

**VIRGINIA RETIREMENT SYSTEM
RICHMOND, VIRGINIA**

**REPORT ON AUDIT
FOR THE YEAR ENDED
JUNE 30, 2000**



AUDIT SUMMARY

Our audit of the Virginia Retirement System for the year ended June 30, 2000, found:

- the financial statements are presented fairly in all material respects;
- no instances of noncompliance with material laws and regulations that are required to be reported;
- a certain matter we consider a reportable condition; however, we do not consider this matter to be material weaknesses in internal control; and,
- adequate implementation of corrective action on prior audit findings, except as noted in the finding entitled “Improve Monitoring Over Plan Administrator Performance for the Sickness And Disability Program.”

Our audit finding includes issues that we explain in detail in the section entitled “Internal Control Findings and Recommendations.”

INTERNAL CONTROL FINDINGS AND RECOMMENDATIONS

Improve Monitoring Over Plan Administrator Performance for the Sickness And Disability Program

The System contracted with a third party to administer the Virginia Sickness and Disability Program (VSDP) beginning December 31, 1998. The administrator's responsibilities include providing case management services; managing, controlling, and adjudicating the non-work related disability claims; issuing long term benefit payments, assisting with litigation management; social security disability consulting, and providing appeals handling resolution. While the contract specifically outlines performance requirements, the System's current policies are not sufficient to adequately monitor or ensure the performance of the administrator.

Our audit found the following issues:

- Several of the long-term disability participants received incorrect payments, four of fifty-eight tested. The System relies on the administrator to make these calculations as well as the payments. Inaccurate payments can negatively impact the Commonwealth and the participant.
- The administrator did not always provide accurate or prompt information to state agencies and institutions. Statewide fieldwork revealed some human resource officers did not receive documentation from the administrator timely, resulting in short-term disability overpayments. Fieldwork also identified cases where human resource officers received incorrect action reports causing either early or late benefit payments. The System believes many of the reporting problems maybe related to delays caused by doctors not promptly returning requested information and poorly designed communication procedures with in the agencies. However, we do not have information to support or dispute this belief.
- Finally, test work found the administrator incorrectly reporting the results of the October 1999 Agency and Employee satisfaction surveys. Inaccurate reporting impedes the System's ability to effectively monitor the administrator.

Our findings are the same as an external analysis performed by Watson and Wyatt for the System. This analysis found the VSDP administrator's procedures were below expected standards in seven of twelve areas. These areas included turnaround time on claims, reporting by the administrator to the System, documentation of communication log, internal audit procedures at the administrator, and documentation of implementation of the program.

The System has recognized the need to improve its monitoring procedures and decided to expand its quarterly review process over the administrator. Previous reviews have covered long-term disability payments, the processes and procedures for short-term disability, and monitoring of customer service representatives and registered case management nurses. The System's Contract Assurance Unit plans to increase its sample sizes and require the administrator document and report correction resolution of identified errors to the System within a specified timeframe.

In addition, the System is working with the administrator to document its controls over the long-term disability program and on ways to improve the long-term disability payment process. The System and administrator are also analyzing methods to communicate short-term disability information to agencies and institutions, including web-enabled reporting, to improve the timeliness of information. Finally, beginning in

2001, an outside vendor, instead of the administrator, will tabulate customer satisfaction survey results and present the findings to the System.

With these expanded procedures, as the System identifies instances of noncompliance with contract requirements, they should assess the penalties the contract provides. Improving these procedures and the administrator's compliance with service delivery requirements will help ensure the proper distribution of VSDP benefits whether they fall under short-term or long-term disability.

September 22, 2000

The Honorable James S. Gilmore, III
Governor of Virginia

The Honorable Vincent F. Callahan, Jr.
Chairman, Joint Legislative Audit
and Review Commission

The Board of Trustees
Virginia Retirement System

INDEPENDENT AUDITOR'S REPORT ON COMPLIANCE AND ON INTERNAL CONTROL OVER
FINANCIAL REPORTING

We have audited the general-purpose financial statements of the **Virginia Retirement System** as of and for the year ended June 30, 2000, and have issued our report thereon dated September 22, 2000. Our report on the general-purpose financial statements is contained in the Comprehensive Annual Financial Report issued by the Virginia Retirement System. We conducted our audit in accordance with generally accepted auditing standards and the standards applicable to financial audits contained in Government Auditing Standards, issued by the Comptroller General of the United States.

Compliance

As part of obtaining reasonable assurance about whether the System's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, and contracts, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance that are required to be reported under Government Auditing Standards.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the System's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. However, we noted a certain matter involving the internal control over financial reporting and its operation that we consider to be a reportable condition. Reportable conditions involve matters coming to our attention relating

to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect the System's ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial statements. The reportable condition, entitled "Improve Monitoring Over Plan Administrator Performance for the Sickness And Disability Program" is described in the section titled "Internal Control Findings and Recommendations."

We believe that the reportable condition described above is not a material weakness. A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses.

Status of Prior Findings

The System has not taken adequate corrective action with respect to the previously reported finding, "Monitor Plan Administrator Performance for the Sickness and Disability Program." Accordingly, we included this finding in the section entitled "Internal Control Finding and Recommendation." The System has taken adequate corrective action with respect to audit findings reported in the prior year that are not repeated in this report.

The Independent Auditor's Report on Compliance and on Internal Control Over Financial Reporting is intended solely for the information and use of the Governor and General Assembly of Virginia, Board of Trustees and management, and is not intended to be and should not be used by anyone other than these specified parties. However, this report is a matter of public record and its distribution is not limited.

EXIT CONFERENCE

We discussed this report with management at an exit conference held on November 3, 2000.

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Richmond, Virginia

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