-87)]

Internal Audit Report	Our Testwork and Conclusions
Our examination and analytical review of Unemployment Insurance Compensation billings revealed that $931,177.31 or 96% of the premium was charged to the federally funded programs (Special Revenue Funds and Child Nutrition) by the Risk Management department, while only $42,802.33 or 4% was charged to the General Fund in the 1994-95 fiscal year.	At the date of their audit report, the amounts in the general ledger agreed to the amounts shown in the report. However, our procedures regarding unemployment insurance compensation billings disclosed that $717,819 or 74% of the premium was charged to federally funded programs (Special Revenue and Child Nutrition) by the School Board and $256,160 or 26% was charged to the General Fund in the 1994-95 fiscal year. The difference between the amounts indicated as being charged to federally funded programs and the General Fund by the Internal Audit department and the amounts indicated by KPMG/B&T is due primarily to an adjustment of $213,358 recorded to the general ledger on October 9, 1995, effective June 30, 1995. This adjustment was recorded after the date of the Internal Audit testwork and premium charges. That adjustment was necessitated by a change in rates provided by UCCS effective January 1, 1995, which had not yet been incorporated into the School Board's computerized payroll system on a timely basis requiring the aforementioned journal entry to manually record the effect of the rate change. The change in rates resulted in reduced premiums to the School Board which are estimated to result in savings of $200,000-$300,000. The effective rates per salary dollar as determined by UCCS were as follows:

	Prior to January 1, 1995	After January 1, 1995
General Fund	.0015	.0010
Special Revenue	.033	.0210
Child Nutrition	.020	.0130

Internal Audit Report	Our Testwork and Conclusions
We were unable to obtain and review any documentary evidence which indicated the basis used to allocate the billings.	Our procedures, inquiries and discussions with management disclosed that the basis used to allocate unemployment insurance compensation billings to federally funded programs and the General Fund are based on the rates as determined by the School Board's third-party insurance carrier, Unemployment Compensation Control Systems, Inc. (UCCS). These rates are incorporated into the School Board's computerized payroll system for the Special Revenue Funds and Child Nutrition Fund and are utilized to allocate unemployment insurance compensation billings to federally funded programs, as well as the General Fund. The actual rates are noted in the previous section. Based on our inquiry and observations, the rates and allocations appear to have been consistently applied since the early 1980's. We conclude that documentary evidence from UCCS does exist to support the basis for premium billings. The basis for the allocation of the billings from UCCS is that all costs as billed are recorded in the insurance fund as a charge to the fund and programs are charged based on contract rates determined by UCCS.
However, these billings were not proportional to the claims cost or budgeted salary expenses, which could both be a rational basis for allocating the actual Unemployment Compensation Insurance legal liability, i.e., General Fund Salaries \$215,667.73 or 85%, Special Revenue \$9,726,000 or 4%, and Child Nutrition \$29,248,000 or 11%. As a result, the allocation is not in compliance with Federal Cost Principles and understated fiscal year 1994-95 General Fund expenditures by \$785,080.36.	Our procedures and discussions with management disclosed that the billings were not proportional to salary expense, as salary expense is not the basis used for the allocation of unemployment compensation insurance billings. Additionally, we could not make a determination that billings for unemployment compensation insurance were not proportional to the related unemployment claims cost for terminated employees as claim cost information segregating federally funded program employees from General Fund employees was not readily available. Lastly, budgeted General Fund salary expense is \$215,667,000 (85%), budgeted Special Revenue salary expense is \$29,248,000 (11%) and budgeted Child Nutrition salary expense is \$9,726,000 (4%) for the 1994-95 fiscal year. OMB Circular A-87 (1981) provides that "total costs of a grant is comprised of the allowable direct cost incident to its performance plus its allocable

Internal Audit Report	Our Testwork and Conclusions
	portion of indirect costs, less applicable credits... Direct costs are those associated with a particular objective." The amounts paid to UCCS are a direct cost of the program for the amounts billed. Our procedures and testwork for unemployment compensation insurance disclosed that billings and charges were in compliance with Federal Cost Principles (OMB Circular A-87 in effect for the period under review).
During the 1993-1994 fiscal years, the General Fund was billed only 30% and 29% of the costs, respectively, versus 85%. The following is a schedule which illustrates the over/under billings by fund and year...(schedule not shown) The above allocation appears to inappropriately allow the Self-Insurance Internal Service Fund to under bill the General Fund itself for its share of Unemployment Insurance, which is a violation the False Claims Act (18 USC #287) and Federal Cost Principles/OMB Circular A-87.	Our review of the aforementioned schedule disclosed no illustration of the over/under billings by fund and year. As previously noted, we conclude that the charges for unemployment compensation are in accordance with OMB Circular A-87 (1981) and therefore there is no violation of the False Claims Act (18 USC #287). Our procedures disclosed nothing to indicate that the current system utilized by the School Board to charge unemployment compensation insurance allows the Self-Insurance Fund to underbill the General Fund for its share of unemployment compensation insurance costs. The Child Nutrition and Special Revenue Funds are billed with each payroll processed, which appears to be consistently applied for over 13 years. The billings are based on rates as provided by UCCS. Furthermore, we noted nothing to indicate any violations of the False Claims Act (18 USC #287) and Federal Cost Principles/OMB Circular A-87 (1981).

Internal Audit Report	Our Testwork and Conclusions
Recommendations:	
1. The Risk Manager should re-allocate billings to the Special Revenue and Child Nutrition Service Programs for 1993-94 through 1994-95 fiscal years in accordance with GASB 10 and Circular A-87.	Disagree. Based on the testwork performed, the method utilized to charge billings to the Special Revenue and Child Nutrition programs for the 1993-94 and 1994-95 fiscal years were in accordance with GASB 10 and OMB Circular A-87 (1981). Furthermore, we noted nothing in the Internal Auditors' Report that addressed the propriety of the billings for the 1993-94 fiscal year. Based on the November 2, 1995 meeting, the Internal Auditor represented to us that only the 1994-1995 year was in question and that no questioned costs are related to previous years.
2. The Division of Financial Services should notify the Superintendent and Compliance Officer about the improper billings and/or violations of Federal cost principles.	Disagree. Not applicable, because the charges were in compliance with OMB Circular A-87.
3. The Superintendent and Compliance Officer should make the appropriate notices to outside Governmental agencies (e.g., Federal Cognizant agencies, State Department of Education).	Disagree. Not applicable, because the charges were in compliance with OMB Circular A-87.

Internal Audit Report - Finding #2

The School Board should consider whether the use of commercial unemployment insurance is practical or if a self-insurance plan would more efficiently service the School Board's needs.

Internal Audit Report	Our Testwork and Conclusions
Currently, the School Board has Unemployment Compensation Insurance coverage provided by a commercially bonded service company (Unemployment Compensation Control Systems, Inc.-UCCS).	Concur. The School Board does have commercial insurance for unemployment provided by UCCS.

Internal Audit Report	Our Testwork and Conclusions
The premiums and claims paid for the unemployment insurance coverages for 1992, 1993, 1994 and 1995 are as follows: (see Exhibit 5). As the above schedule illustrates, the School Board is allowing substantial annual premium surplus (profits) to be retained by UCCS.	Disagree. The Schedule compares premium payments, less claim payments, to determine the surplus retained by UCCS. Based on our review of the UCCS proposal to provide services to the School Board, we are aware of other costs that UCCS bears on behalf of the School Board which were not considered in the analysis (Attachment 1). The contrasting of premium payments to UCCS and claim payments made to UCCS by the Internal Audit department is too limited to ascertain the premium surplus (profits), if any, retained by UCCS. Such a contrast should also consider any additional costs incurred by UCCS in the fulfillment of their contractual obligations to the School Board, as well as the volume of successful defenses on behalf of the School Board of unmerited unemployment claims.
This same unsatisfactory condition was noted in the External Auditors' 1991-92 Management Letter to the Board. Management's response at that time was, "The school district's insurance coverages that are placed with commercial insurance carriers are continually reviewed for self-insurance. Currently we are gathering historical loss data to determine the feasibility of becoming self-insured for automobile and property exposures under a program that would cap losses at an annual aggregate amount. The unemployment compensation program of the district is presently under review to determine the feasibility of becoming self-insured for automobile and property exposures under a program that would cap losses at an annual aggregate amount. The unemployment compensation program of the district is presently under review to determine the reasonableness of costs for the type of services, rendered. Concur with independent auditors findings and will develop procedures whereby the appropriate departments review quarterly reports for propriety and	Concur. The School Board should evaluate, on an on-going basis, the reasonableness of the cost for the type of services rendered for its insurance programs.

Internal Audit Report	Our Testwork and Conclusions
accuracy." The Division of Financial Services, through an RFP, negotiated a $358,495 premium reduction from UCCS in fiscal year 1995. However, there still appears to be an opportunity to save additional premiums through establishment of a self-insurance unemployment plan under the reimbursable method.	
In addition to the above, UCCS filed for Chapter 11 bankruptcy protection from its creditors in May 1993. Further, since UCCS deals with a concentrated market of public agencies throughout the State of Louisiana, there is an unacceptably high risk that they may not have the financial capacity to handle the School Board's claims if large cuts in federal programs are made by various congressional proposals, as anticipated by the Division of Financial Services.	While the viability of UCCS should be a valid concern of the School Board, and the status of UCCS's bankruptcy proceedings should be closely monitored, the Board and management must weigh the facts and determine what is appropriate for the School Board. We cannot comment as to which risks are acceptable or to the potential for large cuts in federal programs, as this is beyond the scope of the procedures performed.
Recommendation: The Risk Management Department and School Board should immediately reconsider (within 90 days) the practicability of the current bonded service insurance arrangement and take steps to implement a more cost effective self-funded or alternative unemployment program, since the current plan has generated an unfavorable surplus of $3,632,243 to UCCS over a four (4) year period.	As the Internal Audit Report quotes from one of our previous management letter comments, we have obviously suggested a similar consideration by management. The 90-day requirement is Internal Audit's opinion as to the urgency of the matter. The surplus noted by Internal Audit appears to be overstated for costs not considered in the analysis, as noted above and in UCCS's proposal. The proposal outlines specific services in addition to paying actual claims which UCCS is required to perform (see attachment 1).

Internal Audit Report - Finding #3

Workers' Compensation Self-Insurance Fund Billings should be in accordance with Federal Cost Principles and Governmental GAAP - GASB 10 and OMB Circular A-87, Cost Principles for State and Local Government (Circular A-87)

Internal Audit Report	Our Testwork and Conclusions
Federal cost principles require self-insurance funds to be established on an actuarially sound basis, premiums reduced to reflect investment income, and self-insurance fund retained earnings not to exceed the combined sales of two months.	Our review of the Federal Cost Principles (OMB Circular A-87 (1981)) in effect for the fiscal year ended June 30, 1995 disclosed no requirements that self-insurance funds had to be established on an actuarially sound basis, that premiums had to be reduced to reflect investment income or that retained earnings were not to exceed the combined sales of two months. The regulations in effect for this period are included in OMB Circular A-87, effective January 15, 1981. As stated in the OMB Circular A-87, contributions to a reserve for self-insurance programs approved by the Federal grantor agency are allowable to the extent that the type of coverage, extent of coverage, and the rates and premiums would have been allowed had insurance been purchased to cover the risks. The excerpts related to fringe benefits and insurance are included as Attachment 2.
Generally Accepted Accounting Principles (GASB 10) require self-insurance funds that provide risk financing services to bill funds for those services provided. Our examination of the Workers' Compensation self-insurance fund determined that the General Fund was not billed workers' compensation self-insurance for fiscal year 1993-94.	We concur that the Worker's Compensation self-insurance fund did not bill the General Fund in 1993-94. Our procedures disclosed that the General Fund was billed only for third-party claims administration payments in the 1993-94 budget. However, the amounts charged to the Federal programs were consistent with prior years. "Contribution to a self insurance reserve program approved by the Federal grantor agency are allowable to the extent that the type of coverage, extent of coverage, and rates and premiums would have been allowed had insurance been purchased to cover the risks." (OMB Circular A-87, 1981). Additionally, amounts charged to the General Fund were based on approved budgets adopted by the Board in response to the General Fund's limited resources and prior excess contributions.

Internal Audit Report	Our Testwork and Conclusions
In addition, the Workers' Compensation self-insurance fund retained earnings exceeded the combined sales of two months at the end of fiscal years 1993 ($4,360,307) and at the end of 1994 ($1,484,362). Further, the Workers' Compensation premium rates billed were not based on actuarial cost less projected investment income, but rather were based on manual rates set by the Department of Insurance for commercial insurance companies.	Our procedures disclosed that the amount of retained earnings and rate is correct as described in the Internal Audit Report. However, based on the review of the regulations in effect, there is no provision in the regulations restricting the amount of the retained earnings for self-insurance funds. As stated in the OMB Circular A-87, contributions to a reserve for self-insurance programs approved by the Federal grantor agency are allowable to the extent that the type of coverage, extent of coverage, and the rates and premiums would have been allowed had insurance been purchased to cover the risks (C.4.c) Attachment 2.
As a result of these actions, the Risk Management Department violated federal cost principles (OMB A-87) and Governmental GAAP (GASB 10).	Our procedures disclosed that charges to the worker's compensation fund were in compliance with Federal Cost Principles (OMB Circular A-87, 1981) and GASB 10.
Recommendations:	
1. The Risk Management Department should establish control procedures designed to assure that self-insurance financial statements are prepared in accordance with GAAP and the rates billed to funds are in accordance with federal cost principles.	The Internal Audit Report does not cite specific changes that need to be made in existing control procedures. Therefore, we are unable to respond to this recommendation.
2. The Division of Financial Services should notify the Superintendent and Compliance Officer about the improper billings and/or violations of Federal cost principles.	We disagree. The charges to the programs are in accordance with OMB Circular A-87 (1981).
3. The Superintendent and Compliance Officer should make the appropriate notices to outside Governmental agencies (e.g., Federal Cognizant agencies, State Department of Education).	We disagree. The charges to the programs are in accordance with OMB Circular A-87 (1981).

Internal Audit Report - Finding #4

Self-Insurance Funds should account for all risks retained in accordance with Governmental General Accepted Accounting Principles (GASB 10)

Internal Audit Report	Our Testwork and Conclusions
Governmental Accounting Standards Board Statement 10 (GASB 10) provides accounting standards for governmental entities that assume the role of the insurer and the role of the insured (risk retention). Our examination determined that fully insured (risk transferred) insurance plans were recorded in the self-insurance fund (risk retention).	Concur.

Recording of the cost of fully insured insurance plans in a Self-Insurance Internal Service Fund was not in accordance with (GASB 10) accounting standards. As a result, the *self-insurance* fund financial statements were not properly reported in the 1993-94 CAFR because it included the following fully insured insurance plans: Fully Insured Plans A. Life, Dental and Vision B. Group Health Insurance C. Boiler and Machinery	Based on our November 2, 1995 meeting with Internal Audit, it was clarified by the Internal Audit staff that the issue was use of the word "self" in the description of the funds. The labeling of "self" insurance funds, as compared to insurance funds, has been changed in the 1994-1995 CAFR. The Group Health Insurance program was fully self-insured for 10 months of 1993-1994. The change in funding status was disclosed in the notes in the 1993-1994 CAFR. Attachment 3.

Recommendation: The Risk Management Department should establish control procedures designed to assure the self-insurance fund Financial Statements are prepared in accordance with Governmental GAAP for the preparation of the CAFR and the Self-Insured Terminated Group Health Insurance Plan should be reported in the self-insurance fund on a liquidation basis of accounting (SOP 92-6).	The accounting and reporting for the Board's health insurance program is governed by the overall concepts of Section C50 of the GASB Codification which properly allows the use of an internal service fund to account for the Board's risk financing activities. The Board has properly accounted for its health insurance program in such an internal service fund. SOP 92-6 is related to the financial accounting and reporting of health and welfare benefit plans, typically those structured under ERISA

Internal Audit Response	Our Testwork and Conclusions
	guidelines. The CAFR is a report on the entire governmental entity and not a report of a health and welfare plan. As such, SOP 92-6 does not apply to the School Board's presentation of its general purpose financial statements.

Part II - Chief Financial Officer's response to the Internal Audit Report dated September 26, 1995

Internal Audit Report - Finding #1

Unemployment Compensation Insurance Billings should be allocated and billed to Special Revenue and Food Service Programs in accordance with Federal and State Cost Principles (Government GAAP - GASB 10 and OMB Circular A-87, Cost Principles for State and Local Governments - Circular A-87)

Internal Audit Recommendation #1. The Risk Manager should re-allocate billings to the Special Revenue and Child Nutrition Service Programs for 1993-94 through 1994-95 fiscal years in accordance with GASB 10 and Circular A-87.

Finance's Response	Our Testwork and Conclusions
Disagree. The premiums charged to the various funds of the School District, General Fund included, are based on the anticipated risk of unemployment claims against the School District and are set by the District's insurer Unemployment Compensation Control Systems, Inc. - UCCS.	Based on the correspondence from Unemployment Compensation Control Systems (UCCS) dated April 4, 1995 and September 15, 1995, the premium rates are set by the insurance carrier based on "actual experience of the groups over our 12 year relationship with Orleans Parish School Board." (Attachment 4)
Further, based on the stated rates, premiums are charged to the individual funds with each biweekly payroll. As shown on Schedule 1, the following rates were in effect for 1993-94 and 1994-95 (schedule not included).... These rates are incorporated in the School District's payroll system and are applied with each payroll along with other statutory benefits such as Teacher's Retirement, Social Security, Medicare, etc....	Concur for Special Revenue Fund and Child Nutrition Fund. Special Revenue and Child Nutrition premium expense for unemployment are charged with each biweekly payroll. The entry from the payroll system also generates an interfund entry between the fund that was expensed and the General Fund and a liability in the General Fund. Quarterly, a manual entry is recorded to reduce the liability set up by the payroll system in the General Fund and to record the revenue in the Internal Service Fund. Each quarter, when the UCCS invoice is paid, the internal service

Finance's Response	Our Testwork and Conclusions
	fund premium expense is recorded. The entry to record the expense in the General Fund is prepared at the end of the year. An analysis is performed by Mr. Bradford to determine the total premium paid to UCCS and the amounts charged to each fund. An entry is then prepared by Mr. Bradford to record the proper amount to General Fund expense and Internal Service Fund revenue for the remainder of the premium not already charged to the Special Revenue and Child Nutrition Funds. In addition, the rates stated for 1993-94 and for July to December 1994-95 agreed to the UCCS contract and the control file within the payroll system. The rates for January to June 1994-95 agreed to correspondence from UCCS dated April 5, 1995 and September 15, 1995. The above understanding was obtained based on an inquiry of Mr. Bradford, observation and recalculation of the labor distribution report, and observations of journal entries on a test basis.
The rates vary by fund type based on the perceived risk of unemployment claims. The rate quoted for the externally funded programs is high due to the nature of funding. Federal and State funded programs are funded on a year by year basis. While certain programs such as Chapter I, which is now Title I, have been around for several years, funding is not guaranteed beyond June 30th of the last action authorization year. The rate for the Child Nutrition Program is based in part on similar assumptions....	Concur. Based on the correspondence from UCCS dated September 15, 1995, rates are set based on "actual experience of groups over our 12 year relationship." We do not comment on whether the federal program will be terminated.
It is Management's contention that the School District's method of allocating cost of unemployment insurance is appropriate and meets the criteria set forth in OMB Circular A-87 to with	Concur. We agreed the cited excerpts and paragraphs to the 1981 OMB Circular A-87 (1981), which was the Circular in effect during this period.
The School District's method of allocating unemployment insurance premiums is in accordance with Circular A-87 as the aforementioned excerpts demonstrate.	Concur. We noted no violation of OMB Circular A-87 (1981).

Finance's Response	Our Testwork and Conclusions
Further, Schedule 1 demonstrates the District's method of charging direct costs, i.e., employee benefits, to the respective funds of the School District. Schedule 1 is divided into five sections ...	Concur with salary expense with the exception of Professional Improvement Program (PIP) salaries being excluded from General Fund salary expense. Based on our discussion with Mr. Henderson on November 2, 1995, the purpose of his report was to demonstrate that the amounts charged were reasonable and consistent. The amounts for PIP were left off the schedule but would not have changed the net result that General Fund, Special Revenue Fund and Child Nutrition Fund were all underbilled for 1994-95. Concur with contribution rate for unemployment insurance, based on our observation of supporting documentation. Concur with allocable premiums with the exception that General Fund allocable premium would be higher with the inclusion of the PIP salaries and the fact that Mr. Henderson's 1994-95 column uses a weighted average contribution rate. Concur with the actual expenses in all funds for unemployment insurance based on the observation of supporting documentation. Concur with variance between actual expenses and allocable expenses as far as classifications as under allocations for 1994-95, based on our recalculation.

Internal Audit Recommendation #2. The Division of Financial Services should notify the Superintendent and Compliance Officer about the improper billings and/or violations of Federal cost principles.

Finance's Response	Our Testwork and Conclusions
Strongly disagree. The Auditor's conclusion regarding the application of direct expenses of the individual funds is incorrect as discussed above. The assumptions that all funds should be charged the same rate for unemployment insurance premiums does not recognize the inherent risk of unemployment related to terminal funding associated with Federal and external grants. The Capital Projects Fund and Self Insurance Fund Administration are by default liabilities of the General Fund since these funds are an extension of the School District's basic operation and have been established solely for accounting purposes. Externally funded programs, including the Child Nutrition Fund, are not extensions of the General Fund.	Concur with representation that rates are set by UCCS based on "actual experience" based on correspondence from UCCS.

Internal Audit Recommendation #3. The Superintendent and Compliance Officer should make the appropriate notices to outside Governmental agencies (e.g., Federal Cognizant agencies, State Department of Education).

Finance's Response	Our Testwork and Conclusions
Disagree. As discussed above, the School District did not under bill the General Fund or pass on excessive charges to the Federal programs. Accordingly, the suggestion of a violation of the False Claims Act and/or Federal Cost Principles/OMB Circular A-87 is unfounded or without merit.	Concur that Management did not violate the False Claims Act or violate provisions of OMB Circular A-87.

Internal Audit Report - Finding #2

The School Board should consider whether the use of commercial unemployment insurance is practical or if a self-insurance plan would more efficiently service the School Board's needs.

Internal Audit Recommendation: The Risk Management Department and School Board should immediately reconsider (within 90 days) the practicability of the current bonded service insurance arrangement and take steps to implement a more cost effective self-funded or alternative unemployment program, since the current plan has generated an unfavorable surplus of $3,632,243 to UCCS over a four (4) year period.

Finance's Response	Our Testwork and Conclusions
Disagree. The decision to maintain the bonded service arrangement was based on several factors, ... As for the profits retained by UCCS, the Auditor's analysis failed to include the cost of maintaining appropriate staff to defend unemployment claims against the District. Further, the analysis does not consider the maximum benefits allowed (MBA) for the claims cited in the Auditors' report. For instance, at the end of 1994 UCCS reported an MBA of approximately $1.3 million. This represents the value of benefits claimants can receive on salary and wages paid by the School District; said benefits are payable over a period of eighteen (18) months.	Concur as to the need for consideration of other factors. Based on our discussion with Mr. Henderson on November 2, 1995, his analysis was intended as an illustration to demonstrate that UCCS bears other costs and risks in addition to claim payments.
While it is not the role of the School District to track profit in a situation of risk transfer it is in the District's interest to be aware of the cost of risk transfer versus the potential cost of retaining the risk. However, one must consider all cost factors: actual claims, administration expense and potential losses, before one could conclude that self insurance is a more viable option. Focusing entirely on the simple analysis of cost of coverage versus claims paid would suggest that the School District should retain (self insure) the risks associated with vehicle liability, property and casualty and boiler and machinery coverage since these exposures are fully insured with little, if any, claim activity. Following is a simple analysis of cost and premiums associated with the decision to self insure unemployment compensation: ...	We concur that other costs and risks are associated with unemployment costs in addition to actual claims and that these other factors should be considered in evaluating the cost of the unemployment insurance coverage. As noted previously, it is a Board and management decision as to the type of insurance and extent of coverage as to which should be obtained.

Internal Audit Report - Finding #3

Workers' Compensation Self-Insurance Fund Billings should be in accordance with Federal Cost Principles and Governmental GAAP - GASB 10 and OMB Circular A-87, Cost Principles for State and Local Government (Circular A-87)

Internal Audit Recommendation #1: The Risk Management Department should establish control procedures designed to assure that Self-Insurance financial statements are prepared in accordance with *GAAP* and the rates billed to funds are in accordance with federal cost principles.

Finance's Response	Our Testwork and Conclusions
Management agrees that financial statements should be prepared in accordance with Generally Accepted Accounting Principles (GAAP) and expenses are in accordance with federal cost principles. However, Management disagrees with the Auditor's conclusion that the School District violated federal cost principles and was not in compliance with GAAP. The federal regulations cited by the Auditor, OMB Circular A-87, were revised, effective September 1, 1995, to include the following criteria relative to self insurance in Section 25 of Attachment B: ...The method of allocating premiums was based on employee job classes and related risk of injury regardless of fund type. The use of employee job classes in determining premiums was consistently applied.	Concur, based on our conclusions as previously described.

As of June 30, 1993, the cumulative excess General Fund contribution for worker's compensation totaled $3,135,323, as shown on Schedule 2. The Special Revenues Fund excess totaled $98,181. For this and budgetary reasons the General Fund Contribution for 1994 was limited to third party claims administration payments. As of June 30, 1994, the cumulative excess General fund contribution totaled $1,890,288 and the Special Revenues Fund deficiency was $319,726. Using the analysis	We agreed amounts in the referenced schedule with minor differences and conclude that this analysis is a reasonable method to determine over payments and under payments. This analysis includes all operating costs of the workers' compensation fund, which includes all salaries of the Risk Management Department, repairs related to litigation, and other costs. The salary related costs should be allocated based on actual time incurred by personnel in Risk Management to all of the School Board's insured programs. The other non-related to workers' compensation costs should also be charged to the

Finance's Response	Our Testwork and Conclusions
shown on Schedule 2, the Federal Government was not under billed for 1993, 1994 and 1995 fiscal years based on actual operating costs of the Worker's Compensation Program. However, the School District's use of premiums or rates to bill Special Revenues and Child Nutrition funds were not based on projected costs but on the historical commercial insurance premiums that were in effect at the time of transition to self insurance. It should be noted that part of the School Board's plan, at the time of transition, was to establish a reserve that equaled one year's premium in the commercial market, which was never accomplished due to increased claims and costs.	appropriate fund. See Part IV for our conclusions related to the potential impact of the exclusion of these costs from management's analysis.

Internal Audit Recommendation #2: The Division of Financial Services should notify the *Superintendent and Compliance Officer about the improper billings and/or violations of* Federal cost principles.

Finance's Response	Our Testwork and Conclusions
The federal regulations, OMB Circular A-87, that were in effect in 1993 and 1994 did not require actuarial studies for self insured *worker's compensation programs.*	Concur. OMB Circular A-87 (1981) was in effect during this period, the Circular does not require actuarial studies for self-insurance funds.
In light of recent changes in the federal regulations regarding cost allocation plans, *Management will develop worker's* compensation rates on an actuarial basis starting with fiscal year 1995-96.	Noted.

Internal Audit Recommendation #3: The Superintendent and Compliance Officer should *make the appropriate notices to outside Governmental agencies* (e.g., Federal Cognizant agencies, State Department of Education).

Finance's Response	Our Testwork and Conclusions
As for the Auditor's assertion that the School District was not in conformity with Governmental GAAP, Management could not determine the nature of the assertion with the information presented since the School District's method of charging premiums does bill individual funds for their representative share based on employee job classes. Exhibit A (not included), an excerpt from the School District's payroll control file, includes three deduction codes for Worker's Compensation premiums ... Given that Management believes that the cost allocation method used by the School District was in accordance with the applicable federal regulations and the General Fund had contributed more than its share of worker's compensation reserves, no further action is required by either the Superintendent and/or Compliance Officer.	Concur, based on our findings as previously reported. See Part IV reference for our overall conclusions. No further action required.

Internal Audit Report - Finding #4

Self-Insurance Funds should account for all risks retained in accordance with Governmental General Accepted Accounting Principles (GASB 10)

Internal Audit Recommendation: The Risk Management Department should establish *control procedures designed to assure the Self-Insurance Fund Financial Statements are prepared in accordance with Governmental GAAP* for the preparation of the CAFR and the Self-Insured Terminated Group Health Insurance Plan should be reported in the Self-Insurance Fund on a liquidation basis of accounting (SOP 92-6).

Finance's Response	Our Testwork and Conclusions
The Life, Dental and Vision plan was a retrospectively rated plan wherein premiums were paid to an insurer based on projections. In those years that the actual claims exceed premiums the School District is billed for the	Concur that the financial statements are prepared in accordance with GASB 10; the wording changes that resulted from the Internal Audit Report further clarify the insurance programs of the School Board.

Finance's Response	Our Testwork and Conclusions
excess. In years where premiums exceed actual claims the excess is refunded to the School District and placed in the Life, Dental and Vision reserve... The key phrase here is "the loss has been retained" which implies the Life, Dental and Vision Plan is not a fully insured plan. Likewise for the *Health Insurance Plan*, which was a fully self-insured Triple Option plan during the 1993-94 fiscal year... Risk financing activities are defined at paragraph 6 as an element of risk management including *risk retention (self-insurance)* and risk transfer to and from an insurer and to a non-insurer. Based on the foregoing interpretation of GASB 10 it is Management's contention that the School District's financial statements are prepared in accordance with governmental GAAP including GASB Statement 10.	

Part III - Internal Audit's Response to the Chief Financial Officer's Response to the Internal Audit Response - Finding #1

Auditor's Comments to Mr. Henderson's Response to Finding #1-Concerning the Over-billing of Unemployment Compensation Insurance Premiums to Federal Programs

Internal Audit Response	Our Testwork and Conclusions
We read Mr. Henderson's response regarding the use of unemployment billing rates based on the perceived risk of unemployment claims set by the District's insurer Unemployment Compensation Control *Systems, Inc. (UCCS).* We reviewed the rates referenced by Mr. Henderson's Schedule 1. We also read Mr. Henderson's assertion that "based on the stated rates, premiums are charged to individual funds each bi-weekly payroll." We examined the Risk Management Department's 1994-95 general ledger history file report and reviewed the journal entries that recorded the billings to the	Disagree. The journal entries that record the expense in the Special Revenue and Child Nutrition funds are done automatically through the payroll system with each biweekly payroll. These entries did utilize the UCCS billing rates; however, the rates that were in effect prior to January 1, 1995 were utilized for the entire fiscal year. As a result, when it was discovered that the incorrect rates had been charged for the six-month period ended June 30, 1995, a journal entry was recorded to properly charge premium expense in each fund reflecting the new premium rates for one-half of the year. It should also be noted that what is recorded quarterly is the expense and revenue in the self-insurance

Internal Audit Response	Our Testwork and Conclusions
individual funds. From our examination, we determined that the journal entries that recorded the unemployment billings to the individual funds were recorded quarterly (not bi-weekly, Mr. Henderson's assertion) and the journal entries did not record the billings to the individual funds utilizing UCCS billing rates.	fund; the expense in the General Fund is recorded at the end of the year. This entry records any remaining UCCS premiums not charged to the Special Revenue and Child Nutrition Funds to the General Fund. These procedures have been consistently applied in prior years. During our status meeting with Mr. Henderson, he noted that when the new rates were revised earlier in the year, the rates in the payroll system were not updated. In preparation of his response to the Internal Auditor's Report, he realized that the rates were not updated by his staff and provided instructions to his staff to correct the problem. These procedures by the Finance Division are what we would expect to occur.
Our Exhibit A documents the difference between UCCS invoice amounts (what should have been billed according to Mr. Henderson's assertions) and the amount actually billed. According to Exhibit A, the General Fund was underbilled $581,102.34, before the $213,358.00 audit adjustment was penciled in. As a result, the Federal Programs were still overbilled $367,744.34. The journal entries that recorded the actual billings did not have sufficient supporting documentation that could explain the billing rates used. We requested the supporting documentation for the actual billing rates from Mr. Carl Coleman, Director of Risk Management Operations. Mr. Carl Coleman has not responded to date to our request for supporting documentation that explains the actual billing rates used. This information should have been readily available to Mr. Carl Coleman, and Mr. Terence Bradford, Insurance Accountant.	Based on our discussion with Mr. Henderson on November 2, 1995, the Orleans Parish School Board was in negotiation with UCCS since the fall of 1994 to set new rates for the School Board's unemployment insurance coverage. The representation that these rates were in negotiation prior to the issuance of Internal Auditor's Report is supported by correspondence from UCCS dated April 4, 1995 regarding the new rates (Attachment 4). In addition, when UCCS invoices are paid, a public voucher is prepared in the Risk Management Department. This public voucher includes an entry that records the premium expense in the self-insurance fund. The public voucher is not the basis to charge premium expense to the other funds; therefore, the public voucher is not the basis for charging costs to the Federal programs. Based on the methodology of using rates as provided by UCCS to bill the Special Revenue Funds and Child Nutrition Fund, and our review of Mr. Henderson's response (addressed in Part III below), we are not aware of any overcharges to Federal Funds. Also, as addressed in Part IV, the Internal Audit Report erroneously includes state and local salaries in its Special Revenue Fund salary amounts, and does not address the non-federal revenue sources of the Child Nutrition Programs.

Internal Audit Report	Our Testwork and Conclusions
Our review of the 1995 actual expenses shown on Mr. Henderson's Schedule 1 (not included) revealed that the costs did not reconcile to the General Ledger as follows: Difference General $ (213,389) Child Nutrition 34,538 Special Revenue 184,206 $ 5,355 The inference from the above implies that the General Fund was under billed and the Child Nutrition and Special Revenue (federal programs were over billed) which supports Finding #1. We extended our audit fieldwork to review the external auditors' audit adjustments and those adjustments prepared by the Financial Services Division subsequent to our Interim Draft Audit report and following Mr. Henderson's September 26, 1995 responses. No adjustments were recorded in the General Ledger as of October 5, 1995; however, we received an anonymous phone call that suggested that an adjustment would be made by the Risk Management Accountant.	It is usual for the Finance Department to accumulate entries prepared during the course of the audit and record them after the completion of the audit fieldwork. The entries are effective as of the year end even though they are posted to the general ledger subsequent to year end. This practice, to our knowledge, has been followed for several years.
On October 4, 1995, we requested copies of such journal entries from Mr. Carl Coleman who has not responded to date for our request for information that should be readily available. Further, we determined from Mr. Derrick Muse, Budget Analyst and Mr. John Paranilam, Child Nutrition Accountant, that an unemployment "penciled in" adjustment was made to the 4th quarter reimbursement claim (correcting over billings) to the Title 1 program and that no formal journal entry has been recorded into the General Ledger. Further, the Request for Funds prepared by Mr. Reginald Zeno, Budget Director, dated	The credit of $466,247.80 to fringe benefits was due primarily to a posting error of $401,508 that was corrected in the general ledger in October 1994 but was not corrected on the request for reimbursement until the omission was detected, which was during the preparation of the 4th quarter request. It was detected when the budget analyst was reconciling the general ledger to the request for reimbursement in preparation for the Schedule of Federal Financial Assistance during the audit. The adjustment was unrelated to the specific issue of unemployment and is unrelated to the Internal Auditors' Report.

Internal Audit Report	Our Testwork and Conclusions
September 28, 1995, revealed that a credit in the amount of ($466,247.80) was issued to Title I (Special Revenue Programs) for Budget Account No. 200 - Employee Benefits (see Exhibit B - not included). Also, Exhibit C (not included) presents a copy of an October 5, 1995 memorandum explaining the adjustment from Mr. Derrick Muse, which indicates that the credit included a $129,686 adjustment that was issued due to an unemployment compensation journal entry that was prepared by Mr. Terence Bradford. According to Mr. Muse's memorandum, the external auditors reviewed and approved the entry as an audit adjusting entry. Appendix B presents copies of adjustment entries.	In addition, we noted that the incorrect rates were in the payroll system for the period January 1, 1995 through June 30, 1995. Since the June 1995 request for reimbursement had not yet been submitted, the June request was adjusted in order to properly request amounts due from the Department of Education. These control procedures appear reasonable.
The inferences from the above facts support our Finding #1 that Federal Programs were over billed. However, we still note that Mr. Henderson's response did not acknowledge the fact that the various Federal program funds were over billed. We have documented in our Interim Draft Audit report, the seriousness of federal program over billings and if immediate action is not taken, regarding these developments, the School Board may be subject to more severe remedial actions and sanctions by the federal government, such as fines, penalties and possible criminal charges. In summary, the assertions made by Mr. Henderson are not supported by verifiable documentary evidence and suggest a possible "cover up" to conceal corrections to Federal Program over billings through "penciling in" unrecorded journal adjustments (that were not supported) to the 4th Quarter federal claims reimbursement (Title I) that bypass the required disclosures and the General Ledger. Further, the Federal programs are still over billed $367,744.34 for	The Internal Auditor's report alleged that there were violations of the False Claims Act and Federal Cost Principles/OMB Circular A-87. Based on our review of Mr. Henderson's response and confirmation at our November 2 meeting, Mr. Henderson's response was intended to demonstrate that this was not the case. Based on our testwork, Mr. Henderson's assertions, included in the Schedule in his report, are supported by evidence--namely the general ledger, UCCS correspondence, and journal entries. Nothing came to our attention during the course of our work, which indicated fraud or a "cover up."

Internal Audit Report	Our Testwork and Conclusions
unemployment insurance cost, even after the penciled in adjustment of $213,358.00, according to the actual UCCS quarterly invoices.	

Internal Audit Response - Finding #2

Auditor's Comments to Mr. Henderson's Response to Finding #2-The School Board should consider whether the use of commercial unemployment insurance is practical or if a self-insurance plan would more efficiently service the School Board's needs

Internal Audit Response	Our Testwork and Conclusions
Mr. Henderson's response, regarding the discussions in Washington during the last twelve months relative to balancing the Federal budget and major reductions in entitlement programs, said the School Board would be unwise to retain this risk at this time. However, we noted in our Finding #2 that the present carrier is going through bankruptcy reorganization procedures and the client base of the carrier is concentrated with insureds that would absorb the brunt of the catastrophic reductions in entitlement programs. Continuing with such a carrier is unwise, as our recent history with GIA has shown. Bonded service with an outside carrier is only viable when there is financial stability and diversity in the client base to absorb catastrophic events that Mr. Henderson is predicting in his response. It is this rationale alone that the Risk Management Department and School Board should immediately reconsider (within 90 days) the practicality of the current bonded service insurance agreement. Mr. Henderson's response did not provide comments relating to these concerns raised in our Finding #2. Further, neither Dr. James Lloyd or Mr. Armand Devezin share Mr. Henderson's perception that there will be any massive reductions in entitlement programs in the near future.	As previously mentioned, the 90-day requirement is Internal Audit's opinion as to the urgency of this matter. We agree that the viability of UCCS should be a valid concern of the School Board and the status of UCCS's bankruptcy proceedings should be closely monitored. Finally, we make no comments on the perceptions stated that there will be any massive reductions in entitlement programs in the near future; no specific legislation has been passed and conclusions regarding any programs would be speculative at this time. As noted previously, the decisions related to insurance coverage and risk retention are Board and management decisions. We do no comment as to the feasibility of the issue, as it is beyond the scope of this report.

Internal Audit Response	Our Testwork and Conclusions
We noted the School Board would have saved $3,632,243 (a comfortable fund reserve) if the external auditor's 1991-92 recommendation was implemented over the last four (4) years. We disagree with Mr. Henderson's assertion that "it is not the role of the School District to track profit in a *situation of risk transfer*", as did the 1991-92 external auditor's finding disagreed with Mr. Henderson's assertion.	We disagree, in that sufficient data was not utilized to make a determination that the School Board would have saved $3,632,243, however, it is still our position that the School Board should continue to evaluate on an ongoing basis the reasonableness of the cost of the type of services rendered.
As for Mr. Henderson's comment about our analysis and the 1991-92 external auditors analysis of profits retained by UCCS, Mr. Henderson failed to mention Maximum Benefits Allowed (MBA) is not an annual (12 months) cost (relevant to our analysis) but a potential 18 month exposure if all unemployment claimants do not find a job. It is not safe to conclude that all unemployed claimants will not find jobs (Mr. Henderson's assumption). Mr. Henderson also failed to point out the School Board has always incurred expenses associated with the defense of unemployment claims, travel and other associated cost, since OPSB Personnel Department staff attend claims appeal hearings along with UCCS representatives. Finally, Mr. Henderson failed to point out that the School Board required UCCS to obtain a $300,000 performance bond, which is inconsistent with his assertion that UCCS would insure $1,238,487 of total expenses, based on expected exposure which supports our estimate of expected claims (Exhibit C not included).	Additionally, we agree that the Maximum Benefits Allowed is a potential exposure if all unemployed claimants do not find a job and that this approach is a conservative method of estimating the potential exposure. Furthermore, the School Board does incur expenses associated with the defense of unemployment claims. Again, as noted previously, as auditors we note areas of improvement or cost efficiency. Ultimately, management and the Board determine the actions to be taken. We do not comment on this section of the Internal Auditor's Response since the recommendation is based primarily on their judgment in matters which were beyond the scope of our expertise.

Internal Audit Response	Our Testwork and Conclusions
Finally, given all relevant cost factors, actual claims, administrative expenses and excluding the 18 month potential exposure (Mr. Henderson's assumption that all unemployed claimants will not find jobs in 18 months), the self insurance option should be continually evaluated. In summary, the assertions made by Mr. Henderson failed to address our concerns regarding the School Board doing business with a bonded service company in bankruptcy reorganization. We feel the above facts support our Finding #2.	We agree that the self-insurance option should be continually evaluated as stated in Finding #2.

Internal Audit Response - Finding #3

Auditor's Comment to Mr. Henderson's Response to Finding #3-Worker's compensation billing should be in accordance with federal cost principles and government GAAP - GASB 10 and OMB Circular A-87

Internal Audit Response	Our Testwork and Conclusions
We read Mr. Henderson's response regarding the use of commercial insurance premiums and Mr. Henderson's assertions that the federal cost principles regarding cost allocation plans will begin after September 1, 1995. We noted in our Finding #3 that federal cost principles require self insurance funds to be established on an actuarial sound basis. We will modify our report to cite the specific federal cost principles (for the benefit of all readers and Mr. Henderson) that have been effective since April 1, 1982. We will reference 45 CFR Part 95.507 (a.2), 45 CFR 95.507 (b.6 and 7) specifically and 45 CFR Parts 75, 205, 232, 302, 304 and 1392 in general. In addition, we noted that federal programs were over billed because the commercial rates weren't adjusted at the end of each fiscal year for the actual experience of the applicable funds (A87.3.a) which is somewhat similar to conditions noted in our Finding #1.	We disagree. We noted no federal cost principles in effect for the fiscal year ended June 30, 1995 requiring self-insurance funds to be established on an actuarial sound basis, nor did we note any regulations requiring that commercial rates be adjusted at the end of each fiscal year for actual experience of the applicable funds.

Internal Audit Response	Our Testwork and Conclusions
We noted in our Finding #3 that GAAP (GASB 10) requires self insurance funds that provide risk financing services to bill funds for those services provided. Mr. Henderson's response documents the General Fund <u>was not</u> billed for fiscal year 1993-94. Mr. Henderson's response documents this was done because the General Fund had accumulated $3,135,323 of excess contributions as of 1992-93 and for budgetary reasons the General Fund contribution for 1993-94 was limited to third party claims administration payments. Mr. Henderson Schedule 2 documents that Special Revenue and Child Nutrition had accumulated as of 1992-93 excess contributions of $98,181 and $619,149, respectively. These federal programs were not given a discount for their excess contributions but were billed for the commercial insurance rates in 1993-94. Mr. Henderson's response did not provide an explanation of the "1993-94 inconsistent treatment of the General Fund and the federal programs (A87 C1.d.)	We agree that GASB 10 requires that self-insurance funds that provide risk financing services to bill funds for those services provided. We also agree that the General Fund was not consistently treated in 1993-1994 in terms of the amounts billed for Workers' Compensation. The General Fund should be charged for the premiums in the future for the premiums not charged in 1993-94; this did not impact charges to Federal funds.
In summary, the assertions made by Mr. Henderson are not supported by a full reading (as opposed to Mr. Henderson's selective reading) of Circular A-87 (which we referenced in our comments), and suggest a lack of awareness of federal cost principles that have been in effect since April 1, 1982 regarding cost allocation plan requirements and not September 1, 1995 as stated by Mr. Henderson. Further, Mr. Henderson's response documents inconsistent billing treatment of the General Fund and Federal Programs, which have resulted in the School Board over billing Federal Programs (that subject the System to remedial actions and sanctions by the Federal Government). The above facts support our Finding #3.	We agree with the finding that there was inconsistent billing treatment for the General Fund; however, we disagree that Federal Programs were overbilled and that the School Board is subject to remedial actions and sanctions by the Federal Government. Part IV of the Report beginning on page 29, further describes our conclusion and recommendation regarding the nonbilling of the General Fund in 1993-94.

Internal Audit Response - Finding #4

Auditor's Comments to Mr. Henderson's Response to Finding #4-Self Insurance Funds should account for all risks retained in accordance with Governmental GAAP - GASB 10.

Internal Audit Response	Our Testwork and Conclusions
We read Mr. Henderson's response regarding fully insured insurance plans. We noted in our Finding #4 that certain insurance plans were fully insured. Mr. Henderson disagreed and said the Life, Dental and Vision plan was a retrospectively rated plan and not a fully insured plan. Further, Mr. Henderson's response said the School District's 1993-94 financial statements were prepared in accordance with governmental GAAP including GASB 10. We reviewed Mr. Henderson's response regarding GASB 10 references for retrospectively rated insurance plans. We noted that the 1993-94 CAFR Notes to the Financial Statements disclosed that the Life, Dental and Vision Plan was a fully insured plan, a position that Mr. Henderson disagrees. Assuming Mr. Henderson's response is correct and the 1993-94 CAFR Notes to the Financial Statements are wrong, the 1993-94 CAFR misrepresented the Life, Dental and Vision Plan as a fully insured insurance plan (violated GASB 10). In addition, the following required disclosures were not made in the 1993-94 CAFR notes to the Financial Statements in accordance with GASB 10: 1. Insurance coverage is based on retrospective policies. 2. Premiums are accrued based on the experience to date of the ultimate claims cost of the group of which the school board is a participant.	The 1994-1995 CAFR disclosure has been updated to incorporate the elimination of the word "self" and additional disclosures related to the retrospectively rated plan were added. The Self-Insurance Internal Service Fund has been revised to read "Insurance" Internal Service Fund and all references thereto appropriately amended.

Internal Audit Response	Our Testwork and Conclusions
The above facts support our finding #4 that the Financial Statements were not in accordance with GASB 10.	The wording issue was addressed by management in the 1994-95 CAFR. The notes do describe the insurance programs of the School Board, and it is our opinion that the financial statements are in accordance with GASB 10. The change in the insurance funds is clearly an immaterial issue.
In addition to the above, we read Mr. Henderson's response regarding Boiler Machinery insurance plan. We reviewed the general ledger and other documentation and noted the Boiler Machinery insurance plan. We reviewed the general ledger and other documentation and noted the Boiler Machinery insurance plan was not billed to any fund for the past two years. As we noted in our comments regarding Finding #3, Governmental GAAP (GASB 10) require self insurance fund that provides risk financing services to bill funds for those services. The above facts support our Finding #4 that the Financial Statements were not in accordance with GASB 10.	The boiler machinery insurance is included in the "Other Insurance Fund" which is funded by contributions from the General Fund. The amounts related to boiler insurance are insignificant.
Mr. Henderson's response did not provide comments regarding our concerns about the self-insured terminated group health insurance plan administered by GIA that should be reported in that self-insurance fund on liquidation basis of accounting (SOP 92-6) and not combined with the fully insured insurance plan administered by Principal Health Care. The above facts support our Finding #4.	We disagree, as SOP 92-6 is not applicable to the School Board's CAFR, as discussed previously.

Part IV - Our Conclusions and Recommendations

Our inquires and observations support our findings and conclusions as summarized in the executive summary on page 1. In addition, we have held a status meeting with each party to confirm the facts as we were made aware of them. In follow-up to the status meeting, we requested the supporting regulations for the findings contained in the Internal Audit Report, which we received on November 3, 1995. While not noted in Part I, we would like to describe briefly the changes in OMB Circular A-87 and the supporting documentation received from Internal Audit. OMB Circular A-87 was originally created in 1968. It was revised under the name of Federal Management Circular 74-4 and revised again in 1981 under the name of OMB Circular A-87. The only subsequent revision to OMB Circular A-87 was approved in 1995. In 1988, OMB issued a proposed revision to OMB Circular A-87, which was not approved until May 1995, effective September 1, 1995. Therefore, the appropriate federal regulations in use during the audit period was the 1981 OMB Circular A-87.

The supporting documentation received from Internal Audit was requested since the audit report did not clearly cite the specific regulations in violation. The audit report cites 45 CFR Part 95; however, Part 95 is applicable to Public Assistance and Medical Assistance Programs and not applicable to Department of Education Programs.

In summary, while the revised OMB Circular A-87 requires changes such as actuarial studies and specific reporting of revenues, expenses and cost transfers, we do recommend the following:

- Periodic updates of rates charged to federal programs to ensure that the original assumptions are still valid.
- Review of the costs charged to worker's compensation needs to be performed. Insurance related costs should be charged to the appropriate funds and non-salary costs need to be charged to the proper fund.
- Review of interest earnings, if any, in the self-insurance funds should also be considered in assessing the premiums charged to all funds.
- The non-payment of full premiums by the General Fund in 1993-94 should be documented as to how the overpayment/underpayment of all funds should be accounted. While no revisions in prior years' reimbursements or financial statements are needed, from a Federal viewpoint, supporting documentation should clearly indicate the surplus accumulated by each funding source and how and when those surpluses (or deficits) are being repaid by those funds. A reasonable time period, such as three to five years, could be used.
- Procedures and policies should be implemented to ensure the prompt and proper application of the A-87 Cost Principles as revised effective September 1, 1995.

In all of the supporting data reviewed, as well as discussions with both parties, in no instance did we note anything to support the alleged violations of the False Claims Act or OMB Circular A-87 (1981).

Very truly yours,

KPMG Peat Marwick LLP

Albert J. Richard III
Partner

Bruno & Tervalon

Alcide J. Tervalon
Partner

FRANK T. MCKUNE
Senior Manager, KPMG Management Consultants

Mr. McKune is a senior manager, located in Denver, Colorado. He is responsible for KPMG's Grants Management Services and Cost Allocation Planning and Performance Services practice in the Midwest and Southwest Regions. He has over 25 years of experience in the area of cost allocation and indirect cost principles and procedures for state and local governments, colleges and universities, hospitals, and nonprofit organizations. He recently returned to KPMG after five years in Washington, D.C. where he was the Director of the Department of Health and Human Services, Division of Cost Allocation and Liaison. He was responsible for the Department's regional negotiation function with responsibility for the negotiation and approval of cost allocation plans in excess of $12 billion annually.

Representative Accomplishments
Mr. McKune has had extensive experience with KPMG in a variety of engagements related to the areas of cost allocation and indirect cost principles and procedures. The major areas of his involvement include the following:

- Development of indirect cost and special service center rates and systems for state and local governments, colleges and universities, hospitals and nonprofit organizations.
- Review and successful negotiation of numerous cost allocation plans and indirect cost rate proposals under OMB Circulars A-87, A-21, A-122, and HHS Hospital Cost Principles, OASC 3.
- Proposal preparation and successful negotiation assistance with the Department of Health and Human Services and other cognizant agencies.
- Development and instruction of numerous seminar workshops on OMB Circulars A-87, A-21, and A-122. Addressed several regional audit forums, accounting associations and specific accounting workshops.
- Development and review of financial management systems for state and local governments and colleges and universities.
- Performance as engagement manager for the resolution of audits with state and local governments, hospitals, and colleges and universities.

Background
Before rejoining KPMG, where he was a senior manager with the Grants Management Service Practice, Mr. McKune:

- Worked for 23 years for the U.S. Department of Health and Human Services as an auditor, financial analyst, cost negotiator, senior cost policy specialist and functional director of the regional cost negotiation function.
- Spent 5 years in Washington, D.C. with the Division of Cost Allocation in policy and functional management.
- Spent 12 years with the Divisions of Cost Allocation in Denver. Responsible for reviewing and negotiating cost allocation plans, indirect cost and fringe benefit rates.
- Spent 6 years with the Denver HHS Regional OIG office as an auditor.

Mr. McKune was awarded a B.S. in accounting from Regis College, Denver, Colorado and he is a Certified Public Accountant.

CHRISTOPHER POLISCHUCK
Manager, KPMG Peat Marwick LLP

Chris Polischuck is a manager in KPMG's national Cost Allocation Planning and Performance Services (CAPPS) practice. He is experienced in cost analysis, cost determination, statistical analysis, and in the review and analysis of management information systems for state and local governments.

Representative accomplishments

Mr. Polischuck's ten years of consulting experience has encompassed a variety of engagements assisting financial administrators in the recovery of direct and indirect costs associated with user fee services, grants, and public assistance programs. The major areas of his involvement include the following:

- Preparation of cost allocation plans and departmental indirect cost rate proposals in accordance with the cost principles set forth in OMB Circular A-87 (state and local governments) and summarization of data to support negotiation of the proposals and indirect cost rates with cognizant federal agency negotiators.

- Preparation of budget full-cost allocation plans for the reasonability of cost reimbursement from outside departments, especially utility funds.

- Preparation of user fee and cost of service studies documenting the full cost of public services and recommendations for increased service fees and new fees. These reports detailed the various components of service cost, and included action plans for implementation of recommended fees. Equity issues regarding various service user groups were also addressed. Implementation of user fee studies resulted in significant increased revenue.

- Preparation of Comprehensive Annual Financial Reports (CAFRs) which received GFOA Certificate of Achievement awards. Prepared three first-time CAFRs in 1994.

- Preparation of utility service fee studies to document current cost of operations and future costs given various proposed scenarios. Proposed service rate structures were developed as a result of costing analysis.

Articles published

"Pricing Public Services at Cost," *Ohio Cities and Villages*, 4/89

"Setting Fees at Cost," *Ontario Municipal Administrators Association Newsletter*, Winter 1990

"*User Fees - A Full Cost Perspective*," *Ontario Municipal Administrators Association Newsletter*, Summer 1990

Background

Mr. Polischuck was awarded a B.S. in Business Administration and an M.A. in Public Administration from Ohio State University. He was formerly a regional manager with David M. Griffith and Associates. Prior to his consulting career, Mr. Polischuck spent six years in state and local government in key positions of financial analysis and management. Mr. Polischuck has lectured and conducted workshops throughout the US including Alaska, and Canada on the subjects of user fees, cost analysis and allocation in local governments. He recently served as an assistant instructor in a series of workshops on changes to Federal Circular A-87. He has also served as a college instructor in governmental accounting.

Additionally, the Bonded Service Contract allows an employer to allocate the cost of unemployment compensation benefits to the actual source of such cost, such as federally funded programs.

Under the Bonded Service Contract, U.C.C.S., Inc. assumes total financial responsibility for your unemployment benefit charges and provides day-to-day cost control management on your behalf. U.C.C.S., Inc.'s financial responsibility is bonded by Universal Surety of America (USA). USA is an A. M. Best "A" Excellent rated insurance company authorized to do business in the State of Louisiana.

The Bonded Service Contract affords the reimbursable employer a fixed rate that will cost significantly less than the taxable option. Our program assumes the responsibility of managing your unemployment compensation liability under current state law. Our staff of experts will provide our clients professional service that will include:

* Paying on your behalf the required reimbursement to the state for all unemployment claims charged to your account, thereby eliminating any risk inherent in the reimbursable method.
* Training and consultation of your supervisory personnel and structuring internal policies that aid an employer in preventing abuse and excess claims payments.
* Processing all unemployment claims and protesting those which should not be paid.
* Representing the employer at all hearings and appeals involving unemployment claims, when applicable.
* Providing immediate access to current claims information involving client employee.
* Supplying quarterly management reports to keep your management and supervisory personnel informed of all matters pertaining to unemployment compensation costs and cost control.
* Working in concert with established public interest groups to actively pursue legislative, administrative and judicial reforms which effect the cost and administration of unemployment compensation law.
* Third Party insulation for the school board and management from decisions to protest or not protest unemployment claims

repair services are allowable.

21. *Payroll preparation.* The cost of preparing payrolls and maintaining necessary related wage records is allowable.

22. *Personnel administration.* Costs for the recruitment, examination, certification, classification, training, establishment of pay standards, and related activities for grant programs, are allowable.

23. *Printing and reproduction.* Costs for printing and reproduction services necessary for grant administration, including but not limited to forms, reports, manuals, and informational literature, are allowable. Publication costs of reports or other media relating to grant program accomplishments or results are allowable when provided for in the grant agreement.

24. *Procurement service.* The cost of procurement service, including solicitation of bids, preparation and award of contracts, and all phases of contract administration in providing goods, facilities and services for grant programs, is allowable.

25. *Taxes.* In general, taxes or payments in lieu of taxes which the grantee agency is legally required to pay are allowable.

26. *Training and education.* The cost of in-service training, customarily provided for employee development which directly or indirectly benefits grant programs is allowable. Out-of-service training involving extended periods of time is allowable only when specifically authorized by the grantor agency.

27. *Transportation.* Costs incurred for freight, cartage, express, postage and other transportation costs relating either to goods purchased, delivered, or moved from one location to another are allowable.

28. *Travel.* Travel costs are allowable for expenses for transportation, lodging, subsistence, and related items incurred by employees who are in travel status on official business incident to a grant program. Such costs may be charged on an actual basis, on a per diem or mileage basis in lieu of actual costs incurred, or on a combination of the two, provided the method used is applied to an entire trip, and results in charges consistent with those normally allowed in like circumstances in non-federally sponsored activities. The difference in cost between first-class air accommodations and less-than-first-class air accommodations are not is unallowable except when less-than-first-class air accommodations reasonably available. Notwithstanding the provisions of paragraphs D.6. and 8., travel costs of officials covered by those paragraphs, when specifically related to grant programs, are allowable with the prior approval of a grantor agency.

C. Costs Allowable With Approval of Grantor Agency

1. *Automatic data processing.* The cost of data processing services to grant programs is allowable. This cost may include rental of equipment or depreciation on grantee-owned equipment. The acquisition of equipment, whether by outright purchase, rental-purchase agreement or other method of purchase, is allowable only upon specific prior approval of the grantor Federal agency as provided under the selected item for capital expenditures.

2. *Building space and related facilities.* The cost of space in privately or publicly owned buildings used for the benefit of the grant program is allowable subject to the conditions stated below. The total cost of space, whether in a privately or publicly owned building, may not exceed the rental cost of comparable space and facilities in a privately-owned building in the same locality. The cost of space procured for grant program usage may not be charged to the program for periods of nonoccupancy, without authorization of the grantor Federal agency.

a. *Rental cost.* The rental cost of space in a privately-owned building is allowable. Similar costs for publicly owned buildings newly occupied on or after October 1, 1980, are allowable where "rental rate" systems, or equivalent systems that adequately reflect actual costs, are employed. Such charges must be determined on the basis of actual cost (including depreciation based on the useful life of the building, interest paid or accrued, operation and maintenance, and other allowable costs). Where these costs are included in rental charges, they may not be charged elsewhere. No costs will be included for purchases or construction that were originally financed by the Federal Government.

b. *Maintenance and operation.* The cost of utilities, insurance, security, janitorial services, elevator service, upkeep of grounds, normal repairs and alterations and the like, are allowable to the extent they are not otherwise included in rental or other charges for space.

c. *Rearrangements and alterations.* Costs incurred for rearrangement and alteration of facilities required specifically for the grant program or those that materially increase the value or useful life of the facilities (Section C.3.) are allowable when specifically approved by the grantor agency.

d. *Depreciation and just allowances on publicly-owned buildings.* The costs are allowable as provided in Section B.11.

e. *Occupancy of space under rental-purchase or a lease with option-to-purchase agreement.* The cost of space procured under such arrangements is allowable when specifically approved by the Federal grantor agency.

3. *Capital expenditures.* The cost of facilities, equipment, other capital assets, and repairs which materially increase the value or useful life of capital assets is allowable when such procurement is specifically approved by the Federal grantor agency. When assets acquired with Federal grant funds are (a) sold; (b) no longer available for use in a federally-sponsored program; or (c) used for purposes not authorized by the grantor agency, the Federal grantor agency's equity in the asset will be refunded in the same proportion as Federal participation in its cost. In case any assets are traded on new items, only the net cost of the newly-acquired assets is allowable.

4. *Insurance and indemnification.*

a. Costs of insurance required, or approved and maintained pursuant to the grant agreement, are allowable.

b. Costs of other insurance in connection with the general conduct of activities are allowable subject to the following limitations:

(1) types and extent and cost of coverage will be in accordance with general State or local government policy and sound business practice.

(2) Costs of insurance or of contributions to any reserve covering the risk of loss of, or damage to, Federal Government property are unallowable except to the extent that the grantor agency has specifically required or approved such costs.

c. Contributions to a reserve for a self-insurance program approved by the Federal grantor agency are allowable to the extent that the type of coverage, extent of coverage, and the rates and premiums would have been allowed had insurance been purchased to cover the risks.

d. Actual losses which could have been covered by permissible insurance (through an approved self-insurance program or otherwise) are unallowable unless expressly provided for in the grant agreement. However, costs incurred because of losses not covered under nominal deductible insurance coverage provided in keeping with sound management practice, and minor losses not covered by insurance, such as spoilage, breakage and disappearance of small hand tools which occur in the ordinary course of operations, are allowable.

e. *Indemnification.* Includes securing the grantee against liabilities to third

ORLEANS PARISH SCHOOL BOARD

Notes to General Purpose Financial Statements

June 30, 1994

The maximum retirement benefit is an amount equal to 2 1/2% of the average compensation for the 3 highest consecutive years of membership service, multiplied by the number of years of service, plus a supplementary allowance of $24.00 per annum. The supplemental allowance is eliminated for members entering the Retirement System on or after July 1, 1986. Employee benefits vest after ten years of service. The plan also provides for death and disability benefits. At June 30, 1993 (the latest year for which the annual financial report is available) the pension benefit obligation for the Employees' Plan, as a whole, the system's net assets available for benefits valued at cost ($922,206,569 at market) and the resulting overfunded pension benefit obligation were as follows:

Pension benefit obligation	$ 739,109,581
Net assets available for benefits	849,044,006
Overfunded pension benefit obligation	$(109,934,425)

Prior year historical trend information reflecting the Employees' Plan progress in accumulating the excess assets required to pay benefits when due is contained in the June 30, 1993 annual financial report.

(c) Other Retirement Benefits

As required by state statutes, the School Board must provide certain health care and life insurance benefits to retired employees. This future liability is not funded but will be payable by the General Fund out of future years' operations. Substantially all of the School Board's employees may become eligible for such benefits upon reaching retirement age. Except for one-half of the dependent coverage, no contributions are required by the retirees to help finance these future benefits and at the present time, a maximum of one-half of the premiums are paid by the State of Louisiana. It is not known whether the State of Louisiana will continue, and if so, at what level, its funding of one-half of the future premiums for the retirees and their dependents.

Health care coverage for eligible retirees is available under either the fully insured health maintenance organization plan (the HMO plan was only in effect for two months during fiscal 1994) or the School Board's self-insured plan. Under the latter plan, both the School Board and the retiree contribute a scheduled amount to the plan; expenses are recognized when the fund liability is incurred for premiums and claims. For fiscal 1994, premiums to provide retiree health care and life insurance benefits, jointly shared between the School Board and the approximately 1,202 participating retirees, were $3,434,975.

NOTE 9 - COMMITMENTS AND CONTINGENCIES

(a) Claims

The School Board is a defendant in a number of lawsuits arising principally in the normal course of operations. In the opinion of the School Board, the outcome of these lawsuits will not have a material adverse effect on the financial statements and, accordingly, no additional provision for losses has been recorded for these lawsuits, except as reported in the financial statements.

(b) Labor Contract

During August, 1993, School Board Representatives and the United Teachers of New Orleans - the teachers', clericals' and paraprofessionals' collective bargaining agent, reached agreement on a new three-year contract, which was approved by 96% of the union members. Retroactive to July 1, 1993, the agreement was approved by the School Board on August 26, 1993. The pact did not include a salary raise for 1993-94. However, it provides for a wage reopener before the second (fiscal 1995) and third (fiscal 1996) years of the contract. School Board Representatives and the United Teachers' of New Orleans have agreed that salaries will remain the same for fiscal 1995.

Attachment 4a p1

Orleans Parish School Board
Unemployment Compensation Rate Schedule

2nd Qtr 1994	Payroll	Rate	Cost	Precentage
General Fund	68,883,600	0.00150	103,325	26.42%
Food Service	2,272,058	0.02000	45,441	11.62%
Special Revenue	7,345,049	0.03300	242,387	61.97%
Total	78,500,707	0.00498	391,153	100.00%

2nd Qtr 1995	Payroll	Rate	Cost	Precentage
General Fund	69,146,413	0.00101	69,840	26.42%
Food Service	2,291,058	0.01341	30,715	11.62%
Special Revenue	7,484,204	0.02189	163,834	61.97%
Total	78,921,675	0.00335	264,388	100.00%

Rounded Rates

2nd Qtr 1995	Payroll	Rate	Cost
General Fund	69,146,413	0.00100	69,146
Food Service	2,291,058	0.01350	30,929
Special Revenue	7,484,204	0.02200	164,652
Total	78,921,675	0.00335	264,728

Attachment 4a p2

Unemployment Compensation Control Systems, Inc.

5353 Florida Blvd. • Baton Rouge, LA 70806

Facsimile Transmission Cover Sheet

Date: 04-Apr-95 09:50:50

To: Terrence Bradford

From: Larry Bay

Re: Rate Structure

Page 1 of 2 Pages

Memo: Terrence,

Following please find a comparison of 2nd Qtr 1994 & 2nd Qtr 1995 Rates and a distribution of cost based on the 1994 rate schedule. We would suggest the Rounded Rates as a budget and billing base. Please call me upon receipt.

Direct (504) 928-2620 Facsimile (504) 928-0360

National Wats (800) 535-2068 Louisiana Wats (800) 272-8317

ATTACHMENT 46

Unemployment Compensation Control Systems, Inc.

5353 FLORIDA BLVD. • P.O. BOX 463 • BATON ROUGE, LA. 70821 • PHONE (504) 928-2620
LA WATS 1-800-272-6317 • NAT'L WATS 1-800-535-2065 • FAX (504) 925-0360 • (504) 928-2682

NSOME
ident

September 15, 1995

these rates were effective 1/1/95

Mr. Carl Coleman
Risk Manager
Orleans Parish School Board
3510 General DeGaulle Drive
New Orleans, Louisiana 70114

Dear Mr. Coleman,

Since the inception of the "Bonded Service Contract" provided by Unemployment Compensation Control Systems, Inc. (UCCS) to the Orleans Parish School Board (OPSB) we have underwritten the account in three (3) distinct rate groups:

General Fund which included teaching, administrative and maintenance staff. The General Fund is the most stable employee group and therefore commands the lowest rate; currently $0.0010 per payroll dollar.

Food Service which includes all cafeteria workers. Food Service is setup as a separate group because it turnover far exceeds that of the other normal employee classes. The current rate for Food Service is $0.0130 per payroll dollar.

Special Revenue which represents all Federal and State special revenue programs which normally last one (1) year, the employees being terminated at the end of the program. Therefore Special Revenue carries the highest rate of $0.021 per payroll dollar.

All the rates have been calculated based on actual experience of the groups over our 12 year relationship with Orleans Parish School Board. The current rates when extended by the approximate Payroll Dollar by group will approximate the $0.00335 rate bid on the current contract. Using the $0.00335 rate across the board skewed your cost allocation of your unemployment cost.

If we can provide additional information please give me a call.

Sincerely,

Larry E. Bey

Exhibit 5

The above allocation appears to inappropriately allow the Self-Insurance Internal Service Fund to underbill the General Fund itself for its' share of Unemployment Insurance, which is a violation the False Claims Act (18 USC #287) and Federal Cost Principles/OMB Circular A-87.

RECOMMENDATIONS:

1. The Risk Manager should re-allocate billings to the Special Revenue and Child Nutrition Service Programs for 1993-94 through 1994-95 fiscal years in accordance with GASB-10 and Circular A-87.

2. The Division of Financial Services should notify the Superintendent and Compliance Officer about the improper billings and/or violations of Federal cost principles.

3. The Superintendent and Compliance Officer should make the appropriate notices to outside Governmental agencies (e.g. Federal Cognizant agencies, State Department of Education).

2. **THE SCHOOL BOARD SHOULD CONSIDER WHETHER THE USE OF COMMERCIAL UNEMPLOYMENT INSURANCE IS PRACTICAL OR IF A SELF-INSURANCE PLAN WOULD MORE EFFICIENTLY SERVICE THE SCHOOL BOARD'S NEEDS**

FINDING: Currently, the School Board has Unemployment Compensation Insurance coverage provided by a commercially bonded service company (Unemployment Compensation Control Systems, Inc.-UCCS). The premiums and claims paid for the unemployment insurance coverages for the 1992, 1993, 1994 and 1995 are as follows:

	1995	1994	1993	1992	Totals
Premium Payments	$973,978	$1,332,473	$1,321,023	$980,727	$4,608,201
Claims Payments by UCCS	147,069	197,182	271,707	360,000	975,958
Surplus Retained by UCCS	$826,909	$1,132,291	$1,049,316	$620,727	$3,632,243

As the above schedule illustrates, the School Board is allowing substantial annual premium surplus (profits) to be retained by UCCS. This same unsatisfactory condition was noted in the External Auditors' 1991-92 Management Letter to the Board. Management's response at that time was, *"The school district's insurance coverages that are placed with commercial insurance carriers are continually reviewed for self-insurance. Currently we are gathering historical loss data to determine the feasibility of becoming self-insured for automobile and property exposures under a program that would cap losses at an annual aggregate amount. The unemployment compensation program of the district is presently under review to determine the reasonableness of costs for the type services rendered. Concur with*