STATE OF LOUISIANA
LEGISLATIVE AUDITOR

Office of Risk Management
Executive Department
State of Louisiana
Baton Rouge, Louisiana

February 17, 1998

Financial and Compliance Audit Division

Daniel G. Kyle, Ph.D., CPA, CFE
Legislative Auditor

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STATE OF LOUISIANA
Baton Rouge, Louisiana

Management Letter
Dated February 4, 1998

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

February 17, 1998

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February 4, 1998

OFFICE OF RISK MANAGEMENT
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Baton Rouge, Louisiana

As part of our audit of the State of Louisiana's financial statements for the year ended June 30, 1997, we conducted certain procedures at the Office of Risk Management. Our procedures included (1) a review of the office's internal controls; (2) tests of financial transactions; (3) tests of adherence to applicable laws, regulations, policies, and procedures governing financial activities; and (4) a review of compliance with prior year report recommendations.

The Annual Fiscal Report of the Office of Risk Management was not within the scope of our procedures, and, accordingly, we express no opinion or any other form of assurance on that report. The office's accounts are an integral part of the State of Louisiana's financial statements, upon which the Louisiana Legislative Auditor expresses an opinion.

Our procedures included interviews with management personnel and other selected agency personnel. We also evaluated selected documents, files, reports, systems, procedures, and policies as we considered necessary. After analyzing the data, we developed recommendations for improvement. We then discussed our findings and recommendations with appropriate management personnel before submitting this written report.

In our prior report for the year ended June 30, 1996, we reported findings concerning the internal audit function, review of original documentation, internal control deficiencies related to claim payments, and noncompliance with the Disaster Assistance program. The finding concerning compliance with the Disaster Assistance program has been resolved. The remaining findings on internal audit function, review of original documentation, and internal control deficiencies related to claim payments are addressed again in this report.

Based on the application of the procedures referred to previously, all significant findings are included in this report for management's consideration.

Lack of Internal Audit Function

For the fourth consecutive year, the Office of Risk Management (ORM) does not have an effective internal audit function to examine, evaluate, and report on its internal control system and to evaluate the extent to which its employees complied with that control system. Act 17 of the 1996 Regular Session of the Louisiana Legislature requires agencies with budgets in excess of $30 million to use existing program resources and table of organization for the purpose of establishing an internal auditor position. In addition, considering the size of ORM's reported assets ($141,766,340) and revenues ($227,103,117), an effective internal audit function is important to ensure that ORM's assets are safeguarded and that ORM's policies and procedures are uniformly applied.

ORM should establish an effective internal audit function. In a memorandum dated September 15, 1997, Ms. Evon L. Wise, State Risk Assistant Director, concurred with the finding and recommendation. Ms. Wise stated that budgetary restrictions have prevented ORM from complying with this requirement. However, funding for an internal auditor position has been approved for the fiscal year ending June 30, 1998, and she expects the position to be filled by that date.

Lack of Review of Original Documentation

For the fourth consecutive year, ORM is not performing, on a sample basis, a field review of the original source documentation to support billings by contract attorneys. We noted that for fiscal year 1997, contract attorneys were compensated and/or reimbursed approximately $10.7 million for expenses that included legal services and other expenses such as telephone, copying charges, postage, et cetera. In support of expenses, it is a practice of ORM to accept from attorneys, copies of receipts and summaries of time worked for legal services substantiated by an affidavit. Claim adjusters then perform desk reviews of these copies of supporting documents using the contract and ORM's billing guidelines as the criteria for review.

A field review of original source documentation has not been conducted since 1990. Considering the magnitude of payments to contract attorneys each year, adequate internal controls would require that ORM perform a field review, on a sample basis, of original source documentation to ensure that billings are accurate and expenses are allowable.

ORM should conduct field reviews on a sample basis of original source documentation maintained by the contract attorneys to ensure that ORM is being properly billed. In a memorandum dated September 15, 1997, Ms. Evon L. Wise, State Risk Assistant Director, concurred with the finding and recommendation. She further stated that ORM plans to use the internal audit position that was approved for the fiscal year ending June 30, 1998, to randomly review billings.

Internal Control Deficiencies Related to Claim Payments

For the second consecutive year, ORM has not exercised adequate controls over claims-related payments. Good internal controls should provide for adequate segregation of duties to safeguard assets, to ensure that accounting data are both accurate and reliable, and to ensure that errors and/or fraud are detected in a timely manner. In addition, EDP controls are necessary to preserve the system's integrity and to provide reliance on the results produced by the system. During the year ended June 30, 1997, the office processed approximately $146 million in claims and related contractual payments. In our consideration of the internal controls, we noted the following weaknesses:

- In a test of 24 users of ORM's outside data service center (Corporate Systems), we noted two employees who have EDP access that allows writing recurring checks with no dollar limit and no supervisory review.

- ORM does not have adequate documentation to evaluate users' access in Corporate Systems. We noted the following inaccuracies in security reports showing the name of system users and their capability to increase reserves and make payments:

  - Forty-eight current users were omitted from one report.

  - Twenty former users were still on another report.

  - In some instances, reports showed two varying interpretations of user capability for a single adjuster.

  Although procedures for reviewing user access, as well as for adding, changing, and deleting user access, are complicated and include the use of several reports, these procedures are not documented. Authorization for some user access is also not documented nor are policies for clerical limits on increasing reserves and making payments in the system.

- Improper data fields were used for reserve input in error. Unused fields should be restricted from input by Corporate Systems.

- For 11 of 16 claims payments tested, it was impossible to discern who increased payment reserves for a total of $10,400,000. Employees did not follow the ORM policy of denoting the person who adjusts reserves for future payments.

- In two observations of the check-write procedures, we found no evidence of supervisor review of portions of the payment forecast, as required by ORM policy. These portions of the forecast accounted for payments of $267,000.

Failure to develop and implement adequate controls over claims and related contractual payments may result in errors and/or fraud that are not detected in a timely manner.

Management should provide for adequate segregation of duties to safeguard assets, to ensure that accounting data are both accurate and reliable, and to ensure that errors and/or fraud are being detected in a timely manner, including procedures to strengthen the integrity of EDP functions. In a memorandum dated October 17, 1997, Mr. Seth E. Keener, Jr., State Risk Director, concurred with the finding and recommendation and outlined a plan of corrective action.

Overstatement of Reserves for Claim Payments

ORM has overstated reserves for second injury claims and has not requested timely reimbursements from the Second Injury Fund. The Second Injury Fund exists to encourage the employment of physically handicapped employees who have a permanent, partial disability by protecting employers and their insurers from excess liability when a subsequent injury to such an employee merges with his preexisting disability. Louisiana Revised Statute 23:1378 divides the financial responsibility for paying second injury claims between the insurer (ORM) and the Second Injury Fund. In addition, it sets limits for insurer reserves for future payments and states that no reimbursement will be made to the insurer unless the insurer certifies compliance with those limits on reserves.

Although ORM made the necessary certifications and set the reserve at the proper amount at the time the Second Injury Board was notified of the claim, we found that ORM's reserves for second injury claim payments had subsequently been increased and exceeded the legal limit in 9 of 16 claims tested, for a total of $219,862. For 4 of the 16 claims, ORM has not requested reimbursements from the Second Injury Fund although ORM has been making payments on these claims for periods of over one to two years. These errors occur when adjusters increase reserves without noticing legal reserve restrictions. Failure to set reserves at the proper amount and failure to bill timely places the office at risk of losing reimbursements from the Second Injury Fund.

In addition, errors in reserves cause misstatements on the financial statements of the State of Louisiana.

ORM should comply with legal limits on reserves for second injury claim payments. Furthermore, ORM should request timely reimbursements from the Second Injury Fund. In a memorandum dated October 17, 1997, Mr. Seth E. Keener, Jr., State Risk Director, concurred with the finding and recommendation. Mr. Keener stated that excess reserves on the claims noted in the finding have been adjusted to the proper limit and reimbursement has been requested for the four claims for which reimbursement was not requested timely. Mr. Keener further stated that a review to verify the reserve amounts and reimbursement status of second injury claims was recently completed.

The recommendations in this report represent, in our judgment, those most likely to bring about beneficial improvements to the operations of the office. The nature of the recommendations, their implementation costs, and their potential impact on the operations of the office should be considered in reaching decisions on courses of action. The findings relating to the office's compliance with applicable laws and regulations should be addressed immediately by management.

By provisions of state law, this report is a public document, and it has been distributed to appropriate public officials.

Respectfully submitted,

Daniel G. Kyle

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Legislative Auditor

JDH:MWB:dl

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