

**DEPARTMENT OF
HUMAN RESOURCE MANAGEMENT**

**REPORT ON AUDIT
FOR THE YEAR ENDED
JUNE 30, 2008**



AUDIT SUMMARY

Our audit of the Department of Human Resource Management, found:

- proper recording and reporting of all transactions, in all material respects, in the Commonwealth Accounting and Reporting System;
- a matter involving internal control and its operation necessary to bring to management's attention; and
- an instance of noncompliance with applicable laws and regulations or other matters that is required to be reported.

- TABLE OF CONTENTS -

	<u>Pages</u>
AUDIT SUMMARY	
AUDIT FINDING AND RECOMMENDATION	1
AGENCY HIGHLIGHTS	2-4
AUDIT OBJECTIVES	5
AUDIT SCOPE AND METHODOLOGY	5-6
CONCLUSIONS	6
EXIT CONFERENCE AND REPORT DISTRIBUTION	6
AGENCY RESPONSE	7
AGENCY OFFICIALS	8

AUDIT FINDING AND RECOMMENDATION

Improve Information System Security Program

The Department of Human Resource Management's Information Security Officer (ISO) is not given the responsibility of managing the Department's overall information security program as required by the Commonwealth's information security policy. We found that the Department has delegated the responsibilities of the ISO to several parties within the organization, and as a result, does not have a complete and consistent information security program. During our review, we found that the Department needs to improve and implement the following components of its information security program.

Risk management plans

The Department has not classified its data according to sensitivity with respect to confidentiality, integrity, and availability as required by the Commonwealth's information standards. Also, while the Department has identified business functions, it has not determined which functions are essential or tied those functions to the supporting information technology (IT) systems.

Additional sensitive information was communicated in a separate document to management marked Freedom of Information exempt under Section 2.2-3705.2 of the Code of Virginia.

Approval and termination procedures for network accounts

The Department does not require proper approval for network account requests, nor does it maintain any related documentation. While the Virginia Information Technologies Agency/Northrop Grumman (VITA/NG) IT Partnership actually sets up the accounts, the Department is responsible for ensuring that the accounts requested are legitimate, approved, and only require the access needed to perform job duties. Department policy also does not include its requirements for least privilege, access removal, or periodic review of accounts, which are required by the Commonwealth's information security standards. In addition, the Department cannot determine when access was removed for separated staff since it does not maintain documentation of termination requests and deletion confirmation.

Password management standards for its sensitive web applications

The Department's sensitive web applications do not comply with the Commonwealth's information security standards, which require specific maximum password age and history. Department policy does not specify if or how passwords will be securely delivered to users. Proper password controls are needed to ensure that confidential data is protected from unauthorized access and manipulation.

One of an ISO's duties is to make certain that the security plan meets current Commonwealth IT standards and that the agency complies with the policies therein. The ISO can accomplish this by performing internal reviews to evaluate the performance of the Department's information security program, make the necessary adjustments, and provide training as the IT environment changes.

We recommend that the Department revise the ISO's employee work profile to include the responsibilities required by Commonwealth policy. We also recommend that the ISO review and evaluate the security program's performance, make any necessary adjustments, and if relevant, provide additional training to the Department's staff.

AGENCY HIGHLIGHTS

The Department of Human Resource Management (Department) administers the Commonwealth's Personnel Act, health insurance plans for state and local employees, and the workers' compensation program. 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 the health insurance, and related benefits.

Administrative Financial Activity

The Department received total resources of approximately \$9.9 million in fiscal year 2008 of which personnel expenses account for \$7.1 million, or 79 percent. 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 2008. The majority of the increase in general fund original to final budget resulted from an increase to offset Virginia Information Technologies Agency (VITA) rate changes. Actual expenses in 2008 were less than the adjusted budget primarily due to financial management practices that anticipated budget reductions.

Analysis of Budgeted to Actual Funding – Fiscal Year 2008

<u>Fund</u>	<u>Original Budget</u>	<u>Final Budget</u>	<u>Actual Expenses</u>
General	\$5,210,993	\$ 5,610,472	\$5,353,541
Special	3,162,082	3,212,082	2,896,806
Trust and Agency	<u>1,115,909</u>	<u>1,115,909</u>	<u>751,383</u>
Total	<u>\$9,488,984</u>	<u>\$ 9,938,463</u>	<u>\$9,001,730</u>

Table 1

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 \$971.3 million in premiums and paid \$848.7 million for claims during fiscal year 2008. The Local Health Insurance Fund received \$211.0 million in premiums and paid \$185.1 million for claims during the same period. Refer to Table 2 below for details regarding the State Health Insurance Fund activity for fiscal years 2007 and 2008.

	<u>State Health Insurance Fund</u>	
	<u>2007</u>	<u>2008</u>
Revenue		
Premiums collected	\$ 907,700,395	\$ 971,303,819
Interest/miscellaneous	<u>9,520,356</u>	<u>11,803,624</u>
Total revenue	<u>917,220,751</u>	<u>983,107,443</u>
Expenses		
Insurance claims	771,428,362	848,667,377
Contractual services	<u>61,884,137</u>	<u>70,312,505</u>
Total expenses	<u>833,312,499</u>	<u>918,979,882</u>
Net income	83,908,252	64,127,561
Beginning net assets	<u>53,282,582</u>	<u>137,190,834</u>
Net asset position	<u>\$137,190,834</u>	<u>\$ 201,318,395</u>

Table 2

As shown in the table above, premiums collected increased approximately \$64 million in fiscal year 2008. 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. Insurance claims expenses for the State Health Insurance program increased approximately \$77 million in fiscal year 2008.

Workers' Compensation Fund

The Office of Workers' Compensation (the Office) 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.

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 workers' 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, Avizent Company, for third party claims administration. The Department contracts for an annual audit of the internal control procedures used by the Avizent Company when processing claims. The Office also contracts with Mercer Oliver Wyman to provide an annual actuarial analysis of the Workers' Compensation Fund. This analysis identifies funding needs and required reserves to meet short and long-term claim obligations.

During fiscal year 2008, the Workers' Compensation Fund received premiums of \$53.8 million and paid \$141.0 million in claims, which includes an accrual for the estimate of claims incurred but not paid as of fiscal year end. Refer to Table 3 below for details regarding the Workers' Compensation Fund activity for fiscal years 2007 and 2008.

<u>Workers' Compensation Fund</u>		
	<u>2007</u>	<u>2008</u>
Revenue		
Premiums collected	\$ 51,519,428	\$ 53,826,225
Interest/ miscellaneous	<u>2,206,430</u>	<u>2,247,557</u>
Total revenue	<u>53,725,858</u>	<u>56,073,782</u>
Expenses		
Insurance claims*	63,578,330	140,995,487
Contractual services	6,994,801	8,582,343
Total expenses	<u>70,573,131</u>	<u>149,577,830</u>
Net loss	(16,847,273)	(93,504,048)
Beginning net assets	<u>(206,648,084)</u>	<u>(223,495,357)</u>
Net asset position	<u>\$(223,495,357)</u>	<u>\$(316,999,405)</u>

Table 3

**The Workers' 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 2008 actuary report estimated required reserves to cover future claim payments (incurred but not paid) as of June 30, 2008 to be \$431.8 million on an undiscounted basis and \$337.1 million on a discounted basis, assuming a three percent interest rate. Of those reserves \$45.2 million would be payouts with premiums billed for fiscal year 2009. 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
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February 20, 2009

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

The Honorable M. Kirkland Cox
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** (Department) for the year ended June 30, 2008. We conducted this performance audit in accordance with generally accepted government auditing standards. 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 objectives were to evaluate the accuracy of recorded financial transactions on the Commonwealth Accounting and Reporting System, review the adequacy of the Department's internal controls, and test compliance with applicable laws and regulations.

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 significance 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.

- Payroll expenditures
- Small purchase charge card
- Appropriations
- Cash receipting and collections of accounts receivable
- Network Security

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 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 a matter involving internal control and its operation and compliance with applicable laws and regulations that requires management's attention and corrective action. This matter is described in the section entitled "Audit Finding and Recommendation."

Exit Conference and Report Distribution

We discussed this report with management on March 31, 2009. Management's response has been included at the end of this report.

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

WJK/alh



COMMONWEALTH of VIRGINIA

SARA REDDING WILSON
DIRECTOR

Department of Human Resource Management

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TO: Karen Ashby, Auditor, Information Systems Security
Goran Gustavsson, Director, Information Systems Security
Karen Helderman, Director, Information Systems Development

FROM: Sara R. Wilson, DHRM Director *Sara R. Wilson*

DATE: 4/15/2009

RE: Audit Finding and Recommendation, Improve Information System Security Program

Thank you for the opportunity to respond to your management finding for the Department of Human Resource Management. We have researched the issues in your report and have revised policies and procedures accordingly. Our focus has consistently been on systems security and integrity and, based on your finding, we appreciate the opportunity to strengthen our infrastructure.

Your recommendation to revise the ISO's employee work profile to include the responsibilities required by the Commonwealth policy has been adopted. The Agency ISO will review and evaluate the security program's performance and provide adjustments and training as necessary.

AGENCY OFFICIALS

Department of Human Resource Management

Sara Redding Wilson, Director

Mary Habel, Director
Office of Health Benefits

Dan Hinderliter, Director
Office of Contracts and Finance

George Gibbs, CFO
Office of Contracts and Finance