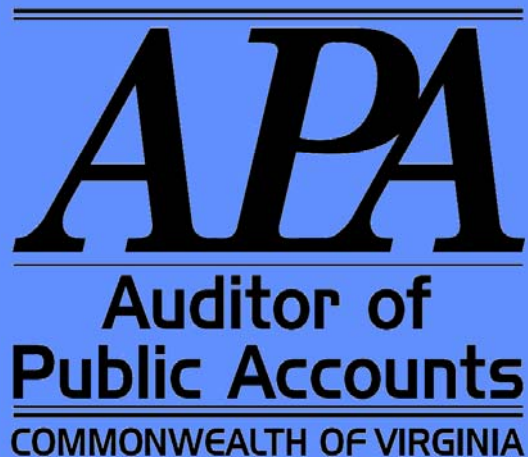


STATE CORPORATION COMMISSION

**REPORT ON AUDIT
FOR THE TWO-YEAR PERIOD ENDED
JUNE 30, 2009**



AUDIT SUMMARY

Our audit of the State Corporation Commission, for the two-year period ended June 30, 2009 found:

- proper recording and reporting of all transactions, in all material respects, in the Commonwealth Accounting and Reporting System and the Commission's accounting records;
- certain matters involving internal control and its operations necessary to bring to management's attention; and
- 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

Evaluate Finance and Revenue Processes

The State Corporation Commission (the Commission) should evaluate its current finance and revenue processes. The Commission operates in a large decentralized environment with each division establishing a majority of its policies and procedures. Management and the Comptroller rely on the divisions to manage the operations and report information, as necessary.

Under this organizational structure, divisions have more autonomy and therefore have different operational processes, policies, and procedures for collecting their revenues, managing their stakeholders, and performing other daily administrative functions. Divisions also have different revenue and management information systems that have varying degrees of capabilities and internal controls.

As a result, some divisions have greater efficiencies and controls than other divisions. Under the current structure, divisions cannot readily coordinate to avoid duplication of efforts and increase efficiencies in the various processes, including revenue collection and management.

The Commission should seek to fully evaluate its finance and revenue operating environment and determine what processes are necessary to establish sufficient internal controls. While gaining its understanding of this environment, the Commission can determine what processes are necessary to accomplish its organizational goals, while minimizing duplication of efforts within each of its divisions.

The Commission should focus its efforts on determining whether centralizing some of its common processes would provide enhanced efficiency of common types of transactions, allow more oversight and guidance to each of its divisions, and improve operations and internal controls. Performing a Commission-wide evaluation of the revenue and finance operating environment will allow the Commission to better focus its efforts on achieving its mission, emphasizing areas of excellence, and highlighting areas where process improvements can occur.

We understand that performing the necessary analysis will take time and careful scrutiny and planning. The Commission should consider undertaking a Commission-wide analysis of these operations and determine which functions should remain decentralized and which functions could more efficiently and effectively operate centrally.

Detailed below are several concerns that the Commission could address by conducting an overall operating assessment.

Establish Sufficient Controls over the Revenue Process

The Commission collects a wide variety of fees and taxes, including insurance premium taxes, consumption taxes, licensing fees, insurance agency fees, and banking assessment fees. As with other processes, each division collects, processes, records, and manages their respective revenues. As a result, the Commission's five revenue divisions use different revenue systems and

collection processes. Each division has their own revenue system to account for and manage their revenues.

Divisions must then either manually enter or electronically transfer their revenue information to the Commission's accounting system. Each division also maintains their own records of revenue receipt, deposits revenues received, and is responsible for ensuring that the reconciliations between their individual systems and the Commission's accounting system are prepared appropriately.

Since the Commission collects and manages revenues in a decentralized environment, we noted that some divisions have more controls and better processes for handling revenues. Other divisions have a lack of sufficient controls surrounding various aspects of the revenue processes. Specifically, we noted the following concerns regarding the Commission's revenue and reconciliation processes:

- Divisions completed monthly reconciliations but do not sufficiently document divisional revenue reconciliations. A majority of the reconciliations we reviewed were incomplete or had inconsistent detail to determine that the divisional revenue system was in balance with the Commission's central accounting system, Oracle.
- Some divisions did not consistently maintain physical security of checks and remittances until deposit.
- Some divisions did not adequately segregate conflicting duties. In one division, we noted that an employee deposits the collections, reconciles the revenue accounts, prepares the accounts receivable reports to the Commission Comptroller, and has system administrator access in that division's revenue system.
- Divisions do not consistently monitor system access to the individual revenue systems. In addition, divisions do not adequately ensure that employees have the least access privilege necessary to perform assigned duties. For example, some employees had unnecessary system administrator access, while other revenue systems do not allow for sufficient restrictions of access.

In addition to determining which revenue functions should remain within the divisions, the Commission should evaluate each division's controls over its revenue collection process to ensure that all revenues collected are promptly deposited, adequately safeguarded, posted to the proper accounts, and that the underlying records reconcile.

Improve the Information Systems Security Program

The Commission is currently working to improve its information security program to address the concerns noted in the prior audit and is addressing the following areas to further strengthen the Commission's information security program.

- Perform a risk assessment
- Complete a business impact analysis

- Prepare a continuity of operations and disaster recovery plan
- Develop physical access policies and procedures
- Develop monitoring procedures for systems, databases, and applications

During the past 18 months, the Commission has developed an information security strategic plan and implemented several information security policies and procedures. The Commission has also selected a consultant to conduct a risk assessment, perform a business impact analysis, and develop a continuity of operations and disaster recovery plan. The consultant expects to complete their work in December 2009.

Improve Firewall Controls

During the prior audit, we noted concerns with the unencrypted remote access to the Commission's internal network. Commission management has addressed this concern and is working on approving and implementing stronger policies and procedures that align with the Commonwealth's security standards and industry best practices, which will reduce the risk to data confidentiality, integrity, and availability.

We encourage the Commission to finalize its firewall policies and procedures, and dedicate the necessary resources to provide appropriate training to the affected stakeholders, and to maintain its firewall to these stronger standards which will assist the Commission in preventing unauthorized access to its network.

Improve Accounts Receivable Reporting

Each division manages and reports their own accounts receivable and the Commission Comptroller has provided only basic guidance for reporting these receivables for financial reporting purposes. In addition, many of the division's revenue systems are not capable of providing readily available accounts receivable data.

As a result, divisions have established their own processes for determining accounts receivable for reporting purposes and accounts receivable balances are not consistently and readily available for review throughout the year. One division transitioned to a new revenue system during the year and as a result, obtained an estimate for the accounts receivable year-end balance from the revenue system's vendor. We later noted that this amount was not a receivable at year-end and therefore caused the Commission to overstate their accounts receivable balance by approximately \$13 million.

The Commission Comptroller should provide additional guidance and oversight over accounts receivable managing and reporting. This includes providing specific direction on how to properly report accounts receivable balances.

Improve Controls over the Payroll Process

During our review of payroll, we noted a lack of proper controls in the payroll process. Specifically, we noted that a payroll employee shared their payroll login system credentials with

another payroll employee in training. As a result, management could not readily determine which individual entered or modified payroll. Management had not provided the new payroll employee with her own payroll system login credentials.

In addition, one Commission employee enters and reviews payroll data and management does not perform the required, detailed precertification review to ensure the accuracy of the payroll information. Therefore, the Commission does not have sufficient review or separation of duties over the precertification process. This increases the risk that unauthorized payroll transactions could occur and go undetected. To reduce this risk, the Commission should strengthen its controls over the payroll process to ensure that there are adequate controls, including separation of duties, management review, and audit trails.

Improve Processes over Wage Employees

The Commission does not have adequate controls over processing and tracking wage employees. Specifically, we have concerns about the following.

- The Commission does not have an adequate formal notification process to ensure that divisions notify Human Resources and Payroll of employee terminations. This increases the likelihood of an employee having access to the Commission's assets, including information systems, after termination.
- The Commission does not have a policy prohibiting employees from submitting their own timesheets after a supervisor approves it. This process increases the risk that an employee could change their timesheet after approval.
- Payroll does not have a listing of supervisors who can approve timesheets so it is unclear who has approval authority for the various divisions within the Commission.

The Commission should include wage employees in the human resources information system and follow the same process that management uses for salary employees terminating. In addition, management should ensure payroll only receives and processes properly approved timesheets.

Document Cost Allocation Plan

The Commission has not clearly documented the methods utilized to allocate indirect costs, including information systems, accounting, human resources, and general counsel, to the regulatory divisions. The Commission has not documented a general overview of the purpose and intent of the cost allocation, as well as the specific procedures each division uses to allocate costs. The Commission should evaluate, revise, if necessary, and document a comprehensive cost allocation plan to ensure that it properly allocates costs to each division. Management should then communicate this allocation process to the regulatory divisions and periodically review the process for continued reasonableness.

Properly Complete Employment Eligibility Verification Forms

The Commission personnel are not timely completing Eligibility Verification Forms (I-9) in accordance with guidance issued by the U.S. Citizenship and Immigration Services of the U.S. Department of Homeland Security. Specifically, we noted that employees did not consistently complete Section 1 of the form at the time their employment began; The Commission should continue to improve the procedures it implemented in response to the prior year finding to ensure compliance with Federal regulations.

AGENCY HIGHLIGHTS

The Commission is an independent agency directed by three commissioners, each elected by the General Assembly for six-year terms. Each commissioner administers specific divisions and the commissioners annually rotate the chairmanship.

The Commission has both regulatory and non-regulatory divisions. The regulatory divisions monitor a number of industries, including utilities, state-chartered financial institutions, securities, retail franchising, insurance, and railroads. The Commission also serves as the Commonwealth's central filing office for corporations, limited partnerships, limited liability companies, business trusts, and Uniform Commercial Code filings.

The non-regulatory divisions provide administrative and legal support to the regulatory divisions. The Commission funds its operations from certain regulatory assessments and fees set by statute. The Commission also collects revenues for the General Fund, other special revenue funds, localities, and other state entities.

Below is a listing of the regulatory and non-regulatory divisions.

Regulatory Divisions:

Clerk of the Commission
Communications
Economics and Finance
Energy Regulation
Financial Institutions
Insurance
Public Service Taxation
Public Utility Accounting
Securities and Retail Franchising
Utility and Railroad Safety

Non-Regulatory Divisions

Commission Comptroller
Council to the Commission
General Council
Hearing Examiners
Human Resources
Information Resources
Information Security
Information Technology
Internal Audit

The following is a description of each Regulatory Division:

Clerk of the Commission

The Clerk is the Commission's official custodian of judicial and administrative records. The Clerk's Office also serves as the central filing office for Uniform Commercial Code financing statements and federal tax liens as well as for thousands of corporations, partnerships, and limited liability companies doing business in Virginia. The Clerk's Office collects various fees from corporations, partnerships, and limited liability companies that register with the Commission. In fiscal year 2008, the Clerk's Office collected \$6.3 million in General Fund revenue and \$47.1 million in special revenue. In fiscal year 2009, the Clerk's Office collected \$5.6 million in General Fund revenue and \$47.4 million in special revenue.

Division of Communications

The Division of Communications (Communications) regulates Virginia's telecommunications industry (other than the federally regulated cellular and wireless communications). Communications reviews rates and costs, evaluates telephone companies' performance, investigates consumer complaints regarding communications service, and oversees the implementation of telecommunications market competition.

Division of Economics and Finance

The Division of Economics and Finance advises the Commissioners on economic and finance issues related to public utilities, conducts research, and develops special studies and forecasts.

Division of Energy Regulation

The Division of Energy Regulation (Energy Regulation) regulates Virginia's investor-owned water and sewer, electric, and natural gas utilities, and member-owned electric cooperatives. Energy Regulation's responsibilities include reviewing rate applications filed by investor-owned utilities and member-owned cooperatives, monitoring utility construction projects, and responding to consumer complaints regarding electric, gas, and water and sewer utilities under the Commission's jurisdiction. The focus of electricity regulation is shifting from setting rates, to implementing the restructuring law under the guidance of the General Assembly.

Bureau of Financial Institutions

The Bureau of Financial Institutions (Financial Institutions) regulates and examines state-chartered banks, trust companies, savings and loans, and credit unions. Financial Institutions also provides licenses and examines mortgage lenders and brokers, and licenses and regulates money order sellers, consumer finance companies, industrial loan association's payday lenders, and credit counseling agencies. Financial Institutions collect revenue from these entities for application fees, license fees, annual assessment fees, examination fees, and investigation fees, which totaled \$12.5 million in fiscal year 2008 and \$11.3 million in fiscal year 2009.

Bureau of Insurance

The Bureau of Insurance (Insurance) regulates over 1,500 insurance companies and 185,000 agents and agencies authorized to operate in Virginia. Insurance examines the financial affairs of each domestic (Virginia-based) insurance company at least once every five years, and requires annual statements from foreign (based outside of Virginia) and alien (based outside of the United States) insurance companies doing business in Virginia. Insurance also assists the public in resolving disputes with insurance companies.

Insurance collects a gross premium tax from insurance companies, which totaled \$397.6 million in General Fund revenue in fiscal year 2008 and \$387.7 million in fiscal year 2009. In addition, Insurance collected \$26.1 million in fiscal year 2008 and \$24.3 million in fiscal year 2009 in special revenue comprised of assessments and license, application, appointment, and other fees. Insurance also collects an assessment from property and casualty insurance companies, which it transfers to the Department of Fire Programs; this totaled \$28.2 million in fiscal year 2008 and \$28.5 million in fiscal year 2009.

In addition, Insurance collects special assessments for the Virginia State Police to investigate insurance fraud. Each licensed insurer doing business in the Commonwealth, by writing any type of property and casualty insurance, except title insurance, pays a special assessment fee equal to a percentage of its direct gross premium income during the preceding calendar year. Insurance can impose a late payment penalty of ten percent of the assessment and retains a portion of the special assessment to cover its administrative expenses. Insurance transferred \$5.2 million in fiscal year 2008 and \$5.1 million in fiscal year 2009 to the Virginia State Police.

Insurance also receives uninsured motorist fees collected by the Department of Motor Vehicles (Motor Vehicles). In accordance with the Code of Virginia, Insurance distributes these funds to the insurance companies who write automobile liability insurance. Motor Vehicles transferred uninsured motorist fees to Insurance totaling \$7.1 million in fiscal year 2008 and \$6.7 million in fiscal year 2009.

Division of Public Service Taxation

The Division of Public Service Taxation (Public Service Taxation) collects state taxes and fees on revenues and services of public service companies (e.g., electricity, water, and other power companies; telecommunications companies; and railroads). Public Service Taxation collects taxes on electricity and natural gas based on a consumption tax imposed on the customers. Public Service Taxation also determines and certifies the assessed value of utility company's property for local property taxation. In fiscal year 2008, the Public Service Taxation collected \$90.8 million in General Fund revenue and \$13.8 million in special revenue. In fiscal year 2009, Public Service Taxation collected \$85.2 in General Fund revenue and \$14.1 million in special revenue.

Division of Public Utility Accounting

The Division of Public Utility Accounting provides the Commissioners with information and analysis on utilities and other entities' accounting and financial information. The Commissioners

use this information when considering utility cases involving rates and services; affiliate transactions, mergers and acquisitions; certificates of public convenience and necessity; alternative regulatory plans; and the restructuring of utility markets.

Division of Securities and Retail Franchising

The Division of Securities and Retail Franchising (Security and Retail Franchising) regulates security brokers and investment advisors in Virginia, registers security industry professionals, and investigates complaints about particular securities, practices, or events. Security and Retail Franchising also registers franchises and trademarks in Virginia and investigates any reports of securities or franchising law violations or misconduct. This division determines what is required under the Virginia Securities Act to register public offerings and conducts private security offerings, reviews offering documents, and approves offers and sales of securities in Virginia. Security and Retail Franchising collected \$9.8 million in special revenue during fiscal year 2008 and \$9.7 million in fiscal year 2009.

Division of Utility and Railroad Safety

The Division of Utility and Railroad Safety (Utility and Railroad Safety) works to ensure safe operation of railroads within the Commonwealth by inspecting facilities, tracks, and equipment. To promote natural gas and hazardous liquid pipeline safety, Utility and Railroad Safety conducts pipeline facilities inspections, reviews records, and investigates incidents. Utility and Railroad Safety also investigates all reports of probable violations of the Underground Utility Damage Prevention Act; this division provides free training relative to the Underground Utility Damage Prevention Act to stakeholders, conducts public education campaigns, and promotes partnership among various parties to further underground utility damage prevention in Virginia.

FINANCIAL INFORMATION

The Commission funds its operations from certain regulatory assessments and fees set by statute and records this activity primarily in four special revenue funds. Depending on the revenue source, the Commission collects revenue annually, quarterly, or monthly and will maintain a cash balance in these special revenue funds as a reserve to prevent a large fluctuation in rates. The Commission also collects a majority of its revenues for the General Fund. In fiscal year 2009, General Fund revenues accounted for 70 percent of the Commission's total collections. The following table shows the total revenues the Commission collected by fund for fiscal years 2008 and 2009.

Table 1

Revenue by Fiscal Year and Fund

<u>Fund</u>	<u>2009</u>	<u>2008</u>
General	\$346,190,936	\$494,685,447
Special Revenue	135,466,007	137,889,999
Trust and Agency	5,148,618	4,264,892
Dedicated Special Revenue	6,154,710	6,668,688
Federal Trust	<u>475,631</u>	<u>461,958</u>
Total	<u>\$493,435,902</u>	<u>\$643,970,984</u>

The Department of Planning and Budget establishes an original expense budget based on the prior biennium budget amount, and adjusts for certain items. The following schedule compares the fiscal years 2008 and 2009 Commission's original and adjusted budgets with actual expenses.

Table 2

Budget to Actual Operating Expenses by Fiscal Year and Fund

	<u>2009</u>		
	<u>Original Budget</u>	<u>Final Budget</u>	<u>Actual Expense</u>
Special Revenue	\$77,793,544	\$77,688,331	\$67,101,813
Trust and Agency	14,090,346	7,246,687	7,163,723
Dedicated Special Revenue	1,248,500	1,687,023	1,504,144
Federal Grants	<u>-</u>	<u>561,958</u>	<u>561,950</u>
Total	<u>\$93,132,390</u>	<u>\$87,183,999</u>	<u>\$76,331,630</u>
	<u>2008</u>		
	<u>Original Budget</u>	<u>Final Budget</u>	<u>Actual Expense</u>
Special Revenue	\$72,866,296	\$72,870,195	\$62,224,708
Trust and Agency	4,669,496	7,618,881	7,497,573
Dedicated Special Revenue	871,449	1,123,449	1,006,067
Federal Grants	<u>-</u>	<u>358,372</u>	<u>347,754</u>
Total	<u>\$78,407,241</u>	<u>\$81,970,897</u>	<u>\$71,076,102</u>

Special Revenue budgeted and expense amounts increased from fiscal year 2008 to 2009 primarily due to increased personnel service costs, a majority of which represents increased salaries

and health care insurance premiums. The original budget for Trust and Agency amounts increased to reflect revenue projections for the uninsured motorist fund; however, action taken by the General Assembly allowed for the Department of Motor Vehicles to retain a greater share of these revenues, requiring the Final Budget to be revised to amounts comparable to 2008. All other budgetary and expense amount remained constant from fiscal year 2008 to 2009.

Payroll costs, including fringe benefits, accounted for approximately 70 percent, or \$53 million, of the Commission's total expenses during fiscal year 2009. During fiscal year 2009, the Commission spent \$11.7 million, or 15 percent, on contractual services and an additional \$7.3 million, or ten percent, on transfer payments. Table 3 details the Commission's operating expenses by major expense category.

Table 3

Operating Expenses by Fiscal Year and Major Category

Category	<u>2009</u>	<u>2008</u>
Personal services	\$52,346,192	\$49,907,371
Contractual services	11,723,665	9,795,094
Supplies and materials	578,155	581,859
Transfer payments	7,370,719	7,678,227
Rent and other continuous charges	1,348,921	850,878
Equipment	<u>2,963,978</u>	<u>2,262,673</u>
Total	<u>\$76,331,630</u>	<u>\$71,076,102</u>



Commonwealth of Virginia

Walter J. Kucharski, Auditor

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

October 8, 2009

The Honorable Timothy M. Kaine
Governor of Virginia

The Honorable M. Kirkland Cox
Chairman, Joint Legislative Audit
and Review Commission

We have audited the financial records and operations of the **State Corporation Commission** for the two year period ended June 30, 2009. 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 recorded financial transactions on the Commonwealth Accounting and Reporting System, review the adequacy of the Commission's internal controls, test compliance with applicable laws and regulations, and review corrective actions of audit findings from prior year reports.

Audit Scope and Methodology

The Commission'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 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.

Revenue
Payroll expenses
Operating expenses
Systems Security

We performed audit tests to determine whether the Commission'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 the Commission's operations. We reviewed the applicable sections of the Code of Virginia and the 2009 Acts of the Assembly. We tested transactions and performed analytical procedures, including budgetary and trend analyses.

Conclusions

We found that the State Corporation 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 accounting principles generally accepted in the United States of America. The financial information presented in this report came directly from the Commonwealth Accounting and Reporting System.

We noted certain matters involving internal control and its operation and compliance with applicable laws and regulations that require management's attention and corrective action. These matters are described in the section entitled "Audit Findings and Recommendations."

The Commission is in the process of taking corrective action with respect to the audit finding entitled "Commonwealth Security Standards" reported in the prior year.

Exit Conference and Report Distribution

We discussed this report with management on October 23, 2009. Management's response has been included at the end of this report.

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.

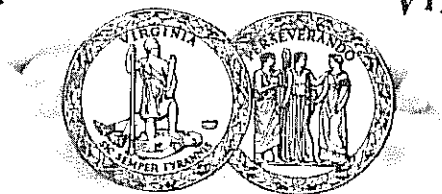
AUDITOR OF PUBLIC ACCOUNTS

MARK C. CHRISTIE
COMMISSIONER

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COMMONWEALTH OF VIRGINIA



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RICHMOND, VIRGINIA 23218-1197

STATE CORPORATION COMMISSION

October 28, 2009

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

Dear Mr. Kucharski:

The State Corporation Commission (Commission) appreciates the time and effort that your staff devoted to review the Commission's financial records and operations for fiscal years 2008 and 2009. The Commission is in agreement with the audit report and has already taken corrective action to address the findings.

As you stated in your audit report, the Commission has made significant progress during the last eighteen months to strengthen our information security program, by developing information security policies and procedures, conducting a risk assessment and a business impact analysis of our operations and developing continuity of operations and disaster recovery plans.

Thank you for the opportunity to review and comment on the draft audit report as well as staff's attention to our comments throughout the audit engagement.

Sincerely,

Mark C. Christie, Chairman

Judith Williams Jagdmann, Commissioner

James C. Dimitri, Commissioner

MCC/esb

STATE CORPORATION COMMISSION

COMMISSIONERS

Mark C. Christie, Chairman

Judith Williams Jagdmann

James C. Dimitri