

**DEPARTMENT OF
HUMAN RESOURCE MANAGEMENT**

**REPORT ON AUDIT
FOR THE YEAR ENDED
JUNE 30, 2006**

APA

**Auditor of
Public Accounts**

COMMONWEALTH OF VIRGINIA

AUDIT SUMMARY

Our audit of the Department of Human Resource Management for the year ended June 30, 2006, found:

- proper recording and reporting of all transactions, in all material respects, in the Commonwealth Accounting and Reporting System.
- no matters involving internal control and its operations necessary to bring to management's attention; and
- no instances of noncompliance with applicable laws and regulations or other matters that are required to be reported.

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AGENCY HIGHLIGHTS

The Department of Human Resource Management (Department) administrates the Commonwealth's Personnel Act and health insurance plans for state and local employees. The Department's responsibilities include providing expertise in the areas of compensation, equal employment compliance, health benefits, and human resources policy and training. The Department 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 Office of Contracts and Finance (Contracts and Finance) does all accounting, finance and procurement activities for the Department. Contracts and Finance also provides underwriting oversight for the Office of Health Benefits which administers health insurance and related benefits.

Administrative Financial Activity

The Department received total resources of approximately \$8.8 million in fiscal year 2006 and \$8.1 million in fiscal year 2005. Personnel expenses account for \$6.4 million, or 75 percent, of fiscal year 2006 expenses. The majority of the remaining expenses are for continuous charges such as rental and insurance payments.

Table 1 (below) summarizes the Department's financial activity for fiscal year 2006 and 2005. The increase in general fund original to final budget in 2006 resulted from an extra pay period in June 2006, cost of living salary adjustments, and increases in health-care expenses. These changes also resulted in a 17.2 percent increase in expenses between fiscal years 2005 and 2006. Actual expenses in 2005 for Non-general funds were less than the adjusted budget primarily due to a lower than expected cost for the Department's Learning Management System.

Table 1

Analysis of Budgeted to Actual Funding - Fiscal Year 2006

<u>Fund</u>	<u>Original Budget</u>	<u>Final Budget</u>	<u>Actual Expenses</u>
General	\$4,655,640	\$5,121,274	\$5,115,371
Non-general	<u>3,587,495</u>	<u>3,691,837</u>	<u>3,348,200</u>
Total	<u>\$8,243,135</u>	<u>\$8,813,111</u>	<u>\$8,463,571</u>

Analysis of Budgeted to Actual Funding - Fiscal Year 2005

<u>Fund</u>	<u>Original Budget</u>	<u>Final Budget</u>	<u>Actual Expenses</u>
General	\$4,416,778	\$4,635,728	\$4,482,895
Non-general	<u>3,467,900</u>	<u>3,467,900</u>	<u>2,739,174</u>
Total	<u>\$7,884,678</u>	<u>\$8,103,628</u>	<u>\$7,222,069</u>

Health Insurance Fund

The Office of Health Benefits administers the comprehensive health benefits and long-term care programs for state employees, state retirees, and their dependents. It also provides health benefits and long-term care programs to local governments and school jurisdiction employees, dependents and retirees.

The Comprehensive Annual Financial Report of the Commonwealth presents the activity of the self-insured health benefits program in two funds administered by the Department. The annual report presents the Local Choice activity as an Enterprise Fund and the State Health Insurance activity as an Internal Service Fund.

The Department oversees the 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. Independent auditors perform annual internal control audits of the third-party administrators.

The State Health Insurance Fund received \$827.97 million in premiums and paid \$715.3 million for claims during fiscal year 2006. The Local Health Insurance Fund received \$184.4 million in premiums and paid \$152.3 million for claims during the same period. Refer to the Table 2 below for details regarding the State Health Insurance Fund activity for fiscal years 2005 and 2006.

<u>State Health Insurance Fund</u>		
	<u>2005</u>	<u>2006</u>
Revenue		
Premiums collected	\$737,264,910	\$827,966,480
Interest/miscellaneous	<u>1,498,017</u>	<u>4,067,555</u>
Total revenue	<u>738,762,927</u>	<u>832,034,035</u>
Expenses		
Insurance claims	677,372,225	715,282,806
Contractual services	<u>47,547,108</u>	<u>52,484,583</u>
Total expenses	<u>724,919,333</u>	<u>767,767,389</u>
Net Income/(loss)	13,843,594	64,266,646
Beginning net assets	<u>(24,827,658)</u>	<u>(10,984,064)</u>
Net asset position	<u>\$ (10,984,064)</u>	<u>\$ 53,282,582</u>

Table 2

As shown in the table above, premiums collected increased approximately \$91 million in fiscal year 2006. The Department sets premium amounts using an actuarial analysis using claims data and actuarial assumptions and principles. Reasons for the premium increase primarily include increased health care costs and enrollment increases. Expenses for the State Health Insurance program increased approximately \$38 million in fiscal year 2006. This increase however was significantly less than the increase in premiums, resulting in a positive net asset position for the Fund at fiscal year end.

Worker's Compensation Fund

The Office of Worker's Compensation (the Office) provides direction to state agency on workers' compensation, workplace safety and loss control, and return to work programs. The Office also determines if the Commonwealth has adequate worker's compensation insurance protection, claims administration, training, and loss control services. The Worker's 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.

The Commonwealth operates a self-insured workers' compensation program administered by the Department. The Comprehensive Annual Financial Report of the Commonwealth shows the program as a component of the Risk Management Internal Service Fund. Entities participating in the worker's compensation program receive annual billings for premiums, which the Department tracks using an in-house database.

The Department has a contract with Managed Care Innovations (MCI) to manage cost containment and claims administration. MCI 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. The Office also contracts with Mercer Oliver Wyman to provide an annual actuarial analysis of the Worker's Compensation Fund. This analysis identifies funding needs and required reserves to meet short and long-term claim obligations

During fiscal year 2006, the Workers' Compensation Fund received premiums of \$49.2 million and paid \$59.3 million in claims. Refer to Table 3 below for details regarding the Worker's Compensation Fund activity for fiscal years 2005 and 2006.

<u>Worker's Compensation Fund</u>		
	<u>2005</u>	<u>2006</u>
Revenue		
Premiums collected	\$ 47,898,452	\$ 49,178,178
Interest/ miscellaneous	<u>1,098,705</u>	<u>1,640,258</u>
Total revenue	<u>48,997,157</u>	<u>50,818,436</u>
Expenses		
Insurance claims*	69,302,555	59,288,045
Contractual services	7,374,049	7,592,122
Total expenses	<u>76,676,604</u>	<u>66,880,167</u>
Net income/(loss)	(27,679,447)	(16,061,731)
Beginning net assets	<u>(161,447,834)</u>	<u>(190,586,353)</u>
Net asset position	<u>\$(189,127,281)</u>	<u>\$(206,648,084)</u>

Table 3

*The Worker's Compensation Fund recognizes an insurance claim when it is incurred, referred to as Incurred But Not Paid (IBNP) claims. This amount includes claim payments already made and those estimated to be IBNP claims.

The fiscal year 2006 actuary report estimated required reserves to cover future claim payments as of June 30, 2006 to be \$284.3 million on an undiscounted basis and \$230.5 million on a discounted basis, assuming a three percent interest rate. Of those reserves \$36.9 million would be payouts with premiums billed for fiscal year 2007 totaling approximately \$50.9 million. As can be seen in the table above, the fund continues to carry a deficit net asset balance; however the average yearly cash balances have covered claims on a short-term basis.



Commonwealth of Virginia

Walter J. Kucharski, Auditor

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

February 9, 2007

The Honorable Timothy M. Kaine
Governor of Virginia
State Capital
Richmond, Virginia

The Honorable Thomas K. Norment, Jr.
Chairman, Joint Legislative Audit
and Review Commission
General Assembly Building
Richmond, Virginia

We have audited the financial records and operations of the Department of Human Resource Management for the year ended June 30, 2006. We conducted our audit in accordance with Government Auditing Standards, issued by the Comptroller General of the United States.

Audit Objectives

Our audit's primary objective was to evaluate the accuracy of the Department's Self Insurance Fund as reported in the Comprehensive Annual Financial Report for the Commonwealth of Virginia for the year ended June 30, 2006. We also evaluated the accuracy of financial and budgetary transactions of the administrative activities of the Department as reported in the Commonwealth Accounting and Reporting System (CARS). In support of these objectives, we evaluated the accuracy of recording financial transactions in CARS and in the Department's accounting records, reviewed the adequacy of the Department's internal controls and tested for compliance with applicable laws, regulations, contracts, and grant agreements, and reviewed corrective actions of audit findings from prior year reports.

Audit Scope and Methodology

The Department's 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.

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. Our review encompassed controls over the following significant cycles, classes of transactions, and account balances.

Revenue
Expenditures
Appropriations
Claims Payable
Premium billing and receivables
Reconciliations
Actuary Reporting

We performed audit tests to determine whether the Department'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 and regulations. Our audit procedures included inquiries of appropriate personnel, inspection of documents, records, and contracts, and observation of the Department's operations. We tested transactions and performed analytical procedures, including budgetary and trend analyses.

Conclusions

We found that the Department of Human Resource Management properly stated, in all material respects, the amounts recorded and reported in the Commonwealth Accounting and Reporting System. The Department records its financial transactions on the cash basis of accounting, which is a comprehensive basis of accounting other than accounting principles generally accepted in the United States of America. The financial information presented in this report came directly from the Commonwealth Accounting and Reporting System.

We noted no matters involving internal control and its operation that we consider necessary to be reported to management. The results of our tests of compliance with applicable laws and regulations disclosed no instances of noncompliance or other matters that are required to be reported under Government Auditing Standards.

The Department has taken adequate corrective action with respect to audit findings reported in the prior year that are not repeated in this letter.

EXIT CONFERENCE AND REPORT DISTRIBUTION

We discussed this report with management on April, 5, 2007.

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.

AUDITOR OF PUBLIC ACCOUNTS

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DEPARTMENT OF HUMAN RESOURCE MANAGEMENT

AGENCY OFFICIALS

Sara Redding Wilson, Director

Mary Habel, Director
Office of Health Benefits

Sue Keener, Director
Office of Worker's Compensation

Dan Hinderliter, Director
Office of Contracts and Finance

George Gibbs, CFO
Office of Contracts and Finance