

**DEPARTMENT OF
HUMAN RESOURCE MANAGEMENT**

**REPORT ON AUDIT
FOR THE THREE YEAR PERIOD ENDED
JUNE 30, 2011**



AUDIT SUMMARY

Our audit of the Department of Human Resource Management for the period July 1, 2008, through June 30, 2011, found:

- proper recording and reporting of all transactions in the Commonwealth Accounting and Reporting System;
- matters involving internal controls and its operations that were 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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AUDIT FINDINGS AND RECOMMENDATIONS

Introduction

As a response to General Fund budget reductions, Human Resources has increased its recovery of overhead costs for managing the Commonwealth's Health Insurance programs, and bills agencies where Human Resources acts as the agency's human resource function. Both these processes include the allocation and recovery of a portion of staff salaries and fringe benefits, as well as other costs.

While Human Resources has not established an internal service fund to record either of these activities, the charges and recoveries do occur from agencies which have federal grants and contracts and pass these costs onto these federal programs. A fundamental costing concept for federal grants and contracts is that in order to have the federal government pay these costs, the agencies know that there is a uniform methodology to recover the costs and that recovery is uniform for all federal grants and contracts. Further, while there may be different methodologies for each type of service, the recovery should not exceed actual cost and the methodology for recovering costs compares planned recoveries to actual cost.

In reviewing the activities related to both the allocation of overhead and billing of services, we believe Human Resources needs to address three fundamental issues. The first is development and documentation of the methodologies used and followed for each of these processes. The second is tracking of actual costs both for salaries and fringe benefits and other expenses, and determining the difference between estimated and actual costs. The third is recording all billings and recoveries as revenue in the appropriate fund.

Document Allocation and Recovery Methodologies

Human Resources has no formal documentation of the process it follows in determining the overhead allocation or the cost recovered for providing human resource services. While staff have begun to develop and follow a method for determining the overhead allocation and billing amounts, there are insufficient processes to determine that the methodology is the same between periods.

Human Resources should document their process, make sure all departments and managers are following the same methodology to allocate the percentage of staff salaries, fringe benefits and costs, and ensure that no costs allocated exceed the actual amounts spent. Management should review the documentation and determine that the methodology is sufficient to meet federal cost allocation or billing requirements. In addition, management should ensure that they are properly accumulating long term costs for system development for future recoveries.

Since Human Resources anticipates the service center for providing human resource services to other state agencies will become an internal service fund, these procedures should also provide the information and documentation to set rates and request additional funding. Also, the effects of over or under recovering or allocating costs should be part of the methodology to set future rates and allocations.

Develop Methods to Track Costs

Since many of allocations and recoveries indirectly involve federal grants and contracts, Human Resources needs to document and show that their allocations and recoveries represent actual costs incurred. While allocations and recoveries are initially estimates of costs, there must be a periodic analysis to show that these estimates reflect actual costs incurred. While adjustments to allocations and recoveries for over or under recoveries may occur, they cannot happen until after a comparison of actual to estimated cost occurs.

Normally, the comparison occurs annually before an entity implements changes in the allocation or recoveries.

The most significant cost within both the allocations and recoveries is salary and fringe benefit costs. There are several methods of tracking salary costs. Those methods include time sheets, verification of the percentage of time worked, and sampling verification of duties performed. While any of these methods are acceptable, all have their inherent difficulties and require that all personnel properly follow the process set out by management. However, while the federal government allows several allocation and recovery methods, the federal government normally requires the adoption and compliance with only one time monitoring process.

The method adopted to monitor and track time for salaries is acceptable for tracking fringe benefit costs. The allocation of tracking other actual costs should allow for easy comparison with estimates for the allocation or recovery methodology.

Evaluate Accounting Needs

While Human Resources has not formally established an internal service fund, the collection for services and recovery of overhead cost is occurring. Therefore, Human Resources needs to begin the process of accumulating the information to accomplish the documentation of methodologies and tracking costs. Within its current framework, Management needs to determine if it has sufficient accounting information to implement this process.

Additionally, part of this evaluation is the consistent recording the allocations and recoveries as either revenue or expenditure refunds for all activities. Appropriate accounting treatment needs to apply to all activities and forms of collections.

AGENCY HIGHLIGHTS

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

Administrative Financial Activity

Human Resource received total resources of approximately \$9.4 million in fiscal year 2011 of which personnel expenses account for \$7.6 million, or 81 percent. The majority of the remaining expenses are for contractual services and continuous charges such as rental and insurance payments.

Tables 1, 2, and 3 (below) summarize Human Resource's financial activity for fiscal year 2009, 2010, and 2011. The majority of the increase in general fund original to final budget in FY 2010 and 2011 resulted from an increase to offset Virginia Information Technologies Agency (VITA) rate changes. Actual expenses in 2009 and 2010 were less than the adjusted budget primarily due to management's practices that anticipated budget reductions, while increases in appropriated amounts during Fiscal 2011 result from Human Resource operating and transferring the CommonHealth program in-house.

Table 1

Analysis of Budgeted to Actual Funding – Fiscal Year 2009

<u>Fund</u>	<u>Original Budget</u>	<u>Final Budget</u>	<u>Actual Expenses</u>
General	\$5,424,537	\$ 4,918,514	\$4,918,323
Special	3,398,895	5,580,046	4,334,312
Trust and Agency	<u>1,172,555</u>	<u>1,311,068</u>	<u>628,845</u>
Total	<u>\$9,995,987</u>	<u>\$11,809,628</u>	<u>\$9,881,480</u>

Source: Commonwealth Accounting and Reporting System

Table 2

Analysis of Budgeted to Actual Funding – Fiscal Year 2010

<u>Fund</u>	<u>Original Budget</u>	<u>Final Budget</u>	<u>Actual Expenses</u>
General	\$5,424,537	\$ 4,216,022	\$4,172,459
Special	3,398,895	5,812,901	4,534,210
Trust and Agency	<u>1,172,555</u>	<u>1,353,822</u>	<u>592,374</u>
Total	<u>\$9,995,987</u>	<u>\$11,382,745</u>	<u>\$9,299,043</u>

Source: Commonwealth Accounting and Reporting System

Table 3

Analysis of Budgeted to Actual Funding – Fiscal Year 2011

<u>Fund</u>	<u>Original Budget</u>	<u>Final Budget</u>	<u>Actual Expenses</u>
General	\$ 3,866,615	\$ 4,212,630	\$4,212,630
Special	5,812,901	6,142,901	4,568,132
Trust and Agency	<u>1,353,822</u>	<u>1,353,822</u>	<u>683,280</u>
Total	<u>\$11,033,338</u>	<u>\$11,709,353</u>	<u>\$9,464,042</u>

Source: Commonwealth Accounting and Reporting System

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 Human Resource. The annual report presents the Local Choice activity as an Enterprise Fund and the State Health Insurance activity as an Internal Service Fund.

In addition, we issued a separate report Review of the State Employees Health Insurance Fund dated October, 2011. This report is an in depth review of the Commonwealth's Health Benefit program.

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 Human Resource. 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 Human Resource tracks using an in-house database.

Human Resource 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. Human Resource 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.

The financial results of the program are part of the Commonwealth's Annual financial report.



Commonwealth of Virginia

Auditor of Public Accounts

Walter J. Kucharski
Auditor of Public Accounts

P.O. Box 1295
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February 1, 2012

The Honorable Robert F. McDonnell
Governor of Virginia

The Honorable Charles J. Colgan
Chairman, Joint Legislative Audit
and Review Commission

We have audited the financial records and operations of the Department of **Human Resource Management** (Human Resource) for the three years ended June 30, 2011. 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 the recorded financial transactions on the Commonwealth Accounting and Reporting System, determine if Human Resource had adequate internal controls, and test Human Resource's compliance with applicable laws and regulations.

Audit Scope and Methodology

Human Resource'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 and classes of transactions and their recording in the appropriate accounts.

Payroll and other disbursements

Recovery of cost of providing administrative services to other agencies and the Health Insurance Trust and Workers' Compensation Fund

Appropriations

Network Security

We performed audit tests to determine whether Human Resource'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 Human Resource's operations. We tested transactions and performed analytical procedures, including budgetary and trend analyses.

Conclusions

We found that Human Resource properly recorded financial transactions in the Commonwealth Accounting and Reporting System.

We noted matters involving internal control and its operation that requires management's attention and corrective action. These matters are described in the section entitled "Audit Finding and Recommendation." 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.

Exit Conference and Report Distribution

We discussed this report with management on February 14, 2012. 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.

AUDITOR OF PUBLIC ACCOUNTS

WJK/clj



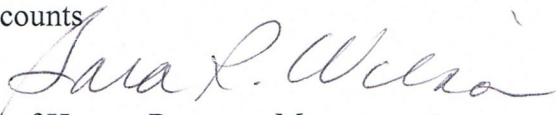
COMMONWEALTH of VIRGINIA

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TO: Walter J. Kucharski
Auditor of Public Accounts

FROM: Sara R. Wilson 
Director, Department of Human Resource Management

DATE: February 21, 2012

RE: Audit of Department of Human Resource Management

Thank you for the opportunity to respond to the recent audit of the Department of Human Resource Management (DHRM). The assertion that DHRM has "proper recording and reporting of all transactions in the Commonwealth Accounting and Reporting System" is appreciated. However, the matters involving internal control and operations identified three separate categories; document allocation and recovery methodologies, develop methods to track costs, and evaluate accounting needs. We feel that these three items are in fact one recommendation which should be labeled "improve documentation of policies".

DHRM will improve the documentation of policies and practices. We look forward to working with the Department of Accounts and Department of Planning and Budget to improve agency practices.

DEPARTMENT OF HUMAN RESOURCE MANAGEMENT

Sara Redding Wilson, Director

Dan Hinderliter, Director
Office of Contracts and Finance

George Gibbs, CFO
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