OFFICE OF RISK MANAGEMENT
COST SAVINGS UPDATE
FISCAL YEAR 2013

PERFORMANCE AUDIT
ISSUED JUNE 25, 2014

LOUISIANA LEGISLATIVE AUDITOR
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LOUISIANA LEGISLATIVE AUDITOR
DARYL G. PURPERA, CPA, CFE

June 25, 2014

The Honorable John A. Alario, Jr.,
President of the Senate
The Honorable Charles E. “Chuck” Kleckley,
Speaker of the House of Representatives

Dear Senator Alario and Representative Kleckley:

This report provides the current status of the Division of Administration’s Office of Risk Management (ORM) contract with F.A. Richard & Associates as of April 30, 2014. This report also provides an update of the cost savings as of June 30, 2013, the end of the third year of the five-year contract. Appendix A contains ORM’s response to this report. I hope this report will benefit you in your legislative decision-making process.

We would like to express our appreciation to the management and staff of ORM for their assistance during this audit.

Sincerely,

Daryl G. Purpera, CPA, CFE
Legislative Auditor

DGP/ch

ORM 2013

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Louisiana Legislative Auditor

Daryl G. Purpera, CPA, CFE, Legislative Auditor

Office of Risk Management
Cost Savings Update for Fiscal Year 2013

June 2014

Audit Control # 40130055

Introduction

This report provides the current status of the Division of Administration's (DOA) Office of Risk Management (ORM) contract with F.A. Richard & Associates (FARA) as of April 30, 2014, and an update of the cost savings results as of June 30, 2013, the third year of the five-year contract.[1] We conducted this audit as a follow-up to our previous performance audit on the results of the second year of the contract. Appendix A contains ORM's response to this report and Appendix B details our scope and methodology. Our objectives were as follows:

Objective 1: What is the chronology and current status of ORM's contract with FARA as of April 30, 2014?

Objective 2: What is the status of the cost savings results from ORM's contract with FARA as of June 30, 2013?

Background

ORM's Contract with FARA. On June 8, 2010, ORM awarded FARA a contract to privatize the state's lines of insurance and loss prevention services. The original amount of the contract was \$68,118,971 and was amended on April 7, 2011, to the total amount of \$74,930,868 (an increase of 10%). According to ORM, additional funds were needed for the acceleration of moving the lines of insurance to FARA because of the high turnover of ORM employees. This is a five-year contract beginning July 1, 2010, and ending on June 30, 2015.

Cost Savings to be Achieved from the Contract. With this contract, FARA guarantees savings of \$50 million in *claims and litigation payments*[2] to the State of Louisiana. ORM projected net program savings of \$22 million as a result of the FARA contract. Net program savings consist of *claims and litigation payment savings* and *administrative and other cost savings.* In addition to FARA's \$50 million in guaranteed savings, ORM will need \$40 million in *administrative and other cost savings* to achieve its projected \$22 million in net program savings mentioned above. This savings does not take into account the \$6.8 million cost increase from the amendment.

[1] ORM provided our office with the results of its cost savings analysis on March 21, 2014.

[2] According to the contract, the guaranteed savings include payment savings in the categories of Claims and Related, Division of Risk Litigation, and Contract Litigation.

Cost Savings for Year Two of the FARA Contract. On June 19, 2013, we issued a performance audit with the status of savings as of June 30, 2012.[3] Based on cumulative Year Two contract costs of $16.6 million, the savings were as follows:

- *Claims and Litigation Payment Savings.* FARA reduced claims payments by approximately $20.3 million (40.6%) of the $50 million guaranteed by the contract.

- *Administrative and Other Cost Savings.* ORM achieved approximately $6.6 million (16.5%) of the $40 million in *administrative and other cost savings.*

- *Net Program Savings.* ORM achieved net program savings of approximately $10.3 million, which is approximately 46.8% of the $22 million.

[3] The report can be found at http://app1.lla.state.la.us/PublicReports.nsf/507105543921B25486257B8F00773DBD/$FILE/00033D1E.pdf.

Objective 1: What is the chronology and current status of ORM's contract with FARA as of April 30, 2014?

As of April 30, 2014, ORM had transferred all of its nine lines of insurance and associated services to FARA. This completed all four phases of the implementation schedule. Exhibit 1 lists the four phases of the transfer of ORM's nine lines of insurance and associated services, including the implementation dates.

Exhibit 1
Implementation Schedule
As of April 2014

Phase	Line of Insurance or Service	Original Contract Implementation Date	Actual Implementation Date
I	• Loss Prevention Services	9/1/2010	7/2/2010
	• Workers' Compensation		9/1/2010
	• Subrogation Recovery		9/1/2010
	• Second Injury Fund Recovery		9/1/2010
II	• Property	1/1/2012	1/16/2012
III	• Medical Malpractice	1/1/2013	8/1/2012
	• General Liability		7/1/2011
IV	• Road Hazard • Auto Liability/Physical Damage	11/1/2013	7/1/2013

Source: Prepared by legislative auditor's staff using information provided by ORM.

Staffing. As of April 30, 2014, ORM had reduced its staff from 140 to 39 employees, with 37 filled positions and two vacancies, for a total reduction of 101 employees (72.1%) from fiscal year 2010.[4] The remaining 39 employees staff ORM's legal, underwriting, information technology, contracts, accounting, and administrative functions. According to ORM, it had 55 authorized positions for fiscal year 2014, but it anticipates that this number will be adjusted to 39 for fiscal year 2014 because of the completion of all lines of insurance transferring to FARA.

Chronology of FARA Contract. Exhibit 2 shows a detailed chronology of the privatization of ORM's lines of insurance and associated services to FARA from September 2009 through April 2014.

[4] Total employee counts include full-time, part-time, and student worker positions and vacancies.

Exhibit 2 Chronology of the Privatization of ORM's Lines of Insurance and Associated Services September 2009 through April 2014	
Date	**Description**
September 2009	In 2009, DOA consults with the Reason Foundation to determine which of ORM's services could potentially be provided by the private sector. On September 2, 2009, the Reason Foundation presents to the Streamlining Commission that DOA has a key privatization opportunity with the claims processing function of ORM.
November 2009	On November 13, 2009, ORM issues a RFP for Claims Administration and Loss Prevention Services.
March 2010	On March 15, 2010, the evaluation committee completes its final evaluations and the Commissioner of Administration selects FARA to privatize ORM's lines of insurance and associated services.
May 2010	On May 19, 2010, ORM justifies the privatization of its lines of insurance and associated services to the Joint Legislative Committee on the Budget (JLCB), including the advantages of privatization, the estimated cost savings, and the reduction of 85 ORM employees over 40 months. Since the RFP was for a five-year contract, ORM had to obtain JLCB's approval per R.S. 39:1514(D). On May 27, 2010, ORM presents the results of the evaluation committee's selection of FARA to the JLCB.
June 2010	On June 8, 2010, ORM awards FARA a contract to privatize the state's lines of insurance and associated services for a total of $68,118,971 over five years.
July 2010	On July 2, 2010, ORM accelerates the transfer of Loss Prevention over to FARA from the original implementation date of September 1, 2010, because of the high turnover of ORM employees. (PHASE I) Per the contract, FARA is required to offer employment to all ORM employees displaced by the implementation of the contract for a minimum of one year.
September 2010	On September 1, 2010, Workers' Compensation, Subrogation Recovery, and Second Injury Fund Recovery transfer over to FARA. (PHASE I)
April 2011	On April 7, 2011, ORM amends the contract amount from $68,118,971 to $74,930,868 (an increase of 10%) for the acceleration of the transfer of General Liability and any additional lines of insurance to FARA.
May 2011	On May 10, 2011, the House Appropriations Committee meets to discuss the performance of FARA and the 10% amendment. On May 20, 2011, Avizent acquires FARA; however, ORM states that this acquisition will not affect operations. FARA continues to employ Louisiana-based employees for the ORM contract.
July 2011	On July 1, 2011, ORM accelerates the transfer of General Liability over to FARA from the original implementation date of January 1, 2013, because of the high turnover of ORM employees. (PHASE III)
December 2011	On December 20, 2011, York Services Group acquires Avizent; however, ORM states that this acquisition will not affect operations. FARA continues to employ Louisiana-based employees for the ORM contract.

Exhibit 2 Chronology of the Privatization of ORM's Lines of Insurance and Associated Services September 2009 through April 2014	
Date	**Description**
January 2012	On January 16, 2012, ORM transfers Property over to FARA. The original implementation date of January 1, 2012, was delayed to allow for additional time for testing and data conversion. (PHASE II)
April 2012	As of April 30, 2012, FARA employs 55 Louisiana-based employees in three offices for the ORM contract.
August 2012	On August 1, 2012, ORM transfers Medical Malpractice over to FARA, accelerating the original implementation date of January 1, 2013. (PHASE III)
April 2013	As of April 30, 2013, FARA employs 80 Louisiana-based employees in four offices for the ORM contract. Of these 80 Louisiana-based employees, eight are former ORM employees. The contract requires FARA to offer employment to all ORM employees displaced by privatization for at least one year.
July 2013	On July 1, 2013, ORM transfers Road Hazard and Auto Liability/Physical Damage over to FARA, accelerating the original implementation date of November 1, 2013. (PHASE IV)
April 2014	As of April 30, 2014, FARA employs 88 Louisiana-based employees in four offices for the ORM contract. Of these 88 Louisiana-based employees, 20 are former ORM employees. The contract requires FARA to offer employment to all ORM employees displaced by privatization for at least one year.
June 2015	The contract with FARA ends on June 30, 2015. According to ORM, it will create a new RFP for a third party administrator to administer the state's lines of insurance and loss prevention services prior to this date.
Source: Prepared by legislative auditor's staff using information provided by ORM.	

Objective 2: What is the status of the cost savings results from ORM's contract with FARA as of June 30, 2013?

As discussed earlier in this report, ORM projects net program savings of $22 million as a result of the FARA contract. Net program savings consist of *claims and litigation payment savings* and *administrative and other cost savings* versus contract costs. FARA guarantees $50 million in *claims and litigation payment savings* to the state during the five-year term of its contract with ORM. In addition to the $50 million in guaranteed savings, ORM will need $40 million in *administrative and other cost savings* to achieve its projection of $22 million in net program savings.

ORM's cumulative cost savings results as of June 30, 2013, the end of the first three years of the FARA contract, in each of these categories is described below.

FARA achieved $34.2 million (68.4%) of the $50 million in *claims and litigation payment savings* guaranteed by the contract. However, in fiscal year 2013, ORM changed its methodology for estimating savings in this category to include workers' compensation claims settled by FARA.

As of June 30, 2013, ORM calculated[5] that FARA had cumulatively reduced *claims and litigation payment savings* by approximately $34.2 million (68.4%) of the $50 million in payment savings the contract guarantees. The $34.2 million total includes $20.7 million in savings related to claims and litigation payments and $13.5 million in savings related to the settlement of workers' compensation claims by FARA.

During fiscal year 2013, FARA requested approval from ORM to start settling more workers' compensation claims. According to ORM, it took FARA the first two years of the contract to become familiar with the state's workers' compensation claims. During this time, FARA settled 101 claims during fiscal year 2011 and 102 claims in fiscal year 2012, which was in line with the 121 claims that ORM settled in fiscal year 2010 before the privatization.[6] During the third year of the contract, however, FARA felt that it was ready to take an "aggressive approach" to settling claims, according to ORM. As a result of this push, FARA settled 212 claims in fiscal year 2013, for an increase in settlements of 107.8% from fiscal year 2012 and a cumulative savings of approximately $13.5 million. Exhibit 3 contains a summary of the cumulative savings related to FARA's settlement of workers' compensation claims during the first three years of the contract.

[5] ORM's cost savings analysis is based on the difference between projected costs if ORM had not privatized versus the actual amount of expenditures accumulated by FARA since the privation. See Appendix C for ORM's methodology for projected costs, which we reviewed for reliability and reasonableness.
[6] ORM's previous methodologies did not include FARA's settlement of workers' compensation claims for estimating cost savings achieved during fiscal years 2011 and 2012.

Exhibit 3 Summary of Workers' Compensation Claims Settlement Savings Achieved by Privatization to FARA Fiscal Year 2011 through Fiscal Year 2013				
	FY 2011 (Contract Year 1)	**FY 2012 (Contract Year 2)**	**FY 2013 (Contract Year 3)**	**Cumulative Settlement Savings Realized by FARA**
A. Number of Claims Settled by FARA	101	102	212	
B. Estimated Cost to State of Settled Claims*	$12,865,417	$11,955,615	$40,099,462	
C. Total Settlements Paid	3,883,458	3,363,274	12,732,861	
D. Actual Settlement Savings by FARA *(B-C)*	8,981,959	8,592,341	27,366,601	
E. Estimated Target Settlement Savings by ORM**	10,469,302	10,469,302	10,469,302	
F. Settlement Savings Realized by Privatization *(D-E)*	(1,487,343)	(1,876,961)	16,897,299	**$13,532,995**

*ORM estimated these amounts using a sample of claims settled and discounted for an average of 10 years.
**Target savings are based on actual settlement savings achieved by ORM in FY 2010.
Source: Prepared by legislative auditor's staff using information provided by ORM.

After Year Three of the contract, ORM changed its methodology for estimating savings to include the results of FARA's workers' compensation claims settlements. While ORM determined the results of FARA's settlements for fiscal years 2011 and 2012 as shown in Exhibit 3, it did not include settlements when it estimated savings for the first two years of the contract. According to ORM, this was because the number and cost of settlements during the first two years of the FARA contract were typical of ORM's history. When ORM and FARA agreed to be more aggressive in identifying settlement opportunities in fiscal year 2013, ORM realized it needed to identify an approach to measure the impact of settlements. **Had ORM not changed its methodology to include the cumulative savings resulting from FARA's settlement of workers' compensation claims, the savings related to *claims and litigation payment savings* as of June 30, 2013, would only have been approximately $20.7 million, or 41.4% of the $50 million guaranteed by the contract.**

Exhibit 4 includes a breakdown of the cumulative *claims and litigation payment savings* achieved by FARA by line of insurance for fiscal year 2013.

Exhibit 4 Claims and Litigation Payment Savings Achieved by FARA Fiscal Year 2011 through Fiscal Year 2013		
Line of Insurance	**Savings** *(in millions)*	**Time Administered by FARA**
Workers' Compensation	$26.5*	3 years
General Liability	3.2	2 years
Property	1.7	1 year
Medical Malpractice	2.8	11 months
Total Savings	**$34.2**	
*Includes $13.5 million in cumulative savings from settlement of workers' compensation claims. **Source:** Prepared by legislative auditor's staff using information provided by ORM.		

FARA's cumulative savings of $34.2 million are approximately 24.8% ahead of schedule for fiscal year 2013 based on ORM's projections. Had ORM not changed its methodology in Year Three of the contract to include savings related to FARA's settlement of workers' compensation claims, FARA's cumulative savings would be approximately $20.7 million, or 24.5% behind schedule based on ORM's projections. ORM had projected cumulative *claims and litigation payment savings* of approximately $4.8 million in fiscal year 2011, $11.2 million in fiscal year 2012, and $11.4 million in fiscal year 2013, for a total of $27.4 million for the first three years of the FARA contract, as shown in Appendix D (see row "Less proposed savings - Claims").

If FARA does not achieve the $50 million in *claims and litigation payment savings*, it must refund the state 3% of the shortfall, up to $1.5 million, which is approximately 2% of the $68.1 million contract.[7] If FARA exceeds the $50 million in savings, the state will pay an additional 3% of the savings greater than $50 million, up to $1.5 million or the maximum of the contract, whichever is less.

ORM achieved savings of approximately $11.9 million (29.8%) of the $40 million in *administrative and other cost savings* it needs to achieve its projected net program savings of $22 million.

As of June 30, 2013, ORM had achieved approximately $11.9 million (29.8%) of the *administrative and other cost savings* it needs to achieve $22 million in expected net savings. These savings are not guaranteed by the contract. Therefore, ORM has two years to achieve the remaining $28.1 million (70.2%). ORM did not develop projections for the amount of *administrative and other costs savings* it would attain during each year of the contract. According to ORM, the remaining $28.1 million *in administrative and other cost savings* will come from reductions in budget items such as contract costs, salaries and benefits, office rent, telecommunications, software licenses, etc.

[7] According to the contract, savings measurement will include adjustments for material changes which are beyond FARA's control, such as changes in law, natural disasters, disruption in the planned contract term, etc.

ORM achieved net program savings of approximately $15.9 million by Year Three of the FARA contract, or 72.3% of the $22 million projected over the five-year contract period.

Taking into account FARA's *claims and litigation payment savings*, ORM's *administrative and other cost savings*, and the approximately $30.2 million (44.3%) that ORM has paid FARA toward the original contract cost of $68.1 million, net program savings as of June 30, 2013, are approximately $15.9 million. Had ORM not changed its methodology in Year Three to include the savings related to FARA's settlement of workers' compensation claims, *claims and litigation payment savings* would have been $20.7 million, resulting in net program savings of only $2.4 million. While the formula for calculating net program savings has not changed, the methodology for estimating the *claims and litigation payment savings* now include savings from workers' compensation savings, as previously discussed. The formula remains as follows:

Cumulative Three-Year Contract Costs ($30.2 million) - Administrative and Other Cost Savings ($11.9 million) - Claims and Litigation Payment Savings ($34.2 million)
= $15.9 million Net Program Savings

This amount is approximately 72.3% of the $22 million ORM projects in net program savings over the five-year contract period. ORM had projected additional program costs of approximately $659,000 during fiscal year 2011, net savings of approximately $5.4 million during fiscal year 2012, and net savings of approximately $5.3 million during fiscal year 2013, for cumulative program cost savings of approximately $10.0 million after Year Three of the FARA contract. Therefore, the cumulative net program savings of $15.9 million for fiscal year 2013 are ahead of schedule by approximately 59% based on ORM's projections, as shown in Appendix D (see row "Net Program Costs/Savings").

APPENDIX A: MANAGEMENT'S RESPONSE

BOBBY JINDAL
GOVERNOR

KRISTY H. NICHOLS
COMMISSIONER OF ADMINISTRATION

State of Louisiana

Division of Administration
Office of Risk Management

June 16, 2014

Mr. Daryl Purpera, CPA
Legislative Auditor
1600 North Third Street
Post Office Box 94397
Baton Rouge, LA 70804-9397

Re: Response to Performance Audit Report Update on the Division of Administration Office of Risk Management

Dear Mr. Purpera:

The State of Louisiana Division of Administration (DOA) would like to thank you and your staff for conducting a performance audit on the cost savings related to DOA's Office of Risk Management (ORM) contract with F.A. Richard & Associates (FARA). I am happy to see that your report confirms the results through June 30, 2013 have exceeded expectations.

ORM monitors two objectives put forward to the Joint Legislative Committee on the Budget when the contract was approved.

1. A contractually guaranteed $50 million in claims and litigation payment savings
2. $22 million in net savings to ORM

As noted in the report, ORM is on track to exceed those objectives.

However, it is important to note that ORM does not specifically report the "Administrative and Other Cost Savings" mentioned in your audit. That measure as calculated in your report is easily misinterpreted because it does not take into account the fact that contract payments are variable. To date, contract payments are significantly lower than initially projected. ORM continues to monitor and pursue efficiencies in all aspects of its operations in order to reduce costs.

While ORM did not change its method of calculating savings for FY2013, it did add an additional component to the calculations due to the ongoing development of the program. As the program continues to evolve, ORM will adjust the measurement methodology to ensure that it accurately reflects the overall financial status of the program.

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Thank you again for your efforts in reviewing this program. We are proud of what the program has achieved so far, and will continue working toward a successful conclusion of the project.

Sincerely,

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

CC: Kristy Nichols
Ruth Johnson
Benjamin Huxen
Meghan Parrish
Monique Appeaning
Patti Gonzalez
Marsha Guedry
Ann Wax
Marsha Pemble

APPENDIX B: SCOPE AND METHODOLOGY

We conducted this review under the provisions of Title 24 of the Louisiana Revised Statutes of 1950, as amended. We conducted this audit in response to legislative interest. Our review focused on the privatization of ORM and the outsourcing of its services to FARA, and covered the period from July 1, 2012 through April 30, 2014. The audit objectives were to answer the following questions:

1. What is the chronology and current status of ORM's contract with FARA as of April 30, 2014?

2. What is the status of the cost savings results from ORM's contract with FARA as of June 30, 2013?

We conducted this performance audit in accordance with generally accepted government auditing standards issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives. To answer our objectives, we reviewed internal controls relevant to the audit objectives and performed the following audit steps:

- Received ORM's summary of cumulative costs savings for the FARA contract as of June 30, 2013 on March 21, 2014.
- Interviewed ORM staff to determine the updated chronology of ORM's contract with FARA through April 30, 2014.
- Obtained and analyzed the reliability and reasonableness of ORM's estimated cost savings methodology and analysis for fiscal year 2013.
- Verified ORM's actual contract costs with ISIS data using the Expenditure report from Business Objects.
- Verified ORM's projected cost for the lines of insurance transferred to FARA using the methodology as seen in Appendix C and supporting documentation received from ORM management.
- Verified ORM's actual cost for the lines of insurance transferred to FARA using supporting documents from ORM and data dumps of individual transactions from FARA's claims processing system (ICE). In addition to the data dumps, some actual expenditures for other claims related cost were verified to the Expenditure report from Business Objects.
- Recalculated ORM's projected costs and actual costs and verified the amounts back to supporting documentation for accuracy and reliability. Confirmed these calculations with ORM staff.

APPENDIX C: ORM'S METHODOLOGY FOR PROJECTING COSTS Fiscal Year 2013

During the contract Request for Proposal evaluation process, ORM estimated net program savings of $22.2 million over the five-year period, through privatization of claims administration services to a third party administrator (TPA). This early savings analysis was based on *Projected Costs* that assumed the full administration of claims would continue in-house. These costs were then reduced by the anticipated net savings through privatization to a TPA.

The contract required implementation using a phased approach; therefore, evaluation was necessary to split the summary projected costs into categories to define projected costs allocable to in-house lines of business and the lines handles by FARA under the phased implementation. This work was completed by the Division of Administration's Office of Finance and Support Services (OFSS) personnel working in a concerted effort with ORM leadership and based on the following assumptions:

- **Workers' Compensation.** Since this line of business is predisposed to follow predictable trends, the actual historical costs incurred by ORM in fiscal year 2010 served as the starting point to arrive at projects costs allocable to Workers' Compensation. Annual inflation factors were applied to Indemnity and Medical costs using Louisiana trend data compiled by the National Council on Compensation Insurance, Inc. (NCCI) to estimate realistic projected costs for comparison to actual costs of Workers' Compensation Claims Administration under FARA. An annual inflation factor of 1.6% was used to project costs in the Contract Litigation and Division of Risk Litigation programs. Annual inflation factors were developed for other cost categories of the Workers' Compensation line of business using the Consumer Price Index data published by the Bureau of Labor Statistics of the U.S. Department of Labor.

- In Year Three a new evaluation component was added to estimate and include the savings for the state from FARA's strategic settlement of Workers' Compensation claims. For this aspect of cost savings, OFSS worked closely with the ORM Claims Unit professionals that monitor the Workers' Compensation program components administered by FARA.

- **General Liability.** The evaluation of General Liability was through the continuation of the method established in fiscal year 2012. Since this line of business is less predictable, a different approach was developed to estimate realistic projected costs for comparison to actual costs of General Liability Claims Administration under FARA. The average of three prior fiscal years of historical cost incurred by ORM served as the starting point to arrive at the allocation of projected costs for General Liability. Projected in-house program cost estimates for fiscal year 2013 were based on the average of actual data from fiscal years 2009, 2010, and 2011. An annual inflation factor of 1.6% was used to project costs in the Contract Litigation and Division of Risk Litigation programs. Annual inflations factors were developed for all other costs of the General Liability line of business using the Consumer Price Index data published by the Bureau of Labor Statistics of the U.S. Department of Labor.

- **Property.** ORM management chose to evaluate direct savings only on regular claims (defined as non-catastrophic), since the impact of catastrophic events is simply not predictable. Since this line of business is also less predictable, a special approach was developed to estimate realistic projected costs for comparison to actual costs of Property Claims Administration under FARA. The average of five years of historical cost incurred by ORM served as the starting point to arrive at the allocation of projects costs for Property. Projected in-house program cost estimates for fiscal year 2013 were based on the average of actual data from calendar years 2007 to 2011. An annual inflation factor of 1.6% was used to project costs in the Contract Litigation and Division of Risk Litigation programs. For Property costs that relate to construction, ORM developed a five-year average inflation, using cost indexes developed by Xactimate, a service company that supports the insurance and reconstruction repair industries. Annual inflation factors were used for all other costs of the Property line of business using the Consumer Price Index data published by the Bureau of Labor Statistics of the U.S. Department of Labor.

- **Medical Malpractice.** Since this line of business is a liability line, the approach developed for the General Liability line was used to estimate costs.

Source: Prepared by legislative auditor's staff based on information provided by ORM.

APPENDIX D: ESTIMATED TOTAL PROGRAM COSTS AND NET SAVINGS
Fiscal Year 2011 Through Fiscal Year 2015

		FY10-11	FY11-12	FY12-13	FY13-14	FY14-15	5-Year Total
ORM In-house	Administration	$13,455,132	$13,719,609	$14,170,188	$14,662,661	$15,242,043	$71,249,633
	Claims and Related	$260,741,997	$211,499,667	$224,812,818	$239,457,094	$255,565,607	$1,192,077,183
	Division of Risk Litigation	$17,311,747	$17,588,735	$17,870,154	$18,156,077	$18,446,574	$89,373,287
	Contract Litigation	$13,967,380	$14,190,858	$14,417,912	$14,648,598	$14,882,976	$72,107,724
	Less savings from planned improvements - Subrogation Recovery contract	($450,000)	($900,000)	($900,000)	($900,000)	($900,000)	($4,050,000)
	Less savings from planned improvements - Pharmacy Benefit Manager	($562,500)	($750,000)	($750,000)	($750,000)	($750,000)	($3,562,500)
	TOTAL PROGRAM COST	$304,463,756	$255,348,869	$269,621,072	$285,274,430	$302,487,200	**$1,417,195,327**
FARA - savings per vendor	Original Contract cost*	$10,002,833	$11,216,448	$14,070,715	$16,261,603	$16,567,373	$68,118,972
	Plus estimated ORM costs - Administration	$10,658,786	$9,921,349	$8,419,292	$6,894,600	$6,845,560	$42,739,587
	Plus estimated ORM costs - Claims & Related	$257,996,997	$208,205,167	$220,963,868	$235,048,249	$251,090,877	$1,173,305,158
	Plus estimated ORM costs - Division of Risk Litigation	$17,311,747	$17,588,735	$17,870,154	$18,156,077	$18,446,574	$89,373,287
	Plus estimated ORM costs - Contract Litigation	$13,967,380	$14,190,858	$14,417,912	$14,648,598	$14,882,976	$72,107,724
	Less proposed savings - Claims	($4,815,000)	($11,159,000)	($11,419,000)	($11,666,000)	($11,611,000)	($50,670,000)
	TOTAL PROGRAM COST	$305,122,743	$249,963,557	$264,322,941	$279,343,127	$296,222,360	**$1,394,974,728**
	Net Program Cost/(Savings)	$658,987	($5,385,312)	($5,298,131)	($5,931,303)	($6,264,840)	**($22,220,599)**

*ORM based all cost savings estimations on the original contract cost and did not re-estimate based on the 10% increase approved in April 2011.
Note: The green shaded columns denote the three fiscal years covered in this report.
Source: Prepared by legislative auditor's staff using information provided by ORM.