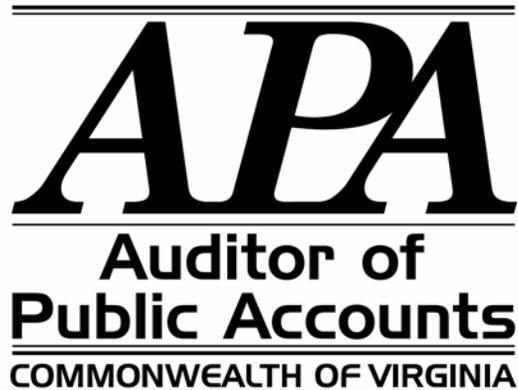


DEPARTMENT OF HUMAN RESOURCE MANAGEMENT

**REPORT ON AUDIT
FOR THE YEAR ENDED
JUNE 30, 2004**



AUDIT SUMMARY

Our audit of the Department of Human Resource Management for the year ended June 30, 2004, found:

- proper recording and reporting of transactions, in all material respects, in the Commonwealth Accounting and Reporting System;
- matters involving the internal control and its operation that we consider reportable conditions; however, we do not consider them to be material weaknesses; and
- no instances of noncompliance or other matters that required reporting.

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DEPARTMENT OF HUMAN RESOURCE MANAGEMENT HIGHLIGHTS

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

Administrative Financial Activity

In fiscal year 2004, the Department’s administrative expenses totaled \$7.1 million, which is a 1.5 percent increase from fiscal year 2003. Personnel expenses account for \$5.5 million (78 percent) of fiscal year 2004 expenses. Continuous charges such as rent and insurance payments account for \$754,734 (11 percent) of fiscal year 2004 expenses.

Table 1 summarizes the Department’s administrative financial activity. The variance between nongeneral funds original and adjusted budgets and actual expenses is due to implementation of the Learning Management System, which provides information on employee development and training. The Department initially paid for the system using nongeneral funds requiring an increased adjusted budget. Other agencies using the system reimbursed the Department, decreasing actual expenses.

Table 1

Fiscal Year 2004 Administrative Financial Activity

| <u>Fund</u> | <u>Original Budget</u> | <u>Adjusted Budget</u> | <u>Actual Expenses</u> |
|------------------|----------------------------|----------------------------|----------------------------|
| General Fund | \$4,203,454 | \$4,321,082 | \$4,262,716 |
| Nongeneral funds | <u>3,131,651</u> | <u>3,654,332</u> | <u>2,824,568</u> |
| Total | <u>\$7,335,105</u> | <u>\$7,975,414</u> | <u>\$7,087,284</u> |

Health Insurance Fund Highlights

The Commonwealth of Virginia offers state employees and retirees, as well as employees of Virginia localities, the opportunity to participate in group healthcare programs. The programs consist of state and local self-insured plans, a Medicare supplement plan, and a commercially-insured health maintenance organization (HMO) plan, as well as dental, outpatient prescription drug, and mental health and substance abuse programs.

The Department is responsible for oversight of contracts for the health benefits programs. The contracts establish standards of performance for claims accuracy, processing time, and savings due to coordination of benefits with other insurance companies. The contracts require the measurement of performance standards through claims audits and impose monetary penalties for failure to meet established standards.

The State Health Insurance Fund received \$638.8 million in premiums and paid \$613.1 million for claims during fiscal year 2004. The Local Health Insurance Fund received \$137.5 million in premiums and paid \$124.9 million for claims during the same period. We will discuss the health insurance plans in more detail in a separate report reviewing the Commonwealth’s statewide self-insurance programs.

Workers' Compensation Fund Highlights

The Workers' Compensation Program transferred to the Department from the Department of General Services in fiscal year 2000. This program protects all state employees from financial loss due to lost work and wages, medical expenses, and other costs associated with a covered injury sustained in the course and scope of employment.

Managed Care Innovations (MCI) has a contract to manage cost containment and claims administration and uses a subcontractor, Frank Gates Service Company, for third party claims administration. The Department contracts for an annual audit of the internal control procedures used by the Frank Gates Service Company when processing claims.

During fiscal year 2004, the Workers' Compensation Fund received premiums of \$47.5 million and paid \$66.6 million in claims. We will discuss the workers' compensation program in more detail in a separate report reviewing the Commonwealth's statewide self-insurance programs.

INTERNAL CONTROL FINDINGS AND RECOMMENDATIONS

Improve Written Policies and Procedures for Internal Controls over Financial Reporting

The Department has inadequate written policies and procedures for their accounting and financial reporting functions. Lack of written policies and procedures represents an internal control weakness and increases the risk that errors, misappropriation of assets, or fraud could occur. The Department compounds this risk by not adequately cross training accounting personnel. If key personnel leave or are unable to perform their duties, having inadequate written policies and procedures increases the risk that remaining staff may not perform accounting and financial reporting duties properly and in accordance with management's direction.

The Department should create and maintain written policies and procedures containing adequate controls to assure the reliability and completeness of financial information, ensure compliance with applicable laws and regulations, and prevent errors and fraud. Further, the Department should implement policies and procedures that require cross training of staff to mitigate risks if key personnel leave or are unable to perform their duties.

Improve Reconciliation Process for Workers' Compensation Claims Disbursements

The Department does not have an effective and timely reconciliation process for Workers' Compensation Claims disbursements. Currently, the Department contracts with Managed Care Innovations (MCI) to administer claims, and uses a subcontractor, Frank Gates Service Company, to make claims disbursements. The Department relies on hand-delivered check registers from MCI to determine disbursement amounts and make deposits to cover outstanding claims checks.

Consequently, the reconciliation of Workers' Compensation Claims disbursements is a manual process. If MCI does not provide the check registers timely or if the registers contain inaccurate information, the Department cannot properly reconcile its outstanding claims checks. The Department should consider automating the process and require MCI to provide accurate check registers in a timely fashion. These changes will facilitate timely claims reconciliations and disbursements and increase the effectiveness and efficiency of the Department's operations.



Commonwealth of Virginia

Walter J. Kucharski, Auditor

**Auditor of Public Accounts
P.O. Box 1295
Richmond, Virginia 23218**

February 17, 2005

The Honorable Mark R. Warner
Governor of Virginia
State Capitol
Richmond, Virginia

The Honorable Lacey E. Putney
Chairman, Joint Legislative Audit
and Review Commission
General Assembly Building
Richmond, Virginia

INDEPENDENT AUDITOR'S REPORT

We have audited selected financial records and operations of the **Department of Human Resource Management** for the year ended June 30, 2004, in support of the Comprehensive Annual Financial Report for the Commonwealth of Virginia. We conducted our audit in accordance with Government Auditing Standards, issued by the Comptroller General of the United States.

Audit Objectives, Scope, and Methodology

Our audit's primary objective was to evaluate the accuracy of the Department's financial transactions as reported in the Comprehensive Annual Financial Report for the Commonwealth of Virginia for the year ended June 30, 2004. In support of this objective, we evaluated the accuracy of recording financial transactions on the Commonwealth Accounting and Reporting System and in the Department's accounting records, reviewed the adequacy of Department's internal control, and tested for compliance with applicable laws, regulations, and contracts.

Our audit procedures included inquiries of appropriate personnel, inspection of documents and records, and observation of the Department's operations. We also tested transactions and performed such other auditing procedures as we considered necessary to achieve our objectives. We reviewed the overall internal accounting controls, including controls for administering compliance with applicable laws, regulations, and contracts. Our review encompassed controls over the following significant cycles, classes of transactions, and account balances.

Revenues
Expenditures

We gained an understanding of the overall internal controls, both automated and manual, sufficient to plan the audit. We considered materiality and control risk in determining the nature and extent of our audit procedures. We performed audit tests to determine whether Department's controls were adequate, had been placed in operation, and were being followed.

Management has responsibility for establishing and maintaining internal control and complying with applicable laws and regulations. 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 and regulations.

Our audit was more limited than would be necessary to provide an opinion on internal control or on overall compliance with laws, regulations, and contracts. Because of inherent limitations in internal control, errors, irregularities, or noncompliance may nevertheless occur and not be detected. Also, projecting the evaluation of internal control to future periods is subject to the risk that the controls may become inadequate because of changes in conditions or that the effectiveness of the design and operation of controls may deteriorate.

Audit Conclusions

We found that Department properly stated, in all material respects, the selected financial records reviewed in support of the Comprehensive Annual Financial Report for the Commonwealth of Virginia listed in the scope section of this report.

We noted certain matters involving internal control and its operation that we consider reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of internal control that, in our judgment, could adversely affect Department's ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial records. These reportable conditions, entitled "Improve Written Policies and Procedures for Internal Controls Over Financial Reporting" and "Improve Reconciliation Process for Workers' Compensation Claims Disbursements," are described in the section entitled "Internal Control Findings and Recommendations." We believe that these reportable conditions are not material weaknesses.

The results of our tests of compliance with applicable laws, regulations, and contracts disclosed no instances of noncompliance or other matters that are required to be reported under Government Auditing Standards.

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

EXIT CONFERENCE

We discussed this letter with management at an exit conference held on March 10, 2005.

AUDITOR OF PUBLIC ACCOUNTS

JP/kva
kva:



COMMONWEALTH of VIRGINIA

Department of Human Resource Management

SARA REDDING WILSON
DIRECTOR

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RICHMOND, VIRGINIA 23219
(804) 225-2131
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March 10, 2005

The Auditor of Public Accounts
P. O. Box 1295
Richmond, Virginia 23218

Dear Sir:

Re: Corrective Action Plan

This is in response to APA's findings of weakness in Internal Controls in the Worker's Compensation program. The two areas of concern were to improve outdated written policies & procedures with adequate cross training and to improve the reconciliation process for the claims disbursement to be completed in a timely manner.

The Department's written procedures were outdated and are now in process of being updated and revised. These updated procedures and written policies are nearly complete and will be within the month barring unforeseen circumstances. Cross training has taken place with the new employee in the Office of Contracts and Finance and is no longer be an issue.

The reconciliation process for claims disbursements has been addressed. In December the Frank Gates Service Company made check register available directly through their web site for employees of the Office of Contract and Finance responsible for this process. There is now in place a cover sheet for the director of Worker's Comp and the DHRM fiscal officer to "sign off" on the completed reconciliation to assure completeness and completion in a timely manner. CPA firm Cherry, Bekaert & Holland has been contracted to review the current procedure and to make recommendations on the process.

We believe these actions adequately address the internal weaknesses detected by APA. George Gibbs, the DHRM Chief Financial Officer, is responsible make sure these corrective actions are implemented.

Sincerely

A handwritten signature in cursive script that reads "Sara R. Wilson".

Sara R. Wilson
Director

DEPARTMENT OF HUMAN RESOURCE MANAGEMENT

Sara Redding Wilson, Director

Mary Habel, Director
Office of Health Benefits

Sue Keener, Director
Office of Workers' Compensation

Thomas J. Clayton, Director
Office of Contracts and Finance