STATE OF LOUISIANA
LEGISLATIVE AUDITOR

Office of Group Benefits
Division of Administration
State of Louisiana
Baton Rouge, Louisiana

December 24, 2002

Financial and Compliance Audit Division

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

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OFFICE OF GROUP BENEFITS
DIVISION OF ADMINISTRATION
STATE OF LOUISIANA

Baton Rouge, Louisiana

Special Purpose Financial Statements
and Independent Auditor's Reports
As of and for the Year Ended June 30, 2002
With Supplemental Information Schedule

December 24, 2002

OFFICE OF GROUP BENEFITS
DIVISION OF ADMINISTRATION
STATE OF LOUISIANA

Special Purpose Financial Statements
and Independent Auditor's Reports
As of and for the Year Ended June 30, 2002
With Supplemental Information Schedule

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OFFICE OF
LEGISLATIVE **A**UDITOR
STATE OF LOUISIANA
BATON ROUGE, LOUISIANA 70804-9397

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December 16, 2002

Independent Auditor's Report
on the Financial Statements

OFFICE OF GROUP BENEFITS
DIVISION OF ADMINISTRATION
STATE OF LOUISIANA
Baton Rouge, Louisiana

We have audited the accompanying special purpose (legal basis) financial statements of the Office of Group Benefits, an office within Louisiana state government, as of and for the year ended June 30, 2002, as listed in the table of contents. These financial statements are the responsibility of management of the Office of Group Benefits. Our responsibility is to express an opinion on these special purpose financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

As described in note 1-B to the financial statements, the accompanying special purpose financial statements present only the funds of the Office of Group Benefits. As such, they present the appropriated and non-appropriated activity of the office that are part of the accounts and fund structure of the State of Louisiana. The Ancillary Appropriation Fund reflects appropriated activity of the office that is part of the General Fund of the State of Louisiana. The non-appropriated fund is an individual fund of the State of Louisiana not subject to budgetary control. Furthermore, the special purpose financial statements have been prepared on a legal basis of accounting, the purpose of which is to reflect compliance with the annual appropriation act for the appropriated fund and the financial position of the non-appropriated fund. These procedures differ from accounting principles generally accepted in the United States of America as described in the notes to the financial statements. Accordingly, the accompanying special purpose financial statements are not intended to and do not present financial position and results of operations in conformity with accounting principles generally accepted in the United States of America.

OFFICE OF GROUP BENEFITS
DIVISION OF ADMINISTRATION
STATE OF LOUISIANA
Audit Report, June 30, 2002

In our opinion, the accompanying special purpose financial statements present fairly, in all material respects, the balances within the appropriated and non-appropriated funds of the Office of Group Benefits at June 30, 2002, and the transactions of such funds for the year then ended, on the basis of accounting described in note 1-D.

In accordance with *Government Auditing Standards*, we have also issued a report dated December 16, 2002, on our consideration of the Office of Group Benefits' internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, and contracts. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

Our audit was made for the purpose of forming an opinion on the accompanying special purpose financial statements of the Office of Group Benefits taken as a whole. The accompanying supplemental information schedule is presented for the purpose of additional analysis and has been subjected to the auditing procedures applied in the audit of the special purpose financial statements and, in our opinion, is fairly stated in all material respects in relation to the special purpose financial statements taken as a whole.

This report is intended solely 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 report is distributed by the Legislative Auditor as a public document.

Respectfully submitted,

Daniel G. Kyle, CPA, CFE
Legislative Auditor

BDC:MVG:AJR:dl

[OGB02]

OFFICE OF GROUP BENEFITS
DIVISION OF ADMINISTRATION
STATE OF LOUISIANA
ALL APPROPRIATED AND NON-APPROPRIATED FUNDS

Balance Sheet (Legal Basis), June 30, 2002

	APPROPRIATED FUND - ANCILLARY APPROPRIATION	NON-APPROPRIATED - AGENCY FUND - DEPENDENT DAY CARE	TOTAL (MEMORANDUM ONLY)
ASSETS			
Cash (note 2)	$8,432,023	$58,195	$8,490,218
Receivables - fees and self-generated revenues	2,718,303		2,718,303
Other receivables		401	401
TOTAL ASSETS	$11,150,326	$58,596	$11,208,922
LIABILITIES AND FUND EQUITY			
Liabilities:			
Payables (note 7)	$22,896,813		$22,896,813
Amounts held in custody for others		$15,097	15,097
Other liabilities		43,499	43,499
Advance due to state treasury (note 13)	50,000		50,000
Deferred revenues	39,488		39,488
Estimated liabilities (note 8)	72,463,000		72,463,000
Total Liabilities	95,449,301	58,596	95,507,897
Fund Equity - fund balance (deficit) (note 14)	(84,298,975)	NONE	(84,298,975)
TOTAL LIABILITIES AND FUND EQUITY	$11,150,326	$58,596	$11,208,922

The accompanying notes are an integral part of this statement.

OFFICE OF GROUP BENEFITS
DIVISION OF ADMINISTRATION
STATE OF LOUISIANA
ANCILLARY APPROPRIATION FUND

Statement of Revenues, Expenditures, and
Changes in Fund Balance (Legal Basis)
For the Year Ended June 30, 2002

REVENUES	
Appropriated by legislature:	
State General Fund by fees and self-generated revenues	$719,165,245
EXPENDITURES	
Appropriated for health and life insurance for active and retired public employees	715,672,312
EXCESS OF REVENUES OVER EXPENDITURES	3,492,933
FUND BALANCE (Deficit) AT BEGINNING OF YEAR	(87,791,908)
FUND BALANCE (Deficit) AT END OF YEAR	($84,298,975)

The accompanying notes are an integral part of this statement.

OFFICE OF GROUP BENEFITS
DIVISION OF ADMINISTRATION
STATE OF LOUISIANA
ANCILLARY APPROPRIATION FUND

Statement of Revenues, Expenditures, and Unexpended Appropriation - Budget Comparison of Current-Year Appropriation - Budget (Legal Basis) and Actual
For the Year Ended June 30, 2002

	BUDGET	ACTUAL	VARIANCE FAVORABLE (UNFAVORABLE)
REVENUES			
Appropriated by legislature:			
State General Fund by fees and self-generated revenues	$727,253,718	$711,548,488	($15,705,230)
EXPENDITURES			
Appropriated for health and life insurance for active and retired public employees	727,253,718	719,441,808	7,811,910
UNEXPENDED APPROPRIATION - CURRENT YEAR	NONE	($7,893,320)	($7,893,320)

The accompanying notes are an integral part of this statement.

OFFICE OF GROUP BENEFITS
DIVISION OF ADMINISTRATION
STATE OF LOUISIANA

Notes to the Financial Statements
As of and for the Year Ended June 30, 2002

INTRODUCTION

The Board of Trustees of the State Employees Group Benefits was created within the Office of the Governor, Division of Administration, effective July 1, 1998, as provided by Louisiana Revised Statutes (R.S.) 42:871-879. Act 1178 of the 2001 Regular Session of the Louisiana Legislature changed the name of the State Employees Group Benefits Program to the Office of Group Benefits and removed the authority of the Board of Trustees to make policy decisions.

The office was formed to administer a program of group health and life insurance for active and retired state employees, active and retired school board employees, and certain political subdivisions' employees, as authorized by state statute. The office also administers the cafeteria plan and flexible-spending plan for plan members. The office's operations are divided into executive, administrative services, field service, claim service, claims processing, fiscal, data processing, and quality assurance. Approximately 124,190 plan members are enrolled in the program for fiscal year 2001-2002, of which 27,039 are enrolled through HMO contracts. The office has 355 authorized full-time staff positions. Funds are reestablished annually by provisions of the Ancillary Appropriations Act.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A. BASIS OF PRESENTATION

The Governmental Accounting Standards Board (GASB) promulgates accounting principles generally accepted in the United States of America and reporting standards for state and local governments. These principles are found in the *Codification of Governmental Accounting and Financial Reporting Standards*, published by the GASB. However, the accompanying special purpose financial statements have been prepared on a legal basis prescribed by the Division of Administration, Office of Statewide Reporting and Accounting Policy (OSRAP), which differs from accounting principles generally accepted in the United States of America as explained in the following notes.

The office is budgeted as an ancillary appropriation and has been previously reported as an internal service (proprietary) fund. Since June 30, 1987, the office's operations have resulted in a fund deficit. In view of the deficit, the Division of Administration, OSRAP, decided that the office was no longer operating as an internal service fund as defined by accounting principles generally accepted in the United States of America and should be reported on the basis of accounting described in note 1-D.

B. REPORTING ENTITY

The State of Louisiana has been determined to be the reporting entity under accounting principles generally accepted in the United States of America. The accompanying financial statements present activity of an office of state government and, therefore, are part of the funds of the State of Louisiana and its basic financial statements. Annually, the State of Louisiana issues basic financial statements that are audited by the Louisiana Legislative Auditor.

C. FUND ACCOUNTING

The Office of Group Benefits uses fund accounting, along appropriation lines, to reflect its compliance with provisions of the annual appropriation act and to reflect the financial position of its non-appropriated funds. This differs from the fund accounting of accounting principles generally accepted in the United States of America where the intent is to measure the financial position and results of operations of the governmental reporting entity as a whole. Therefore, the funds within the accompanying financial statements have been divided between appropriated and non-appropriated funds and not by the conventional fund types.

The funds do not include any noncurrent assets or liabilities. Noncurrent assets, capital assets, and long-term liabilities are reflected in the State of Louisiana's basic financial statements.

The funds presented in the special purpose financial statements are described as follows:

APPROPRIATED FUNDS

Ancillary Appropriation Fund

The Office of Group Benefits administers a self-insured group health insurance program and group life insurance program for state employees, for other specified public employees, and for individuals who qualify for continued group health coverage under the Consolidated Omnibus Reconciliation Act (COBRA) of 1985. The group life insurance program is underwritten by Prudential Insurance Company of America. This fund accounts for the office’s appropriated revenues, operating expenditures, and minor capital acquisitions.

NON-APPROPRIATED FUND

Agency Fund - Dependent Day Care

The Dependent Day Care agency fund accounts for transactions of a qualified dependent care assistance program pursuant to Internal Revenue Code, Title 26, Subtitle A, Chapter 1, Subchapter B, Part III, Section 129. Plan members make deposits into the fund through payroll deductions and make withdrawals when qualifying dependent day care expenditures have been incurred. This fund is custodial in nature (assets equal liabilities) and does not involve measurement of results of operations.

D. BASIS OF ACCOUNTING

The accounting and financial reporting treatment applied to a fund is determined by its measurement focus. The funds in the accompanying financial statements measure the resources provided by the legislature to fund current-year expenditures and the use of those resources by the office.

Basis of accounting refers to when revenues and expenditures are recognized and reported in the financial statements, regardless of the measurement focus applied. The accompanying financial statements reflect revenues and expenditures in accordance with applicable statutory provisions and regulations of the Division of Administration, Office of Statewide Reporting and Accounting Policy.

Under the foregoing legal provisions, the office uses the following practices in recognizing revenues and expenditures:

Revenues

State General Fund appropriations are recognized in the amounts appropriated to the extent withdrawn from the state treasury. Fees and self-generated revenues are recognized when earned, to the extent that they will be collected within 45 days of the close of the fiscal year.

Expenditures

Expenditures are generally recognized under the modified accrual basis of accounting when the related fund liability is incurred, except that obligations of employees' vested annual and sick leave are recognized as expenditures when paid. Furthermore, any expenditures of a long-term nature for which funds have not been appropriated during the current year are not recognized in the accompanying financial statements.

E. BUDGET PRACTICES

The ancillary appropriation, made for the operations of the office, is an annual lapsing appropriation consisting of self-generated funds. Revenues and expenditures for budget purposes are recognized on the basis of accounting as described in note 1-D, except that revenues reflected on Statement C include carryover monies and receipts that have been recorded as deferred revenue when collected. In addition, salaries and related benefits and health claims are recognized when paid on Statement C. The revenues and expenditures shown on Statement B are reconciled with the respective amounts shown on Statement C as follows:

Statement B revenues	$719,165,245
Add - deferred revenues	39,488
Less:	
Prior-year deferred revenues	(727,865)
Escrow fund transfer	(829)
Prior-year deficit cash carryover	(6,927,551)
Statement C revenues	$711,548,488
Statement B expenditures	$715,672,312
Add - estimated liabilities (net)	3,792,000
Less - payroll payable (net)	(22,504)
Statement C expenditures	$719,441,808

The office is prohibited by statute from over expending the program levels established in the budget. Budget revisions are granted by the Joint Legislative Committee on the Budget. Interim emergency appropriations may be granted by the Interim Emergency Board. The budget information included in the financial statements includes the original appropriation plus a subsequent amendment as follows:

Original approved budget	$709,843,155
Increases for additional claim expenditures	17,410,563
Total	$727,253,718

Statement C reflects that the office did not exceed its budget for fiscal year 2001-2002. The annual appropriation provides that any unexpended balance in the office's self-generated funds may be retained as fund equity to fund future expenditures of the office. The non-appropriated funds are not subject to budgetary control.

F. CASH

Cash includes cash on hand, demand deposits, and cash in state treasury. Under state law, the office may deposit funds with a fiscal agent bank organized under the laws of the State of Louisiana, the laws of any other state in the union, or the laws of the United States.

G. LONG-TERM OBLIGATIONS

The office is by statute not allowed to incur bonded indebtedness and, therefore, no recognition within the accompanying financial statements is necessary. Furthermore, any long-term obligations of the office arising from installment purchases, lease commitments, judgments, compensated absences, loss adjusting expenses for health claims, or from any other source are not recognized in the accompanying special purpose financial statements.

H. COMPENSATED ABSENCES

Employees earn and accumulate annual and sick leave at various rates, depending on their years of service, without limitation on the balance that can be accumulated. Upon separation of employment, employees or their heirs are compensated for up to 300 hours of unused annual leave at the employee's hourly rate of pay but are not compensated for unused sick leave. Unused annual leave in excess of 300 hours plus unused sick leave is used to compute retirement benefits. The liability for unused annual and sick leave is not recorded in the accompanying financial statements.

Certain employees of the office are eligible to earn compensatory time, as defined by the Department of Civil Service and the Fair Labor Standards Act. These employees can earn and accumulate one hour or one and one-half hour for each hour of overtime worked, depending on their position and rate of pay. Generally, the employees are allowed to carry up to 360 hours of accrued compensatory leave from one calendar year to another; however, under federal regulations, certain employees are compensated for unused compensatory leave six months after the end of the quarter in which the leave was earned. Accumulated compensatory leave is not accrued (reflected) in the accompanying special purpose financial statements.

I. TOTAL COLUMN ON BALANCE SHEET

The total column on the balance sheet is captioned Memorandum Only to indicate that it is presented only to facilitate financial analysis. Data in this column does not present financial position in conformity with accounting principles generally accepted in the United States of America. Neither is such data comparable to a consolidation.

2. CASH

Cash is composed of the following:

Petty cash on hand	$100
Demand deposits	49,900
Cash on deposit with the state treasury	8,440,218
Total	$8,490,218

These deposits are stated at cost, which approximates market. Under state law, these deposits (or resulting bank balances) must be secured by federal deposit insurance or the pledge of securities owned by the fiscal agent bank. The market value of the pledged securities plus the federal deposit insurance must at all times equal the amount on deposit with the fiscal agent. The office has deposit balances (collected bank balances) of $99,565 at June 30, 2002. These deposits are fully secured from risk by federal deposit insurance (GASB Risk Category 1).

Cash balances held and controlled by the state treasurer are secured from risk by the state treasurer through separate custodial agreements, and the risk disclosures required by accounting principles generally accepted in the United States of America are included within the state's basic financial statements. The following is a summary of cash in the state treasury:

Means of finance	$10,770,066
Operating account	(2,388,043)
Escrow account	58,195
Total	$8,440,218

3. PENSION PLAN

Substantially all employees of the office are members of the Louisiana State Employees Retirement System, a cost sharing, multiple-employer defined benefit pension plan. Required disclosures for the plan for fiscal year 2002 are included in the Louisiana Comprehensive Annual Financial Report prepared by the Louisiana Division of Administration, Post Office Box 94095, Baton Rouge, Louisiana 70804-9095.

4. POSTEMPLOYMENT HEALTH CARE AND LIFE INSURANCE BENEFITS

The office provides certain continuing health care and life insurance benefits for its retired employees. Substantially all of the office's employees become eligible for these benefits if they reach normal retirement age while working for the office. The benefits for retirees and similar benefits for active employees are provided through the office and the Prudential Insurance Company of America, the life insurance underwriter. The monthly premiums are paid jointly by the employee and the office. The office's costs of providing retiree health care and life insurance benefits are recognized as expenditures when the monthly premiums are paid. For the year ended June 30, 2002, the costs of retiree benefits totaled $151,505 for 43 retirees.

5. JUDGMENTS, CLAIMS, AND SIMILAR CONTINGENCIES

The following pending suits have been reported to the Attorney General's Office and are not reflected in the accompanying financial statements:

1. The office is involved in 21 lawsuits at June 30, 2002. The office has been advised by legal counsel that, while it is impossible to ascertain the ultimate legal and financial responsibility with respect to such litigation as of June 30, 2002, it is the staff's opinion that the ultimate aggregate liability will be $129,541. In addition, it is reasonably possible that an additional $139,196 liability could be imposed. These amounts are not reflected in the accompanying special purpose financial statements, but the settlement amount would be paid by the office if judgment were rendered in favor of the plaintiff.

2. In addition to the 21 lawsuits disclosed above, the office filed a declaratory judgment action on May 5, 2000, in the Nineteenth Judicial District Court for the Parish of East Baton Rouge against the Vernon Parish School Board and the St. Landry Parish School Board. The action resulted from the office's decision to risk rate the school boards' premiums in accordance with R.S. 42:851(A)(5)(b)(iii). The school boards contend that their premiums should not be risk rated and have filed reconventional demands asking the court to declare that their premiums should not have been risk rated and demanding reimbursement of the additional premiums paid. It is the staff's opinion that the ultimate aggregate liability will be $4,103,382, plus interest and costs.

Claims and litigation costs of $37,370 were incurred in the current year and are reflected in the accompanying financial statements.

Obligations and losses arising from judgments, claims, and similar contingencies not relating to health and life claims are paid through the state's self-insurance fund or by General Fund appropriation and are not reflected in the accompanying special purpose financial statements.

The self-insurance fund is operated by the Office of Risk Management, the state agency responsible for the state's self-insurance program.

6. COMPENSATED ABSENCES

The liability for unused annual leave payable at June 30, 2002, computed in accordance with the *Codification of Governmental Accounting and Financial Reporting Standards* Section C60.104, is estimated to be $1,329,409. The leave payable is not accrued (reflected) in the accompanying special purpose financial statements.

The liability for accrued compensatory leave at June 30, 2002, computed in accordance with the *Codification of Governmental Accounting and Financial Reporting Standards* Section C60.104, is estimated to be $62,789. Accumulated compensatory leave is not accrued (reflected) in the accompanying special purpose financial statements.

7. PAYABLES

Payables at June 30, 2002, consist of $22,598,200 for accounts payable and $298,613 for accrued payroll payable. Accounts payable includes a $4,455,000 final invoice from the former prescription benefits manager, Merck-Medco. This invoice still has not been paid because of a dispute resulting from an audit performed on fiscal year 1998-1999 claims.

8. ESTIMATED LIABILITIES

The estimated liabilities for health claims reported but unpaid (RBU) and incurred but unreported (IBU), as shown on Statement A in accordance with the instructions of the Division of Administration, Office of Statewide Reporting and Accounting Policy, total $72,463,000 at June 30, 2002. The estimated liability for the RBU and IBU is based upon information submitted by the actuarial firm of Milliman USA, Inc.

9. INTEREST EARNINGS

The Office of Group Benefits does not maintain investment accounts. The State Treasurer's Office invests the office's idle funds. The amount of interest paid by the Treasurer's Office during the fiscal year was $556,961.

10. LEASE AND RENTAL COMMITMENTS

The office has several noncancelable operating leases for rental of office and warehouse space. The remaining annual operating lease payments are presented as follows:

Fiscal year	Office Space	Other	Total
2002-2003	$685,798	$84,274	$770,072
2003-2004	370,118		370,118
2004-2005	40,956		40,956
2005-2006	21,357		21,357
Total	$1,118,229	$84,274	$1,202,503

All lease agreements have non-appropriation exculpatory clauses that allow for lease cancellation if the Louisiana Legislature does not make an appropriation for their continuation during any future fiscal period. Total operating lease expenditures for fiscal year 2001-2002 amounted to $900,983. The Office of Group Benefits does not have any capital lease agreements at June 30, 2002.

11. INSTALLMENT PURCHASES

In fiscal years 2000 and 2001, the office entered into various installment purchase agreements with the Division of Administration under the Louisiana Equipment Acquisition Fund Program for the purchase of equipment. The following is a summary of installment transactions of the office for the year ended June 30, 2002:

Balance at June 30, 2001	$833,626
Installment payments	(409,584)
Total	$424,042

The following is a summary of future minimum installment payments as of June 30, 2002:

Fiscal Year	
2002-2003	$439,011
Less - amount representing interest	(14,969)
Total	$424,042

12. DEFERRED COMPENSATION PLAN

Certain employees of the office participate in the Louisiana Public Employees Deferred Compensation Plan adopted under the provisions of the Internal Revenue Code Section 457. Complete disclosures relating to the Plan are included in the separately issued audit report for the Plan, available from the Louisiana Legislative Auditor, Post Office Box 94397, Baton Rouge, Louisiana 70804-9397.

13. ADVANCE DUE TO STATE TREASURY

The office received an advance from the state treasury for imprest fund operations totaling $50,000, as authorized by the Commissioner of Administration in accordance with Title 39 of the Louisiana Revised Statutes. The fund is permanently established and periodically replenished from office operating funds.

14. FUND BALANCE (DEFICIT)

As shown on Statement A, at June 30, 2002, the office has a fund balance deficit of $84,298,975. During the fiscal year ended June 30, 2002, the deficit decreased by $3,492,933. The office is attempting to resolve the deficit by continuing to implement the preferred provider option and the exclusive provider option. In addition, a health premium rate increase and benefit modifications will be in effect for the 2002-2003 fiscal year, as discussed in note 17.

15. UNRECORDED ESTIMATED LIABILITIES

The office has not recognized a potential liability of approximately $1,200,000 for Medicaid claims. This amount is based on claims submitted by the Health Management Systems, Incorporated, on behalf of the Department of Health and Hospitals. Medicaid is payor of last resort, and these claims were previously paid by Medicaid for plan members of the office. This potential liability is not recorded in the special purpose financial statements.

16. GASB 34 ACCRUALS

The following schedule presents the adjustments necessary to convert modified accrual basis accounts receivable, as shown in Statement A, to full accrual basis accounts receivable as required by the Office of Statewide Reporting and Accounting Policy.

	Accounts Receivable - Modified Accrual Basis	Full Accrual Adjustment	Allowance for Doubtful Accounts	Accounts Receivable - Full Accrual Basis
Appropriated Revenues - fees and self-generated	$2,718,303	$2,106,589	($372,699)	$4,452,193
Appropriated Expenditures - pharmaceutical rebates		3,327,628		3,327,628
Non-Appropriated Revenues - agency funds	401			401

17. SUBSEQUENT EVENTS

A) The Office of Group Benefits implemented a new claims processing system on July 1, 2002, replacing the RIMS system that had been in place since 1994.

B) The Office of Group Benefits implemented a 17% aggregate rate increase on July 1, 2002, for its preferred provider organization (PPO) and exclusive provider organization (EPO) health plans.

C) The Office of Group Benefits began billing and collecting funds from individual state agencies under the Budget Deficit Reduction Act in October 2002. Act 1182 of the 2001 Regular Session of the Louisiana Legislature reserved $62 million in excess state revenues for the Office of Group Benefits, and Act 137 of the 2002 First Extraordinary Session of the Louisiana Legislature increased this amount to $66,392,430. The Office of Planning and Budget allocated additional funds to state agencies in the fiscal year 2003 budget to pay the Office of Group Benefits.

D) The Office of Group Benefits discontinued the administration of the EPO health plan in the Baton Rouge region on July 1, 2002. Plan members in the Baton Rouge region have the option of selecting EPO coverage administered by either Blue Cross of Louisiana or R. A. Richard and Associates (FARA).

E) AmCare Health Plans of Louisiana, Inc., a contracted HMO carrier for the Houma/Thibodeaux, Lafayette, Alexandria, and Lake Charles regions, was placed into receivership in September 2002. Administration of the HMO plan for these regions has been taken over by FARA.

F) The Office of Group Benefits contracted with Advanced PCS during fiscal year 2002 for pharmaceutical services. The contract provided that the Office of Group Benefits would receive rebates from pharmaceutical manufacturers once those rebates had been received by Advanced PCS. At the end of fiscal year 2002, an estimated $3,327,628 was due to the Office of Group Benefits relating to these rebates, including $324,909 and $618,688 still due from the first and second quarters, respectively, of fiscal year 2002.

G) Act 1178 of the 2001 Regular Session of the Louisiana Legislature increased the state's share of active employees' health insurance premiums from 58% to 65% effective July 1, 2002.

H) The Office of Group Benefits implemented a Medical Flexible Spending Account under IRS regulations, administered by Fringe Benefits, effective July 1, 2002. The account allows a state employee to deposit pre-tax income into an escrow fund for reimbursement of medical expenses incurred during the fiscal year.

I) Executive Order MJF 2002-24, as amended by MJF 2002-26, created the Office of Group Benefits Study Commission on September 5, 2002, to study the current operations of the Office of Group Benefits and recommend improvements. The commission was required to draft a comprehensive written report to the governor. According to management, the report is tentatively scheduled to be issued January 15, 2003.

J) The Office of Group Benefits entered into an agreement with Louisiana State University (LSU) to allow LSU employees participating in the "Definity Plan" to be deemed participants in the Office of Group Benefits health plans. Participants shall be given credit for "years of participation" in the Definity Plan for the purpose of calculating retirement health insurance benefits under Revised Statute 42:851(A)(1)(d)(i) as if the member were a participant in the PPO or EPO plans. The agreement began on July 1, 2002, and LSU is fully responsible for the administration and obligations of this plan.

OFFICE OF GROUP BENEFITS
DIVISION OF ADMINISTRATION
STATE OF LOUISIANA
SUPPLEMENTAL INFORMATION SCHEDULE
For the Year Ended June 30, 2002

SCHEDULE OF CHANGES IN ASSETS AND LIABILITIES - NON-APPROPRIATED FUND

Changes in assets and liabilities for the Dependent Day Care Agency Fund for the year ended June 30, 2002, are presented on Schedule 1.

OFFICE OF GROUP BENEFITS
DIVISION OF ADMINISTRATION
STATE OF LOUISIANA
NON-APPROPRIATED FUND - AGENCY FUND

Schedule of Changes in Assets and Liabilities
For the Year Ended June 30, 2002

	BALANCE JULY 1, 2001	ADDITIONS	DEDUCTIONS	BALANCE JUNE 30, 2002
Dependent Day Care Fund				
ASSETS				
Cash	$67,279	$339,558	($348,642)	$58,195
Receivables	585	401	(585)	401
TOTAL ASSETS	$67,864	$339,959	($349,227)	$58,596
LIABILITIES				
Amounts held in custody for others	$25,546	$295,480	($305,929)	$15,097
Other liabilities	42,318	44,479	(43,298)	43,499
TOTAL LIABILITIES	$67,864	$339,959	($349,227)	$58,596

OTHER REPORT REQUIRED BY

GOVERNMENT AUDITING STANDARDS

The following pages contain a report on compliance with laws, regulations, and contracts and on internal control over financial reporting as required by *Government Auditing Standards*, issued by the Comptroller General of the United States. This report is based solely on the audit of the financial statements and includes, where appropriate, any reportable conditions and/or material weaknesses in internal control or compliance matters that would be material to the presented financial statements.

OFFICE OF
LEGISLATIVE **A**UDITOR
STATE OF LOUISIANA
BATON ROUGE, LOUISIANA 70804-9397

DANIEL G. KYLE, PH.D., CPA, CFE
LEGISLATIVE AUDITOR

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December 16, 2002

<u>Report on Compliance and on Internal Control Over Financial Reporting</u>
<u>Based Solely on an Audit of the Special Purpose Financial Statements</u>
<u>Performed in Accordance With *Government Auditing Standards*</u>

OFFICE OF GROUP BENEFITS
DIVISION OF ADMINISTRATION
STATE OF LOUISIANA
Baton Rouge, Louisiana

We have audited the special purpose financial statements of the Office of Group Benefits, an office within Louisiana state government, as of and for the year ended June 30, 2002, and have issued our report thereon dated December 16, 2002. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Compliance

As part of obtaining reasonable assurance about whether the Office of Group Benefits' special purpose financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, and contracts, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and, accordingly, we do not express such an opinion. The results of our tests disclosed the following instances of noncompliance that are required to be reported under *Government Auditing Standards*.

Dual Employment of Chief Information Officer

For the second consecutive year, the Office of Group Benefits (OGB) appears to have violated the dual employment law by hiring a Chief Information Officer (CIO) on a part-time basis but paying him the equivalent of a full-time salary plus leave benefits. This individual also holds full-time employment as the Director of Information Technology (IT) with the Department of Natural Resources. OGB pays this individual $100 per hour to serve as its CIO and the Department of Natural Resources pays him $41.96 per hour. He performs essentially the same duties for both agencies but is paid individually by each agency and is granted leave benefits by each agency. Besides granting him leave benefits, both agencies are contributing retirement benefits on his behalf. In addition to possible dual employment within state agencies, during his work hours the individual serves as and performs the duties of the President of the Louisiana Council of Information Services Directors, a nonprofit organization comprised of state IT employees.

Louisiana Revised Statute (R.S.) 42:63(E) states that no person holding a full-time appointive office or full-time employment in the government of this state shall at the same time hold another full-time appointive office or full-time employment in the government of the state of Louisiana. The Department of Civil Service approved the part-time employment of the CIO at OGB based on the provisions of Attorney General Opinion 99-5. This opinion, dated May 13, 1999, provides that the law does not prohibit an individual from holding *full-time* state employment and *part-time* state employment, but emphasizes that the law prohibits a state employee from contracting with a state executive branch agency. However, the CIO's hourly part-time rate and leave benefits indicate that he is being paid twice that which is paid for full-time employment while performing the same job duties. The hourly part-time rate is also commensurate with the rate paid to a contractor for such services. Under either scenario, this arrangement appears to violate the intention and spirit of the law.

We understand OGB has undertaken a number of information technology upgrades. During the last year, the office converted to a new claims adjudication software program and made substantial improvement in the Internet service capabilities. The office made many information system changes and modifications to comply with new federally mandated rules and requirements, such as the Health Insurance Portability and Accountability Act. In a letter to the Department of Civil Service dated August 10, 2001, the OGB Chief Executive Officer justified the need for this CIO position by stating that compliance with these new standards of business will require "retooling of the organization with appropriate hardware and software in a timely manner, setting up proper management training programs, providing the best services to plan members and providers, and promoting the positive image of the organization." However, OGB could hire a full-time CIO at the salary currently being paid for part-time service and increase the effectiveness of the CIO position in dealing with the challenges that face the office.

Management of OGB should reevaluate this arrangement and not indirectly do what state law does not allow it to do directly. OGB management maintains that the employment arrangement of the CIO was approved by Civil Service and is cost-effective and better served the interest of OGB. For management's complete response, see Appendix A, pages 1-5.

Noncompliance With Administrative Procedures Act

OGB amended and implemented a policy without following the procedures required by the Administrative Procedures Act. R.S. 42:802 provides OGB's chief executive officer with certain powers to establish and administer benefit plans under the direction of the commissioner of administration for life, health, and other benefit programs offered through the office. Specifically, R.S. 42:802(A)(2) provides that OGB shall administer and implement all programs provided or authorized for it by law which relate to rulemaking and shall be subject to the provisions of the Administrative Procedures Act.

The 2001-2002 Preferred Provider Organization (PPO) Plan Document, Article I (Eligibility), Section (B)(2)(b) allows a retiree from one participant employer to be covered (1) as an active employee of another participant employer or (2) as a retiree of the participant employer from which he is retired. The new policy, which amends the PPO Plan Document, allows option 2 only. In other words, once retired, a retiree must remain "retired" from the agency from which he/she retired and may never return to active status, even though he/she is reemployed by another agency.

The effect of the change in policy could be significant to the employee's source of funding. The average employer share of the premium at July 1, 2002, for a retired employee and spouse, with no Medicare coverage, is $610 more than the employer share of the premium for an active employee and spouse. The average employer share of the premium at July 1, 2002, for a retired employee and spouse, with Medicare coverage for one, is $214 more than the employer share of the premium for an active employee and spouse. Under option 2 if a retiree premium is paid with state General Fund monies, then when a retired employee returns to work in a program financed with federal funds, the state General Fund continues to absorb the premium cost. If the employee were considered active, with the premiums paid by the current employer, the federal program would reimburse the state for the most of the employer's share of premiums. In addition, the federal government may express future concern with the state charging federal programs for higher retiree premiums assessed to active employees.

Management amended the plan document internally because the chief executive officer determined that he has the authority to interpret OGB rules and resolve any inconsistencies therein. However, R.S. 42:802(A)(2) seems to be clear about the applicability of the Administrative Procedures Act. Unauthorized and unpublished changes to rules and regulations impacted the public's right to due process, created additional costs to state agencies for retirees, and caused some active employees who were previously retired from state service to lose benefits.

OGB should follow Louisiana law and the Administrative Procedures Act when amending rules and regulations. Management did not concur with the finding and recommendation. For management's complete response, see Appendix A, pages 6-8.

Additional Comments: Management responded that they "agree that OGB is subject to the Administrative Procedure Act, however, the action in question is an interpretation of an existing rule and does not result in an amendment of that rule." Management also indicated that with the implementation of Act 455 of 2001, "a consistent interpretation and application of the retiree participation rule was necessary in order to resolve numerous technical and administrative problems and assure that benefit deductions are properly accounted for."

While management feels it is merely *interpreting* the current retiree participation rule, OGB has eliminated the option described in the PPO Plan Document that allows a retiree from one participant employer to be covered as an active employee of another participant employer. Eliminating the option with only internal correspondence from the chief executive officer constitutes an unauthorized and unpublished change to the PPO Plan Document. The change should have been made following the procedures required by the Administrative Procedures Act.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Office of Group Benefits' internal control over financial reporting to determine our auditing procedures for the purpose of expressing our opinion on the special purpose financial statements and not to provide assurance on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be material weaknesses. A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the special purpose financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operations that we consider to be material weaknesses.

This report is intended solely for the information and use of the Office of Group Benefits 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 report is distributed by the Legislative Auditor as a public document.

Respectfully submitted,

Daniel G. Kyle

Daniel G. Kyle, CPA, CFE
Legislative Auditor

BDC:MVG:AJR:dl

[OGB02]

Appendix A

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

State of Louisiana
Office of Group Benefits
P.O. Box 44036
Baton Rouge, Louisiana 70804

November 26, 2002

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

Re: Dual Employment of Chief Information Officer

Dear Dr. Kyle:

This correspondence is in response to a finding by the Office of Legislative Auditor entitled "Dual Employment of Chief Information Officer".

The Office of Group Benefits (OGB) does not concur with this finding. Enclosed you will find correspondence from the Department of State Civil Service which approved the employment of a Chief Information Officer in the unclassified service. Also enclosed, you will find correspondence from the Board of Ethics stating that, in their opinion, there was no violation of the Code of Ethics in this situation.

We believe that utilization of an employee from another state agency was cost-effective and better served the interest of OGB than use of a third party contractor. As mentioned in our response last year, OGB has undertaken a number of information technology upgrades. During the past twelve months we have converted to a new claims adjudication software program and made substantial improvement in our internet service capabilities. These projects are in the final stages of completion at this time.

The skills needed to design, evaluate, and implement the changes noted in the paragraph above are not available within OGB. Therefore, we are faced with the decision of using an outside contractor or seeking other alternatives. It was determined that the best way to accomplish our goals was to utilize the services of an individual who could supervise state employees, who was thoroughly knowledgeable of state procurement procedures, and who had an in-depth knowledge of the information technology goals that have been established for state agencies.

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800.414.6409
Lake Charles
337.475.8052
800.525.3256
Metairie
504.838.5136
800.335.6208
Monroe
318.362.3435
800.335.6206
Shreveport
318.676.7026
800.813.1574
TDD
225.925.6770
800.259.6771

In addition to the above, disciplinary actions have been instituted against the current director of information technology at OGB. The individual currently is not working for this agency. Due to the data – intensive nature of the work performed by this agency it is essential that we have the services of a highly qualified leader in the information technology division. In conclusion, we feel the use of an employee from another agency added a greater value at a lower cost than the use of a third party contractor.

Thank you for the opportunity to respond to this issue. If I may provide additional information or assistance, please contact me.

Sincerely,

A. Kip Wall
Chief Executive Officer

AKW/djj

Enclosures

State of Louisiana
BOARD OF TRUSTEES
STATE EMPLOYEES GROUP BENEFITS PROGRAM
P.O. BOX 66677, AUDUBON STATION
BATON ROUGE, LOUISIANA 70806

August 10, 2001

Mr. Allen Reynolds, Director
Department of Civil Service
P.O. Box 94111
Baton Rouge, LA 70804

Re : OGB - CIO

Dear Mr. Reynolds:

The Office of Group Benefit is requesting permission under Civil Service Rule 4.1(d) 1 to establish an unclassified part-time position to serve as a Chief Information Officer (CIO). As you are aware, the Office of Group Benefit handles health insurance for the entire state. The health industry is undergoing tremendous changes. We are mandated by federal rules, such as HIPPA, to adopt systemic modifications for our business processes, Information Technology systems and infrastructure. There are organizations in Louisiana such as Blue Cross and Blue Shield who estimate to spend over 15 million dollars to comply with HIPPA.

We are ill equipped with resources and the require skills of a senior level executive who will assist the Chief Executive Officer in strategic planning, restructuring the organization for better performance and compliance with HIPPA. This effort will require the retooling of the organization with appropriate hardware and software in a timely manner, setting up proper management training programs, providing the best services to plan members and providers, and promoting the positive image of the organization

The Division of Administration has provided the services of Mr. Rizwan Ahmed to us through DNR for a limited time and we have found him to be a suitable person to serve in the position of CIO. Mr. Ahmed was able to examine the complex issues the organization faces and has an aggressive plan to combat the tremendous challenges faced by the health industry in general, and the Office of State Group Benefit in particular.

Mr. Ahmed will be able to perform a task that would otherwise require an executive level consultant, costing the state a significant amount of money. An outside consultant may not posses the enthusiasm and leadership skills demonstrated by Mr. Ahmed and his knowledge of state rules and regulations.

RECEIVED
AUG 1 4 2001
Dept. of Civil Service

Mr. Robert D. Harper, the undersecretary and appointing authority of Mr. Ahmed at the Department of Natural Resources has graciously agreed to have Mr. Ahmed assist the Office of Group Benefit on a part-time basis, while performing full time duties at the Department of Natural Resources. The Department of Natural Resources will also allow Mr. Ahmed to develop flexible working hours to accommodate the needs of the two organizations.

We appreciate your consideration of our request to appoint Mr. Ahmed as a CIO beginning Monday, August 20, 2001 for a period of 24 months pursuant to Rule 4.1(d) 1. If you have questions or comments, please contact me.

Sincerely,

A. Kip Wall
Chief Executive Officer

Cc Robert D. Harper, Undersecretary
HR Director

APPROVED
DEPARTMENT OF
STATE CIVIL SERVICE
AUG 17 2001

DIRECTOR

2002-154

Created By: Claudia Holland on 04/23/2002 at 02:45 PM
Category: Ethics Advisory Opinions

April 16, 2002

Mr. Mark E. Falcon
Avant & Falcon
429 Government St.
Baton Rouge, La 70802

RE: Ethics Board Docket No. **2002-154**

Dear Mr. Falcon:

The Louisiana Board of Ethics, at its April 11, 2002 meeting, considered your request for an advisory opinion regarding whether any conflicts of interest are presented by a person being employed as the Director of Technology for the Department of Natural Resources (DNR) and employed as the Chief Information Officer for the Office of Group Benefits. You stated that Rizwan Ahmed has been a full-time employee of DNR since October of 1996 and has been a part-time employee of Group Benefits since September of 2001.

The Board concluded, and instructed me to inform you, that the Board declined to render an opinion as to past conduct. Note, however, that your request failed to present any Ethics Code issues. You may wish to contact the Attorney General's office regarding dual officeholding.

If you have any additional questions, please do not hesitate to contact me at (225) 922-1400 or (800) 842-6630.

Sincerely,

LOUISIANA BOARD OF ETHICS

Kristen K. Morgan
For the Board

....

State of Louisiana
Office of Group Benefits
P.O. Box 44036
Baton Rouge, Louisiana 70804

September 9, 2002

Ms. Marsha V. Guedry, CPA
Audit Manager
Office of Legislative Auditor
1600 North Third Street
Baton Rouge, LA 70804

Re: Noncompliance with Administrative Procedures Act

Dear Ms. Guedry:

I am in receipt of your correspondence dated August 29, 2002 which included a draft audit finding entitled Noncompliance with Administrative Procedures Act. The Office of Group Benefits (OGB) does not concur with this finding.

We agree that OGB is subject to the Administrative Procedure Act, however, the action in question is an interpretation of an existing rule and does not result in an amendment of that rule. LSA-R.S. 42:803B(1) states in pertinent part, as follows:

> The Chief Executive Officer of OGB "shall exercise all functions necessary for the administration and implementation of the policies and rules of the office which relates to rule making, licensing, regulation, enforcement, and adjudication, including personnel management.

The rule in question states, in pertinent part, as follows:

> A retiree retired from one participant employer may be covered as an active employee of another participant employer or as a retiree of the participant employer from which he retired, *but not both*. (Emphasis added)

Act 455 of 2001 created a situation in which retired state workers could return to work without penalty to their retirement income benefits. Two issues arose under the Act. One issue, which was raised by the Louisiana State Employees Retirement System, involved "tracking" employees between the retirement program and active employment. A consistent interpretation and application of the retiree participation rule was necessary in order to resolve numerous technical and administrative problems and assure that benefit deductions are properly accounted for. The second issue relates to properly funding health benefits. Retiree premiums are intended to cover the cost of retiree benefits. If retirees change to an active classification and pay an active premium rate, active employees will be forced to subsidize retiree health costs.

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800.335.6206
Shreveport
318.676.7026
800.813.1574
TDD
225.925.6770
800.259.6771

www.groupbenefits.org

The draft finding questions the advisability of the rule interpretation and states that "... when a retired employee returns to work in a program financed with federal funds, the state General Fund continues to absorb the premium cost. If the employee were considered active, with the premiums paid by the current employer, the federal program would reimburse the state for most of the employer's share of premiums ...". OGB assumes the reverse of this scenario could be true. If a state employee's retiree benefits are funded through federal funds, money from the state General Fund is not used to subsidize retiree benefits. Accordingly, we cannot determine if there is an advantage or disadvantage related to the manner in which the rule is applied.

We also disagree with the assertion that the interpretation " ... created additional cost to state agencies for retirees ..." This is not accurate. Had the retiree not returned to work, the former employer would still pay for retiree coverage. No additional costs are generated. Alternatively, if the retiree returned to work and was classified as an active employee, OGB would incur a decrease in funding which, as stated above, would result in costs being transferred to active employees.

The draft finding further states that the rule interpretation "... cost some active employees who were previously retired from the state to lose benefits ..." When the rule was implemented, retired employees who were not participants in OGB were not allowed to enroll in the health plan if they returned to active employment during part of the FY 2001-02 plan year. Upon review, this policy was subsequently changed. OGB will attempt to clarify the future participation of retired employees, who are not participants in the OGB health plan, through an amendment to the rule.

Finally, it should be understood that this interpretation of the rule simply allocates funding between state agencies, that is, the former employer through which the employee retired, the current employer through which the retiree is employed, and OGB. Prior to the current interpretation of the rule in question, some retirees returned to work and were classified as active employees and paid active employees rates and other retirees returned to work as an active employee but continued to pay retiree rates. This resulted in an inconsistency under the rule which was clarified through an interpretation by the agency responsible for administering the rule.

OGB is granted the authority to interpret the rules and we believe our position is supported by applicable law as reflected in an opinion issued by the Louisiana First Circuit Court of Appeals which states:

> "Considerable weight should be afforded to an administrative agency's construction of a statutory scheme that it is entrusted to administer and deference must be awarded to its administrative interpretations. *Chevron, U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837, 844, 104 S.Ct. 2778, 2782-83, 81 L.Ed.2d 694 (1984). In light of the judicial standard of review pertaining to an administrative agency's construction and interpretation of federal legislation, we decide that the same standard of review must be afforded to the DEQ regarding the construction and interpretation of the rules and regulations under its authority. We believe that an agency such as the DEQ should be entitled to deference regarding its interpretation and construction of the rules and regulations that it promulgates. Where the legislature has authorized the DEQ to promulgate rules and regulations, such is analogous to the situation where Congress has explicitly left a void for a federal agency to fill. Accordingly, we find that the DEQ's interpretations should stand unless they are arbitrary, capricious, or manifestly contrary to its rules and regulations. *In The Matter of Recovery I, Inc.* 635 So.2d 690 (La. App. 1 Cir. 1994), No. 93 CA 0441, writ denied, 639 So.2d 1169 (La. 1994).

Sincerely,

A. Kip Wall
Chief Executive Officer

AKW/djj