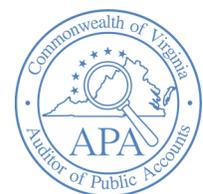




DEPARTMENT OF HUMAN RESOURCE MANAGEMENT

REPORT ON AUDIT FOR THE YEAR ENDED JUNE 30, 2019

Auditor of Public Accounts
Martha S. Mavredes, CPA
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AUDIT SUMMARY

Our audit of the Department of Human Resource Management (Human Resource Management) for the fiscal year ended June 30, 2019, found:

- proper recording and reporting of all transactions, in all material respects, related to the Health Insurance Fund, the Local Choice Health Care Fund, the Line of Duty Act Fund, and the Workers' Compensation Fund except as noted in the finding entitled "Improve Internal Controls Over Financial Reporting;"
- two findings involving internal control and its operation necessary to bring to management's attention, one of which is considered to be a material weakness; and
- one finding considered to be an instance of noncompliance with applicable laws and regulations that is required to be reported.

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AUDIT FINDINGS AND RECOMMENDATIONS

Improve Controls Over Financial Reporting

Type: Internal Control

Severity: Material Weakness

Repeat: Yes (first issued in fiscal year 2018)

Human Resource Management should continue to strengthen internal controls over financial reporting to ensure compliance with Governmental Accounting Standards Board (GASB) Statement No. 75, Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions (OPEB). As the administrator of the statewide Pre-Medicare Retiree Healthcare plan, Human Resource Management's Contracts and Finance Department prepares and disseminates required financial reporting information to participating entities for inclusion in the participant's individual financial statements. For the fiscal year ended June 30, 2019, Human Resource Management did not properly prepare the financial schedules to comply with all requirements of GASB Statement No. 75. The financial schedules prepared by Human Resource Management's Contracts and Finance Department contained significant errors. The errors identified include:

- incorrectly including a beginning balance adjustment in the current year journal entries, which employers use in the preparation of their individual financial statements;
- adjusting journal entries not resulting in the proper ending OPEB liability for the individual employers;
- improperly excluding the amortization of prior year changes in proportion in the schedule of deferred inflows and outflows; and
- incorrect use of the expected benefit payments instead of the actual benefit payments for fiscal year 2018, which resulted in a difference of approximately \$22.6 million.

Human Resource Management relies heavily on a third-party actuary to compile the required information necessary for the GASB Statement No. 75 financial reporting. The errors described above are a result of delays in Contracts and Finance providing necessary information to the actuary. These delays resulted in Contracts and Finance and Health Benefits Services not having sufficient time to review and analyze the actuary report and prepare the financial reporting information. Further, the contract with the actuary does not clearly define the scope, deliverables, or deadlines related to GASB Statement No. 75 reporting.

During fiscal year 2019, Human Resource Management developed internal deadlines related to the GASB Statement No. 75 reporting; however, many of these deadlines were not met. Further contributing to the errors in the financial information is Human Resource Management's lack of a formal review process of the compiled information. Contracts and Finance and Health Benefits Services do not properly review the actuary report prior to the preparation of the financial schedules. A detailed review

of the actuary report is necessary to ensure Human Resource Management identifies errors and omissions in a timely manner and to ensure that Human Resource Management agrees with the assumptions used by the actuary. We consider this to be a material weakness in internal control, as there is a reasonable possibility that Human Resource Management will not prevent, detect or correct material misstatements of the financial information and required disclosures in a timely manner.

Human Resource Management should modify the existing contract with the actuary, or procure a new contract, specific to the requirements and deadlines for the annual GASB Statement No. 75 reporting. Additionally, Contracts and Finance should work with Health Benefits Services to establish a formal review process for the actuary report, the financial information, and the required disclosures. The actuary report and disclosures both contain financial and program specific information that will require the coordination of these two service areas at Human Resource Management to properly review.

Improve Web Application Security Controls

Type: Internal Control and Compliance

Severity: Significant Deficiency

Repeat: Partial (first issued in fiscal year 2014)

Human Resource Management continues to not implement certain minimum security controls for a sensitive web application required by the Commonwealth's Information Security Standard, SEC 501 (Security Standard), and industry best practices. Lacking application controls can create vulnerabilities that expose data to potential compromises and effect system availability, which, could lead to reputational damage and financial penalties for Human Resource Management.

We communicated the specific control weaknesses and compliance references to management in a separate document marked Freedom of Information Act Exempt (FOIAE) under § 2.2-3705.2 of the Code of Virginia due to it containing descriptions of security mechanisms.

The weaknesses identified in the FOIAE document continue to persist in Human Resource Management's environment due to limited information technology (IT) resources and inadequate collaboration with the Virginia Information Technologies Agency (VITA). Human Resource Management should allocate the necessary resources and continue to work with VITA to remediate the weaknesses and meet the requirements in the Security Standard. Remediating these weaknesses will help to protect the confidentiality, integrity, and availability of data in the application environment.

AGENCY HIGHLIGHTS

The Department of Human Resource Management (Human Resource Management) administers the Commonwealth's Personnel Act, health insurance plans for state and local employees, health benefits plans for the Virginia Line of Duty Act, and the workers' compensation program. Human Resource Management's responsibilities include providing expertise in the areas of compensation, equal employment compliance, health benefits, and human resources policy and training. Human Resource Management is also the Commonwealth's central source for information about the Commonwealth's employment work force and provides a listing of state employment opportunities.

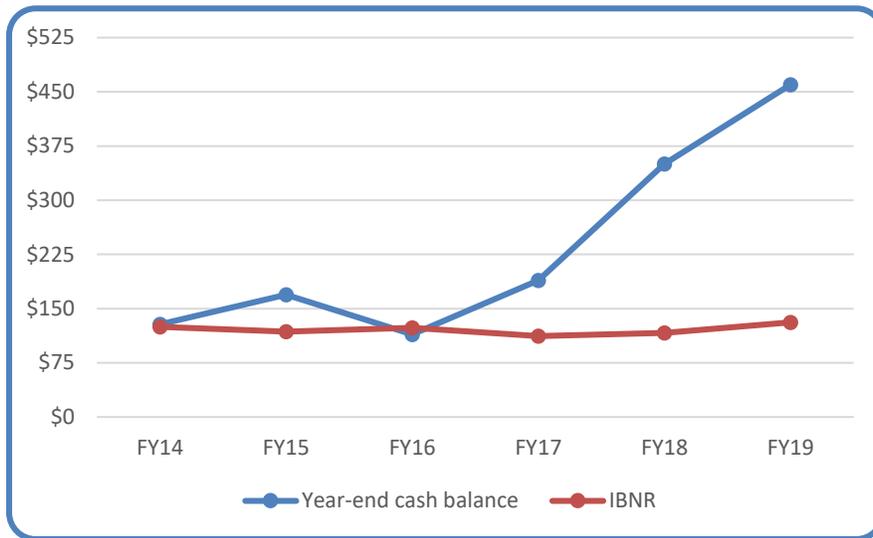
The Contracts and Finance service area within Human Resource Management manages all accounting, finance, and procurement activities for the agency. Contracts and Finance also provides accounting services for the Health Benefits Services and the Workers' Compensation service areas within Human Resource Management. Contracts and Finance contracts with actuaries to perform annual valuations for the Health Insurance Fund, the Local Choice Health Care Fund, the Line of Duty Act Fund, and the Workers' Compensation Fund. The actuarial valuations include an estimate of the incurred but not reported (IBNR) claims for each fund. The IBNR represents the amount owed for valid claims that have not yet been reported as of the fiscal year-end, and is used in the preparation of the Commonwealth's Comprehensive Annual Financial Report.

Health Insurance Fund

Health Benefits Services administers the comprehensive health benefits and long-term care programs for state employees, state retirees, and their dependents. Human Resource Management contracts with Anthem Blue Cross and Blue Shield to serve as the administrator for the Commonwealth's statewide standard preferred provider organization (PPO) health plan. Additionally, Human Resource Management contracts with Kaiser Foundation Health Plan of the Mid-Atlantic States to administer the consumer driven health plan. AON Consulting, Inc. provides services to evaluate the actuarial liabilities and reserve requirements of the self-funded health benefits program. As shown in Chart 1 below, premium revenue has exceeded claims expenses for each of the past three fiscal years, resulting in a cash balance of \$459.6 million at June 30, 2019. Due to the growing cash balance in the Health Insurance Fund, Chapter 854 of the 2019 Acts of Assembly included a health insurance holiday for the two pay periods in October 2019 in which state agencies and institutions of higher education paid no health insurance premiums.

**State Employee Health Insurance Fund
(\$ in millions)**

Chart 1

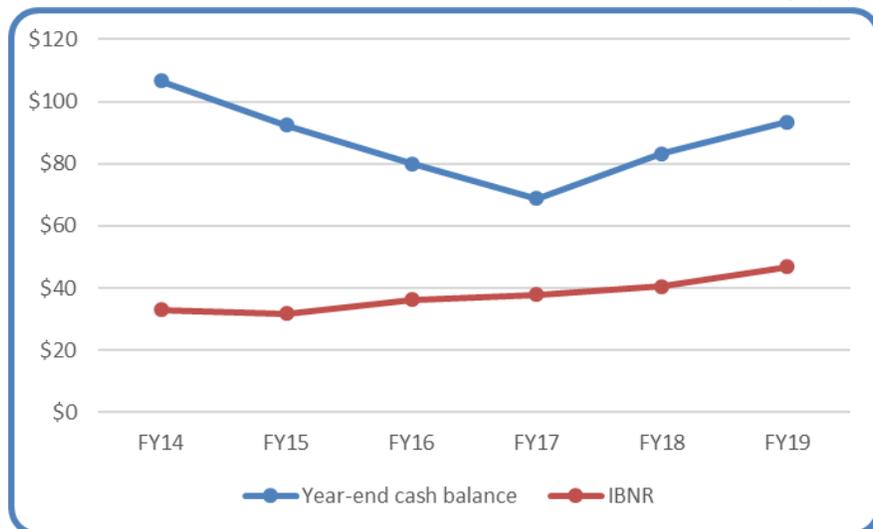


Local Choice Health Care Fund

Health Benefits Services administers The Local Choice (TLC) health benefits program, which provides health benefits and long-term care programs to local government and school jurisdiction employees, dependents, and retirees. Six health plans are available as options for the participating jurisdictions. Human Resource Management contracts with Anthem Blue Cross and Blue Shield and Kaiser Permanente to serve as the administrators of the TLC health plans. In fiscal year 2019, revenues exceeded expenses for the TLC fund for the second consecutive year. As shown in Chart 2 below, the year-end cash balance has consistently exceeded IBNR.

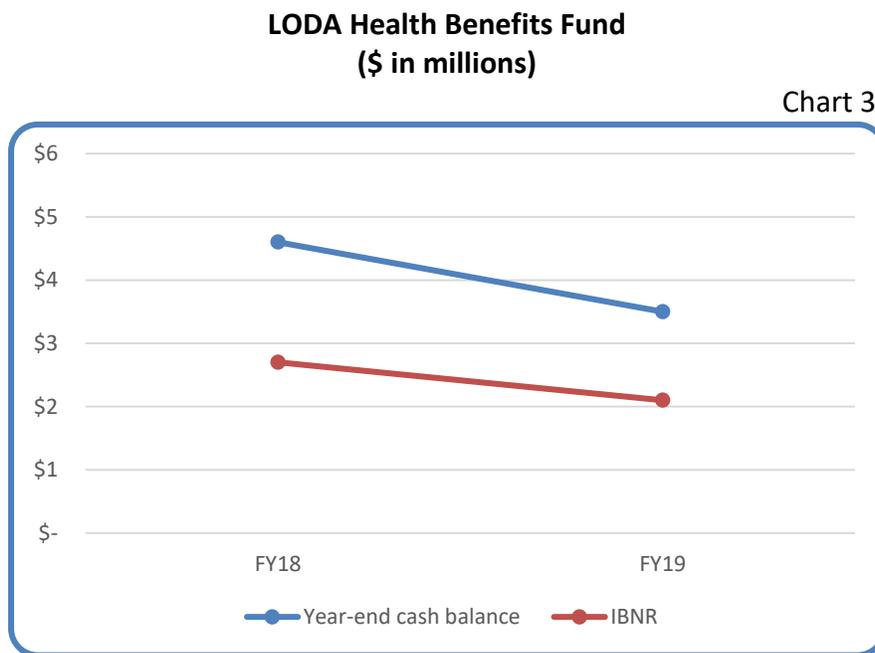
**The Local Choice Health Care Fund
(\$ in millions)**

Chart 2



Virginia Line of Duty Act Fund

The Virginia Line of Duty Act (LODA), established under § 9.1-400 of the Code of Virginia, provides benefits to eligible family members of eligible employees and volunteers killed in the line of duty, and to those eligible employees and volunteers disabled in the line of duty and their eligible family members. The Virginia Retirement System (VRS) is responsible for making all eligibility determinations and issuing benefit payments on behalf of entities that participate in the LODA Trust Fund administered by VRS. Beginning in fiscal year 2018, Human Resource Management is responsible for administering the LODA Health Benefits Plans. As of June 30, 2019, the cash balance in the LODA benefits fund is \$3.5 million with an estimated IBNR of \$2.1 million. Chart 3 below shows a comparison from fiscal year 2018 to fiscal year 2019.

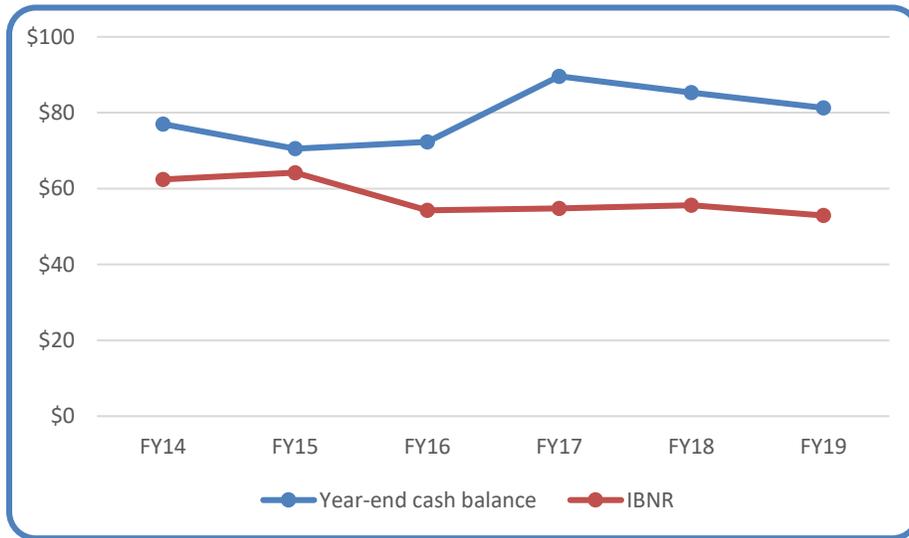


Workers' Compensation Fund

The Office of Workers' Compensation provides direction to state agencies on workers' compensation, workplace safety and loss control, and return to work programs. The Office also determines if the Commonwealth has adequate workers' compensation insurance protection, claims administration, training, and loss control services. The Workers' Compensation Fund provides all state employees with a covered injury sustained in the course and scope of employment with salary and wage protection, medical expenses, and other costs. Human Resource Management contracts with Managed Care Innovations to manage cost containment and claims administration. The Office also contracts with Oliver Wyman to provide an annual actuarial analysis of the Workers' Compensation Fund. Chart 4 below shows that cash balances have remained relatively consistent over the past six fiscal years.

**Worker's Compensation Fund
(\$ in millions)**

Chart 4



Information Systems

Human Resource Management's Office of Information Technology manages the Commonwealth's personnel management system. This system consists of a database used for processing and managing position, personnel, compensation, and health benefits data. The benefits system is a subsystem of the personnel management system that maintains health benefits records on all eligible state and local employees, employee dependents, and participating retirees.

Human Resource Management manages a time, attendance, and leave system. This system allows employees to electronically record time worked, submit leave requests, and record leave used. Managers are able to electronically approve time worked and leave submissions, and download reports to support absence management. Currently over 60 agencies with over 17,000 end users are using the system.

The Department of Accounts is in the process of developing an integrated component of the Commonwealth's accounting and financial reporting system, which will include functionality to replace Human Resource Management's personnel management; benefits management; and time, attendance, and leave systems. Representatives from Human Resource Management with an expertise in human resources, benefits administration, and the current personnel management system, are working with the Commonwealth's accounting and financial reporting system team to aid in the project design and implementation. The new integrated human resource system is currently in the project build stage, with phased release dates of March 2021 and October 2021.



Martha S. Mavredes, CPA
Auditor of Public Accounts

Commonwealth of Virginia

Auditor of Public Accounts

P.O. Box 1295
Richmond, Virginia 23218

December 13, 2019

The Honorable Ralph S. Northam
Governor of Virginia

The Honorable Thomas K. Norment, Jr.
Chairman, Joint Legislative Audit
and Review Commission

We have audited the financial records and operations of the **Department of Human Resource Management** for the year ended June 30, 2019. We conducted this audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in Government Auditing Standards, issued by the Comptroller General of the United States, in support of the Commonwealth's Annual Financial Report Audit. 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.

Audit Objectives

Our audit's primary objective was to evaluate the accuracy of Human Resource Management's financial transactions as reported in the Comprehensive Annual Financial Report for the Commonwealth of Virginia for the year ended June 30, 2019, which includes the Health Insurance Fund, the Local Choice Health Care Fund, the Line of Duty Act Fund, and the Worker's Compensation Fund. In support of this objective, we evaluated the accuracy of recorded financial transactions in the Commonwealth's accounting and financial reporting system, in Human Resource Management's accounting records, and in supplemental information and attachment submissions to the Department of Accounts; reviewed the adequacy of Human Resource Management's internal control; tested for compliance with applicable laws, regulations and contract agreements; and reviewed corrective actions of audit findings from the prior year report.

Audit Scope and Methodology

Management of Human Resource Management has responsibility for establishing and maintaining internal control and complying with applicable laws, regulations and contract agreements. Internal control is a process designed to provide reasonable, but not absolute, assurance regarding the

reliability of financial reporting, effectiveness and efficiency of operations, and compliance with applicable laws, regulations and contract agreements.

We gained an understanding of the overall internal controls, both automated and manual, sufficient to plan the audit. We considered materiality and risk in determining the nature and extent of our audit procedures. Our review encompassed controls over the following significant cycles, classes of transactions, and account balances.

- Contract procurement
- Revenues
- Actuary reporting
- Information systems security
- Financial reporting
- Claims expenses
- Service organization reporting

We performed audit tests to determine whether Human Resource Management’s controls were adequate, had been placed in operation, and were being followed. Our audit also included tests of compliance with provisions of applicable laws, regulations, and contract agreements. Our audit procedures included inquiries of appropriate personnel, inspection of documents, records, and contracts, and observation of Human Resource Management’s operations. We performed analytical procedures, including budgetary and trend analyses. We also tested details of transactions to achieve our objectives.

A non-statistical sampling approach was used. Our samples were designed to support conclusions about our audit objectives. An appropriate sampling methodology was used to ensure the samples selected were representative of the population and provided sufficient, appropriate evidence. We identified specific attributes for testing each of the samples and when appropriate, we projected our results to the population.

Our consideration of internal control over financial reporting was for the limited purpose described in the section “Audit Objectives” and was not designed to identify all deficiencies in internal control over financial reporting that might be material weaknesses or significant deficiencies and; therefore, material weaknesses or significant deficiencies may exist that were not identified. However, as described in the section entitled “Audit Findings and Recommendations,” we identified deficiencies in internal control that we consider to be material weaknesses and significant deficiencies.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A material weakness is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity’s financial statements will not be prevented, or detected and corrected on a timely basis. A significant deficiency is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Conclusions

We found that Human Resource Management properly stated, in all material respects, the amounts recorded and reported in the Commonwealth's accounting and financial reporting system, in Human Resource Management's accounting records, and in supplemental information and attachment submissions to the Department of Accounts for inclusion in the Comprehensive Annual Financial Report for the Commonwealth of Virginia.

We noted certain matters involving internal control and its operation and compliance with applicable laws, regulations and contract agreements that require management's attention and corrective action. These matters are described in the section entitled "Audit Findings and Recommendations."

Human Resource Management has not taken adequate corrective action with respect to the previously reported findings titled "Improve Controls Over Financial Reporting" and "Improve Web Application Security Controls." Accordingly, we included these findings in the section titled "Audit Findings and Recommendations." Human Resource Management has taken adequate corrective action with respect to audit findings reported in the prior year that are not repeated in this report.

The results of our consideration of the Commonwealth's internal control over financial reporting and on our tests of its compliance with certain provisions of law, regulations and contract agreements, and other matters related to the audit of the Commonwealth's Comprehensive Annual Financial Report for the year ended June 30, 2019, will be included in the Commonwealth of Virginia Single Audit Report, which will be issued in February 2020.

Exit Conference and Report Distribution

We discussed this report with management on January 28, 2020. Management's response to the findings identified in our audit is included in the section titled "Agency Response." We did not audit management's response and, accordingly, we express no opinion on it.

This report is intended for the information and use of the Governor and General Assembly, management, and the citizens of the Commonwealth of Virginia and is a public record.

Martha S. Mavredes
AUDITOR OF PUBLIC ACCOUNTS

JMR/vks



EMILY S. ELLIOTT
DIRECTOR

COMMONWEALTH OF VIRGINIA
Department Of Human Resource Management

James Monroe Building
101 N. 14th Street, 12th Floor
Richmond, Virginia 23219
Tel: (804) 225-2131
(TTY) 711

January 30, 2019

Ms. Martha S. Mavredes, CPA
Auditor of Public Accounts
P.O. Box 1295
Richmond, VA 23218

Dear Ms. Mavredes:

We have reviewed your report on the performance audit of the Department of Human Resource Management (DHRM) for the fiscal year ending June 30, 2019. We appreciate your staff providing a detailed review of each finding.

We acknowledge the repeat material weakness finding in the preparation for financial disclosures under the Governmental Accounting Standards Board (GASB) Statement No. 75, related to the post-employment benefits other than pensions. This was the second year of GASB 75 reporting for DHRM. DHRM is currently working with its actuary to modify our existing contract, which will include dates that DHRM is required to present allocation and census data to the actuary. The contract modification will also include dates by which the actuary will complete financial disclosures. We anticipate the contract modification to be in place by March 31, 2020.

DHRM will also develop procedures to include the Office of Health Benefits in the review of the actuary report. The Office of Health Benefits and the Office of Contracts and Finance will work together to ensure all data and reports are accurate.

We acknowledge the deficiency found in the area of Information Technology. We are committed to taking the necessary corrective action identified. We appreciate APA's recognition of improvements made during the audit period.

Sincerely,

A handwritten signature in cursive script that reads "Emily S. Elliott".

Emily S. Elliott, Director

An Equal Opportunity Employer

DEPARTMENT OF HUMAN RESOURCE MANAGEMENT

As of June 30, 2019

Emily Elliott, Director

Rue Collins White, Chief Deputy Director

Richard Whitfield, Director
Contracts and Finance

Gene Raney, Director
Health Benefits Services

Kristie McClaren, Director
Workers' Compensation

Antonio Villafaña
Chief Information Officer

Belchior Mira
Information Security Officer