

**VIRGINIA INFORMATION PROVIDERS
NETWORK AUTHORITY
RICHMOND, VIRGINIA**

**REPORT ON AUDIT
FOR THE YEAR ENDED
JUNE 30, 2003**



AUDIT SUMMARY

Our audit of the Virginia Information Providers Network Authority for the year ended June 30, 2003, found:

- the accompanying financial statements present fairly, in all material respects, VIPNet's financial position as of June 30, 2003, and the changes in its financial position and its cash flows for the year then ended, in conformity with generally accepted accounting principles;
- no material weaknesses in the internal control over financial reporting; and
- no instances of noncompliance with material laws and regulations that are required to be reported.

Overview of the Authority's Service Vendor, Virginia Interactive

Through a public solicitation process in 1997, the Virginia Information Providers Network Authority (Authority) entered into a contract with Virginia Interactive, LLC (Interactive) to serve as the Authority's network manager. Interactive provides all the investment capital to develop the network and charges service fees to fund its operation. Interactive employs its own staff who performs web development and programming, systems administration, marketing, accounting, and graphic design.

The Authority has an 11 member Board and two staff. The Department of Information Technology (now known as VITA) provides administrative services for the Authority such as maintaining accounting records, processing payroll, paying state entities their revenues from Interactive activities, and paying Interactive for their services. Interactive deposits all its collection for services including on-line transactions into the Authority's bank account. The Authority holds these funds in trust for distribution to the various users of Interactive's services.

Interactive works with various state and local entities to design their web pages and to facilitate on-line sales. Before providing any service, Interactive negotiates a service charge with the entity, which can be a flat dollar amount or a percentage. Interactive agrees to manage the collection of on-line sales and then transfer the sales revenue to the entity each month. In a few instances, Interactive has agreed to allow the entity to collect their own revenue and Interactive bills the entity for their service charge. Further, Interactive has also agreed with some entities to have the Authority pay the sales revenue more often than monthly because the entity needs the revenue for cash flow purposes.

An example of a service provided by Interactive is on-line gift shop sales for the Library of Virginia. Buyers can use a credit card to shop on-line from the Library's gift shop website. Interactive collects the purchase amount electronically and deposits it into the Authority's bank account. At month end, Interactive requests the Authority to pay a portion of the sales amount to the Library of Virginia. Interactive then bills the Authority for their fee for providing the service for the Library.

Interactive also facilitates outside organizations access to public information and collects an on-line fee for this service. For example, insurance companies pay fees to Interactive to inquire about driving records. Interactive collects the fee for this service and deposits it into the Authority's bank account. Interactive then requests the Authority to transfer a portion of the fee to the Department of Motor Vehicles. Again, Interactive bills the Authority for their fees for providing this service.

In fiscal year 2003, Interactive collected \$34 million in on-line revenue from a variety of sources with the largest source being insurance companies with driving record inquiries. Of the \$34 million collected and deposited into the Authority's bank account, Interactive requested the Authority to transfer about \$28 million

to other entities. Interactive also billed the Authority about \$6 million as payment for their fees. Based on Interactive's financial report, their operating expenses are about \$2 million, which results in a net profit to Interactive of nearly \$4 million annually.

Lack of Revenue Accounting System and Internal Controls leads to Transfer and Billing Errors

Our review found that Interactive does not have a revenue accounting system, as defined and required by the contract between Interactive and the Authority. In addition, there are no formal accounting policies and procedures adopted by Interactive management, only informal and incomplete documentation created by the Interactive accountant to describe how she performs her daily job functions.

The lack of a revenue accounting system has resulted in the Interactive accountant creating a series of informal worksheet reports from network statistical databases, on-line banking records, and credit card transaction files in an inconsistent manner throughout the year. The Authority uses these ad hoc reports as the basis for making payments to entities and for paying Interactive their service fees. We found this manual process has resulted in errors that we cannot resolve due to the lack of an audit trail. Two examples follow.

- We found differences in Interactive records in the amount reported by Interactive as revenue and the deposits into the Authority's bank account. The Interactive accountant described that Interactive approves the payments to entities based on sales recorded on their network, regardless of whether or not Interactive ever collects the cash.

Because Interactive does not have a revenue accounting system that shows unpaid sales, the accountant finds it very difficult to determine whether Interactive ever collects the cash. Also, since the Interactive accountant does not reconcile to the bank statement monthly, there is no documentation of the difference. As a result, we cannot identify and determine the reason for differences in the Interactive reported revenue and cash deposited in the bank.

- The Authority has an undistributed cash balance, which has reached about \$700,000 during fiscal year 2003. Based on the Code of Virginia, the Authority should have minimal cash at year-end because it should have paid the other entities or Interactive its service fee.

The Authority's accountant found that the Interactive accountant did not identify and report as revenue approximately \$500,000 in automated clearinghouse bank credits for fiscal 2003. In effect, Interactive failed to claim this amount as service charges and under billed the Authority by this amount. The Authority and Interactive are resolving this issue and determining if similar errors occurred in the past.

The contract between Interactive and the Authority requires Interactive to maintain an accounting system "to include a numbered chart of accounts, books of original entry of all transactions, appropriate subsidiary ledgers, a general ledger which includes to-date postings, and an audit trail through financial statement. Such books may either be maintained on paper or on computer with appropriate backup."

Maintaining such an accounting system requires written accounting policies and procedures approved by Interactive management. Management creates accounting policies and procedures to communicate the internal control structure designed and approved by management provide guidance on how to handle accounting transactions accurately, completely, and with proper approval. Interactive management's failure to adopt accounting policies and procedures has left the Interactive accountant to create documents and internal controls as she believes necessary.

We recommend that Interactive improve their existing statistical and credit card databases and systems to provide an adequate revenue accounting system as required by the contract. Further, the Interactive management must adopt formal accounting policies and procedures.

Finally, the Authority staff and Board should review the implementation of all these recommendation to ensure accountability to the Commonwealth. If Interactive fails to take action, the Board should review its options under the contract.

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AGENCY RESPONSE

BOARD MEMBERS



Commonwealth of Virginia

Walter J. Kucharski, Auditor

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

January 30, 2004

The Honorable Mark R. Warner
Governor of Virginia

The Honorable Lacey E. Putney
Vice Chairman, Joint Legislative Audit
and Review Commission

The Board of Directors
Virginia Information Providers Network Authority

We have audited the accounts and records of the **Virginia Information Providers Network Authority** as of and for the year ended June 30, 2003, and submit herewith our complete reports on financial statements and compliance and internal control over financial reporting.

INDEPENDENT AUDITOR'S REPORT ON FINANCIAL STATEMENTS

We have audited the accompanying basic financial statements of the **Virginia Information Providers Network Authority** (VIPNet), as of and for the year then ended June 30, 2003, as listed in the Table of Contents. These financial statements are the responsibility of VIPNet's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our 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. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Virginia Information Providers Network Authority as of June 30, 2003, and the changes in its financial position and its cash flows for the year then ended, in conformity with accounting principles generally accepted in the United States of America.

The Virginia Information Providers Network Authority has not presented Management's Discussion and Analysis that the Governmental Accounting Standards Board has determined is necessary to supplement, although not required to be part of, the basic financial statements.

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

In planning and performing our audit of the financial statements of Virginia Information Providers Network Authority as of and for the year ended June 30, 2003, we considered internal controls over financial reporting and tested compliance with certain provisions of laws, regulations and contracts 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.

Compliance

As part of obtaining reasonable assurance about whether VIPNet'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 VIPNet'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. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be material weaknesses. 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. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

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, the VIPNet Board 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 on February 17, 2004.

AUDITOR OF PUBLIC ACCOUNTS

KKH/kva

kva:

VIRGINIA INFORMATION PROVIDERS NETWORK AUTHORITY
STATEMENT OF NET ASSETS
As of June 30, 2003

ASSETS	
Current assets:	
Cash with Treasurer of Virginia (Note 2)	\$ 667,017
Accounts receivable (Note 3)	<u>2,890,536</u>
Total assets	<u>3,557,553</u>
LIABILITIES	
Current liabilities:	
Accounts payable	9,259
Accrued compensated absences (Note 6)	9,671
Due to state agencies (Note 4)	2,428,776
Due to Virginia Interactive (Note 5)	<u>853,556</u>
Total liabilities	<u>3,301,262</u>
NET ASSETS	
Unrestricted	<u><u>\$ 256,291</u></u>

The accompanying Notes to Financial Statements are an integral part of this statements.

VIRGINIA INFORMATION PROVIDERS NETWORK AUTHORITY
STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS
As of June 30, 2003

Operating revenues:	
Charges for services	<u>\$ 5,864,194</u>
Operating expenses:	
Payments to Virginia Interactive	4,741,209
Telecommunication and computer operating services	147,871
Personal expenses	140,079
Rent, insurance, and other related charges	7,615
Other expenses	<u>12,185</u>
Total operating expenses	<u>5,048,959</u>
Operating income	<u>815,235</u>
Nonoperating revenue (expenses) (Note 7):	
Receipts on behalf of others	28,300,238
Payments for receipts collected on behalf of others	<u>(28,300,238)</u>
Total nonoperating income	<u>-</u>
Income before transfers	815,235
Transfer to the General Fund of the Commonwealth	<u>(683,935)</u>
Change in net assets	131,300
Total net assets, June 30, 2002	<u>124,991</u>
Total net assets, June 30, 2003	<u><u>\$ 256,291</u></u>

The accompanying Notes to Financial Statements are an integral part of the financial statements.

VIRGINIA INFORMATION PROVIDERS NETWORK AUTHORITY
STATEMENT OF CASH FLOWS
As of June 30, 2003

Cash flows from operating activities:

Cash receipts from access and subscription fees	\$ 5,923,337
Cash payments for contractual services	(4,845,341)
Cash payments to employees	(138,310)
Cash payments to suppliers for goods and services	<u>(7,561)</u>

Net cash provided by operating activities	<u>932,125</u>
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Cash flows from noncapital financing activities:

Cash transfer out to the General Fund of the Commonwealth	(683,935)
Cash received on behalf of others	28,300,238
Cash payments for receipts collected on behalf of others	<u>(28,300,238)</u>

Net cash used in noncapital financing activities	<u>(683,935)</u>
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Net increase in cash	248,190
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Cash, July 1, 2002	<u>418,827</u>
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Cash, June 30, 2003	<u><u>\$ 667,017</u></u>
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RECONCILIATION OF OPERATING INCOME TO NET CASH PROVIDED
BY OPERATING ACTIVITIES:

Operating income	\$ 815,235
Adjustments to reconcile operating income to net cash provided by operating activities:	
Changes in assets and liabilities:	
(Increase) in accounts receivable	(137,619)
Increase in due to state agencies	196,762
(Decrease) in accounts payable	(796,996)
Increase in due to Virginia Interactive	853,556
Increase in accrued compensated absences	<u>1,187</u>

Net cash provided by operating activities	<u><u>\$ 932,125</u></u>
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The accompanying Notes to Financial Statements are an integral part of the financial statements.

VIRGINIA INFORMATION PROVIDERS NETWORK AUTHORITY

NOTES TO FINANCIAL STATEMENTS

AS OF JUNE 30, 2003

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A. Basis of Presentation

The accompanying financial statements have been prepared in conformance with accounting principles generally accepted in the United States of America as prescribed by the Governmental Accounting Standards Board (GASB) and the Financial Accounting Standards Board (FASB).

B. Reporting Entity

The Virginia Information Providers Network Authority (VIPNet) was created by the General Assembly to help the Commonwealth streamline and enhance the ways in which citizens and businesses access government information and services via the Internet's World Wide Web. The vision of VIPNet is to establish a single, electronic gateway to government information that will improve access to free information while, at the same time, build value-added services for commercially-viable information that is needed by the business community. The accompanying financial statements include all funds over which VIPNet exercises or has the ability to exercise oversight authority. VIPNet has no component units and is a related organization of the Commonwealth and as such is not included in the Commonwealth's Comprehensive Annual Financial Report.

C. Measurement Focus, Basis of Accounting, and Financial Statement Presentation

The financial statements of the proprietary funds are reported using the economic resources measurement focus and the accrual basis of accounting. Revenues are recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows.

Proprietary funds distinguish operating revenues and expenses from nonoperating items. Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with a proprietary fund's principal ongoing operations. Revenues and expenses not meeting this definition are reported as nonoperating.

GASB Statement 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting*, provides governments two options for reporting their proprietary fund activities. All proprietary funds reported herein apply all applicable GASB pronouncements and all FASB statements and interpretations, Accounting Principles Board (APB) opinions and Accounting Research Bulletins (ARB) issued on or before November 30, 1989, unless those conflict with or contradict GASB pronouncements. In accordance with GASB Statement 20, VIPNet has elected not to apply FASB pronouncements issued after November 30, 1989.

D. Budgets and Budgetary Accounting

VIPNet's budget is prepared principally on a cash basis and represents appropriations as authorized by the General Assembly. No payments can be made out of the state treasury, except in pursuance of appropriations made by law.

E. Cash with the Treasurer of Virginia

VIPNet's cash and cash equivalents are considered to be cash with the Treasurer of Virginia.

2. CASH WITH THE TREASURER OF VIRGINIA

All state funds of VIPNet are held by the Treasurer of Virginia, pursuant to Section 2.2 - 1800, et. seq., Code of Virginia, who is responsible for the collection, disbursement, custody, and investment of state funds. The fund's equity in pooled state funds is reported as "Cash with Treasurer of Virginia" on the Statement of Net Assets and is not categorized as to credit risk.

3. ACCOUNTS RECEIVABLE

Accounts receivable consist primarily of the accrual of fees associated with driver's records accessed by insurance companies during the month of June.

4. DUE TO STATE AGENCIES

Due to state agencies are amounts owed by VIPNet to specific state agencies for collection of access and subscription fees. The majority of these collections are due to the Department of Motor Vehicles for driver's records accessed during the month of June.

5. DUE TO VIRGINIA INTERACTIVE

Due to Virginia Interactive consist primarily of net profits owed to Virginia Interactive for services received prior to year-end. Virginia Interactive serves as VIPNet's network manager.

6. COMPENSATED ABSENCES

Accrued compensated absences activity for the year ended June 30, 2003, was as follows:

	<u>Beginning Balance</u>	<u>Additions</u>	<u>Reductions</u>	<u>Ending Balance</u>	<u>Amount Due within One Year</u>
Compensated Absences	<u>\$8,484</u>	<u>\$6,215</u>	<u>\$5,028</u>	<u>\$9,671</u>	<u>\$9,671</u>

7. NON-OPERATING REVENUE AND EXPENSES

VIPNet collects access and subscription fees on behalf of various state agencies and nonstate entities. The largest customer, by far, is the Department of Motor Vehicles. Payments for receipts collected on behalf of others reflect these amounts.

8. RELATED PARTY TRANSACTIONS

Through a public solicitation process in 1997, VIPNet's Board entered into a public/private partnership with Virginia Interactive, LLC, to serve as VIPNet's network manager. Since no tax dollars are used to fund the network, Virginia Interactive provided all the investment capital to develop the network and fund its operations for the first year. Based on the partnership contract, Virginia Interactive retains all net profits, up to the amount provided in the Appropriations Act. Net profits consist of all revenue left over after paying other state agencies for their services and withholding amounts for the reasonable and necessary expenses of the Board. Net profits transferred to Virginia Interactive for the year ending June 30, 2003, totaled \$4,741,209.

9. RETAINED EARNINGS

The Board is allowed to withhold amounts for reasonable and necessary expenses of the Board. In order to have cash available when expenses are incurred, withholding for the Board is a set dollar amount for each month. Any amount withheld and not spent as of June 30, 2003, is classified as Net Assets.

10. PENSION PLAN AND OTHER POST RETIREMENT BENEFITS

Employees of VIPNet are employees of the Commonwealth of Virginia. The employees participate in a defined benefit retirement plan administered by the Virginia Retirement System (VRS). The VRS also administers life insurance and health-related plans for retired employees. Information related to these plans is available at the statewide level only in the Commonwealth of Virginia's Comprehensive Annual Financial Report (CAFR). The Commonwealth of Virginia, not VIPNet, has the overall responsibility for contributions to these plans.

11. RISK MANAGEMENT

VIPNet is exposed to various risks of loss related to torts: theft or, damage to, and destruction of assets; errors and omissions; non-performance of duty; injuries to employees; and natural disasters. VIPNet participates in insurance plans maintained by the Commonwealth of Virginia. The state employee health care and worker's compensation plans are administered by the Department of Human Resource Management and the risk management insurance plans are administered by the Department of Treasury, Division of Risk Management. Risk management insurance includes property, general liability, medical malpractice, faithful performance of duty bond, automobile, and air and watercraft plans. VIPNet pays premiums to each of these Departments for its insurance coverage. Information related to the Commonwealth's insurance plans is available at the statewide level in the Commonwealth of Virginia's Comprehensive Annual Financial Report.



COMMONWEALTH of VIRGINIA

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TDD VOICE- TEL. NO.
371-8076

March 31, 2004

Mr. Walter J. Kucharski
Auditor of Public Accounts
P. O. Box 1295
Richmond, Virginia 23218

Dear Mr. Kucharski:

Thank you for the opportunity to review and comment on the APA's draft report of the audit of the Virginia Information Providers Network Authority for the year ended June 30, 2003. Attached please find our comments, including an action plan of response to the report recommendations.

As always, it was a pleasure to work with your staff, in particular Karen Helderman. If you have any questions or comments, please let us know.

Sincerely,

A handwritten signature in black ink, appearing to read "Lemuel Stewart, Jr.", written in a cursive style.

Lemuel C. Stewart, Jr.
CIO of the Commonwealth

A handwritten signature in black ink, appearing to read "Rodney T. Willett", written in a cursive style.

Rodney T. Willett
VIPNet, General Manager

Attachment

C: Chairman George Newstrom, Information Technology Investment Board

VIPNet of VITA Audit Response

Pursuant to the recent meeting with Karen Helderman from the Auditor of Public Accounts (APA), the following response outlines the actions acceptable to the APA that have been, or will soon be, taken to address the concerns expressed in the APA's audit of VIPNet of VITA and the VIPNet network manager, Virginia Interactive (VI).

1. Revenue Accounting System for Tracking Receivables

VI relies upon an automated system to track all online transactions that flow through VIPNet. That system, which is a customized version of the customer billing software created by VI's parent company, NIC, generates user invoices and provides an electronic accounting and audit trail of all revenue activity through the network since 1998.

However, as the APA identified in this audit, VI's finance staff currently relies upon manual processes to supplement the automated system in order to track receivables. VI is addressing the receivables issue through enhancements to its customer database system scheduled for completion by the end of August 2004. It is important to note that VI assumes the risk of loss on the collection of receivables.

Effective immediately, VI will provide a monthly list of sales by customer to VITA by the 5th day of the following month. This list of monthly sales will be incorporated into a receivables accounting process that will document a roll forward of receivables balances showing current months sales, collections and write-offs. Finally, an aged receivables listing will be developed on a monthly basis and forwarded to VITA by the 5th day of the month beginning July 1st.

2. Transfers of Credit Card-Based Payments to Agencies

The APA audit noted that VI failed to request adequate transfers to VI's account for the online credit card services that VIPNet provides for agencies, where the collected funds are deposited into a VIPNet bank account and then transferred to the respective agencies via a complicated flow of funds process. VI has resolved the credit card transactions issue through a change in its credit card processing system. By the end of July 2004, all VIPNet customers with online credit card services will be converted to agency specific payment accounts so that funds collected from the online transactions are deposited directly into agency bank accounts.

3. Document Accounting Procedures

The audit indicated a need for VI management to formalize and document internal accounting policies. VI follows nationally accepted accounting standards and practices in its network operations, as specified by NIC and its independent auditor, PriceWaterhouseCoopers. The complicated flow of funds process for Virginia has required VI to adopt additional, Virginia-specific, accounting policies and procedures. (This flow of funds process was instituted because of an interpretation of the Virginia

Constitution from the Office of the Attorney General. It is unlike any flow of funds process or accounting process in any other state.) To date, VI management has documented, in coordination with VIPNet of VITA staff, only the procedures for the state's flow of funds. VI management now is in the process of documenting its internal, Virginia-specific procedures. VI will provide a copy of those internal accounting procedures to VITA and the APA before the end of June 2004.

4. Monitoring of VIPNet of VITA Account

As a means of proactively addressing any future discrepancies that may occur in the balance of funds held by VIPNet of VITA and what payments are due to VI, the APA has recommended that VI and VITA better monitor the VIPNet of VITA bank account balance. Accordingly, VITA will provide VI with access to transaction information for the VIPNet of VITA bank account for review beginning in March 2004.

5. Sourcing Governance

Even though it is not an APA recommendation, VITA will initiate a more proactive sourcing governance process with Virginia Interactive, including the requirement for VITA Finance and Audit oversight responsibility. Monthly VIPNet financial reports and performance data will be provided to the VITA CFO and Director of Audit for their review. VITA Audit and Finance staff will conduct quarterly reviews of VIPNet operations and compliance with APA recommendations.

VIRGINIA INFORMATION PROVIDERS NETWORK AUTHORITY
Richmond, Virginia

BOARD MEMBERS

As of June 30, 2003

Jerry Simonoff, Chairman

Nelson Worley, Vice Chairman

Richard Byrd

Cheryl Clark

Rob Jones

Chuck Mills

George C. Newstrom

Dolly Oberoi

Ab Quillian

Scott Walker

Carol Dois Woodward