

STATE OF LOUISIANA LEGISLATIVE AUDITOR

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

February 5, 2003



Financial and Compliance Audit Division

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Albert J. Robinson, Jr., CPA

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

Management Letter
Dated January 23, 2003

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 5, 2003



OFFICE OF
LEGISLATIVE AUDITOR
STATE OF LOUISIANA
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January 23, 2003

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, 2002, 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 office'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 an opinion.

In our prior management letter on the Office of Risk Management for the year ended June 30, 2001, we reported findings relating to the lack of an internal audit function and misstated reserves and untimely reimbursement requests for second injury claims. The finding related to the internal audit function has been resolved by management. The finding related to second injury claims is 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* will also be included in the State of Louisiana's Single Audit Report for the year ended June 30, 2002.

Inaccurate Annual Financial Report

The Office of Risk Management (ORM) did not submit an accurate Annual Fiscal Report (AFR) for fiscal year ended June 30, 2002, to the Division of Administration, Office of Statewide Reporting and Accounting Policy (OSRAP). Louisiana Revised Statute (R.S.) 39:79 authorizes the commissioner of administration to establish the format of each agency's AFR and requires a signed affidavit that the financial statements present fairly the financial position of the agency. The Division of Administration uses ORM's AFR and disclosures during the compilation of the state's annual financial statements. Good internal control includes establishing formal written procedures for compiling financial information included in the AFR and developing an adequate review process. The AFR

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OFFICE OF RISK MANAGEMENT EXECUTIVE DEPARTMENT STATE OF LOUISIANA

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and additional disclosures that were submitted to OSRAP had the following errors, omissions, or inconsistencies:

- In the "GASB 34 Accruals" note (note AA), premium receivables were understated by \$169,069; due from others totaling \$4,462,766 was omitted; and the amount not expected to be collected in one year was understated by \$4,757,611.
- Total assets on the Balance Sheet (Statement A) were understated by \$122,735. Premium receivables were understated by \$215,912 and prepaid expenses were overstated by \$93,177.
- Total liabilities on the Balance Sheet (Statement A) were understated by \$653,272. Accounts payable were overstated by \$566,502; claim payables were overstated by \$199,465; and prepaid insurance premiums totaling \$112,696 were omitted.
- Reserve for continuation of operations on the Balance Sheet (Statement A) was overstated by \$2,301,503 and did not agree with reserves for continuing operations in note U, which was overstated by \$5,357,942.
- Revenue on the Statement of Revenues, Expenditures, and Changes in Fund Balances (Statement B) was overstated by \$166,138.
- Fund balance on the Balance Sheet (Statement A) did not agree to fund balance on the Statement of Revenues, Expenditures, and Changes in Fund Balances (Statement B) by \$10,678,974.
- In additional disclosure related to annuities, the total amount of annuities purchased was overstated by \$2,850,354 and the amount of annuities outstanding at June 30, 2002, was overstated by \$2,663,815.
- In the table "Changes in Aggregate Claims Liabilities" included as additional disclosure, claims payments for 2001-02 were overstated by \$32,857,656 and claims and changes in estimates were overstated by \$32,132,075. This occurred because ORM failed to reconcile claims payments per the claims management system to the state's general ledger accounting system.

Furthermore, much of the supporting documentation for the notes and additional disclosures was prepared after the AFR was submitted.

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EXECUTIVE DEPARTMENT
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Management has not placed sufficient emphasis on ensuring that the AFR is properly prepared and reviewed for errors or omissions. Undetected inaccuracies in financial reporting by the office could cause misstatements in the state's Comprehensive Annual Financial Report.

Management should develop procedures to include written instructions and high-level supervisory review of financial information and note disclosures to detect and correct errors before submitting that information to OSRAP. Management should also have supporting documentation prepared for the notes and additional disclosures before submitting the AFR. Management concurred with the finding and recommendation and outlined a corrective action plan (see Appendix A, page 2).

**Access to Information Systems
Not Properly Restricted**

ORM did not establish adequate internal control over assigning and monitoring access given to users of the Integrated Statewide Information System (ISIS). Good internal control requires that (1) duties are segregated so that no one user is in a position to both initiate and approve transactions and therefore potentially conceal errors or fraud; (2) strict confidentiality of passwords and identification (ID) codes is maintained; and (3) access to information systems is promptly removed when users terminate employment.

The following deficiencies were noted:

- Employees share passwords and ID codes and inadequate segregation of duties exists because the same person can both initiate and approve transactions on-line. Nine transactions in a one-day period were entered and approved by the same user. We were informed by one employee that the ID and password of a second employee was used to both enter and approve these transactions during a period when numerous employees were absent and there was a backlog of work.
- Four individuals still had active ID codes even though they had terminated employment.

These deficiencies occurred because ORM management did not establish adequate procedures for assigning and monitoring access given to information system users and did not emphasize the importance of protecting the confidentiality of ID codes and passwords. Failure to establish adequate internal control in an on-line data entry environment could result in fraud or errors in the processing of transactions.

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ORM should develop information system access policies and procedures to ensure that (1) duties are properly segregated; (2) employees are prohibited from sharing IDs and passwords; and (3) access is disabled in a timely manner when users terminate employment. Management concurred with the finding and recommendation and outlined a corrective action plan (see Appendix A, page 3).

Noncompliance With Controls Over Time and Attendance Reporting

ORM did not adhere to the office's established time and attendance reporting procedures. ORM's payroll procedures require that (1) the payroll clerk complete a checklist to verify the accuracy and completeness of time and attendance records within 10 working days of the payroll period ending date; (2) the payroll supervisor review the checklist and related time and attendance records within 20 working days of the payroll period ending date; and (3) the payroll clerk report errors and problems to employees and supervisors on a prescribed form. In addition, Civil Service Rule 15.2 requires the employee and supervisor to certify the number of hours of attendance or absence from duty on the time and attendance records. A review of time and attendance reporting procedures for 26 pay periods in fiscal year 2002 disclosed the following:

- For nine (35%) pay periods, the payroll clerk had not prepared the required checklist. The payroll clerk informed us that her failure to prepare the checklists resulted from her inability to gather complete and accurate time and attendance documentation from employees and supervisors. This documentation included employee and/or supervisor signatures on time sheets, leave slips that agreed to the time sheets, and employee sign in and out times documenting arrival at and departure from work.
- Six (35%) of 17 checklists prepared by the payroll clerk were not reviewed and approved by the payroll supervisor.
- Six (55%) of 11 checklists were approved by the supervisor from 30 days to 6 months after the pay period ending date.
- No forms were on file to document errors or problems reported to employees and supervisors. The payroll clerk informed us that she discontinued using the form because of a lack of response from the employees and management.

The above conditions occurred because of an inadequate review of the payroll clerk's work as required by the office's established control procedures. Furthermore, management has not placed sufficient emphasis on adherence to established controls

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over time and attendance reporting. Failure to adhere to the established controls increases the risk of payroll errors and/or fraud and increases the risk of noncompliance with state regulations.

Management should require employees to adhere to established time and attendance reporting procedures. In addition, the payroll clerk should timely report to management any problems in gathering time and attendance records. Management concurred with the finding and recommendation and outlined a corrective action plan (see Appendix A, page 4).

Inaccurate Data Recorded in the Claims Management System

ORM did not have adequate control procedures over claims data recorded in the claims management system. A good system of internal control would include procedures to ensure that claims data are recorded accurately and obligations associated with those claims are properly reported. ORM (the state's insurer) sets limits on the amount of claims for which the state will be liable and purchases coverage above this limit from commercial insurance carriers. ORM's procedures require that certain codes be used in the claims management system to identify claims for which the state is responsible (state claims) and claims for which the commercial insurance carrier is responsible (excess carrier claims). It is also ORM's policy to request reimbursements semiannually from commercial insurance carriers on claims for which the carriers are responsible. ORM uses claims data recorded in the claims management system to (1) estimate and report liabilities associated with state claims in the notes to its annual fiscal report, and (2) request reimbursements from the commercial insurance carriers. In a review of the 98 excess carrier claims recorded in the claims management system, the following errors were noted:

- Fifty-five (56%) excess carrier claims were incorrectly coded as state claims.
- Payments totaling \$151,792 for claims to be paid by the state were erroneously coded to excess carrier claims. For one claim, payments by ORM exceeded the commercial carrier's coverage limit by \$106,027. For four other claims, payments totaling \$45,765 were not eligible for reimbursement from the commercial carriers since ORM paid the claims.
- Payments by ORM totaling \$139,274 were coded to state claims while the reimbursement of the payments was coded to excess carrier claims.
- Payments totaling \$579,172 were coded as excess carrier claims although reimbursement requests had been denied by the commercial

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insurance underwriters--one because ORM had not met the self-insurance limit by \$155,180 and the other because ORM had not requested timely reimbursement of \$423,992 from the Second Injury Fund. When denied by the underwriters, these amounts should have been coded to state claims.

- Reimbursements totaling \$1,532,043 were not requested from commercial insurance carriers on a semiannual basis.
- A reimbursement totaling \$18,140 had not been posted to the excess carrier claim in the claims management system.

These errors can be attributed to insufficient emphasis on internal control by management and employees. Failure to establish and follow adequate control procedures increases the risk that undetected errors will result in inaccurate financial reports and an inaccurate estimation of state obligations. Failure to request timely reimbursements affects ORM's ability to recover amounts due from the commercial insurance carriers.

Management should establish controls to ensure accurate data are recorded in the claims management system, including developing written policies and procedures and adequately training staff. In addition, management should develop a review process that involves not only a high-level review, but also a detailed review of claims data supporting the estimation of claims liabilities to ensure that errors are detected timely. Management concurred with the finding and recommendation and outlined a corrective action plan (see Appendix A, page 5).

Misstated Reserves and Untimely Reimbursement Requests

For the sixth 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 preexisting 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, state law 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. Furthermore, ORM policy requires that employees request reimbursements from the Second Injury Fund at least semiannually.

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- In a test of 41 second injury claims, the reserves for weekly benefits of 19 (46%) claims were overstated by \$258,849. Also, reimbursements of up to \$298,865 for 11 (27%) claims had not been requested semiannually from the Second Injury Fund.
- The reserves for medical reimbursements for two (12%) of 17 claims tested were understated by \$378,865.
- In a test of 16 second injury claims closed during the year, four (25%) were closed even though reimbursements of up to \$128,517 had not been requested from the Second Injury Fund.

Management has not adequately supervised or properly trained its employees on the laws and regulations governing the Second Injury Fund. Errors in reserves result in noncompliance with state law and 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 should comply with legal limits on reserves for claims eligible for reimbursement by the Second Injury Fund, set reserves at the proper amount, and request timely reimbursements from the Second Injury Fund. Management should also ensure that employees are properly trained and supervised in the laws and regulations related to the Second Injury Fund. Management concurred with the finding and recommendation and outlined a corrective action plan (see Appendix A, page 6).

The recommendations in this letter represent, in our judgment, those most likely to bring about beneficial improvements to the operations of the office. The varying 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. Findings relating to the office's compliance with applicable laws and regulations should be addressed immediately by management.

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**OFFICE OF RISK MANAGEMENT
EXECUTIVE DEPARTMENT
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Management Letter, Dated January 23, 2003
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This letter is intended for the information and use of the office 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,

A handwritten signature in black ink, appearing to read "Grover C. Austin". The signature is fluid and cursive, with a large initial "G" and "A".

Grover C. Austin, CPA
First Assistant Legislative Auditor

JDH:BMcC:PEP:dl

[ORM02]

Appendix A

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



State of Louisiana
DIVISION OF ADMINISTRATION
OFFICE OF RISK MANAGEMENT

M. J. "MIKE" FOSTER, JR.
GOVERNOR

MARK C. DRENNEN
COMMISSIONER OF ADMINISTRATION

November 18, 2002

Dr. Daniel G. Kyle, CPA, CFE
Legislative Auditor
Office of the Legislative Auditor
State of Louisiana
P.O. Box 94397
Baton Rouge, LA 70804-9397

RE: Response to Legislative Audit Finding

Dear Dr. Kyle:

The Office of Risk Management has received from your office the final draft of ORM's financial and compliance audit. Attached to this letter is management's response to the audit.

The management of the Office of Risk Management appreciates the work performed by your audit team and the report of their findings. It is our wish that ORM continue to cooperate, as it has in the past, in the efforts you make in our behalf.

Should you have any questions at any time, please do not hesitate to call.

Sincerely,

A handwritten signature in cursive script, appearing to read "J.S. Thompson, Jr.", written in black ink.

J.S. Thompson, Jr.
State Risk Director

JST/PW

Attachment

Office of Risk Management
Response to Financial and Compliance Audit
November 18, 2002

Finding: Inaccurate annual fiscal report

The Office of Risk Management concurs with the findings. This was the first year for implementation of GASB 34 and there were several issues involved. ORM feels that the instructions provided for implementation and reporting due to GASB 34 were unclear. ORM is a unique agency within the state and presents problems in trying to conform to reporting requirements, in preparation of two sets of financial statements, one utilized for combining ORM into the CAFR and one utilized for the statewide cost allocation plan and management decisions, both of which must be completed in the time other agencies complete one.

Several of the errors were due to transactions being entered during the fiscal year and corrections not being made until the year end close. The errors on the annuities originated due to the death of a claimant and the refunding of \$1.8 mil (cost of annuity minus any payouts). The refund was offset against the cost of the annuity, however, the formula which calculates the balance due was not changed to reflect that no other payments were pending. This was the first time that we had an occurrence of this type.

Corrective Actions:

ORM has inquired about training for preparation of the annual financial report. We were informed that although training was provided in the past, it has not been available for last few years. However, several requests have been received and the training classes may be re-instituted. We have requested notification in that event. If training is not re-instituted, ORM accounting personnel will request meetings with the appropriate personnel in advance to clarify how items unique to ORM should be reported. In addition, ORM accounting personnel has implemented cross-training to ensure that accounting personnel understand the significance of transactions and their effect on the financials.

Management is committed to putting more emphasis on ensuring that the AFR is properly prepared and reviewed for errors and omissions. To facilitate this process we are restructuring the Accounting Unit to more clearly define responsibilities and provide for improved internal controls. This should be implemented by February 28, 2003.

The contact person for this finding is Lynette Bayham.

Office of Risk Management
Response to Financial and Compliance Audit
November 18, 2002

Finding: Access to Information Systems Not Properly Restricted

The Office of Risk Management concurs with the finding Access to Information Systems Not Properly Restricted.

ORM encountered several problems which led to this breakdown. The sharing of passwords occurred due to a shortage of personnel. During this time, Accounting had 4 vacant positions. In order to get payments out to vendors, the Accountant Technician who was approved to enter payments, but who was doing the work of two vacant positions already, logged on and allowed the Accountant Supervisor to enter payments under her user ID. The Accountant Supervisor would then approve payments under her own user ID, however in one instance she forgot and paid and approved using the same ID. This was done only in cases of absolute need due to vendors complaining of late payments. As soon as the vacancies were filled, the proper procedures were re-instituted.

In the case of active ID's for employees who had terminated employment, there was a breakdown in procedures due to personnel changes. Part of the exit process was to notify appropriate security managers for each system used that the employee had terminated and that user ID's should be removed. Due to personnel changes and lack of training, this procedure was not followed.

Corrective Actions:

As soon as it became known that the process of sharing passwords and ID codes was occurring, the Accountant Administrator 2 notified all accounting personnel via email that this was not an acceptable practice and that under no circumstances was that to be done. The email also stated that anyone found to be sharing passwords/user ID's could be subject to disciplinary action.

The notification form that was part of the exit process to notify security personnel that ID's needed to be inactivated has been re-instituted and quarterly security audits will be conducted. Information system access policies and procedures are being developed and will be in place by December 31.

The contact person for this finding is Pam Whiteside.

Office of Risk Management
Response to Financial and Compliance Audit
November 18, 2002

Finding: Noncompliance with Controls over Time and Attendance Reporting

The Office of Risk Management concurs with the findings. The shortage of accounting personnel and absences of accounting management due to circumstances beyond their control exacerbated this problem. The payroll clerk discontinued use of forms due to what she felt was a lack of support by management and lack of personnel for proper oversight allowed this discontinuance to go unnoticed.

Corrective Actions:

All of the payrolls are being reviewed and completed. Management has placed sufficient emphasis on adherence to established controls over time and attendance reporting procedures. Payroll clerk has been notified to reinstate the form to request and document errors or problems as well as the required checklist. Additional personnel have been trained and made responsible for ensuring that procedures are followed. ORM management has instructed Unit Officers to hold supervisors and managers accountable in the performance, planning and review (PPR) process for timely and accurate adherence to time and attendance reporting procedures. All ORM PPR documents include an item for "Compliance with Applicable Law, Rules, Policies, and Procedures". Non-compliance with the Time and Attendance Reporting procedures will be reflected in this item.

The contact person for this finding is Andre Metoyer.

**Office of Risk Management
Response to Financial and Compliance Audit
November 18, 2002**

Finding: Inaccurate data recorded in the Claims Management System

The Office of Risk Management concurs with the findings.

Upon review of a list run by ORM personnel, ORM found that there were 44 CGL claims that listed the coverage code for the primary claim rather than the correct excess code.

Reimbursements totaling \$1,532,043.00 were not requested from commercial insurance carriers on a semi-annual basis. Workers' compensation has procedures which require adjusters to request reimbursement from Excess Carriers every six (6) months. Adjusters have not done this and supervisors failed to instruct subordinates to conform on file review.

Corrective Actions:

ORM is making all necessary corrections and implementing training in these areas. In addition, management has established an Information Technology section, which will be responsible for developing, and running reports for review by supervisory personnel to ensure accurate data is recorded. Written policies are being reviewed with personnel and will be updated as necessary to ensure that sufficient internal controls are established and followed.

The ORM underwriting unit had previously prepared a coding matrix, which outlines the levels of self-insurance and excess insurance. This was reviewed with the adjusters.

Both supervisors and adjusters have been again reminded to conform to established procedures and will be held accountable in the PPR process. Request for the reimbursement of \$1,532,043.00 has now been submitted.

Reimbursement totaling \$18,140 has been posted to the excess carrier claim in the claims management system and adjusters have been requested to verify posting prior to closing the claim.

We expect all corrections to be completed and reports for verification to be in place by January 31, 2003. The contact person for this finding is Ann Wax.



State of Louisiana
DIVISION OF ADMINISTRATION

OFFICE OF RISK MANAGEMENT

RECEIVED
LEGISLATIVE AUDITOR

M. J. "MIKE" FOSTER, JR.
GOVERNOR

02 DEC -6 PM 12:54

MARK C. DRENNEN
COMMISSIONER OF ADMINISTRATION

December 5, 2002

Dr. Dan G. Kyle, CPA, CFE
Legislative Auditor
Office of the Legislative Auditor
Post Office Box 94397
Baton Rouge, Louisiana 70804-9397

Dear Dr. Kyle:

RE: Single Audit Finding - Misstated Reserves and Untimely Reimbursement Requests

This office appreciates the opportunity to provide a response to your draft report on the reference finding. We concur with the adverse finding that for the sixth consecutive year, the Office of Risk Management (ORM) has misstated reserves for second injury claims and has not requested timely reimbursement from the Second Injury Fund (SIF) in spite of periodic training and established procedures concerning the SIF.

Corrective Action:

Immediate corrective action was taken on the tested claims that were noncompliant with the state law. The appropriate reserve adjustments or the request for reimbursement of eligible medical and/or indemnity benefits were made within the past ninety days.

Karen Jackson, the Worker's Compensation Claims Manager, will be responsible for the corrective action to address inadequately supervised and improperly trained employees in the area of SIF recoveries. She will conduct a mandatory training session for supervisors, adjusters and examiners to review RS 23:1378 relative to SIF as well as established ORM office procedures concerning the reserving and recovery of SIF claims. This mandatory training is tentatively scheduled for January, 2003. In the future, all new worker's compensation employees will receive the same training.

The worker's compensation supervisors have been instructed to diary, for review, the claims that have been identified as eligible for recovery from the SIF. These claims are to be reviewed on a quarterly basis to make sure the adjusters have adequately reserved the SIF

claims in accordance with the established procedures and that reimbursements have been requested in a timely manner.

The Workers' Compensation Claims Manager, supervisors, adjusters and examiners will be held accountable for adherence to the established procedures. The individual productivity files will reflect each employee's compliance with the SIF recovery procedures. Ann Wax, the State Risk Claims Officer, will be responsible for enforcing this performance expectation.

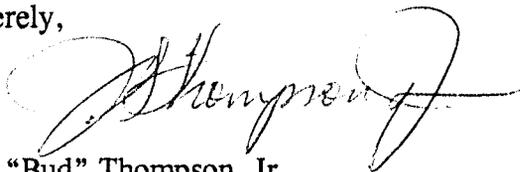
Completion Date:

The training will take place January, 2003 and the other corrective actions will be ongoing.

Management is committed to putting more emphasis on ensuring that established procedures are followed by setting higher performance standards for ORM employees.

If you have any questions, please contact me at 339-3879.

Sincerely,

A handwritten signature in cursive script, appearing to read "J. S. Thompson, Jr.", written in black ink.

J. S. "Bud" Thompson, Jr.

JSTR:PHR/ic