STATE OF LOUISIANA

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

March 24, 2004

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OFFICE OF RISK MANAGEMENT
EXECUTIVE DEPARTMENT
STATE OF LOUISIANA

Baton Rouge, Louisiana

Management Letter
Dated February 26, 2004

March 24, 2004

OFFICE OF
LEGISLATIVE AUDITOR
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February 26, 2004

OFFICE OF RISK MANAGEMENT
EXECUTIVE DEPARTMENT
STATE OF LOUISIANA
Baton Rouge, Louisiana

As part of our audit of the State of Louisiana's financial statements for the year ended June 30, 2003, we considered the Office of Risk Management's internal control over financial reporting. We examined evidence supporting certain accounts and balances material to the State of Louisiana's financial statements, and we tested the department's compliance with laws and regulations that could have a direct and material effect on the State of Louisiana's financial statements as required by *Government Auditing Standards.*

The Annual Fiscal Report of the Office of Risk Management is not audited or reviewed by us, and, accordingly, we do not express an opinion 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 opinions.

In our prior management letter on the Office of Risk Management for the year ended June 30, 2002, we reported findings relating to access to information systems not properly restricted, noncompliance with controls over time and attendance reporting, inaccurate data recorded in the claim management system, inaccurate annual fiscal report, and misstated reserves and untimely reimbursement requests for second injury claims. The findings related to access to information systems not properly restricted, noncompliance with controls over time and attendance reporting, and inaccurate annual fiscal report have been resolved by management. The findings related to inaccurate data recorded in the claim management system and untimely reimbursement requests for second injury claims are addressed again in this letter.

Based on the application of the procedures referred to previously, all significant findings are included in this letter for management's consideration. All findings included in this management letter that are required to be reported by *Government Auditing Standards* have also been included in the State of Louisiana's Single Audit Report for the year ended June 30, 2003.

Deficit in Road Hazard Line of Insurance

The Road Hazard line of insurance has accumulated a deficit of $605,000,000, at June 30, 2003, which resulted from the Office of Risk Management (ORM) making claim payments for road hazards over several years, while no premiums were collected from the Department of Transportation and Development to cover settlements of suits against the state of Louisiana. For five consecutive years, we have reported that ORM used premiums collected from state agencies for various other lines of insurance, such as medical malpractice, general liability, automobile, et cetera, to fund road hazard claim payments.

The Division of Administration made a decision effective July 1, 2002, that ORM would no longer pay road hazards claims from premiums collected from other lines of insurance, although no solution has been proposed to fund the $605 million deficit created by the payment of prior road hazard claims. Settlement of road hazard claims now requires a direct legislative appropriation of state General Fund monies.

In the month preceding the decision to require legislative appropriation, June 2002, the Attorney General and ORM settled a lawsuit against the Department of Transportation and Development that resulted in payments of over $5 million relating to a suit that had been filed in 1998.

The details of this particular suit are summarized as follows:

- On April 9, 1997 accident records reflect that an intoxicated driver ran a stop sign and hit another car in East Carroll Parish. A passenger in the car who was hit by the intoxicated driver was permanently disabled and suit was filed by the passenger's mother in April 1998 against the drivers of the two vehicles, the state, and others. The plaintiff alleged, among other things, that the intersection was defective.

- The plaintiff attorneys included a law firm in Monroe, a state senator from Monroe, a state senator from Livonia, and an attorney from Baton Rouge. The state was represented by a contract attorney from Monroe who was selected by the Attorney General.

- East Carroll Parish Police Jury settled with the plaintiff for $380,000 before trial.

- In February 2002, a jury trial was held in the Sixth Judicial District Court. The jury found the Department of Transportation and Development 100% at fault. The total award was in excess of $11 million.

- One week after the trial, the chief of the Litigation Section in the Attorney General's Office made a firm recommendation that the state should appeal the jury decision to the Court of Appeal, Second Circuit. He felt that the award exceeded legal caps and that similar cases against the Department of Transportation and Development in which the offending motorist was intoxicated did not result in the state being 100% liable. The contract attorney representing the state agreed.

- In April 2002, a judgment was issued by the court, but the award was reduced to approximately $7 million because certain legal caps had been exceeded in the original judgment.

- Subsequent to the judgment, attorneys for both parties entered into negotiations to settle the case. In May 2002, the state and the plaintiff attorneys agreed to a settlement. On May 15, 2002, the Litigation Subcommittee of the Joint Legislative Committee on the Budget concurred with an ORM request to settle the matter for $5 million. On June 13, 2002, two weeks before the decision made by the Division of Administration to require legislative appropriation for road hazard claims, ORM made settlement payments totaling $5 million to the plaintiff and plaintiff attorneys. ORM and the Attorney General concluded that the settlement was in the state's best interest and that exposure could exceed that amount if the state was required to include judicial interest in any final settlement.

- Soon after the judgment was rendered in the Sixth Judicial District Court against the state, an appeal was filed by the insurance carrier that provides excess insurance coverage to the state for road hazard claims. Less than one year after the $5 million settlement, on May 14, 2003, the Court of Appeal, Second Circuit, reversed the earlier judgment rendered against the state, although ORM had already made payment to the plaintiff attorneys. The appeals court conclusion provides that "we reverse the ruling of the trial court from our determination that the jury was manifestly erroneous and clearly wrong in not finding the driver's intoxication and his failure to stop at the point nearest the intersection as the sole cause-in-fact of the accident." The state did not include the excess carrier in its initial defense, although the excess carrier maintained liability for claims in excess of $5 million. The excess carrier was represented in the appeal by the same attorney in Monroe who contracted for the state's defense and who at one time had suggested to the state that it should appeal the judgment of the lower court.

- The settlement also included a payment to the state Medicaid program since the plaintiff had incurred medical costs that were paid by the state. Thus, the settlement included a payment of $144,392 to the state as reimbursement for costs. The payment was only a partial payment for costs of over $200,000 that were incurred. Representatives of the state Medicaid program agreed to take a lesser amount from the settlement made to the plaintiffs. ORM provided the check to the state's contract attorney who in a June 2003 letter, one year after the check was written, informed the state Medicaid program that the check was in the possession of a state senator who represented the plaintiff and participated in the settlement. He indicated that the Medicaid program needed to contact the senator to satisfy Medicaid's lien.

In summary, a decision was made by state officials to make a settlement payment of $5 million to the plaintiff based on a trial court decision instead of filing the appropriate appeal. If state officials had pursued the issues through appropriate legal channels in lieu of settlement, the Road Hazard Program might have decreased the deficit in the program by $5 million. The state routinely settles claims, which are generally based on informed legal decisions. Therefore, it is very difficult to ascertain whether a good decision is ever made since settlement usually brings closure to the issues. In this particular case, since the excess carrier elected to appeal to a higher court, it is evident that pursuit of this case to the appeals court may have saved the state up to $5 million that it had previously settled.

The Division of Administration and ORM should present suggestions to the legislature as to how the state might resolve the $605 million deficit in the Road Hazard Program. The state should also review its defense, appeals, and settlement of claims policies for cases brought against the state to prevent unnecessary payments to plaintiffs and their attorneys. In addition, ORM should submit payments directly to the Medicaid program that result from settlement of claims incurred by the Medicaid program, which are subsequently reimbursed through self-insurance. Management did not concur with the finding noting that the finding did not consider subsequent events, continuing appeals, and additional efforts and actions on the part of ORM and the Division of Administration (see Appendix A, pages 1-2).

Additional Comments: The following facts remain: (1) in prior years, the Division of Administration and ORM used premiums collected from various lines of insurance to pay road hazard claims; (2) a deficit exists in the Road Hazard line of insurance of $605 million; (3) the Division of Administration and ORM chose to settle rather than appeal a lower court judgment that was ultimately overturned by a higher court; and (4) a refund payment to the Department of Health and Hospitals/Medicaid program was held by the plaintiff's attorney for over one year, and according to management, it does not appear that this payment has yet been received by the state.

Inaccurate Data Recorded in the Claims Management System and Untimely Reimbursement Requests

For the second consecutive year, ORM did not ensure that excess carrier claims data are properly recorded in the claims management system. In addition, ORM did not request reimbursements from or file the claims with the commercial carriers in a timely manner. A good system of internal controls would include procedures to ensure claims data are recorded accurately, obligations associated with those claims are properly reported, and reimbursements from and claims filed with the commercial carriers are

timely. ORM's policy and procedures require the adjusters to request reimbursement from the commercial carriers on a semi-annual basis.

A test of 14 excess carrier claims closed during FYE 2003 and 14 open excess carrier claims with any payment activity during FYE 2003 revealed that $245,074 in commercial carrier reimbursements were not requested in a timely manner, resulting in $18,591 in penalty costs assessed by the excess claims carrier. In addition, the Estimated Future Liability is understated by $282,716.

Management has not placed sufficient emphasis on internal controls over the claims data recorded in the claims management system, commercial carrier reimbursement requests, and filing of claims with the commercial carriers. ORM has developed procedures for requesting reimbursements on a semiannual basis; however, those procedures have not been adequately implemented. Inaccurate claims data in the claims management system and untimely reimbursement effort increases the risk that the estimate of future claim liabilities will be materially misstated. Untimely filing efforts increase the risk that the state may incur significant costs for penalties imposed by the commercial carriers.

Management should establish and implement adequate internal controls to ensure that excess carrier claims data are accurately recorded in the claims management system and that recovery and filing efforts are timely. Management concurred in part with the finding, noting that ORM filed timely reimbursement requests against excess carriers, but failed to report to the excess carrier on a timely basis, prior to the coverage limit being reached that a claim could potentially be filed. Management outlined a plan of corrective action (see Appendix A, pages 3-4).

Misstated Reserves and Untimely Reimbursement Requests

For the seventh consecutive year, ORM has misstated reserves for second injury claims and has not requested timely reimbursements from the Second Injury Fund. Louisiana Revised Statute (R.S.) 39:1527 et al. created ORM as the state's self-insurance agency. 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 pre-existing disability. R.S. 23:1378 divides the financial responsibility for paying second injury claims between the state's insurer (ORM) and the Second Injury Fund. In addition, ORM policy states that a notice of claim must be filed against the Second Injury Board within one year from the date of the issuance of the first payment, and the adjuster must request reimbursement once every three to six months until the

claim is closed. ORM policy also outlines reserve requirements for medical and indemnity claims.

In 42 of 58 (72%) second injury claims tested, errors were noted resulting in a net understatement of second injury claim reserves of $635,984 and a net of $161,395 not collected by ORM from the Second Injury Fund.

Although management has developed policies and procedures regarding reimbursement from the Second Injury Fund and setting and adjusting the reserves on claims, these policies have not been adequately implemented. Errors in the reserves may cause misstatements of liabilities in the state's financial statements. Failure to request reimbursement in a timely manner may affect ORM's ability to recover costs.

ORM management should ensure that the reserves for claims are adjusted to reflect the actual and estimated expenditures or the required reserve limit per department policies and procedures. Second Injury Fund reimbursements for medical and weekly benefit expenditures should be requested in a timely manner and any excess reimbursements returned to the fund. Management concurred in part with the finding, noting that some of the amount mentioned in the finding is not recoverable and that the Second Injury Fund does not always respond promptly to requests for reimbursement. Management outlined a plan of corrective action (see Appendix A, page 5).

Additional Comments: We addressed the amount that was not collected, not whether or not the amount was recoverable. ORM's untimely actions can affect whether or not an amount is recoverable.

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

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

Respectfully submitted,

Grover C. Austin, CPA
First Assistant Legislative Auditor

MJ:WG:PEP:ss

[ORM03]

Appendix A

Management's Corrective Action Plans and Responses to the Findings and Recommendations

State of Louisiana
DIVISION OF ADMINISTRATION
OFFICE OF THE COMMISSIONER

Kathleen Babineaux Blanco
GOVERNOR

Jerry Luke LeBlanc
COMMISSIONER OF ADMINISTRATION

February 4, 2004

Mr. Grover Austin, CPA
First Assistant Legislative Auditor
Office of the Legislative Auditor
P. O. Box 94397
Baton Rouge, LA 70804-9397

Dear Mr. Austin:

RE: Office of Risk Management Audit Findings

Finding: Deficit in Road Hazard Line of Insurance

The Division of Administration, Office of Risk Management (ORM) does not concur with the finding since in large part the "finding" is based upon erroneous information, assumptions, and implications, which are invalid.

The finding is based in large part on the initial review and recommendations of the Division of Risk Litigation's attorney assigned to the case (not the DRL, Chief of Litigation Services as noted in the finding). The finding does not take into account subsequent events and discussions held between the Division of Risk Litigation, Office of Risk Management, Contract Attorney's, Plaintiff Attorney's, Attorney General, and Division of Administration, with regards to this case that eventually led to a decision to settle the claim.

The finding stipulated in Paragraph 4, Subparagraph 8, Page 2, is erroneous in that it assumes the litigation effort is complete. The 2nd Circuit Court of Appeals decision was the subject of a writ application filed by the plaintiffs to the Louisiana Supreme Court. This writ was granted in the fall of 2003. The case was argued before the Louisiana Supreme Court on January 22, 2004, and the parties are now awaiting a decision from that court. The matter as of this date is not final as to the excess carrier, therefore it is not evident that pursuit of this case may have saved the state up to $5 million.

The finding is contradictory in that it states that "The state routinely settles claims, which is generally based on informed legal decisions." but later implies that improper processes were followed and that the body empowered with the final decision, namely the Litigation

Subcommittees of the Joint Legislative Committee on the Budget" was in error and their actions costs the state $5 million dollars. The information presented to the committee was done in conjunction with the state's chief legal counsel, namely the Attorney General, who after considerable review provided the decision and supporting justification for settlement. It is difficult to ascertain how the finding was issued when in fact the decision was based upon documented legal justification and confirmed by the appointed body of the State Legislature.

With regard to the Medicaid issue, ORM adjusters experience difficulty when attempting to determine the amounts paid by the Medicaid program for treatment rendered to a claimant. Medicaid prefers to deal directly with the claimant and does not respond to requests from ORM for information. As a result, when ORM is settling claims that include Medicaid liens, Medicaid is included as a payee on the settlement check and the plaintiff attorney/claimant must settle with Medicaid to secure their endorsement before the settlement check can be cashed.

In addition, ORM has reviewed its litigation management in order to prevent unnecessary payments. ORM also initiated the employment of a staff attorney whose duties are to counsel and advise the staff regarding tort litigation and review all Request for Settlement Authority documents for settlement, defense, and/or appeal of litigated cases

In closing, the ORM has always recommended and submitted actuarially based premiums in the annual budget request to the Division of Administration (DOA) that includes an amount for Road Hazard claims coverage and an amount to eliminate the existing $605 million deficit over a ten year period. Budget constraints in recent years have required that the DOA reduce the premiums requested to the level of cash needs that excludes Road Hazard claims. Those decisions have been confirmed by action of the Legislature. Consequently, the provisions of the finding related to resolving the deficit in the Road Hazard Program appear to be misdirected.

Please be advised that Mr. J. S. "Bud" Thompson, Jr. is the contact person responsible for corrective action.

Sincerely,

Whitman J. Kling, Jr.
Deputy Undersecretary

WJK/.JST/THA

c: Mr. J. S. "Bud" Thompson, Jr.
State Risk Director

State of Louisiana
DIVISION OF ADMINISTRATION

OFFICE OF RISK MANAGEMENT

KATHLEEN BABINEAUX BLANCO
GOVERNOR

JERRY LUKE LEBLANC
COMMISSIONER OF ADMINISTRATION

January 23, 2004

Mr. Grover Austin, CPA
First Asst. Legislative Auditor
Office of the Legislative Auditor
State of Louisiana
P. O. Box 94397
Baton Rouge, LA 70804-9397

RE: Office of Risk Management Audit Findings

Dear Mr. Austin:

Finding: Inaccurate Data Recorded in the Claims Management System and Untimely Reimbursement Requests

The Office of Risk Management concurs in part with the finding. ORM has filed timely reimbursement requests against excess carriers once coverage limits have been reached, but has failed to report to the excess carrier on a timely basis prior to the coverage limit being reached that a claim could potentially be filed against the excess carrier. The penalties that were assessed were on files that had previously been reported to the excess carrier. Since the initial claim was reported late, each time the excess carrier makes a reimbursement, they deduct a penalty.

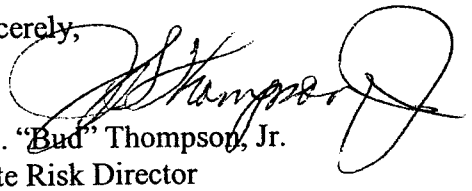
Karen Jackson is the contact person responsible for corrective action.

Files noted with a failure to properly record claim data in the claim management system have all been corrected. These were excess carrier claims files on which expense and legal costs were paid. Adjusters and supervisors have again been reminded that these expenses are to be paid on the primary claim. Supervisors have been instructed that a routine part of file review should include ensuring proper handling of excess carrier claims.

Procedures for handling of Excess Carrier claims have been updated and have been put in a format designed to be easy to follow. The penalty assessed by the excess carrier will be transferred to a separate coverage code for miscellaneous tort because this amount will never be recovered. When reimbursements are received and the carrier stipulates the penalties amount, then that amount also will be transferred to the claim with a coverage code for miscellaneous tort.

A monthly report of claims that might require excess carrier notification is generated from the Claims Management System. Managers and Supervisors will review all the claims on the report to ensure that proper procedures are followed. In addition, the normal file reviews will include this requirement.

Sincerely,



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

JST/THA/tha

State of Louisiana
DIVISION OF ADMINISTRATION

OFFICE OF RISK MANAGEMENT

KATHLEEN BABINEAUX BLANCO
GOVERNOR

JERRY LUKE LEBLANC
COMMISSIONER OF ADMINISTRATION

January 23, 2004

Mr. Grover Austin, CPA
First Asst. Legislative Auditor
Office of the Legislative Auditor
State of Louisiana
P. O. Box 94397
Baton Rouge, LA 70804-9397

RE: FY 04 Office of Risk Management Audit Findings

Dear Mr. Austin:

Finding: Misstated Reserves and Untimely Reimbursement Requests.

The Office of Risk Management concurs in part with this finding. The amount mentioned in the finding as uncollected is not recoverable in its entirety. Amounts for recoverable items provided for in R.S. 23:1378 had been requested from the Second Injury Fund (SIF). The SIF does not always promptly respond to requests for reimbursements because of budget constraints, etc.

Karen Jackson is the contact person responsible for corrective action.

The Office of Risk Management makes reimbursement requests on a regular basis on all approved Second Injury Fund (SIF) claims utilizing a vendor that specializes in seeking approval and recovery of SIF claims. This is significantly improving the recovery rate.

Reserves are now correctly stated in the claims mentioned in the finding.

Supervisors have been instructed to ensure that adjusters adhere to claims processing procedures and reserving guidelines as a regular part of the file review of SIF claims.

Sincerely,

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

JST/THA/tha