



DEPARTMENT OF HUMAN RESOURCE MANAGEMENT

REPORT ON AUDIT FOR THE YEAR ENDED JUNE 30, 2024

Auditor of Public Accounts
Staci A. Henshaw, CPA

www.apa.virginia.gov
(804) 225-3350



AUDIT SUMMARY

Our audit of the Department of Human Resource Management (Human Resource Management) for the year ended June 30, 2024, found:

- proper recording and reporting of all transactions, in all material respects, related to the State Health Plans Program for Pre-Medicare Retirees, the Health Insurance Fund, the Local Choice Health Care Fund, the Line of Duty Act Fund, and the Workers' Compensation Fund, in the Commonwealth's accounting and financial reporting system, in Human Resource Management's accounting records, and in supplemental information and attachments submitted to the Department of Accounts (Accounts), after adjustment for the misstatements noted in the finding "Strengthen Controls over Financial Reporting";
- three matters involving internal control and its operation necessary to bring to management's attention; two of which are considered a significant deficiency and one that is considered a material weakness;
- no instances of noncompliance with applicable laws and regulations or other matters that are required to be reported; and
- adequate corrective action with respect to two prior audit findings and recommendations identified as complete in the [Findings Summary](#) included in the Appendix.

In the section titled "Internal Control and Compliance Findings and Recommendations" we have included our assessment of the conditions and causes resulting in the internal control and compliance findings identified through our audit as well as recommendations for addressing those findings. Our assessment does not remove management's responsibility to perform a thorough assessment of the conditions and causes of the findings and develop and appropriately implement adequate corrective actions to resolve the findings as required by Accounts in Topic 10205 – Agency Response to APA Audit of the Commonwealth Accounting Policies and Procedures Manual. Those corrective actions may include additional items beyond our recommendation.

Human Resource Management is one of several entities cited in a risk alert in Accounts' fiscal year 2024 audit report. The "Financial Reporting" risk alert identifies the increased risk that the Commonwealth may not meet the deadline for the Annual Comprehensive Financial Report, which could jeopardize the Commonwealth's bond rating, because multiple agencies have increasingly submitted inaccurate and late financial information to Accounts over the past several fiscal years. As an entity that is contributing to this increased risk for the Commonwealth, Human Resource Management's corrective action to correct the issues in the finding "Strengthen Controls over Financial Reporting" is essential to reducing the risk to the Commonwealth.

- TABLE OF CONTENTS -

	<u>Pages</u>
AUDIT SUMMARY	
INTERNAL CONTROL AND COMPLIANCE FINDINGS AND RECOMMENDATIONS	1-5
AUDIT SCOPE OVERVIEW	5
INDEPENDENT AUDITOR'S REPORT	6-9
APPENDIX – FINDINGS SUMMARY	10
AGENCY RESPONSE	11-12

INTERNAL CONTROL AND COMPLIANCE FINDINGS AND RECOMMENDATIONS

Strengthen Controls over Financial Reporting

Type: Internal Control

Severity: Material Weakness

First Issued: Fiscal Year 2022

The Department of Human Resource Management (Human Resource Management) needs to strengthen internal controls over financial information submitted to the Department of Accounts (Accounts). The Finance and Administration Division (Finance and Administration) is responsible for submitting information to Accounts, including attachments and supplemental information items that Accounts uses to prepare the Commonwealth's financial statements and required disclosures. Multiple submissions to Accounts contained significant errors that Finance and Administration did not identify during its review process.

Human Resource Management reports financial activity related to the Health Insurance Fund to Accounts on the Internal Service Fund (Internal Service) and Internal Service Funds – Conversion to Government-wide Statement of Activities (Conversion) Attachments. Accounts uses the information in these attachments to prepare the Commonwealth's financial statements. Human Resource Management reported \$1.9 billion in claims expense for the Health Insurance Fund in fiscal year 2024. Finance and Administration resubmitted the attachments to correct the following errors:

- Finance and Administration overstated premium revenue from internal entities by \$160.5 million in part one of the Conversion Attachment.
- Finance and Administration understated premium revenue from external entities by \$143.5 million in step two of the Conversion Attachment.
- Finance and Administration understated claims expense from external entities by \$116.9 million in part three of the Conversion Attachment.
- Finance and Administration did not consistently classify drug rebates, resulting in a \$44.7 million adjustment to reclassify claims expense on the Internal Service Attachment.
- Finance and Administration did not accrue a drug rebate receivable, resulting in an overstatement of claims expense of \$32.2 million on the Internal Service Attachment.

Human Resource Management reports financial activity related to the Local Choice Health Care Fund on the Enterprise Fund (Enterprise) Attachment. Accounts uses the information in this attachment to prepare the Commonwealth's financial statements. Human Resource Management reported \$521.8 million in claims expense for the Local Choice Health Care Fund in fiscal year 2024. Finance and Administration resubmitted the Enterprise Attachment to correct the following errors:

- Finance and Administration did not properly accrue a drug rebate receivable, resulting in an overstatement of claims expense of \$13.8 million on the Enterprise Attachment.
- Finance and Administration did not consistently classify drug rebates, resulting in a \$12.4 million adjustment to reclassify claims expense on the Enterprise Attachment.

Human Resource Management reports financial activity related to the Workers' Compensation Fund on the Internal Service and Conversion Attachments and Internal Service Claims Payable Supplemental Item. Accounts uses the information in these attachments and supplemental item to prepare the Commonwealth's financial statements. Human Resource Management reported \$44.6 million in claims expense for the Worker's Compensation Fund in fiscal year 2024. Finance and Administration resubmitted the Internal Service and Conversion Attachments and Internal Service Claims Payable Supplemental Item to correct the following errors:

- Finance and Administration understated its claims payable balance at year-end by \$176.6 million on the Internal Service Claims Payable Supplemental Item.
- Finance and Administration did not properly allocate revenue, resulting in an understatement of Receipts from Other Funds of \$30.7 million and an overstatement of Receipts for Sales and Services of \$30.7 million on the Internal Service Attachment.
- Finance and Administration omitted \$18.6 million in operating expenses from part three of the Conversion Attachment.

Finance and Administration also needs improve its review of financial transactions entered into the Commonwealth's accounting and financial reporting system. Finance and Administration recorded an expense voucher to the incorrect fund, resulting in an overstatement of claims expense of \$32.3 million for the Local Choice Health Care Fund and an equal understatement of claims expense for the Health Insurance Fund.

The Commonwealth Accounting Policies and Procedures (CAPP) Manual Topic 20905 states that agency management is responsible for instituting internal control over the recording of financial transactions that is designed to provide reasonable assurance regarding the reliability of those records. Human Resource Management's financial activity is material to the Commonwealth's financial statements; therefore, it is essential for the agency to have strong internal controls and financial reporting practices. Insufficient internal control increases the risk of Human Resource Management reporting inaccurate information in the Commonwealth's financial statements.

Finance and Administration is responsible for procurement and financial accounting and reporting. Both functions have experienced significant turnover and continue to be understaffed despite Human Resource Management's attempts to hire and retain staff. The lack of staffing resources in these functions resulted in the remaining staff managing several competing mission-critical functions at once. Additionally, Finance and Administration does not have sufficient policies and procedures to ensure

accurate and complete financial reporting. These issues contributed to the errors identified and corrected during the audit.

Human Resource Management should continue to fill vacant positions in Finance and Administration to ensure staffing levels are adequate for the division. Additionally, Finance and Administration should revise its written policies and procedures to ensure they provide adequate instruction needed to report financial information accurately and completely. Finally, Finance and Administration should improve its managerial review of financial transactions and financial reporting information submitted to Accounts.

Improve Controls over Health Insurance Premium Revenue Reconciliations

Type: Internal Control

Severity: Significant Deficiency

The Finance and Administration Division needs to improve its policies and procedures for preparing monthly health insurance premium revenue reconciliations. Each month, Finance and Administration performs a revenue reconciliation and revenue reasonableness review using actual health insurance enrollment figures from the Commonwealth’s human resource and payroll management system and the premium revenue recorded in the Commonwealth’s accounting and financial reporting system. For the two randomly selected months tested, reconciliation amounts did not agree to source documentation. Further, Finance and Administration did not investigate and explain significant reconciling differences between the two sources. Additionally, there was no evidence of when the reconciliation was performed nor evidence of review by a separate individual.

CAPP Manual Topic 20905 requires agency management to institute internal control over the recording of financial transactions that is designed to provide reasonable assurance regarding the reliability of those records. Additionally, it requires agencies to “publish [their] own internal policies and procedures documents, approved in writing by agency management. The lack of complete and up-to-date internal policies and procedures, customized to reflect the agency’s staffing, organization, and operating procedures, reflects inadequate internal control.”

Human Resource Management’s financial activity is material to the Commonwealth’s financial statements, so it is essential for the agency to have strong internal controls. Finance and Administration should perform an adequate review and retain evidence of a separate preparer and reviewer to demonstrate adequate segregation of duties. The procedures should also define a threshold over which reconciling differences are considered significant and specify actions the preparer should take in the case of significant reconciling differences between actual health insurance enrollment figures from the Commonwealth’s human resource and payroll management system and the premium revenue recorded in the Commonwealth’s accounting and financial reporting system.

Several factors contributed to the errors identified, including significant turnover in key positions within Finance and Administration. Human Resource Management recruited new staff during the audit period for positions that were historically responsible for preparing the reconciliation. However, the

employees did not follow documented policies and procedures, and management did not perform an adequate and timely review of the reconciliations as required by policies and procedures.

Management should continue to fill vacant positions to ensure a more stable and adequate staffing level. As Finance and Administration fills vacant positions, it should ensure it has adequate written policies and procedures in place over key processes and identifies opportunities for cross-training to ensure there are sufficient measures in place to mitigate the effects of potential turnover in the future. Finance and Administration should also properly train and supervise new employees in key positions to ensure the accuracy of financial information and to identify any potential issues or errors in recording health insurance premium revenue.

Improve Third-Party Service Provider Oversight

Type: Internal Control

Severity: Significant Deficiency

Human Resource Management relies on service providers to administer benefits provided under the State Health Insurance Plan, the Local Choice Health Plan, the Line of Duty Act Plan, and the Workers' Compensation Program. Human Resource Management did not obtain and review system and organization controls (SOC) reports for all service providers that administer benefits on Human Resource Management's behalf. Specifically, Human Resource Management was not able to provide evidence that it received a SOC report for one of its service providers nor was it able to provide a completed SOC assessment for that vendor. Additionally, Human Resource Management could not provide evidence that it reviewed a vendor-prepared SOC assessment for an additional service provider.

SOC reports, specifically SOC 1, Type 2 reports, provide an independent description and evaluation of the operating effectiveness of service providers' internal controls over financial processes and are a key tool in gaining an understanding of a service provider's internal control environment and maintaining oversight over outsourced operations. Human Resource Management contracts with a vendor to perform annual reviews of relevant SOC reports and provide its assessment through a report checklist. Human Resource Management reviews the SOC report assessments provided to it by the vendor.

CAPP Manual Topic 10305 requires agencies to have adequate interaction with service providers to appropriately understand the service provider's internal control environment. Agencies must also maintain oversight of service providers to gain assurance over outsourced operations. Agencies must annually certify to Accounts that they have maintained oversight of service providers through review of SOC reports.

Without sufficient review of SOC reports, Human Resource Management cannot ensure its complementary user entity controls are sufficient to support reliance on the service providers' control design, implementation, and operating effectiveness. By not obtaining the necessary SOC reports and documenting its review of the reports, Human Resource Management is increasing the risk that it will not detect a weakness in a service provider's environment. Human Resource Management did not perform a review of all SOC reports because it has not clearly assigned responsibility for obtaining and

reviewing SOC reports and assessments. Additionally, its policies do not define a timeframe for obtaining and reviewing SOC reports.

Human Resource Management should obtain, review, and document an assessment of SOC 1, Type 2 reports for service providers that significantly affect its financial activity. Additionally, Human Resource Management should ensure its policies clearly define the parties responsible for obtaining and reviewing SOC reports. Policies and procedures should also comply with the requirements outlined in the CAPP Manual and should include, but not be limited to, the timeframes for obtaining SOC reports from the service provider. Finally, Human Resource Management should ensure it retains evidence of the receipt and review of applicable SOC reports.

AUDIT SCOPE OVERVIEW

Human Resource Management administers the Commonwealth's Personnel Act, health insurance plans for state and local employees, and 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 workforce and provides a listing of state employment opportunities.

The agency submits financial information to the Department of Accounts for inclusion in the Commonwealth's Annual Comprehensive Financial Report (ACFR). Significant funds applicable to Human Resource Management include the Health Insurance Fund, the Local Choice Health Care Fund, the Line of Duty Act Fund, and the Workers' Compensation Fund. Human Resource Management's Office of Finance and Administration contracts with actuaries to perform annual valuations for estimates of claims incurred but not reported (IBNR) for each fund. IBNR claims represent the amount owed for valid unreported claims as of fiscal year-end, which significantly impact Human Resource Management's financial activity for the fiscal year under audit. Additionally, Human Resource Management is responsible for providing other state agencies with schedules and footnote disclosure templates for the State Health Plans Program for Pre-Medicare Retirees related to Governmental Accounting Standards Board (GASB) Statement No. 75.

Audit procedures are performed to ensure that applicable amounts and disclosures within the ACFR are accurate and complete based on data recorded in the Commonwealth's accounting and financial reporting system and other supporting documentation. The audit also aims to verify that the design and implementation of related internal controls is adequate and reasonable. This includes a review of information system access and security over significant systems.



Staci A. Henshaw, CPA
Auditor of Public Accounts

Commonwealth of Virginia

Auditor of Public Accounts

P.O. Box 1295
Richmond, Virginia 23218

December 13, 2024

The Honorable Glenn Youngkin
Governor of Virginia

Joint Legislative Audit
and Review Commission

Margaret "Lyn" McDermid
Secretary of Administration

Janet Lawson
Director, Department of Human Resource Management

We have audited the financial records and operations of the **Department of Human Resource Management** (Human Resource Management) for the year ended June 30, 2024. 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 Comprehensive 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 Annual Comprehensive Financial Report for the Commonwealth of Virginia for the year ended June 30, 2024, which includes the State Health Plans Program for Pre-Medicare Retirees, the Health Insurance Fund, the Local Choice Health Care Fund, the Line of Duty Act Fund, and the Workers' 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 supplemental information and attachments submitted to the Department of Accounts (Accounts); reviewed the adequacy of Human Resource Management's internal control; tested for compliance with applicable laws, regulations, contracts, and grant agreements; and reviewed corrective actions with respect to audit findings and recommendations from prior year reports.

Audit Scope and Methodology

Management of Human Resource Management has responsibility for establishing and maintaining internal control and complying with applicable laws, regulations, contracts, and grant 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, contracts, and grant 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
- Actuarial reporting
- Information systems security
- Financial reporting
- Claims expenses
- Service organization monitoring

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, contracts, and grant 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, and tested details of transactions to achieve our audit objectives. We also confirmed IBNR estimates with outside parties.

A nonstatistical 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 (internal control) was for the limited purpose described in the section “Audit Objectives” and was not designed to identify all deficiencies in internal control 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 titled “Internal Control and Compliance Findings and Recommendations,” we identified certain 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. We consider the deficiency titled "Strengthen Controls over Financial Reporting," which is described in the section titled "Internal Control and Compliance Findings and Recommendations," to be a material weakness.

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. We consider the deficiencies titled "Improve Controls over Health Insurance Premium Revenue Reconciliations" and "Improve Third-Party Service Provider Oversight," which are described in the section titled "Internal Control and Compliance Findings and Recommendations," to be significant deficiencies.

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 attachments submitted to Accounts for inclusion in the Commonwealth's Annual Comprehensive Financial Report, after adjustment for the misstatements noted in the finding titled "Strengthen Controls over Financial Reporting."

We noted certain matters involving internal control and its operation and compliance with applicable laws, regulations, contracts, and grant agreements that require management's attention and corrective action. These matters are described in the section titled "Internal Control and Compliance Findings and Recommendations."

Human Resource Management has taken adequate corrective action with respect to prior audit findings and recommendations identified as complete in the [Findings Summary](#) included in the Appendix.

Since the findings noted above include those that have been identified as material weaknesses and significant deficiencies, they will be reported as such in the "Independent Auditor's Report on Internal Control over Financial Reporting and on Compliance and Other Matters Based on an Audit of the Financial Statements Performed in Accordance with Government Auditing Standards," which is included in the Commonwealth of Virginia's Single Audit Report for the year ended June 30, 2024. The Single Audit Report will be available at www.apa.virginia.gov in February 2025.

Exit Conference and Report Distribution

We discussed this report with management at an exit conference held on February 3rd, 2025. Government Auditing Standards require the auditor to perform limited procedures on Human Resource Management's response to the findings identified in our audit, which is included in the accompanying section titled "Agency Response." Human Resource Management's response was not subjected to the other auditing procedures applied in the audit and, accordingly, we express no opinion on the response.

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.

Staci A. Henshaw
AUDITOR OF PUBLIC ACCOUNTS

SDB/clj

FINDINGS SUMMARY

Finding Title	Status of Corrective Action*	First Reported for Fiscal Year
Improve Controls over GASB Statement No. 75 Financial Information Review	Complete	2023
Improve IT Risk Management and Contingency Planning Program	Complete	2023
Strengthen Controls Over Financial Reporting	Ongoing	2022
Improve Controls over Health Insurance Premium Revenue Reconciliations	Ongoing	2024
Improve Third-Party Service Provider Oversight	Ongoing	2024

* A status of **Complete** indicates management has taken adequate corrective action. **Ongoing** indicates new and/or existing findings that require management's corrective action as of fiscal year end.



JANET L. LAWSON
DIRECTOR

COMMONWEALTH OF VIRGINIA
Department Of Human Resource Management

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

February 5, 2025

Ms. Staci A. Henshaw, CPA
The Auditor of Public Accounts
P. O. Box 1295
Richmond, Virginia 23218

Dear Ms. Henshaw:

Thank you for the opportunity to respond to the annual audit of the Department of Human Resource Management (DHRM) for the year ended June 30, 2024. We have reviewed the findings identified in the report and DHRM's responses are below.

We acknowledge that the APA Financial Audit Report has four flaws. The financial activity shown in the financial statement attachments created for the Health Insurance Fund, Workers Compensation, and The Local Choice is the first area of weakness. We recognize the need to strengthen controls over the reconciliation of health insurance premium revenue. Our written policies and procedures pertaining to conflict-of-interest training requirements need to be improved, which brings us to our third weakness. The fourth weakness is acquiring and reviewing Service Organization Control reports. Corrective measures have already been identified and are something we are committed to implementing.

As stated in the APA's audit report, our financial staff plans to address the weaknesses that have been found. We also recognize the value of recording the relevant procedures. And have begun documenting all of our procedures. We are committed to quickly addressing any remaining flaws.

Like FY 23, we experienced multiple permanent staffing departures in FY 24, which resulted in vacancies. Early in FY 24, the entire procurement team left for other positions. This left the CFO to finalize several high-risk contracts. We promptly hired a financial analyst in December after an accounting specialist was reclassified as a financial analyst in early FY 24; however, the position was vacated once more in July 2024. Shortly after the year-end attachments were submitted in September, the other financial analyst departed. As a result, there was no financial analyst in the finance department from July to January. The CFO was then left to review the attachments for corrections and work with the fiscal manager to make any necessary changes. As of today, we are fully staffed and are optimistic our staff will remain for a long period of time.

To prepare for the FY25 year-end audit, the fiscal staff has gathered to review the policies and procedures and talk about any changes. The fiscal staff will investigate every item that was identified as a weakness. To improve controls over Health Insurance Premium Revenue reconciliations and address the first and second weaknesses for financial activity reported on the financial statement attachments and the revenue reconciliations, we have scheduled a training every Tuesday. During these scheduled meetings/training

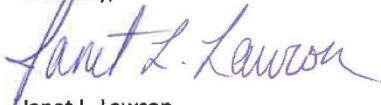
An Equal Opportunity Employer

we will go over each attachment, review each reconciliation, profit and loss statements etc. The main issue on the revenue reconciliation, was DHRM was not receiving the decentralized agencies reconciliation each month. We have contacted each agency and begun monitoring the receipts of monthly reconciliations to DHRM. We have also set up a workbook to assist in tracking premiums paid as opposed to premiums charged which will show the amount that needs to be accrued at the end of the year. Through this training the new financial analysts will gain practical knowledge about the attachments and be able to examine each one for problems. Additionally, this will give the fiscal manager and CFO information to check the submissions for accuracy. This will draw attention to the problems and investigate the reasons behind the errors to insure they do not occur in FY 2025.

We acknowledge the deficiencies found in the examination of the Service Organization Control reports. The ARMICS Audit was moved from July start to a January start. Based on the change in performance period it may have caused some confusion with the receipt of each SOC Reports. Finance has created a schedule of the SOC reports and their measurement period and the receipt dates of each report. This will allow Finance Team to follow-up with the consultants prior to the audit of any reports that have not been received and reviewed.

DHRM remains committed to continuous improvement and thanks your staff and you for all your assistance and guidance during our review. I appreciate the work of your team and APA's recommendations.

Sincerely,

A handwritten signature in blue ink that reads "Janet L. Lawson". The signature is written in a cursive style with a large initial "J".

Janet L. Lawson
Director