

Final Audit Follow-Up

As of May 31, 2015



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City Auditor

Acquisition of Commercial Insurance Coverages

(Report #1404 issued December 12, 2013)

Report #1509

May 29, 2015

Summary

The Office of the Treasurer-Clerk has taken appropriate steps to revise the process for the City's acquisition of commercial insurance coverages. The revised process has resulted in meaningful savings to the City.

In audit report #1404, we recommended the Office of the City Treasurer-Clerk's Risk Management section consider revising its methods for acquiring commercial insurance coverages. Instead of using the "Defined Coverage Method" and "Appointment Method," we recommended consideration be given to using the "Broker of Record Method" or an appropriately modified version of that method. We reported that (1) the existence of a limited carrier (insurer) market for many of the City's coverages, (2) the practice of other local governmental entities, and (3) the potential for reducing and better controlling broker fees/compensation all indicated that changing methods may be to the City's benefit.

In response to the resulting audit recommendations, the Treasurer-Clerk's Risk Management section established an action plan to obtain subsequent coverages using a revised method, the Broker of Record Method, for property coverages or a modified version of that method for other coverages (e.g., liability coverages).

Our follow up shows that the Treasurer-Clerk's Risk Management section followed through on the planned actions and obtained subsequent property and non-property coverages using the Broker of Record Method, with the City Commission selecting the broker (Public Risk Insurance Agency, or PRIA) after discussing and considering information and recommendations provided by the Risk Management section.

Our analyses show the actions taken have resulted in meaningful savings to the City. In regard to non-

property coverages for (1) excess workers' compensation, (2) aviation liability, (3) pension fiduciary liability, (4) EMS professional liability, and (5) statutory death benefits for police and fire, our analyses, as reflected in our initial follow-up report (#1502), showed an anticipated **savings in total costs, including premiums and broker fees and commissions, in the amount of \$15,471 for coverages acquired in fiscal year (FY) 2015. Of that total savings, \$10,963 was attributable to a reduction in broker fees. The remaining savings of \$4,508 was attributable, not only to the change in methods, but also to changes in market conditions, coverages, and policy structure.**

Regarding property coverages, our analyses show the change in method will result in **savings of \$419,157 for coverages acquired in FY 2015. Of that amount, \$51,969 is attributable to a reduction in broker fees and the remaining \$367,188 is attributable to a premium reduction.** As noted in the previous paragraph, the premium reduction is the result of changes in the insurance market and policy structure in addition to the change in method.

As part of the actions taken that resulted in the noted savings, the Treasurer-Clerk's Office executed contracts with PRIA for their brokerage services. For the most part, the executed contracts contain appropriate terms and conditions. However, for the smaller contract (non-property coverages), we have recommended the Treasurer-Clerk attempt to execute a contract amendment that provides that any commissions received by PRIA (that are directly related to the coverages acquired for the City) be paid to the City, or otherwise credited against the fixed annual fee paid PRIA for their services. Such a provision is already included in the larger contract for property coverages. Such provisions should be included to mitigate the risk that the broker will "shop for" and recommend to the City coverages that provide

direct commissions to the broker (i.e., that would be in addition to the fixed or “flat” fee paid the broker by the City).

Table 1 within this report more fully addresses the actions taken.

We commend the Office of the Treasurer-Clerk for the actions taken to complete the action plan steps. We appreciate the assistance and cooperation from the Treasurer-Clerk’s Risk Management staff during this audit follow-up.

Scope, Objectives, and Methodology

We conducted this audit follow-up in accordance with the International Standards for the Professional Practice of Internal Auditing and Generally Accepted Government Auditing Standards. Those standards require we plan and perform the audit follow-up 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 follow-up objectives.

Report #1404

The audit inquiry resulting in report #1404 was conducted as directed by the City Commission (Commission) to address the City’s process for acquiring commercial insurance coverages. Those coverages are maintained to mitigate certain City risks relative to property loss and liability. Concerns were expressed by the Commission that the methods currently and historically used by the City to acquire commercial insurance coverage did not provide sufficient competition among potential providers (insurance brokers and carriers). As a result, concerns were expressed that the City may be paying too much for the purchased coverages.

To address those concerns, we performed procedures to answer the following six questions:

1. What are the standard industry practices for selection of insurance brokers and carriers?
2. How many years has the City used the current insurance brokers and how much has the City paid those brokers during that period?

3. For each time the City acquired commercial insurance coverages, was a competitive process (e.g., Request for Proposals, or RFP) used; and when used, how many proposals/responses were received?
4. What methods are used by other governmental entities in their acquisition of commercial insurance coverages?
5. Is the City paying too much for its commercial insurance coverages because its acquisition methods do not provide for effective competition?
6. What can be done to improve the methods used by the City in the acquisition of commercial insurance?

To answer those questions, we performed the following audit procedures:

- We identified laws, rules, policies, and procedures governing the City’s acquisition of commercial insurance coverages.
- We reviewed available industry literature and met with knowledgeable City staff (Risk Management section within the Office of the Treasurer-Clerk) and industry professionals regarding the methods for acquisition of commercial insurance.
- We identified the types of commercial insurance coverage purchased by the City (exclusive of health insurance and other insurance coverages pertaining to employee benefits and performance bonds).
- We determined the amount of insurance premiums and broker fees/commissions paid by the City for commercial insurance coverages over the last decade.
- We identified the insurance brokers (and carriers) from whom the City acquired insurance coverages and how long those brokers have been used by the City.
- We identified the methods used by the City’s Office of the Treasurer-Clerk Risk Management section to acquire the commercial insurance coverages.
- We identified and evaluated the individual purchases of commercial insurance coverages by the City over the last decade.

- We surveyed ten other local government entities within the state of Florida to determine their methods for acquiring commercial insurance coverages.

Through completion of the described audit procedures, we developed a recommendation to be considered by management for enhancing and improving the City's method for acquiring commercial insurance coverages.

Report #1509

This is our second and final follow-up on action plan steps identified in audit report #1404. The purpose of this follow-up is to report on the progress and status of efforts to complete action plan steps due for completion as of March 31, 2015. To determine the status of the action plan steps, we interviewed staff, made observations, and reviewed relevant documentation.

Background

Overview: Insurance is a mechanism used by an entity to control and mitigate the risk of loss of property or loss resulting from liability for specific events or circumstances. An entity may be "self-insured" for part or all such risks and may purchase commercial insurance for those risks not covered through self-insurance.

Under the concept of self-insurance, an entity generally establishes a separate fund for the purpose of setting aside resources to pay claims (e.g., property or liability) as they occur. On the other hand, when acquiring commercial insurance an entity in essence pays a fee (insurance premium) to transfer that risk to a separate commercial entity. When events occur (losses), claims are filed with that commercial entity (insurer) to obtain funds to cover losses incurred by the insured entity as the result of the insured event.

The City of Tallahassee is self-insured for some risks and acquires commercial insurance for other risks. Specifically, the City maintains reserve funds to self-insure for:

- Workers' Compensation up to \$1 million per event.
- General Liability (includes premises liability, operational liability, employment practice liability, police civil liability, etc.).

- Automobile Liability.

Commercial insurance coverage is obtained by the City to cover remaining risks, to include:

- Workers' Compensation for events in excess of \$1 million.
- Property damage or loss.
- Airport Liability.
- Statutory Death Benefits for police and firefighters.
- Professional Liability for City personnel providing basic and advanced lifesaving services (e.g., firefighters and emergency medical technicians, or EMTs).
- Fiduciary Liability for City Pension Advisory Boards.

The original audit inquiry only addressed the City's acquisition of commercial insurance coverages. The City's self-insurance programs were not included in the scope of that audit or this follow-up audit.

Governing Laws, Policies, and Procedures: City Commission Policy 242 and the City's Procurement Manual provide for competitive acquisition/procurement of goods (commodities) and services for which the cost is expected to exceed certain thresholds. Under the City's procedures, the specific competitive procurement method that should be used depends on the amount of the expected costs. For purchases where the expected costs are between \$1,000 and \$25,000, quotes should be obtained from at least three vendors. For purchases with expected costs greater than \$25,000, written formal proposals/bids should be solicited by the City through either the "Request for Proposals (RFP)" process or the "Invitation for Bid (IFB)" process. The RFP process should be used for purchases where the selection of the vendor is dependent on factors in addition to costs/fees, such as experience and ability of the potential vendors to provide the desired services.

Pursuant to the noted City policy and procedures, all City acquisitions of insurance coverages addressed in the original audit inquiry were in amounts that required application of one of the described competitive procurement methods.

Original Inquiry Results and Current Status

Question No. 1 - What are the standard industry practices for selection of insurance brokers and carriers? In the initial audit inquiry we identified several methods that an entity may use to acquire commercial insurance coverages. As reported, some involved solicitation of competitive proposals and some did not involve competition. As reported, the appropriate method depends on various circumstances, such as the number of carriers willing and capable of providing the specific coverages and the nature of relationships between brokers and carriers.

Question No. 2 - How many years has the City used the current insurance brokers and how much has the City paid those brokers during that period? We reported over the last ten years the City had acquired the vast majority of its coverages through one broker, J. Smith Lanier & Co. and its predecessor companies. Broker fees/compensation for the last ten years totaled approximately \$3.24 million, or 9.1% of total premiums paid.

Question No. 3 - For each time the City acquired commercial insurance coverages, was a competitive process (e.g., Request for Proposals, or RFP) used; and when used, how many proposals/responses were received? As reported, the City primarily used a competitive method (Defined Coverage Method) in the acquisition of coverages. Under that method, the broker and carriers are selected as part of *one unified process*. Specifically, the entity to be insured (e.g., City) requests proposals for coverages when determinations are made that insurance coverages are needed. Interested brokers go to the insurance market and find and obtain commitments from carriers willing to underwrite those coverages. Those brokers that are successful in obtaining such commitments then submit a proposal to the City. The submitted proposals include a combination of brokerage services as well as specific insurance coverages from individual carriers. The insured entity then evaluates all proposals and selects the broker and carrier(s) with the most favorable proposal(s).

In addition, we reported that in some instances the City used a non-competitive method (Appointment Method) to acquire insurance coverages.

Question No. 4 - What methods are used by other governmental entities in their acquisition of commercial insurance coverages? In contrast to the two methods used by the City, our surveys of ten other local governments showed the Broker of Record Method was the method used by those entities for acquiring commercial insurance coverages. Under that method, the broker is competitively selected (through a RFP process) *separate* from the acquisitions of the desired insurance coverages. Criteria used in the selection of brokers under this process generally include consideration of broker fees/compensation as well as the experience and ability to provide the needed brokerage services.

Question No. 5 - Is the City paying too much for its commercial insurance coverages because its acquisition methods do not provide for effective competition? Broker fees/compensation paid by nine of the ten surveyed local governments, each using the Broker of Record Method, averaged 5.11% of total premiums paid for purchased coverages. In comparison, the broker fees/compensation for City policies in place at the time of the initial audit and acquired under the Defined Coverage Method and Appointment Method represented 8.8% of total annual premiums. As reported, if the City had paid 5.11% in broker fees/compensation, it would have paid approximately \$150,000 less annually in broker fees/compensation for coverages in place at the time of the original audit inquiry. The larger portion of those savings would be attributable to property coverages.

Question No. 6 - What can be done to improve the methods used by the City in the acquisition of commercial insurance? In the initial audit inquiry we recommended the Treasurer-Clerk's Risk Management section consider revising its methods for acquiring commercial insurance coverages. Specifically, instead of using the Defined Coverage Method and Appointment Method, we recommended consideration be given to using the Broker of Record Method or a modified version of that method. As reported, there is no guarantee that changing to another method will result in savings to the City. However, (1) the existence of a limited carrier market for many of the City's coverages, (2) the practices of other local governmental entities, and (3) the potential for reducing and better

controlling broker fees/compensation all indicated that changing methods may be to the City’s benefit.

In response to our audit inquiry and recommendations, the Treasurer-Clerk agreed that a change in methods would be made. Accordingly, an action plan was developed to acquire future coverages under a revised method. As shown in

Table 1 below, the Office of the Treasurer-Clerk’s Risk Management section has used that revised method (Broker of Record Method) to obtain subsequent insurance coverages for the City.

**Table 1
Action Plan Steps from Audit Report #1404
Due as of March 31, 2015, and Current Status**

Action Plan Steps Due as of March 31, 2015	Current Status as of May 31, 2015
<ul style="list-style-type: none"> • Using a version of the “Broker of Record Method,” issue a RFP for broker selection for the following coverages: (1) excess workers’ compensation, (2) aviation liability, (3) pension fiduciary liability, (4) EMS professional liability, and (5) statutory death benefits for police & fire with an October 2014 inception date. <ul style="list-style-type: none"> – Engage consultant to prepare RFP specifications, evaluation criteria, and RFP document. – Release RFP. – Receive and evaluate responses to RFP and identify broker(s) for recommendation to City Commission for approval. – Obtain City Commission approval for broker selection. 	<ul style="list-style-type: none"> ❖ In our first follow-up report (#1502), we reported the Treasurer-Clerk’s Risk Management section had completed this action plan step with the exception of executing an appropriate contract with the selected broker. As reported in that first follow-up report, the broker selected by the City Commission (i.e., PRIA) through an RFP process had been used to obtain the applicable non-property coverages (e.g., (1) excess workers’ compensation, (2) aviation liability, (3) pension fiduciary liability, (4) EMS professional liability, and (5) statutory death benefit for police & fire). As also reported, meaningful costs savings had been realized through the revised process for acquiring the applicable coverages. Our only follow-up recommendation was that the Treasurer-Clerk’s Risk Management section continue its ongoing efforts to negotiate and execute an appropriate contract with the broker. <p>During our current follow-up engagement, we determined the Treasurer-Clerk’s Risk Management section had subsequently executed a contract with PRIA for the brokerage services. Among other things, that contract provides for:</p> <ul style="list-style-type: none"> • An annual fixed broker fee to be paid by the City in the amount of \$18,500 for the term of the contract. • The broker to fully disclose policy commissions or other remuneration received for the sale of policies. • The broker to fully disclose to the City any contingent payments (e.g., commissions) received by the broker as a direct consequence of insurance policies obtained on behalf of the City as a result of the contract. • The broker to permit the City to conduct an audit of all remuneration/revenues received that

	<p>were attributable to the City’s account and to fully cooperate with persons designated by the City to perform such an audit.</p> <p>While we commend the Treasurer-Clerk’s Risk Management section for including these contractual terms, we noted that the terms do not require that any “contingent payments (e.g., commissions) received by the broker as a direct consequence of insurance policies obtained on behalf of the City as a result of the contract” to be paid to the City or otherwise credited against the \$18,500 annual fee. Such a provision should be included to mitigate the risk that the broker will “shop for” and recommend to the City coverages that provide direct commissions to the broker (i.e., that would be in addition to the \$18,500 fee paid the broker by the City).</p> <p>In response to our inquiry and discussions on this matter, the Treasurer-Clerk’s Risk Management section did include the recommended contractual provision in the contract executed with the broker (Public Risk Insurance Agency, or PRIA) for <u>property coverages</u>. (See the subsequent action plan step.) We recommend that efforts be made to amend the previously executed broker services contract for <u>non-property coverages</u> such that any commissions or contingent payments, received by PRIA as a direct result of policies sold to the City, be paid to the City or otherwise credited against the annual \$18,500 fee. In response to this recommendation, the Treasurer-Clerk’s Office responded that an effort to amend the contract as recommended would be made. Based on that stated intent, we turn responsibility for finalizing this action plan step over to management of the Treasurer-Clerk’s Office.</p>
<ul style="list-style-type: none"> ● Using a version of the “Broker of Record Method,” issue a RFP for broker selection for the following property coverages: (1) commercial property and boiler & machinery, (2) Renaissance Building, (3) fine arts, and (4) Neighborhood Stabilization Program properties with an April 2015 inception date. <ul style="list-style-type: none"> – Engage consultant to prepare RFP specifications, evaluation criteria, and RFP document. – Release RFP. – Receive and evaluate responses to RFP and identify broker(s) for recommendation to City Commission for approval. 	<ul style="list-style-type: none"> ✓ Through the City’s Purchasing Division, the Treasurer-Clerk’s Risk Management section released a RFP for broker services for property coverages under the Broker of Record Method, as recommended in the initial audit. The RFP was released November 17, 2014. Responses were received, evaluated, and rated, with a proposal for selection of a broker submitted to the City Commission through an agenda item on February 25, 2015. Based on their evaluation and discussion, the City Commission awarded the contract for property insurance brokerage services to PRIA. The subsequently executed contract provides for PRIA to be paid an annual “flat fee” of \$115,000 for their services. The Treasurer-Clerk’s Risk Management

<p>– Obtain City Commission approval for broker selection.</p>	<p>section used PRIA to obtain required property insurance coverages on behalf of the City. Those coverages were effective May 1, 2015.</p> <p>We compared total costs for property coverages (broker fees and premiums) obtained under the Broker of Record Method to total coverage costs for the prior year, for which the Defined Coverage Method had been used. Our comparison shows that the change from use of the “Defined Coverage Method” to the “Broker of Record Method” for obtaining property insurance coverages will result in total savings of \$419,157 for coverages acquired during FY 2015. Of that amount, \$51,969 is attributed to a reduction in brokerage fees and \$367,188 is attributable to a reduction in premiums. That premium reduction is the result of changes in the insurance market and policy structure in addition to changing to the Broker of Record Method. This action plan step is complete.</p>
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Table Legend:

- Issue to be addressed from the original audit.
- ✓ Action taken and completed; issue addressed and resolved.
- ❖ Action taken and substantially completed; responsibility for ensuring completion of remaining action turned over to management.

Additional Analyses

As part of this follow-up engagement and our prior follow-up engagement (report #1502), we compared for applicable coverages (1) the premium costs and (2) fees chargeable by the former brokers under the prior contracts and method (Defined Coverage Method) to (1) the premium costs and (2) fees charged for those coverages by the current broker contracted under the Broker of Record Method. The purpose of the comparisons was to ascertain any cost savings realized from changing methods.

In regard to non-property coverages for (1) excess workers’ compensation, (2) aviation liability, (3) pension fiduciary liability, (4) EMS professional liability, and (5) statutory death benefits for police and fire, our analyses, as reflected in audit report #1502, showed an anticipated **savings in total costs, including premiums and broker fees and commissions, in the amount of \$15,471 for coverages acquired in FY 2015. Of that total savings, \$10,963 was attributable to a reduction in broker fees. The remaining savings of \$4,508 was attributable, not only to the change in**

methods, but also to changes in market conditions, coverages, and policy structure.

Regarding property coverages, the change in method shows **savings in total costs of \$419,157 for coverages acquired in FY 2015. Of that amount, \$51,969 is attributable to a reduction in broker fees and the remaining \$367,188 is attributable to a premium reduction.** As noted in the prior paragraph, the premium reduction is the result of changes in the insurance market and policy structure in addition to the change in method.

Conclusion

The Office of the Treasurer-Clerk as directed by the City Commission has taken positive actions to revise the City’s process for acquiring commercial insurance coverages. Actions taken have resulted in meaningful savings to the City.

We appreciate the assistance and cooperation from the Treasurer-Clerk’s Risk Management staff during this audit follow-up.

Appointed Official's Response

City Treasurer-Clerk:

We are pleased that we were able to address each of the action plan steps identified in the initial audit report. We also concur with the City Auditor's recommendation of an additional provision to the contract for broker services for non-property coverages. Though our efforts to incorporate such a provision in the original contract for non-property services were not successful, we were able to make it a part of the larger contract for property services. Based on that success, we are optimistic that the additional provision can be added to the non-

property contract during our annual policy renewal discussion with the broker.

We are also pleased that the agreed-upon action steps have resulted in flat fees for broker services at a reduction of \$62,932 in annual cost to the City. While we are also pleased that premiums were reduced by \$371,696 year over year, we understand that this reduction is largely dependent on market conditions and changes in policy structure.

We would like to thank the City Auditor for devoting the resources necessary to understand the various processes involved and for conducting this audit in such a professional manner.

Copies of this final audit follow-up #1509 or audit report #1404 may be obtained from the City Auditor's website (<http://www.talgov.com/auditing/auditing-auditreports.aspx>) or via request by telephone (850 / 891-8397), by FAX (850 / 891-0912), by mail or in person (Office of the City Auditor, 300 S. Adams Street, Mail Box A-22, Tallahassee, FL 32301-1731), or by e-mail (auditors@talgov.com).

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