

AUDIT SUMMARY

Our audit of the Virginia Workers' Compensation Commission for the twenty-one months ended March 31, 1999, found:

- proper recording and reporting of transactions, in all material respects, in the Commonwealth Accounting and Reporting System;
- no material weaknesses in the internal controls tested; however, we did find certain matters we consider reportable conditions; and
- no material instances of noncompliance with applicable laws and regulations tested.

Our audit findings include issues that we explain in detail in the section entitled "Workers' Compensation Commission Highlights."

- TABLE OF CONTENTS -

AUDIT SUMMARY

INDEPENDENT AUDITOR'S REPORT

WORKERS' COMPENSATION COMMISSION HIGHLIGHTS

June 9, 1999

The Honorable James S. Gilmore, III
Governor of Virginia
State Capitol
Richmond, Virginia

The Honorable Richard J. Holland
Chairman, Joint Legislative Audit
and Review Commission
General Assembly Building
Richmond, Virginia

INDEPENDENT AUDITOR'S REPORT

We have audited the financial records and operations of the **Virginia Workers' Compensation Commission** for the twenty-one months ended March 31, 1999. We conducted our audit in accordance with Government Auditing Standards, issued by the Comptroller General of the United States.

Audit Objectives, Scope, and Methodology

Our audit's primary objectives were to review the Commission's accuracy of recording financial transactions on the Commonwealth Accounting and Reporting System, adequacy of the internal controls, and compliance with applicable laws and regulations.

Our audit procedures included inquiries of appropriate personnel, inspection of documents and records, and observation of operations. We also tested transactions and performed other such auditing procedures as we considered necessary to achieve our objectives. We reviewed the overall internal accounting controls, including controls for administering compliance with applicable laws and regulations over the significant cycles, classes of transactions, and account balances:

Accounts Receivable
Revenue and Cash Receipts
Expenditures and Procurement

We obtained an understanding of the relevant policies and procedures for these internal accounting controls. We considered materiality and control risk in determining the nature and extent of our audit procedures. We performed audit tests to determine whether the policies and procedures 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.

The Commission's management has responsibility for establishing and maintaining an internal control structure and complying with applicable laws and regulations. The objectives of an internal control structure are to provide reasonable, but not absolute, assurance that assets are safeguarded and that transactions are processed in accordance with management's authorization, properly recorded, and comply with applicable laws and regulations.

Our audit was more limited than would be necessary to provide an opinion on internal controls or on overall compliance with laws and regulations. Because of inherent limitations in internal controls, errors, irregularities, or noncompliance may nevertheless occur and not be detected. Also, projecting the evaluation of the internal controls to future periods is subject to the risk the procedures may become inadequate because of changes in conditions, or that the effectiveness of the design and operation of policies and procedures may deteriorate.

Audit Conclusions

We found the Commission properly stated, in all material respects, the amounts recorded and reported in the Commonwealth Accounting and Reporting System. The Commission records its financial transactions on the cash basis of accounting, which is a comprehensive basis of accounting other than generally accepted accounting principles.

We noted certain matters involving the internal control structure and its operation that we consider reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal controls, that in our judgment, could adversely affect the Commission's ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial records. These reportable conditions are discussed in the section entitled, "Workers' Compensation Commission Highlights." We believe none of the reportable conditions are material weaknesses.

Further, the results of our tests of compliance disclosed no instances of noncompliance that are required to be reported under Government Auditing Standards. However, we did find an immaterial instance of noncompliance that is described in the section entitled, "Workers' Compensation Commission Highlights."

The Commission has not taken adequate corrective action with respect to audit findings, "Closely Monitor Consultants" and "Complete Information Security Plan" reported in the prior year.

EXIT CONFERENCE

We discussed this report with management at an exit conference held on August 11, 1999.

AUDITOR OF PUBLIC ACCOUNTS

KKH:whb
Whb:22

WORKERS' COMPENSATION COMMISSION HIGHLIGHTS

The Commission administers the Workers' Compensation Act that protects employees with work related accidents by compensating them for lost wages and medical expenses. The Commission processes, manages, and adjudicates all workers' compensation claims in Virginia. The Commission's major activities include hearing and investigating compensation claims, determining the amounts and duration of awards, and managing claim awards. In addition, the Commission administers claim awards for victims of crime.

To fund the Workers' Compensation Act activities, the Commission collects a tax on workers' compensation insurance premiums. This revenue totals approximately \$11.5 million annually and the majority of collections go into either the Administrative or Uninsured Employer Funds.

The Commission pays all normal operating costs from the Administrative Fund. Annual Fund expenses total nearly \$9 million and consists primarily of payroll costs.

The Uninsured Employer Fund provides workers' compensation benefits to employees whose employers did not obtain insurance coverage. Expenses from this fund average \$2.5 million annually. The Deputy Commissioner conducts hearings with all uninsured claimants to determine the amount of their award. The Commission attempts collection against uninsured employers with recovery efforts that include filing liens against the uninsured employer, using the Department of Taxation's Debt Set-Off program, and sending claims to the Office of Attorney General's collections unit. However, collection is very unlikely as most uninsured employers either have few assets or enter bankruptcy processing.

The Commission uses the Crime Victim Compensation Fund to account for fines imposed on convicted criminals (approximately \$2.5 million annually) and the award of monies to victims of violent crimes who suffer physical injury or death (approximately \$1.5 million annually). In addition, the Commission receives monies from the Federal Government to help compensate victims of violent crimes. As of March 31, 1999, the Commission has received \$97,000 in their Federal Trust Fund.

System Replacement and Year 2000 Compliance

The Commission recently converted their network to Microsoft NT and accounting applications to Microsoft Access through a systems replacement initiative that began in 1997. The systems replacement project is an integral part of their Year 2000 solution. The Commission hired a computer consulting firm to design and implement all systems including the servers, networks, and accounting systems.

One of the consulting firm's employees acted as the Information Systems Manager until April 1999, when the Commission hired a new Information Systems Manager. The Commission gave the Consultant responsibility for overseeing the replacement of all systems, coordinating Year 2000 efforts, and reporting progress to the Century Date Change Initiative (CDCI) office.

Reporting to CDCI has been poor over the past year. The Commission submitted a plan to CDCI that called for re-writing critical systems to make them Year 2000 compliant. Later, when the Commission decided to replace all applications, they failed to submit a revised plan. Consequently, the Commission's

progress was being measured and reported based on an invalid Year 2000 plan. The Consultant failed to submit a revised plan earlier to CDCI. In June 1999, the new Information System Manager's revised plan was submitted and approved by CDCI.

Closely Monitor Consultants

Commission management delegated the resolution of Year 2000 to a Consultant who represented management at meetings with CDCI. Reporting to CDCI has been inaccurate during the past year and ineffective communication between the Consultant and CDCI failed to resolve the issue.

As noted in our prior report, Commission management must closely monitor the systems project to ensure that consultants working on the project meet the Commission's needs. While Commission management may delegate the Year 2000 plan to others, they are ultimately responsible for the success of the plan.

As of May 1999, the Commission has completed approximately 95 percent of its system replacement project, all new systems are operational and each component tested for Year 2000 compliance. However, the server and the database have not been Year 2000 tested simultaneously. The Commission plans to test these in June 1999. The Electronic Data Interchange (EDI) program is the last element of the systems project.

The Commission uses the EDI program for the electronic transmission of a few accident reports and small medical claims. The consulting firm is writing the program in Microsoft Access and plans to have it operational by July 1, 1999. The consulting firm will remain at the Commission until August 1999 or until it completes all work.

Before finalizing the systems replacement project, the Commission must complete an Information Security plan. Components of a security plan include a business impact analysis, risk assessment and disaster recovery plan. A complete plan identifies business processes that rely on information systems and the threats and vulnerabilities that may affect the systems.

Complete Information Security Plan

As noted in prior years, the Commission does not have a current, documented business impact analysis and risk assessment that are part of an overall Information Security Plan. Without a risk assessment, unknown threats could result in alteration, theft, or destruction of valuable information resources.

The Commission should perform and fully document a comprehensive business impact analysis and risk assessment for all information systems, as required by the Council on Information Management (CIM) Standard 95-1. In addition, the Commission should develop a policy and procedure to update their Information Security Plan regularly.

The Commission has completed a draft disaster recovery plan containing only recommendations and does not have a documented, detailed plan. The Commission indicates that they will resort to manual procedures in the event of system failures. However, they have no written plan that details procedures and responsibilities. Lack of a disaster recovery plan will create a confused environment, and affect operations during a system failure.

Develop Contingency Plan

The Commission must develop and implement a detailed disaster recovery plan. Currently, if a disaster such as Year 2000 system failures strike, the Commission assumes the risk of not resuming critical business activity promptly by either recovering its computing capability or using alternate manual procedures.

VIRGINIA WORKERS' COMPENSATION COMMISSION
Richmond, Virginia

COMMISSIONERS

Virginia R. Diamond, Chairman

William L. Dudley

Lawrence D. Tarr