DEPARTMENT OF HEALTH & HUMAN SERVICES

Office of Inspector General

Memorandum

Date MAR 19 1992

From Richard P. Kusserow
Inspector General

Subject Review of the State of Tennessee Self-Insurance Funds (A-04-91-00023)

To Arnold R. Tompkins
Assistant Secretary for Management and Budget

The purpose of this memorandum is to alert you to the issuance on March 23, 1992, of our final report. A copy is attached.

The subject review, based upon certain agreed-upon procedures, was performed by the certified public accounting firm of Carmichael, Ingle, Saffert & Brasher, P.C., under a contract with the Office of Inspector General. The review disclosed that the Claims Award Fund (one of Tennessee's self-insurance funds) had a $27.5 million adjusted fund balance at June 30, 1990 of which 20 percent, or $5.5 million represents the Federal share of the excess reserve balance.

The Office of Management and Budget (OMB) Circular A-87, which establishes cost principles for State and local governments, provides for Federal reimbursement of allowable costs and precludes profit or charges in excess of cost.

The funds that are maintained by the State of Tennessee are:

- The Claims Award Fund which was established to provide coverage for negligence or nuisance claims against State agencies and employees.
- The Employee Group Insurance Fund which was established to provide health coverage to employees of State agencies.
- The Teacher Group Insurance Fund which was established to provide health coverage to employees of local school districts within the State.

We recommended that the State make a financial adjustment of $5,497,455 for the Federal share of the fund balance in excess of Federal cost principles. Additionally, the

State must ensure that charges to Federal programs are in accordance with OMB Circular A-87 and the Statewide Cost Allocation Plan agreement with the Division of Cost Allocation.

The latter two funds had a deficit balance. We made no specific recommendations regarding the Employee Group Insurance fund or the Teacher Group Insurance Fund. However, we believe that fund deficits should be eliminated by adjustment in premiums charged to departments and agencies. The Federal Government would then share appropriately in these costs.

Tennessee officials basically concurred with our findings and recommendations. However, the State desires to discuss the resolution of all issues, including the underfunding of the State Employee Insurance Fund with the appropriate Department of Health and Human Services officials responsible for final settlement of findings.

If you have any questions, please contact me or have your staff contact John A. Ferris, Assistant Inspector General for Human, Family and Departmental Services Audits at (202) 619-1175.

Attachment

Department of Health and Human Services

OFFICE OF
INSPECTOR GENERAL

STATE OF TENNESSEE
NASHVILLE, TENNESSEE

ACCOUNTANTS' REPORT ON AGREED-UPON PROCEDURES IN REGARD TO SELF-INSURANCE FUNDS

Richard P. Kusserow
INSPECTOR GENERAL

A-04-91-00023

STATE OF TENNESSEE
NASHVILLE, TENNESSEE

ACCOUNTANTS' REPORT ON AGREED-UPON PROCEDURES IN REGARD TO SELF-INSURANCE FUNDS

FOR THE FISCAL YEAR ENDING JUNE 30, 1990

CARMICHAEL, INGLE, SAFFERT & BRASHER, P.C.
2970 CLAIRMONT ROAD, SUITE 780
ATLANTA, GEORGIA 30329-1634

Common Identification No.
A-04-91-00023

DEPARTMENT OF HEALTH & HUMAN SERVICES

Office of Inspector General
Office of Audit Services

REGION IV
P.O. BOX 2047
ATLANTA, GEORGIA 30301

Common Identification Number
A-04-91-00023

Mr. David L. Manning, Commissioner
Department of Finance and Administration
State Capitol
Nashville, Tennessee 37219

Dear Commissioner Manning:

Enclosed is the final report on the Results of our Review of the State of Tennessee Self-Insurance Funds.

The review was performed by the Certified Public Accounting firm of Carmichael, Ingle, Saffert and Brasher, P.C. which is under contract with the Department of Health and Human Services, Office of Inspector General, Office of Audit Services.

Excess reserves of $27,487,277 accumulated in the Claims Award Fund. The State of Tennessee should ensure that charges to Federal programs are in accordance with Office of Management and Budget Circular A-87 and the Statewide Cost Allocation Plan agreement with the Division of Cost Allocation. Based on the results of the review, we recommend that the State of Tennessee make a financial adjustment for $5,497,455 to restore the Federal equity in the Fund.

In the written response to our draft report, State officials indicated that a formal exit conference was not necessary and they generally agreed with our findings and recommendations.

The designation of financial or management practices as questionable or a recommendation for the disallowance of costs incurred or claimed, as well as other conclusions and recommendations in this report, represent the findings and opinions of the HHS, OIG, Office of Audit Services.

We request that you respond to the HHS action official named below within 30 days from the date of this letter. Your response should present any comments or additional information that you believe may effect the final determination.

In accordance with the principles of the Freedom of Information Act (Public Law 90-23), Office of Inspector General, Office of Audit Services reports issued to the Department's grantees and contractors are made available, if requested, to members of the press and general public to the extent information contained therein is not subject to exemptions in the Act which the Department chooses to exercise. (See 45 CFR Part 5.)

To facilitate identification, please refer to Common Identification Number A-04-91-00023 in all correspondence relating to this report.

Sincerely yours,

Emil A. Trefzger, Jr.
Regional Inspector General
for Audit Services, Region IV

Enclosure

Direct Reply To:

Director
Division of Cost Allocation and Liaison
W.J. Cohen Bldg. - Room 1067
330 Independence Ave., S.W.
Washington, D.C. 20201

cc: William R. Snodgrass
Comptroller of the Treasury
State of Tennessee
State Capitol, First Floor
Nashville, Tennessee 37219

TABLE OF CONTENTS

Carmichael, Ingle, Saffert & Brasher, P.C.

Certified Public Accountants

2970 Clairmont Road, N.E., Suite 780
Atlanta, Georgia 30329
(404) 321-1978
Facsimile (404) 329-0961

Mr. Emil A. Trefzger, Jr., CPA
Regional Inspector General for Audit Services, Region IV
U.S. Department of Health and Human Services
Office of Inspector General, Office of Audit Services
101 Marietta Tower, Suite 1401
Atlanta, Georgia 30323

Dear Mr. Trefzger:

The purpose of this report is to provide you with the RESULTS OF CERTAIN AGREED-UPON PROCEDURES OF THE SELF-INSURANCE FUNDS OF THE STATE OF TENNESSEE.

EXECUTIVE SUMMARY

Our agreed-upon procedures revealed three self-insurance funds being maintained by the State of Tennessee. The Employee Group Insurance Fund and the Teachers Group Insurance Fund did not appear to have excess fund balances, and therefore, no specific recommendations were made regarding those Funds. The Claims Award Fund, however, had a $27,487,277 adjusted fund balance at June 30, 1990 of which 20%, or $5,497,455, represents the Federal share of the excess reserve balance. We recommend the State of Tennessee make a financial adjustment of $5,497,455 for the Federal share of the Fund balance in excess of Federal cost principles.

The State agreed with our recommendation to adjust the Claims Award Fund balance. The State's Response and the Auditor's Comments are summarized after the Recommendation section of our finding. Refer to Appendix B for a complete copy of the State's response.

INTRODUCTION

BACKGROUND

The Office of Management and Budget (OMB) Circular A-87 allows States to recover costs of goods and services provided in the administration of Federal grant programs. Some of these goods and services are provided by a central State agency and billed directly to the user agency. It is intended that the central State agency operate on a break-even basis through user charges for goods and services provided. A profit indicates an overcharge for goods and services and a loss, an undercharge.

Circular A-87 classified central State service agencies which directly bill for goods and services as either cost-reimbursement or reserve-type activities. The reserve-type activity that directly bills must maintain a reserve fund balance (usually based on an actuarial study), in order to meet present and future claims. The reserve-type directly billed activity (usually referred to as trust fund) is designed to collect sufficient revenue from billings and investment income to pay for present and future claims and for complete administration of the activity.

The joint or common costs of any goods or services benefitting Federally-funded programs must be recovered through the Statewide Cost Allocation Plan (SWCAP). The approved SWCAP is an agreement between the State of Tennessee and the Department of Health and Human Services (DHHS), that is negotiated by the DHHS, Division of Cost Allocation (DCA). The plan identifies which costs are to be allocated to various programs and which costs may be billed directly to the user agency.

SCOPE

Our preliminary review steps included meetings with representatives of DCA in Atlanta, Georgia. We obtained pertinent information concerning the State of Tennessee's SWCAP and reviewed the objectives of the agreed-upon procedures with DCA.

Our examination was performed in Nashville, Tennessee at the administrative offices of each of the Funds reviewed from April 26, 1991 to June 5, 1991. Our examination was made in accordance with certain agreed upon procedures performed in accordance with Governmental Auditing Standards, 1988 Revision, issued by the Comptroller General of the United States solely to assist the U.S. Department of Health and Human Services in connection with its evaluation of self-insurance funds.

We obtained the General Purpose Financial Statements (GPFS) of the various departments of the State of Tennessee for the fiscal year ending June 30, 1990, performed an analysis of these statements and determined that the above listed Funds needed further evaluation. For each of the three self-insurance funds, we performed, but were not limited to, the following procedures:

1. obtained and reviewed financial statements and other financial data of each individual Fund;

2. determined if the Fund had significant Federal Financial Participation;

3. reviewed the reserve balances for reasonableness;

4. determined if any transfers of funds occurred during the fiscal year or prior fiscal years; and

5. determined if premium rates were justified.

During our examination, we did not test the financial statements of these Funds, nor did we review the Funds costs for allowability.

FINDINGS AND RECOMMENDATIONS

Our examination revealed an excess fund balance of $27,487,277 in the Claims Award Fund. We have estimated that 20 percent or $5,497,455 is the Federal share of the reserve balance in excess of Federal cost principles.

The Employee Group Insurance Fund and the Teacher Group Insurance Fund appeared to have reasonable fund balances and we have made no recommendations in regard to these Funds.

CLAIMS AWARD FUND

The Claims Award Fund is a self-insurance fund established by the State of Tennessee to provide coverage for claims falling within one or more of the nineteen categories:

A. The negligent operation or maintenance of any motor vehicle or any other land, air or sea conveyance;

B. Nuisances created or maintained;

C. Negligently created or maintained dangerous conditions on State controlled real property. The claimant under this subsection must establish the foreseeability of the risks and must have given notice to the proper State officials at a time sufficiently prior to the injury for the State to have taken appropriate measures;

D. Professional malpractice;

E. Negligent care, custody or control of persons;

F. Negligent care, custody or control of personal property;

G. Negligent care, custody or control of animals. Damages are not recovered under this section for damages caused by wild animals;

H. Negligent construction of State sidewalks and buildings;

I. Negligence in planning and programming, inspection, design construction, maintenance or approval of plans and construction of public highways and bridges if such activity is mandated or undertaken pursuant to State or Federal law;

J. Dangerous conditions on State maintained highways. The claimant under this subsection must establish the foreseeability of the risk and must have given notice to the proper State officials at a time sufficiently prior to the injury for the State to have taken appropriate measures;

K. Worker's compensation claims by State employees, including injuries incurred by national guard members, State defense force members, civil air patrol members, civil defense agency personnel and emergency forest firefighters while on active duty and in the course of that duty;

L. Actions for breach of a written contract between the claimant and the State which was executed by one or more State officers or employees with authority to execute the contract;

M. Negligent operation of machinery and equipment;

N. Negligent deprivation of statutory rights, except for actions arising out of claims over which the Civil Service Commission has jurisdiction;

O. Claims for the recovery of taxes collected or administered by the State, except any tax collected or administered by the Commissioner of Revenue;

P. Claims for the loss, damage or destruction of the personal property of State employees based on Tennessee Code Section 9-8-111;

Q. Claims for injuries incurred by persons where such injury occurred while the person was a passenger in a motor vehicle operated by a State employee while such employee was acting within the scope of employment;

R. Claims for libel and/or slander where a State employee is determined to be working within the scope of employment; and

S. Claims for compensation filed under the Criminal Injuries Compensation Act compiled in Title 29, Chapter 13 and Tennessee Code Section 40-24-107.

We reviewed the Claims Award Fund's accounting records from January 1, 1986, which is the inception of the Fund, through June 30, 1990. Our review revealed:

A fund balance at June 30, 1990 of $27,487,277 accumulated in excess of Federal cost principles from three major sources. First, the excess fund balance arose primarily during the fiscal year ending June 30, 1990 due to premiums being charged of $26,923,000 and expenses of $12,113,000, resulting in an operating profit of $14,810,000, which included a transfer to the General Fund of $6,300,000 on June 30, 1990. Secondly, an adjustment of $12,528,000 was made to the financial statements during the fiscal year ending June 30, 1990 based on an actuarial determination that the liability recorded in previous years was overstated. Lastly, the remaining $149,000 arose due to total revenues exceeding total expenses over the prior five-year life of the Fund.

Accrual basis fund balance at June 30, 1990 per the State Auditor's audited financial statements	$21,187,277
Transfer out to the General Fund	6,300,000
Adjusted fund balance at June 30, 1990	$27,487,277

Office of Management and Budget (OMB) Circular A-87, which establishes cost principles for State and Local governments, provides for Federal reimbursement of allowable costs and precludes charges in excess of cost.

OMB Circular A-87, Attachment A, Section A.1 states in part:

> "... no provision for profit or other increment above cost is intended."

OMB Circular A-87, Attachment B, Part D.2 states:

> "Contributions to a contingency reserve or any similar provision for unforeseen events are unallowable."

We determined the Federal share of the excess reserve balances in accordance with the following DCA policy:

- For State agencies, DCA has determined a standard estimated Federal Financial Participation rate of 20%.

We have determined that of the $27,487,277 adjusted fund balance, 20% or $5,497,455 is the Federal share of the reserve balance in excess of Federal cost principles.

The adjusted fund balance of $27,487,277 arose in the State fiscal year ending June 30, 1990 because premiums charged in the June 30, 1990 fiscal year exceeded expenditures and an adjustment was made to the fund balance in order to properly reflect the actuarial determined claims outstanding.

RECOMMENDATION

We recommend that the State of Tennessee:

1. Make an adjustment that will restore the Federal equity in the $27,787,277 adjusted fund balance which has been estimated to be $5,497,455. (Refer to Exhibit I).

2. Ensure that charges to Federal programs are in accordance with OMB Circular A-87 and the Statewide Cost Allocation Plan agreement with DCA.

STATE'S RESPONSE

The State of Tennessee basically concurs with the finding. However, the State desires to discuss the resolution of all issues, including the underfunding of the State Employee Insurance Fund, with the appropriate HHS officials responsible for final settlement of audit findings. See Appendix B for the complete text of auditee comments.

EMPLOYEE GROUP INSURANCE FUND

The Employee Group Insurance Fund is a self-insurance fund established by the State of Tennessee to provide health coverage to employees of State agencies.

We reviewed the Employee Group Insurance Fund's accounting records from January 1, 1978, which is the inception of the Fund, to June 30, 1990. Our review revealed that the fund balance appeared reasonable due to a deficit fund balance at June 30, 1990 of ($7,883,000). Therefore, we have no specific recommendations in regard to this Fund.

TEACHER GROUP INSURANCE FUND

The Teacher Group Insurance Fund is a self-insurance fund established by the State of Tennessee to provide health coverage to employees of local school districts within the State of Tennessee.

We reviewed the Teacher Group Insurance Fund's accounting records from January 1, 1986, which is the inception of the Fund, to June 30, 1990. Our review revealed that the fund balance appeared reasonable due to a deficit fund balance at June 30, 1990 of ($5,134,000). Therefore, we have no specific recommendations in regard to this Fund.

STATE OF TENNESSEE
SELF-INSURANCE REVIEW
SCHEDULE OF FEDERAL RECLAIM

Claims Award Fund

Fund balance at June 30, 1990 per Tennessee State Auditor's audited financial statements	$21,187,277
Adjustments to fund balance:	
Transfer to the General Fund of the State of Tennessee on June 30, 1990.	6,300,000
Adjusted Fund Balance	$27,487,277
Amount of Federal Reclaim:	
State of Tennessee	$27,487,277
Division of Cost Allocation's standard estimated Federal Financial Participation Rate	20%
TOTAL FEDERAL RECLAIM	$ 5,497,455

Carmichael,
Ingle, Saffert
& Brasher, P.C.

Certified Public Accountants

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APPENDIX A

Mr. Emil A. Trefzger, Jr., C.P.A.
Regional Inspector General for Audit Services, Region IV
U. S. Department of Health and Human Services
Office of Inspector General
Office of Audit Services
101 Marietta Tower, Suite 1401
Atlanta, Georgia 30323

ACCOUNTANTS' REPORT ON AGREED-UPON PROCEDURES

We have performed certain agreed-upon procedures, as discussed below, to accounting records of the State of Tennessee as of June 30, 1990, solely to assist the U.S. Department of Health and Human Services in connection with its evaluation of self-insurance funds of various States. It is understood that this report is subject to the Freedom of Information Act (Public Law 90-23) which governs all reports issued by or through the U.S. Department of Health and Human Services.

We evaluated the self-insurance funds of the State of Tennessee to:

- determine the need for self-insurance funds;
- determine the basis for the self-insurance funds;
- identify self-insurance funds which have significant Federal participation;
- identify self-insurance funds which have generated excess reserve balances; and
- determine the Federal equity in the excess reserve balances, if any.

Because the above procedures do not constitute an audit made in accordance with generally accepted auditing standards or Governmental Auditing Standards (1988 Revision) issued by the Comptroller General of the United States, we do not express an opinion on any of the accounts or items referred to above. In connection with the procedures referred to above, no matters came to our attention that caused us to believe that the specified account or items should be adjusted other than those recommended in the Findings and Recommendations section of the report. Had we performed additional procedures or had we made an audit of the financial statements in accordance with generally accepted auditing standards, matters might have come to our attention that would have been reported to you. This report relates only to the accounts and items specified above and does not extend to any financial statements of the State of Tennessee taken as a whole.

Carmichael, Ingle, Saffert & Brasher, PC

CARMICHAEL, INGLE, SAFFERT & BRASHER, P.C.
June 5, 1991

STATE OF TENNESSEE
DEPARTMENT OF FINANCE AND ADMINISTRATION
STATE CAPITOL
NASHVILLE, TENNESSEE 37219-517

DAVID L. MANNING
COMMISSIONER

December 5, 1991

Mr. Emil A. Trefzger, Jr., CPA
Regional Inspector General for Audit Services Region IV
U.S. Department of Health and Human Services
Office of Inspector General, Office of Audit Services
101 Marietta Tower, Suite 1401
Atlanta, Georgia 30323

Dear Mr. Trefzger,

I have reviewed the accountants report on the results of certain agreed-upon procedures of the self-insurance funds of the State of Tennessee.

The State of Tennessee basically concurs with the finding that the Claims Award Fund had an adjusted fund balance of $27,487,277 as of June 30, 1990, and that 20 percent - or the federal share - of that reserve balance would constitute $5,497,455.

While we are certainly committed to making charges to federal programs being in accordance with OMB Circular A-87, the report does not address the question of the underfunding of the State Employee Insurance Fund. This issue is of concern to the state, and probably merits more discussion.

At the present time, I don't think that a formal exit conference will be necessary. However, it might be useful for us to meet to review the final figures on the finding, as well as to discuss the underfunding issue and ultimate resolution of these issues.

Sincerely,

Danny L. Creekmore, CPA
Assistant Commissioner for Accounting

cc: David L. Manning
Art Hayes
Clyde Phillips