

**STATE CORPORATION COMMISSION
RICHMOND, VIRGINIA**

**REPORT ON AUDIT
FOR THE YEAR ENDED
JUNE 30, 2002**



AUDIT SUMMARY

Our audit of the State Corporation Commission for the year ended June 30, 2002, found:

- proper recording and reporting of transactions, in all material respects, in the Commonwealth Accounting and Reporting System and in the Commission's accounting records;
- internal control matters that we consider to be reportable conditions; however, we do not consider these findings to be material weaknesses; and
- an instance of noncompliance with selected provisions of applicable laws and regulations.

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AGENCY BACKGROUND AND FINANCIAL HIGHLIGHTS

The State Corporation Commission is an independent agency directed by three commissioners; each elected by the General Assembly for six-year terms. Effective February 1, 2002, the Commission chairman assumed the role of chief operating officer for the agency. All sixteen divisions will report directly to the chairman. The commissioners will continue to rotate the chairmanship on an annual basis. The Commission has both regulatory and non-regulatory divisions. The regulatory divisions monitor such industries as utilities, banks, securities, retail franchising, insurance, and corporations. The non-regulatory divisions provide administrative and legal support. The Commission funds its operations from certain regulatory assessments and fees set by statute. The Commission collects revenues for the General Fund, other state special funds, localities, and other entities. The Commission collected a total of \$370,974,133 in revenue for the General Fund for fiscal year 2002.

The regulatory and non-regulatory divisions are shown below.

<u>Regulatory Divisions</u>	<u>Non-Regulatory Divisions</u>
Insurance	Commissioners' Offices
Securities and Retail Franchising	General Counsel
Financial Institutions	Hearing Examiners
Public Service Taxation	Commission Comptroller
Public Utility Accounting	Information Resources
Communications	Human Resources
Energy Regulation	Information Technology
Economics and Finance	
Railroad Regulation	
Clerk of the Commission	

REGULATORY DIVISIONS

Bureau of Insurance

The Bureau of Insurance regulates over 1,500 insurance companies and 100,000 agents authorized to operate in Virginia. The Bureau examines the financial affairs of each of the domestic (Virginia-based) insurance companies at least once every five years and requires annual statements from foreign (companies based outside of Virginia) and alien (companies based outside of the United States) insurance companies doing business in Virginia. The Bureau also assists the public in resolving disputes with insurance companies.

The Bureau of Insurance collects revenue from a Gross Premium Tax from insurance companies, which totaled \$293,013,135 in General Fund revenue in fiscal year 2002. The Bureau collected \$23,576,871 in special revenue comprised of assessments and license, application, appointment, and other fees during fiscal year 2002. The Bureau also collects an assessment from Fire and Casualty Insurance companies, which it transfers to the Department of Fire Programs. In fiscal year 2002, the Bureau transferred \$16,937,633.

The Bureau also collects special assessments for the Virginia Department of 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. The Bureau 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. The Bureau transferred \$3,706,802 to the State Police by fiscal year end.

The Bureau also receives uninsured motorist fees collected by the Department of Motor Vehicles. The Bureau distributes these funds to the insurance companies who write automobile liability insurance in accordance with Section 38.2-3001 of the Code of Virginia. In fiscal year 2002, DMV transferred uninsured motorist fees to the Bureau totaling \$14,360,865.

Division of Securities and Retail Franchising

The Division of Securities and Retail Franchising regulates security brokers and investment advisors in Virginia. The Division also registers franchises and trademarks in Virginia and investigates any reports of securities or franchising law violations or misconduct. The Division of Securities and Retail Franchising collected \$7,770,396 in special revenue during fiscal year 2002.

Bureau of Financial Institutions

The Bureau of Financial Institutions regulates and examines state-chartered banks, savings and loans, and credit unions. The Bureau also licenses and examines mortgage lenders and brokers, and licenses and regulates money order sellers, consumer finance companies, and debt counseling services.

The Bureau collects revenue from these entities for application fees, license fees, annual assessment fees, examination fees, and investigation fees. In fiscal year 2002, the Bureau collected \$10,330,528 in special revenue.

Division of Public Service Taxation

The Division of Public Service Taxation collects state taxes and assessments on revenues and property of public service companies (e.g., electricity, water and other power companies; telecommunications companies, railroads etc.). The Division collects taxes on electricity and natural gas based on a combined corporate income tax on utility companies and a consumption tax on consumers. Before January 1, 2001, utilities paid a gross receipts tax.

In fiscal year 2002, the Division of Public Service Taxation collected \$71,761,199 in General Fund revenue and \$29,686,845 in special revenue, net of revenue transfers totaling \$470,777.

Division of Public Utility Accounting

The Division of Public Utility Accounting provides the Commission with accounting and financial information. The Commission uses 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 Communications

The Division of Communications regulates Virginia's telecommunications industry (other than cellular and wireless, which are federally regulated.) This Division reviews rates and costs, evaluates telephone

companies' performance, investigates consumer complaints regarding communications service, and oversees the implementation of telecommunications market competition.

Division of Energy Regulation

The Division of Energy Regulation regulates Virginia's investor-owned water and sewer, electric, and natural gas utilities, and member-owned electric cooperatives. This Division's responsibilities include reviewing rate applications filed by investor-owned utilities and member-owned cooperatives, monitoring utility construction projects, inspecting gas and hazardous liquid pipelines safety, and responding to consumer complaints regarding electric, gas, and water and sewer utilities under the Commission's jurisdiction. As a result of the deregulation of electricity, the Commission added a consumer services representative to handle consumer inquiries and the focus of electricity regulation is shifting from setting rates to implementing the restructuring law under the guise of the General Assembly.

Division of Economics and Finance

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

Division of Railroad Regulation

The Division of Railroad Regulation works with the Federal Railroad Administration to ensure safe operations of railroads within the Commonwealth. The Division investigates citizen complaints regarding the blocking of rail crossings, conducts accident investigations, inspects railroad tracks and bridges to promote safe movement of freight and passengers throughout the state, and inspects rail cars and locomotives to ensure compliance with federal standards.

The 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 2002, the Clerk's Office collected \$6,199,798 in General Fund revenue and \$21,626,072 in special revenue.

NON-REGULATORY DIVISIONS

The non-regulatory divisions provide the Commission with administrative and legal support.

INTERNAL CONTROL AND COMPLIANCE FINDINGS AND RECOMMENDATIONS

Improve Information Systems Program

The Commission is not in compliance with Commonwealth's Standard for Information Technology Security, SEC2001-01.1. The Commission needs to maintain documentation of its Information Security Program to include a risk assessment, business contingency plans, and security awareness and training. The Information Security Program should also include adequate Information Security Policies and Procedures. A review of the current security policies and procedures indicate the following weaknesses.

- The policy does not make any statement of responsibility for key security personnel such as Network Administrators, Security Officer, System Administrators, or Information Technology Director.
- No stated security controls or procedures for vendors who may need to access SCC system resources for system maintenance.
- Nothing in the policy concerning encryption, whether it is a control the agency supports having in place for securing critical information and if it is used.
- Nothing in the policy concerning remote access or dial-up capabilities for users.
- The policy does not identify key contacts to report policy violations.

An Information Security Policy is the driving force for maintaining security controls. It contains management's views and directives toward security. Having inadequate policies and procedures could place the agency at risk for lack of security controls, resulting in unauthorized access to critical systems and data.

We recommend that the Commission improve its Information Security Program by completing a risk assessment; business contingency plan; and improve its information security policies and procedures to include the controls stated above.

Improve Security Controls for the Cisco External Internet Router

The Commission should strengthen security over its main router. The current controls on the router could allow unauthorized access to the router and possible access to critical information. Current controls could also result in attacks placed on the router that would prevent it from functioning in its normal capacity or that would prevent the router from functioning entirely.

We recommend the Commission place the proper security controls on the router that will serve as a safeguard against unauthorized access to critical information.

Develop a Schedule for Reviewing Firewall Logs

The Commission's staff only review the firewall logs if they suspect that someone is attempting inappropriate access or misusing the internet. The firewall logs maintain a record of everyone attempting to contact the Commission through the internet or the staff's use of the internet. Without regularly reviewing the logs, the Commission does not have a means of monitoring inappropriate usage or attempted access.

We recommend the Commission develop procedures to regularly monitor logs for unauthorized access to firewall resources. These procedures should include periodic review of unsuccessful logon attempts, and attempted access at inappropriate hours.

February 11, 2003

The Honorable Mark R. Warner
Governor of Virginia
State Capitol
Richmond, Virginia

The Honorable Kevin G. Miller
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 **State Corporation Commission** for the year ended June 30, 2002. 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 evaluate the accuracy of recording financial transactions on the Commonwealth Accounting and Reporting System, review the adequacy of the Commission's internal control, and test compliance with applicable laws and regulations.

Our audit procedures included inquiries of appropriate personnel, inspection of documents and records, and observation of the Commission's operations. We also tested transactions and performed such other 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. Our review encompassed controls over the following significant cycles, classes of transactions, and account balances:

Revenues
General Controls over Information Systems

We obtained an understanding of the relevant internal control components sufficient to plan the audit. We considered materiality and control risk in determining the nature and extent of our audit procedures. 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.

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.

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

Audit Conclusions

We found that the Commission properly stated, in all material respects, the amounts recorded and reported in the Commonwealth Accounting and Reporting System and in the Commission's accounting records. 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 in the United States of America. The financial information presented in this report came directly from the Commonwealth Accounting and Reporting System and the Commission's accounting records.

We noted certain matters involving internal control and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of internal control 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. Reportable conditions are included in the "Internal Control and Compliance Findings and Recommendations" section of the report. We believe that none of the reportable conditions is a material weakness.

The results of our tests of compliance with applicable laws and regulations disclosed one instance of noncompliance that is required to be reported under Government Auditing Standards. This matter of noncompliance is included in the finding entitled "Improve Information Systems Program" in the "Internal Control and Compliance Findings and Recommendations" section of the report.

This report is intended for the information of the Governor and General Assembly, management, and the citizens of the Commonwealth of Virginia and is a public record.

EXIT CONFERENCE

We discussed this report with management at an exit conference held on April 22, 2003.

AUDITOR OF PUBLIC ACCOUNTS

WHC:whb
whb:25

STATE CORPORATION COMMISSION
Richmond, Virginia

COMMISSION OFFICIALS

Clinton Miller, Chairman

Hullihen Williams Moore

Theodore V. Morrison, Jr.