

**REVIEW OF ARTHUR J. GALLAGHER & COMPANY
INSURANCE BROKERAGE SERVICES**

APRIL 2006




**CITY AUDITOR'S OFFICE
CITY OF GAINESVILLE, FLORIDA**

City of
Gainesville

Inter-Office Communication

April 11, 2006

TO: Audit and Finance Committee
Mayor Pegeen Hanrahan, Chair
Mayor-Commissioner Pro Tem Chuck Chestnut, Member

FROM: 
Brent Godshalk, City Auditor

SUBJECT: Review of Arthur J. Gallagher & Company Insurance Brokerage Services

Recommendation

The Audit and Finance Committee recommend that the City Commission:

- 1) Accept the City Auditor's report and the City Manager's response; and
- 1) Instruct the City Auditor to conduct a follow-up review on recommendations made and report the results to the Audit and Finance Committee.

Explanation

On August 8, 2005, the City Commission directed the City Auditor to review Arthur J. Gallagher's (Gallagher) records related to their return of approximately \$1.3 million to the City of Gainesville (the City). The City Commission also directed the City Auditor to report back to the City Commission regarding how much the City had been overcharged and what the appropriate level of interest due from Gallagher would be. On December 8, 2005, the City Auditor provided an interim report to the Mayor and members of the City Commission related to these issues (Attachment 1), which resulted in the City receiving an additional \$514,000 settlement payment from Gallagher.


The City Commission also directed the City Auditor to review internal City procedures related to insurance brokerage services and to provide recommendations for any necessary improvements in the processes related to insurance brokerage services. The attached report provides recommendations for improvement and includes a written response from the City Manager.

We request that the Committee recommend the City Commission accept our report and the City Manager's response. Also, in accordance with City Commission Resolution 970187, Section 10, Responsibilities for Follow-up on Audits, we request that the Committee recommend the City Commission instruct the City Auditor to conduct a follow-up review on recommendations made and report the results to the Audit and Finance Committee.

City of
Gainesville

Inter-Office Communication

March 17, 2006

TO: Russ Blackburn, City Manager
FROM: 
Brent Godshalk, City Auditor
SUBJECT: Review of Arthur J. Gallagher & Company Insurance Brokerage Services

On August 8, 2005, the City Commission directed the City Auditor to review Arthur J. Gallagher's (Gallagher) records related to their return of approximately \$1.3 million to the City. The City Commission also directed the City Auditor to report back to the City Commission regarding how much the City had been overcharged and what the appropriate level of interest due from Gallagher would be. On December 8, 2005, the City Auditor provided an interim report to the Mayor and members of the City Commission related to these issues, which after further negotiations with Gallagher, resulted in the City receiving an additional \$514,000 settlement payment.

The City Commission also directed the City Auditor to review internal City procedures related to insurance brokerage services and to provide recommendations for any necessary improvements. We have now completed this portion of our review and have prepared the attached draft report, indicating where further efforts are needed to strengthen management controls.

In accordance with Commission Resolution 970187, Section 9, your written response to the recommendations presented in the attached report is due within 30 days and should indicate an actual or expected date of implementation. Our final report, which will include your written response, will then be submitted to the City Commission's Audit and Finance Committee for review and approval. As we previously discussed, it would be preferable to have this item completed while the current City Commission is seated, if possible. However, the Clerk's Office has indicated a preference for scheduling the next Audit and Finance Committee meeting on April 11, 2006 at 1:30 pm, which would require an expedited management response.

Please let me know your thoughts on the timing of presenting this report to the Audit and Finance Committee and if you have any comments or questions that will facilitate your response. We would like to thank Risk Management Director Steve Varvel for the courteous and cooperative treatment afforded us during our review. Our recommendations for improving procedures and controls have been reviewed with Steve and with Administrative Services Director Becky Rountree.

cc: Steve Varvel, Risk Management Director
Becky Rountree, Administrative Services Director

TABLE OF CONTENTS

Review of Arthur J. Gallagher & Company Insurance Brokerage Services

OBJECTIVES, SCOPE AND METHODOLOGY	1
BACKGROUND INFORMATION	1-3
ISSUES, CONCLUSIONS, RECOMMENDATIONS AND MANAGEMENT'S RESPONSE	
1. City Payment Process Regarding Gallagher Invoices	4
2. Timing of 2005 Insurance Brokerage Request for Proposals	5-6
3. Communication Issues Regarding Insurance Coverage	7
4. City Commission Approval of Contract Extensions	8
5. Apparent Code of Ethics Violation Regarding Acceptance of Gratuities	9-10

OBJECTIVES, SCOPE AND METHODOLOGY

In accordance with a City Commission referral of August 8, 2005, the City Auditor's Office has completed a Review of Arthur J. Gallagher & Company (Gallagher) Insurance Brokerage Services. The first objective of this review was to provide the City Commission with an independent assessment of the reliability, validity and relevance of the financial information provided by Gallagher related to the return of \$1.3 million to the City and to determine an appropriate level of interest due from Gallagher. A second objective was to evaluate the system of management control within the City related to the placement and monitoring of insurance coverage. Management controls include the processes for planning, organizing, directing and controlling program operations, including systems for measuring, reporting and monitoring program performance. Management is responsible for establishing and maintaining effective controls that, in general, include the plan of organization, methods and procedures to ensure that goals are met.

Our review was conducted in accordance with *Government Auditing Standards* issued by the Comptroller General of the United States and accordingly included such tests of records and other auditing procedures as we considered necessary under the circumstances. Our procedures included interviewing Gallagher and City staff, reviewing relevant documents maintained by Gallagher and the City related to premiums and commissions paid for insurance brokerage services and assessing compliance with City contracts, policies and procedures. We also interviewed Risk Management Directors from other Florida municipalities and reviewed professional literature on current issues, trends and investigations related to the insurance brokerage industry. The scope of our review generally included records from 1988 through 2005 made available to our office and considered relevant to this audit.

We provided an interim report to the Mayor and members of the City Commission on December 8, 2005 (Attachment 1) related to the accuracy of the \$1.3 million previously returned to the City, identifying adjustments to the original amount received and an appropriate level of interest due from Gallagher. Based on our review and the resulting interim report, the City Manager and City Attorney completed negotiations with Gallagher resulting in the City receiving an additional \$514,000 settlement payment from Gallagher.

We have since completed the portion of our review focused on the City's system of management control related to the placement and monitoring of insurance coverage. Based on the results of our review, we prepared specific issues and recommendations for improvement that were discussed with management. These recommendations, as well as management's written response, can be found in the following sections of this report.

BACKGROUND INFORMATION

The City of Gainesville is self-insured in the areas of Worker's Compensation, general, auto liability, Public Officials liability and health insurance. Excluding health and life, the City's Fiscal Year 2005 insurance budget was approximately \$4.3 million, which included state assessment fees, broker/consultant fees, loss control reporting fees, claims administration fees and claims reserves for the self-funded Worker's Compensation and liability program.

The City contracted with Gallagher for insurance brokerage and consulting services from 1988 through 2005. Services provided included the review, analysis, recommendation and placement of all insured and self-funded programs in the areas of property, casualty and liability coverages, as well as processing policy change endorsements, policy review and monitoring claims.

Insurance Broker/Consultant Responsibilities and Compensation

Generally, a retail insurance broker/consultant is responsible for obtaining multiple quotes for insurance coverages and evaluating the optimal price and coverage based on individual client needs. Retail brokers contact insurance carriers directly to obtain quotes and/or use the services of wholesale brokers, which may be an affiliated company of the retail broker. Retail brokers receive payment in the form of fixed fees from the client, commissions on the placement of insurance policies or a combination of the two. Commissions received by retail brokers for policies placed can range from 5% to 30% of the total cost of a policy, with the commission traditionally passed on to the client as part of the total premium cost.

Historically, retail brokers have sometimes received contingent commissions from specific carriers based on the volume of policies written and resulting claims experienced. Contingent commissions are not typically assigned to specific client accounts but rather the aggregate business produced. Contingent commissions can lead to retail brokers steering clients to specific carriers for higher commission fees. Such practices have been the focal point of recent investigations conducted by several state attorney generals around the country, sometimes resulting in large settlement payments to clients and increased media attention.

Events Surrounding Gallagher's Retention of Excess City of Gainesville Commissions

Gallagher has provided insurance brokerage and consulting services under contracts with the City from 1988 through 2005. The 1988 through 1991 contract was based on a fixed fee of \$39,000, with any commissions received attributable to the City to be fully disclosed and credited against the fee. For the period from 1988 to 1991, Gallagher provided a recap to the City summarizing all commissions received and reimbursed the City for the amount exceeding the fixed fee, with an adjustment for additional services provided.

The 1991 through 1999 contract indicated that Gallagher was to receive payment in the form of commissions from premiums placed, with an additional provision for quarterly fixed fees of \$19,800 per year. Contract terms generally placed a cap on commissions to be retained by Gallagher of 7.5% per policy placed, with additional commissions in excess of the 7.5% cap required to be "disclosed and credited to the City to reduce fees up to the full extent of the quarterly amounts due under the contract."

The 1999 through 2005 contract again indicated that Gallagher's commissions would be capped at 7.5%, with an additional provision for quarterly fixed fees of \$12,000 per year. Gallagher's price proposal for this contract noted that quarterly fees would be "offset by insurance placement commissions in excess of 7.5%." It also noted that Gallagher would provide a detailed breakdown of costs and services by year at the end of the contract term.

For contracts from 1991 through 2005, commissions in excess of 7.5% per policy received by Gallagher were apparently never disclosed or credited to the City. During the same time period, quarterly fixed fees were never billed or paid.

In late 2004, in part as a result of an investigation of contingency fee structures of insurance brokers by the New York Attorney General's Office, the Florida Attorney General's Office (AGO) requested client files from several insurance brokers, one of them being Gallagher. In January 2005, the Florida AGO notified the City of Gainesville that the AGO was conducting an investigation into possible antitrust violations involving the purchase of insurance through insurance brokers by Florida public entities and requested the City provide copies of all RFP's, contracts and correspondence relative to our transactions with brokers and insurance companies since January 1998.

During our review, Gallagher informed us that they engaged outside counsel in 2004 to review internal processes to ensure there were no issues similar to those found by the New York Attorney General's Office. Gallagher indicated that while this internal review did not disclose any improprieties in Gallagher's activities, it did identify inconsistencies in the contract language and billing practices for the City contracts from 1991 through 2005. Based upon their review into the inconsistencies, Gallagher indicated that they began preparing schedules of all premiums and commissions paid by the City from 1991 through 2005. This was also completed for Alachua County and the City of Lakeland, who had similar contracts with capped commissions. On June 21, 2005, Gallagher representatives met with the City's Risk Management Director and delivered a check for excess commissions in the amount of \$1,310,985, supported by a spreadsheet summarizing Gallagher's analysis. According to Gallagher, the excess commissions were a result of an internal control problem at Gallagher. They also indicated that their employment of the account representative for each of these three public entities had been terminated.

ISSUE #1

City Payment Process Regarding Gallagher Invoices

Discussion

As noted in the background information section of this report, City contracts with Gallagher from 1991 through 2005 generally capped the commissions to be retained by Gallagher at 7.5% for each policy placed. Contracts indicated that commissions in excess of the 7.5% cap would be disclosed and credited to the City to reduce fees up to the full extent of fixed quarterly amounts due under the contracts.

As insurance policies were placed for the City, Gallagher would submit an invoice indicating the total amount due from the City to Gallagher, the insurance company with which the policy was placed, the policy number and the effective dates of the coverage. After a review by the Risk Management Department to ensure that the total amount invoiced matched the premium initially quoted, City management would authorize payment to Gallagher for the total premium.

During our review of Gallagher's records, we noted that when insurance policies were placed for the City, Gallagher typically received an invoice from the carrier, which stated the total premium quoted as well as the commission to be earned by Gallagher. Gallagher was invoiced by the insurance company for the net difference between the total premium charged to the City and the commission earned by Gallagher for placement of the policy. Commissions would generally range from 10% to 20% of the total premium. However, the commission information was never reported to the City, even though this information was clearly required by the terms of the contract. At the same time, Gallagher never charged the City quarterly fees set forth in the contracts nor netted them against commissions earned greater than 7.5%.

Conclusion

It is clear that Gallagher did not initially comply with the terms of their contracts with the City. At the same time, City management did not properly administer the terms of the contracts, which generally required that commissions in excess of 7.5% per policy be reported to the City and netted against quarterly fees. Invoices paid by the City did not include supporting documentation necessary to ensure commission caps were properly applied and reimbursed when applicable.

Recommendation

We recommend management obtain and review supporting documentation necessary to ensure that the City is not overpaying for contractual services received and that contract terms are properly followed. Even though the City's current contract for insurance brokerage services is based on a fixed fee and requires the broker to net out any commissions received from the premium charged to the City, management should require the broker to provide documentation, including documentation provided by the insurance carrier to the broker, necessary to ensure compliance.

Management's Response

Management concurs with the recommendation. Beginning with the last renewal, the City required Gallagher to provide carrier invoices and confirmation of commissions, if any, prior to paying any invoices. This practice has continued with our current broker, Marsh USA. The renewal includes the carrier quote and a disclosure form sent by Marsh. The form shows all remuneration earned by Marsh and any wholly owned wholesale subsidiary. The current broker contract is for a fixed fee, requires compensation disclosure and includes a right to audit. Management is confident that the process has been improved and this type of an over retention of commissions will not happen again.

Timing of 2005 Insurance Brokerage Request for Proposals

Discussion

The City has historically used the services of a contractual insurance broker/consultant to assist in managing its various insured and self-funded programs. These services include the review, analysis, recommendation and placement of all insured and self-funded programs in the areas of property, casualty and liability coverages, as well as processing policy change endorsements, policy review and monitoring claims. The City used the contracted services of Gallagher from 1988 through 2005. On April 30, 2005 the latest contract was set to expire, requiring the City to conduct a competitive process before awarding the next insurance broker contract.

Management established an initial timetable to send Requests for Proposals (RFP) out on April 1st, 2005 with responses due back by April 20th. Oral presentations, if necessary, were to begin the week of April 25th and the contract was expected to be awarded on April 29th. This initial timeline did not provide opportunity for the City Commission to review or approve the contract until sometime in May, after the previous contract expired.

According to subsequent management documents, the RFP's were not advertised until April 8th, while the bid opening still occurred as originally scheduled on April 20th. From April 22nd to May 2nd an evaluation team comprised of the Risk Management Director, the Worker's Compensation Loss Manager and a GPD Captain reviewed the two written proposals received. On May 3rd, the evaluation team's rankings were provided to the Purchasing Division. Based on some uncertainty regarding one of the proposer's public utilities experience, oral presentations were provided by the two proposers on May 20th to the evaluation team and two GRU managers. On May 24th, Purchasing was notified of the team's final recommendation to award a contract to Gallagher and both firms submitting proposals were sent notification of the decision.

On June 21st, Gallagher representatives delivered a check for \$1,310,985 to City management to compensate the City for excess commissions received over the term of previous contracts along with a spreadsheet summarizing the excess commissions. On June 27th, a consent item was placed on the City Commission agenda recommending the award of a three-year contract with an option for two one-year renewals to Gallagher. It should be noted that this recommendation was first made to the City Commission almost two months after the previous contract with Gallagher had expired on April 30th.

Prior to and coinciding with this process, many changes were taking place within the insurance brokerage industry regarding contingent commissions and potential steering of clients to specific insurance carriers. In January 2005, the State of Florida Attorney General's Office (AGO) notified the City of Gainesville that the AGO was conducting an investigation into possible antitrust violations involving the purchase of insurance through insurance brokers by Florida public entities and requested the City provide copies of all RFP's, contracts and correspondence relative to our transactions with brokers and insurance companies since January 1998. Despite these events and industry articles suggesting precautions to be taken in securing brokerage services, we found the 2005 RFP package was identical to the one prepared in 1999, including allowing prospective vendors the opportunity to propose any pricing variables, including those based on commissions. The Gallagher proposal received in April 2005 suggested a continuation of the previous pricing arrangement with the City, generally capping commissions to be retained by Gallagher at 7.5% for each policy placed.

Conclusion

In our opinion, the 2005 RFP process for insurance brokerage services conducted by management was not adequately planned and failed to adequately consider factors relevant to the process, including the timing of the previous contract expiration, issues related to investigations of the insurance brokerage industry, current trends taking place in the industry and pricing strategies to protect the City's interests. A contributing factor to the problems encountered with this RFP process may be a lack of training, professional certification and continuing education in risk management. Ongoing continuing education required through professional designations would help to ensure management adequately keeps up with ongoing trends and issues of concern in the insurance industry. Other Risk Management Directors we discussed this with indicated insurance licenses or other professional designations would be beneficial.

Recommendation

We recommend management ensure that adequate time is provided for competitive bid/proposal processes in order to effectively encourage competition among contractors and to allow for proposals to be thoroughly evaluated and presented to the City Commission for review and approval prior to contract expirations.

We also recommend that management consider pursuing professional designations in risk management to increase knowledge and ensure skills are developed to better administer the City's insurance programs. One possibility is the Associate in Risk Management (ARM) designation, which is administered by the Insurance Institute of America. Courses are offered by this organization regarding risk management, controls and risk financing and are designed to benefit corporate and government safety personnel and those responsible for risk financing and control.

Management's Response

The process for the RFP was initiated in March 2005 and management believed that the process could be completed in a time frame that would have placed the item on the City Commission agenda in early May. However, there was a delay in getting the RFP out to interested parties. This can be attributed, in part, to the workload of the purchasing staff. Staff tried to expedite the response and review process to accommodate the timeframe needed to make a recommendation to the City Commission. Management agrees to initiate future RFP processes earlier to provide ample time to conclude the process prior to contract expiration, including time, when possible, for unexpected delays in the process.

Management is committed to continuing the enhancement of both the Risk Management Director and his staff's professional qualifications to ensure that staff is up to date with changes in the industry. We are open to explore professional certifications as appropriate for risk management staff. However, management disagrees that there is a nexus between this issue and that of certifications held by the Risk Management Director. The Risk Management Director has served in this position since April 1999 after working in both the Finance and Office of Management and Budget and has been involved with both the General Insurance Fund and the Employees Health and Accident Benefits Fund since 1990 in varying capacities. The Risk Management Director and his staff attend both the annual state and national conferences for the Public Risk Management Association.

ISSUE #3

Communication Issues Regarding Insurance Coverage

Discussion

During our review of invoices paid to Gallagher, we found two instances in which the City paid for insurance coverage not needed. The first instance involved paying an overlapping month of coverage for builders risk coverage related to construction at the Kelly Plant in 2001. A 12 month policy expiring April 14, 2001 was replaced with month to month coverage beginning on March 14, 2001. As a result of the overlapping dates, an additional \$13,000 in coverage was purchased and paid for even though it was not needed, as it was included in the annual premium.

Second, we noted an issue that occurred in 2003 in which an error in payroll information related to general liability coverage resulted in the City paying an additional \$103,000 for coverage not needed. Management inadvertently provided total annual salary information for GRUCom to the insurance provider instead of correctly providing information related to the employees involved in a specific contract requiring the liability coverage. Attempts to have this error corrected were unsuccessful because the insurance company had previously verified the information with City management on two separate occasions.

Conclusion

Management did not properly review and provide accurate information to the insurance carrier to ensure the City did not pay for unnecessary or duplicating coverage. The total premiums paid due to lack of understanding and insufficient oversight was \$116,000.

Recommendation

We recommend Risk Management improve communications with the City's insurance broker and operating departments when providing information to the carrier that has a direct bearing on coverage and rates. Additionally, greater oversight is needed by Risk Management to ensure coverage and premiums cover the time period required.

Management's Response

Management does concur that there was a communication breakdown with respect to the GRUComm audit request. The policy lists GRUComm as the insured entity and the request was for GRUComm's covered payroll. Risk Management supplied the carrier with the payroll information reported to the State of Florida for worker's compensation purposes. This was an isolated incident that has not happened since. Management acknowledges that communication is very important and is committed to making sure this does not happen again.

Management concurs that an invoice was paid that overlapped the policy period. This invoice was mailed directly to GRU and was an oversight. Future policy payments will be sent through Risk Management so that coverage terms can be verified prior to payment.

City Commission Approval of Contract Extensions

Discussion

In 1991, based on a competitive selection process, the City Commission authorized the City Manager to negotiate and execute a three-year contract with Gallagher with three optional one-year extensions. In 1994, 1995 and 1996, the City Commission approved one-year extensions to the contract. In 1997, the City Commission authorized an additional six-month extension and in 1998, an additional one-year extension was authorized based on requests by City management. Management indicated that the additional extensions were necessary to change the timing of the current contract term and to provide sufficient time to prepare an RFP for the next contract period.

In 1999, the City Commission authorized a new three-year contract with Gallagher with **two** optional one-year extensions, based on a competitive selection process. However, the actual contract executed indicated a three-year term with **three** optional one-year extensions. In 2002, 2003 and 2004, the contract with Gallagher was extended by management. However, unlike the extensions for the 1991 contract, extensions to the 1999 contract were not submitted for approval to the City Commission.

Contract extensions require a decision to determine whether to continue with the current contractor or to proceed to a competitive process. The Purchasing Division initiated a procedure in March 2000 requiring contract managers to provide written justification that implementing an optional contract extension is in the best interests of the City and whether there are any opportunities for participation by identified local small/women/minority businesses. Management did not prepare written justification for extending the 2002, 2003 or 2004 annual extensions with Gallagher.

Conclusion

The insurance broker contract extensions in 2002, 2003 and 2004 were not submitted to the City Commission for approval. In our opinion, contracts initially requiring City Commission approval should also receive approval for extensions to ensure management has adequately reviewed and considered the services provided by the vendor and to ensure the best value for services continues to be received. Although City Commission approvals of contract extensions are not clearly addressed by Purchasing Policies and Procedures, they are customary.

Recommendation

We recommend when a contract requires initial approval by the City Commission, subsequent contract extensions should be forwarded for approval along with a written explanation regarding the reasons for the contract extension. We also recommend management take steps necessary to ensure that contracts executed match the terms authorized by the City Commission.

Management's Response

There is no policy that requires previously Commission approved contracts, which contain extensions, be brought back before the Commission to have said extensions separately approved. Therefore, the Risk Management Department's actions in accordance with this contract were in compliance with existing policies and previously provided guidance of the purchasing staff.

Management agrees that the original agenda item was not consistent with the terms and conditions set forth in the RFP and the contract. The RFP and the contract allowed for three one-year renewals. In the future, management will scrutinize agenda items to ensure they are consistent with the RFP.

ISSUE #5

Apparent Code of Ethics Violation Regarding Acceptance of Gratuities

Discussion

Policy Number 28 of the City's Personnel Policies and Procedures contains a Code of Ethical Standards, which states in Section 5 - Conflict of Interest:

No employee shall solicit or accept free or discounted goods, services, prizes, gifts, favors, accommodations, entertainment, discounted loans or anything else of value.

Section 6 - Gratuities in General continues:

Discretion and caution are recommended. In accepting even nominal gifts, treats or benefits of any kind, all employees should carefully refrain from incurring obligations expressed, implied or reasonably presumable by others. Therefore, ordinary discretion suggests a polite but firm refusal of even minor largess (including food or drink) from those having business relationships with the City, or from those who may be affected by the professional judgment and job performance of the gift recipient. This paragraph does not intend to inhibit normal gift giving among family and friends on festive occasions. It does aim to discourage business oriented or other gifts with even the subtlest connotations of reciprocal obligations that could be fulfilled with preferential treatment.

During our review of City expenditures to Gallagher, we noted a January 2003 correspondence from the Gallagher account representative extending a dinner invitation to the City's contract administrator and his family as a postscript to a discussion of a City insurance issue. When we discussed this issue with the City's contract administrator, he indicated that he did receive on occasion paid meals from the Gallagher contract representative during the term of this contract.

We also noted correspondence dating back to 1991 indicating that the City's previous contract administrator for the Gallagher contract had dinner with three Gallagher associates where he offered extensive advice to Gallagher representatives on how to effectively market the public sector. The internal Gallagher memo indicated that the City's contract administrator "is a staunch supporter of Gallagher and considers us to be the 'premier firm' serving the public sector." Another Gallagher internal memo several days later stated, "We just signed our second three year brokerage and consulting contract with the City of Gainesville. Additionally, the contract more than doubled (Gallagher) Tampa Bay's annual revenue on the account. As a result of the recent Florida PRIMA conference, and (the City of Gainesville contract administrator's) endorsement, my assistant ... is actually receiving calls from cities and counties asking us to work on their accounts."

Conclusion

Although it is important for management to maintain a professional relationship with contractual representatives, we noted several indications of a close relationship between City management and the City's insurance broker's representatives that could potentially impair the independence or objectivity of management. We also noted indications of an apparent violation of the City's Code of Ethical Standards regarding the acceptance of gratuities related to this contract.

Recommendation

We recommend management take appropriate action to address the receipt of gifts described above and to ensure that all City contract administrators are reminded periodically of the City's Code of Ethical Standards and its importance in maintaining and enhancing the public's trust of government.


Management's Response

While management does not believe that staff's impartiality was impaired, we will take appropriate action. Management will reinforce the City's Code of Ethical Standards with contract administrators on a regular basis and will monitor the activity of employees.

City of
Gainesville

Inter-Office Communication

December 8, 2005

TO: Honorable Mayor and Members of the City Commission
FROM: 
Brent Godshalk, City Auditor
SUBJECT: Arthur J. Gallagher & Co. Insurance Broker Update

On August 8, 2005, the City Commission directed the City Auditor to review Arthur J. Gallagher's (Gallagher) records related to their return of approximately \$1.3 million to the City of Gainesville (the City). The City Commission also directed the City Auditor to report back to the City Commission regarding how much the City had been overcharged and what the appropriate level of interest due from Gallagher would be.

After receiving this referral, the City Auditor's Office worked with the City Attorney's Office to establish a legal agreement with Gallagher allowing the City to immediately deposit the \$1.3 million check received without hindering the City's ability to seek additional compensation, including interest, from Gallagher. This was accomplished and the check was deposited into the City's bank account on August 22, 2005.

At the same time, staff of the City Auditor's Office traveled to Gallagher's offices in Clearwater, Florida and reviewed documentation related to insurance products brokered by Gallagher for the City from 1991 through 2005. A key portion of our review was verifying the overcharges identified by Gallagher against 3rd party documentation Gallagher received from insurance providers. Based on our review, we identified adjustments to the approximate \$1.3 million previously received from Gallagher totaling approximately \$19,000 to the City's benefit. Gallagher was very cooperative in providing access to the records necessary for us to complete this phase of our review and has agreed with these adjustments.

We then prepared an interest calculation model identifying the City's lost opportunity costs associated with the excess commissions paid by the City during the 14 year period under review. The model mirrored the methodology utilized by the City of Lakeland Internal Audit Department previously agreed to by Gallagher. However, we used the City of Gainesville's annual operating yield on investments, averaging 5.4% from 1995 through 2005, for each fiscal year during the period and applied these rates to the excess commissions retained by Gallagher. Lakeland used the Florida State Board of Administration pooled interest rate for the respective fiscal years, averaging 4.2% from 1995 through 2005, since this is where Lakeland invests short-term cash balances. Our analysis identified a total interest amount due of approximately \$600,000.

After discussing this analysis with the City Manager and City Attorney, Gallagher was provided a detailed summary of our analysis identifying total additional monies due from Gallagher to the City as of September 30, 2005 in the amount of \$611,555. Gallagher responded to our analysis by submitting a proposal requesting the City utilize the Florida State Board of Administration pooled interest rate for the respective fiscal years. Gallagher's proposal identified total additional monies due from Gallagher to the City as of September 30, 2005 in the amount of \$411,299.

Arthur J. Gallagher & Co. Insurance Broker Update
December 8, 2005
Page 2

Discussions have continued with Gallagher to try to reach final agreement on the total amount due the City. In the interest of reaching an amicable resolution on this issue, the City Auditor, City Manager and City Attorney presented a proposal to average the two sets of interest rates, resulting in an amount due from Gallagher of \$514,272, including accrued interest through December 2005. The City Manager and City Attorney will continue negotiations with Gallagher and present a recommended settlement to the City Commission for approval at a future meeting. The City Auditor's Office is turning our focus to completing the portion of the City Commission referral related to our review of the City's system of internal control surrounding the placement and monitoring of insurance coverage. We intend to issue our resulting final audit report to the City Commission's Audit and Finance Committee after providing the City Manager an opportunity to provide a written response to our recommendations for improvement.

Please feel free to contact me if you have any questions or comments regarding this update or any other issues.

CC: Charter Officers