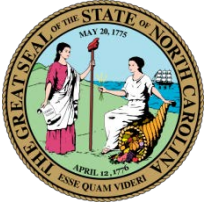


STATE OF NORTH CAROLINA
Office of the State Auditor



Beth A. Wood, CPA
State Auditor

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August 31, 2016

The Honorable Pat McCrory, Governor
The Honorable Senator Phil Berger, Co-Chairman, Joint Legislative Commission on
Governmental Operations
The Honorable Representative Tim Moore, Co-Chairman, Joint Legislative Commission on
Governmental Operations
The Honorable Senator Ralph Hise

This letter presents the results of our financial related audit of the post-tax Employee Insurance Committee (EIC) supplemental benefits program.

The 21 state agencies that use the state's payroll processing system, BEACON, reviewed a draft copy of this report. All 21 agencies indicated that they agreed with the findings, however, only one agency provided written comments, as there were no recommendations made in this report. Those written comments are included starting on page seven.

The audit objectives were to determine whether (1) the same opportunity for fraud existed with the post-tax EIC supplemental benefits program that occurred within the NCFlex program and (2) whether EIC members received improper gifts. The audit scope was limited to fiscal years 2014 and 2015.

To accomplish our audit objectives, auditors interviewed personnel and post-tax supplemental benefit contract vendors, reviewed post-tax supplemental benefit contracts, and examined documentation supporting recorded transactions and operations.

As a basis for evaluating internal control, auditors applied the internal control guidance contained in professional auditing standards. However, our audit does not provide a basis for rendering an opinion on internal control, and consequently, we have not issued such an opinion.

We conducted this audit in accordance with generally accepted government auditing standards applicable to performance audits. 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 that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

We wish to express our appreciation to the staff of each agency for the courtesy, cooperation, and assistance provided us during the audit.

If you have any questions, please do not hesitate to contact my office.

A handwritten signature in cursive script that reads "Beth A. Wood".

Beth A. Wood, CPA
State Auditor

BACKGROUND

The Employee Insurance Committee (EIC) program was established by NCGS § 58-31-60 to allow state employees to purchase supplemental benefits with post-tax payroll dollars. The purpose of each agency's EIC is to:

- Review insurance to determine if those products meet the needs and desires of the agency's employees
- Select the types of insurance products that reflect the needs and desires of the agency's employees
- Competitively select the insurance products the EIC determined best reflect the needs and desires of the agency's employees.

The five- to nine-member EICs are appointed to three-year terms by the head of the agencies. Members are selected from eligible agency employees who have been with the agency for at least one year. The EIC membership make-ups should fairly represent the work forces in the agencies and be selected without regard to any political or other affiliations.

Agency EICs and their members do not receive separate funding to administer and participate in the EIC program.

FINDINGS

1. COMPONENTS THAT ALLOWED NC FLEX FRAUD TO OCCUR WERE NOT PRESENT IN EIC PROGRAM

The opportunity to embezzle funds that existed within the pre-tax NC Flex Benefits Program¹ did not exist with the Employee Insurance Committee (EIC) post-tax supplemental benefits program.

Two components were necessary to embezzle funds in the NC Flex Benefits Program:

1. **A Source of Funds** - Pre-tax NC Flex benefit providers were required to pay \$3 per year for each employee enrolled in each benefit plan.² These funds were deposited in a Communication Fund for the purpose of promoting, marketing, and communicating the opportunities and benefits of the NC Flex Benefits Program to state employees.
2. **Access to the Funds** - The Communication Fund was managed by a third-party administrator and held outside of state control. According to a May 2016 Office of State Budget and Management audit,³ the former NC Flex program manager and other employees misappropriated about \$525,000 between May 2012 and February 2015 by submitting fraudulent receipts to the third-party administrator for reimbursement.

However, those two components did not exist for the EIC program.

There was no source of funds for anyone to access in the EIC program because post-tax benefit providers did not pay a fee to market and communicate to state employees.⁴ In fact, auditors noted explicit terms in 27 of the 51 post-tax benefit contracts reviewed (53%) indicating post-tax benefit providers were required to incur and pay their own marketing and communication expenses.⁵

To verify that no funds existed, auditors first selected the largest four⁶ of the 21 state agencies that processed payroll through BEACON and participated in EIC programs. The largest four state agencies represented:

- 30,299 of the 32,953 (92%) employees enrolled in EIC programs
- \$30.9 million of the \$33.2 million (93%) in employee payroll deductions

Auditors then reviewed EIC post-tax benefit contracts and interviewed post-tax benefit providers and executive management from those agencies.

¹ The NC Flex Benefits Program is administered by the Office of State Human Resources.

² Contract RFP #201100962-NC Flexible Spending Accounts, Section Three – Scope of Work, Subsection C.4.

³ “North Carolina Office of State Human Resources – NC Flex Program” Investigative Report 2016-OSHR-INV-1, May 2016.

⁴ The NC Flex Program required pre-tax benefit providers to pay a fee to market and communicate to state employees. See footnote 2.

⁵ The other 24 contracts (47%) did not specify which party was responsible for marketing and communication expenses.

⁶ The largest four agencies were the Department of Public Safety, the Department of Health and Human Resources, the Department of Transportation, and the Administrative Office of the Courts.

FINDINGS

The audit found that:

- None of the 17 (0%) post-tax benefit contracts reviewed contained contract terms requiring providers to pay membership fees in exchange for offering their products to state employees⁷
- 10 out of 10 (100%) post-tax benefit providers certified that they did not pay any membership fees in exchange for offering their products to state employees
- 20 out of 20 (100%) agency managers⁸ certified that providers did not pay any membership fees in exchange for offering their products to state employees

Auditors also determined that the 34 contracts between 17 other⁹ state agency EICs and their post-tax benefit providers did not contain contract terms requiring providers to pay membership fees in exchange for offering their products to state employees.

Since the post-tax EIC program did not have a Communication Fund type arrangement, there were no funds available to be mishandled, abused, or misused as allegedly occurred with the NC Flex program.

2. EMPLOYMENT INSURANCE COMMITTEES DID NOT RECEIVE IMPROPER GIFTS FROM POST-TAX BENEFIT PROVIDERS

The Employee Insurance Committees (EICs) and their members did not participate in the same improper gifting that allegedly occurred with the NC Flex program.

A May 2016 Office of State Budget and Management audit found that two pre-tax benefit providers had purchased thousands of dollars' worth of items and services for the benefit of the NC Flex program and program employees.¹⁰ Such purchases included hotel stays, airfare, gift cards, iPads, laptops, and computer tablets.

Auditors found no indication that EIC members received any gifts or services from post-tax benefit providers. Additionally, auditors found no indication that EIC members or members of executive management were aware that post-tax benefit providers had donated gifts of any kind to their respective state agencies.

⁷ The NC Flex Program required pre-tax benefit providers to pay a fee to market and communicate to state employees. See footnote 2.

⁸ Auditors obtained written certification statements from the General Counsel, Human Resources Director, Benefits Director/EIC Chairperson, Internal Audit Director, and Chief Financial Officer of each of the four agencies in our sample.

⁹ These 17 agencies comprise the remaining 8% of employees and 7% of employee payroll deductions that processed payroll through BEACON and participated in EIC programs.

¹⁰ "North Carolina Office of State Human Resources – NC Flex Program" Investigative Report 2016-OSHR-INV-1, May 2016.

FINDINGS

To verify that EIC members did not receive improper gifts or services, auditors first selected the largest four¹¹ of the 21 state agencies that processed payroll through BEACON and participated in EIC programs. The top four state agencies represented:

- 30,299 of the 32,953 (92%) employees enrolled in EIC programs.
- \$30.9 million of the \$33.2 million (93%) in employee payroll deductions.

Auditors then interviewed post-tax benefit providers and executive management from those agencies.

The audit found that:

- None of the 7 (0%) post-tax benefit providers surveyed indicated they had provided gifts or services to EICs or any EIC members;
- 20 of the 20 (100%) agency managers¹² certified they had no knowledge that post-tax benefit providers had donated any gifts, services, or other rewards to EICs or any EIC members;
- 20 of the 20 (100%) agency managers certified they had not received any gift or services from post-tax benefit providers.

Auditors also surveyed human resource directors, benefits managers, and EIC chairpersons at another 17 state agencies¹³ to determine whether they received any gifts, prizes, promotions, reimbursements, or any other rewards from the post-benefit providers. None of the 21 respondents reported receiving any of the items listed above.

Auditors did note that two of the seven post-tax benefit providers surveyed indicated they had provided gifts to two state agency Health and Wellness Committees.

However, Health and Wellness Committees are not involved in the selection and award of post-benefit provider contracts.

Furthermore, the gifts donated by the post-tax benefit providers were given away as door prizes to employees who had attended the Health and Wellness Fairs. Auditors confirmed that none of the employees who won the door prizes were members of any EIC.

¹¹ The largest four agencies were the Department of Public Safety, the Department of Health and Human Resources, the Department of Transportation, and the Administrative Office of the Courts.

¹² Auditors obtained written certification statements from the General Counsel, Human Resources Director, Benefits Director/EIC Chairperson, Internal Audit Director, and Chief Financial Officer of each of the four agencies in our sample.

¹³ These 17 agencies comprise the remaining 8% of employees and 7% of employee payroll deductions that processed payroll through BEACON and participated in EIC programs.

MATTER FOR FURTHER CONSIDERATION

The General Assembly should consider ending the post-tax supplemental Employee Insurance Committee (EIC) benefits program and allowing employees to purchase post-tax benefits through the NC Flex Program.

Administration of the EIC benefits program at the agency level is costly to the State. In an August 2015 report, the Program Evaluation Division found that an estimated 1,840 to 3,312 annual state employee hours were spent in EIC meetings during 2014.

Evaluators also found that the Office of the State Controller incurred an additional \$14,220 to \$56,880 each year in costs to administer payroll processing and payroll deduction setup in BEACON for EIC products.

In addition, administering the EIC benefits program is not a core activity at the individual agency level. Unlike the Office of State Human Resources, individual agencies do not have employees with the expertise in procurement, evaluation, and management of supplemental benefit products.

Since 1994, four investigations or reviews have found significant problems with the EIC program.

1. In October 1994, the “Insurance Payroll Deduction Report to Joint Legislative Commission on Governmental Operations” stated:
 - EICs had not been appointed or are not functioning
 - Agencies had not developed written procedures for how EICs should conduct business
 - EICs do not keep meeting minutes
 - Competitive bidding may be at risk
 - Costs, benefits and product offerings vary across state agencies. The variation raises questions about whether state employees are treated equitably and fairly in relation to the benefits offered for state employment.

2. In September 1995, the State Treasurer issued, “Review of State Employee Supplemental Insurance Programs – The Report of the State Treasurer’s Departmental Task Force” and found:
 - The present committee system is unwieldy, guaranteeing a lack of uniformity and availability of products and prohibits operating efficiencies
 - There is not one location to go and find records of all EIC, their membership, insurance products available to employees that provides reassurance that the program is being administered in the best interest of the participating employees
 - **Most EICs lack the experience and expertise necessary to make informed evaluations and selections of products (emphasis added)**
 - **Because of lack of experience and expertise, coupled with poorly defined criteria for evaluation, contracts are often awarded to those with whom the agency is already doing business or to those with whom the committees are not familiar (emphasis added)**

MATTER FOR FURTHER CONSIDERATION

- Product availability varies greatly across state agencies, raising a question of equity among employees
 - Prices of insurance products vary from agency to agency.
3. In an April 1996 report, the Senate Select Committee on State Employee Insurance Issues made the following recommendations:
- Require a central vendor registry in the Department of Administration
 - Require employee insurance committees to report their activities to the Department of Administration
 - Require the Department of Insurance to provide, within available funds, technical assistance to the employee insurance committees
 - Require employee insurance committees to rebid contracts at least once every three years
4. In August 2015, the General Assembly Program Evaluation Division issued the report, "North Carolina Should Centralize Management of State Employee Supplemental Insurance Benefits." The report noted:
- EICs are ineffective and have failed to manage the selection of supplemental insurance products
 - The separation of EICs and NC Flex results in overlapping and duplicative supplemental insurance offerings and makes product comparison and selection challenging for state employees
 - Weak oversight and management of supplemental insurance elections and payroll deductions by agencies and universities presents risks to employees and the State
 - The General Assembly should centralize supplemental insurance benefits by creating a single committee that would oversee all supplemental insurance offerings, including the NC Flex program

Based on the problems identified with the EIC program over the past 22 years, the General Assembly should consider whether the NC Flex program could better provide post-tax employee insurance benefits.

RESPONSE



State of North Carolina

ROY COOPER
ATTORNEY GENERAL

Department of Justice
PO Box 629
Raleigh, North Carolina
27602

REPLY TO: Kristi Jones
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FAX: (919) 716-0803

June 21, 2016

Ms. Carla C. Jacobs
Assistant State Auditor
Office of the State Auditor
2 S. Salisbury St.
Raleigh, NC 27603

Dear Ms. Jacobs:

On behalf of the North Carolina Department of Justice (NCDOJ), I am writing to respond to your draft findings concerning the "EIC Supplemental Insurance Program Audit". The draft findings and DOJ response is as follows:

Finding 1:

There was no opportunity to embezzle state funds in the EIC post-tax benefits program like the one that existed in the NCFlex Program Communication Fund.

Unlike the NCFlex Program, post-tax benefit providers did not pay a fee to state agencies to promote, market, and communicate opportunities related to the EIC post-tax benefits program. Instead, post-tax benefit providers incurred and paid their own marketing and communication expenses. As a result, no funds were available that could have been mishandled, abused, or misused.

NCDOJ Response: The NCDOJ agrees with these findings and conclusions.

Finding 2:

We found no instances of improper gifting to state employees by post-tax supplemental contract vendors.

We surveyed the post-tax supplemental contract vendors of the top four participating agencies and found that only two vendors donated items (\$25 and \$50 gift cards, 19" color televisions) directly to state agencies. Vendor registration forms sent by those agencies encouraged vendors to bring an item to donate that would be given away as a door prize

RESPONSE

during health and wellness fairs. The door prizes are awarded by drawing tickets submitted by employees who had attended the fair.

NCDOJ Response: The NCDOJ agrees with these findings and conclusions. Furthermore, the NCDOJ was not a state agency who received gift cards, color televisions or related promotional items associated with the EIC Supplemental Insurance Program.

We appreciate the professional and constructive work your team has conducted during the course of this audit engagement.

Sincerely,



Kristi Jones
Chief of Staff
N.C. Department of Justice

cc: Nels Roseland; Deputy Chief of Staff, Accounting Director
Barbara Gibson, Human Resources Director II
Tiesha Pope, Internal Auditor

ORDERING INFORMATION

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This audit required 524 hours at an approximate cost of \$53,059.