



VIRGINIA WORKERS' COMPENSATION COMMISSION

INTERNAL CONTROL QUESTIONNAIRE REVIEW RESULTS AS OF JULY 2023

Auditor of Public Accounts
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Commonwealth of Virginia

Auditor of Public Accounts

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P.O. Box 1295
Richmond, Virginia 23218

September 18, 2023

Evelyn McGill, Executive Director
Virginia Workers' Compensation Commission
333 E. Franklin Street
Richmond, Virginia 23219

INTERNAL CONTROL QUESTIONNAIRE REVIEW RESULTS

We have reviewed the Internal Control Questionnaire for the **Virginia Workers' Compensation Commission** (Workers' Compensation). We completed the review on July 20, 2023. The purpose of this review was to evaluate if the agency has developed adequate internal controls over significant organizational areas and activities and not to express an opinion on the effectiveness of internal controls. Management of Workers' Compensation is responsible for establishing and maintaining an effective control environment.

Review Process

During the review, the agency completes an Internal Control Questionnaire that covers significant organizational areas and activities including payroll and human resources; revenues and expenses; procurement and contract management; capital assets; grants management; debt; and information technology and security. The questionnaire focuses on key controls over these areas and activities.

We review the agency responses and supporting documentation to determine the nature, timing, and extent of additional procedures. The nature, timing, and extent of the procedures selected depend on our judgment in assessing the likelihood that the controls may fail to prevent and/or detect events that could prevent the achievement of the control objectives. The procedures performed target risks or business functions deemed significant and involve reviewing internal policies and procedures. Depending on the results of our initial procedures, we may perform additional procedures including reviewing evidence to ascertain that select transactions are executed in accordance with the policies and procedures and conducting inquiries with management. The "Review Procedures" section below details the procedures performed for Workers' Compensation. The results of this review will be included within our risk analysis process for the upcoming year in determining which agencies we will audit.

Review Procedures

We evaluated the agency's corrective action for the 2020 internal control questionnaire review finding. The agency has taken adequate corrective action with respect to the review finding reported in the prior review.

We reviewed a selection of system and transaction reconciliations in order to gain assurance that the statewide accounting system contains accurate data. The definitive source for internal control in the Commonwealth is the Agency Risk Management and Internal Control Standards (ARMICS) issued by the Department of Accounts (Accounts); therefore, we also included a review of ARMICS. The level of ARMICS review performed was based on judgment and the risk assessment at Workers' Compensation. Our review of Workers' Compensation's ARMICS program included a review of all current ARMICS documentation and a comparison to statewide guidelines established by Accounts. Further, we evaluated Workers' Compensation's process of completing and submitting attachments to Accounts.

We reviewed the Internal Control Questionnaire and supporting documentation detailing policies and procedures. As a result of our review, we performed additional procedures over the following areas: payroll and human resources; revenues and expenses; capital assets; and information technology and security. These procedures included validating the existence of certain transactions; observing controls to determine if the controls are effectively designed and implemented; reviewing transactions for compliance with internal and Commonwealth policies and procedures; and conducting further review over management's risk assessment process.

As a result of these procedures, we noted an area requiring management's attention. This area is detailed in the "Review Results" section below.

Review Results

We noted the following area requiring management's attention resulting from our review:

- Workers' Compensation is not properly accounting for leases in accordance with Governmental Accounting Standards Board (GASB) Statement No. 87. Management did not properly evaluate and record the group of leased assets with the same contracted vendor, lease term, and interest rate. In addition, management did not follow the correct procedure for determining the interest rate. Commonwealth Accounting Policies and Procedures Manual Topic 31200, which references GASB Statement No. 87 for leases, requires agencies to group leases for recording in the lease accounting system to ensure proper classification of long-term and short-term leases; and to evaluate explicit, implicit, and incremental borrowing rates before resorting to using the prime rate for a reasonable and accurate interest rate. Management should update the lease procedures to comply with GASB Statement No. 87 and properly record and classify leases in accordance with this standard.

We discussed this matter with management on August 7, 2023. Management's response to the finding identified in our review is included in the section titled "Agency Response." We did not validate

management's response and, accordingly, cannot take a position on whether or not it adequately addresses the issues in this report.

This report is intended for the information and use of management. However, it is a public record, and its distribution is not limited.

Sincerely,

Staci A. Henshaw
Auditor of Public Accounts

JDE/clj



COMMONWEALTH OF VIRGINIA
Workers' Compensation Commission

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Robert A. Rapaport, Chairman
R. Ferrell Newman, Commissioner | Wesley G. Marshall, Commissioner
James J. Szablewicz, Chief Deputy Commissioner
Evelyn V. McGill, Executive Director | Jason S. Quattropani, Clerk

November 9, 2023

Staci A. Henshaw, CPA
Auditor of Public Accounts
Commonwealth of Virginia
P. O. Box 1295
Richmond, Virginia 23218

Dear Ms. Henshaw:

We are in receipt of your Internal Control Questionnaire Review Results report. The Report makes the following finding to improve internal controls over leases.

- Workers' Compensation is not properly accounting for leases in accordance with Governmental Accounting Standards Board (GASB) Statement No. 87. Management did not properly evaluate and record the group of leased assets with the same contracted vendor, lease term, and interest rate. In addition, management did not follow the correct procedure for determining the interest rate. Commonwealth Accounting Policies and Procedures Manual Topic 31200 which references GASB Statement No. 87 for leases requires agencies to group leases for recording in the lease accounting system to ensure proper classification of long-term and short-term leases; and to evaluate explicit, implicit, and incremental borrowing rates before defaulting to the prime rate for a reasonable and accurate interest rate. Management should update the lease procedures to comply with GASB Statement No. 87 and properly record and classify leases in accordance with this standard.

Commission's Response: For the review period covering the ICQ audit, VWC leased office space and copiers. Subscription-based Information Technology Arrangements (SBITAs) were added at the end of FY23. Immediately after our June 20th APA meeting to discuss leases and capital assets, to ensure correct classifications, FSD staff updated the group of leased assets with the same contracted vendor and lease term in the Commonwealth's Lease Accounting Systems (LAS). Since the meeting, FSD staff have also researched determining the correct interest rate to use for leases. Contracts were reviewed and no interest rate components are included in any of the VWC lease contracts. LAS personnel were consulted as well as other state agencies. VWC holds no debt/borrowings and does not have interest rates readily

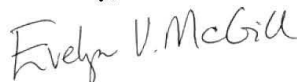
available to evaluate. Copier vendors were also consulted regarding the implicit lending rate. The procedure regarding interest rates has been updated to include:

- Leases with the same contracted vendor and lease term shall be grouped together in LAS so the system correctly assigns the lease as short-term or long-term.
- The LAS system defaults to the Prime Interest Rate. Before the Prime Interest Rate is selected, a good faith effort shall be documented to research an implicit interest rate to be assigned to the lease. This can include, but not be limited to researching the fair market value (fmv) or suggested retail price (srp) of the leased equipment or property and consulting with the contracted vendor. If fmv or srp is attainable, the amount paid over the lease term (plus any implementation costs) less the fmv/srp divided by the fmv/srp value can be used to calculate an implicit rate.

Example: A copier is leased for \$225 for 36 months (\$8,100) + \$250 for implementation (\$8,350). The fmv of the copier is \$8,000. $\$8,350 - \$8,000 = \$350$; $\$350$ divided by $\$8,000 = 4.38\%$ implicit interest rate.

Thank you and your Audit Team for conducting the internal control audit of VWC. We appreciate the strong partnership with the APA and look to respond to eh recommendations accordingly.

Sincerely,



Evelyn V. McGill
Executive Director