

STATE CORPORATION COMMISSION

**REPORT ON AUDIT
FOR THE YEAR ENDED
JUNE 30, 2012**

APA

**Auditor of
Public Accounts**

COMMONWEALTH OF VIRGINIA

AUDIT SUMMARY

Our audit of the State Corporation Commission, for the period ended June 30, 2012 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;
- instances of noncompliance with applicable laws and regulations or other matters that required reporting; and
- the Commission has taken adequate corrective action with respect to audit findings reported in the prior year.

In response to allegations received through the Fraud, Waste, and Abuse Hotline and an anonymous letter received by this office, we adapted our review of the State Corporation Commission for fiscal year 2012 to incorporate additional work in the areas of procurement, compensation, and other various expenses. The additional work included interviews with management and employees, review of documents, and analysis of data. We did not find any evidence to substantiate the allegations of fraud or abuse. We did note concerns with internal controls and compliance over personnel and procurement activities, which are included in the section "Audit Findings and Recommendations" along with findings from our financial audit. In addition, we performed a review after the initial Hotline call and issued a letter dated February 29, 2012, that addresses the specific allegations made to the Fraud, Waste, and Abuse Hotline, noting that the allegations were unfounded.

- TABLE OF CONTENTS -

	<u>Pages</u>
AUDIT SUMMARY	
INTRODUCTION	1-2
AUDIT FINDINGS AND RECOMMENDATIONS	3-8
COMMISSION HIGHLIGHTS	9-12
FINANCIAL INFORMATION	13-16
INDEPENDENT AUDITOR'S REPORT	17-18
COMMISSION RESPONSE	19-21
COMMISSION OFFICIALS	22

INTRODUCTION

In response to allegations received through the Fraud, Waste, and Abuse Hotline and an anonymous letter received by this office, we adapted our review of the State Corporation Commission for fiscal year 2012 to incorporate additional work in the areas of procurement, compensation, and other various expenses. The additional work included interviews with management and employees, review of documents, and analysis of data. We did not find any evidence to substantiate the allegations of fraud or abuse. We did note concerns with internal controls and compliance over personnel and procurement activities, which are included in the section "Audit Findings and Recommendations" along with findings from our financial audit. In addition, we performed a review after the initial Hotline call and issued a letter dated February 29, 2012, that addresses the specific allegations made to the Fraud, Waste, and Abuse Hotline, noting that the allegations were unfounded.

The Commission is an independent department of government established by Article 9 of the Virginia Constitution. As an independent department of government, the Commission does not fall under any of the three branches of government. As such, the Commission does not necessarily follow the same laws, rules, and regulations that state agencies follow. Code of Virginia Section 2.2-2905 exempts the Commission from the Virginia Personnel Act. Therefore, the Commission establishes its own policies and procedures over personnel administration governing the appointment, promotion, discipline, dismissal, and other related conditions of employment. In addition, the Virginia Information Technologies Agency (VITA) has authority over the procurement of information technology goods and services for executive branch agencies only. Judicial, legislative, and independent agencies are not subject to VITA's procurement authority. Therefore, the Commission has unlimited authority over information technology procurement.

The Commission is subject to the Virginia Public Procurement Act and the Agency Procurement and Surplus Property Manual. However, for years the Commission has operated in good faith on the basis that certain provisions of the Act, specifically those provisions that reference executive branch agencies, the Governor, or his Executive Orders, did not apply to Commission procurement procedures because of the Commission's status as an independent department of government. The Commission has established internal policies for any requirement to which they have taken exception to ensure adequate controls. This includes approvals for sole source contracts and for increasing a fixed-price contract by more than 25 percent of the original contract amount, to name a few. The Commission has not sought approval from the Governor or the Director of the Department of General Services for these approvals related to any contract over the years. In 2008, the Commissioners delegated this approval authority to the newly created position of Chief Administrative Officer, which is the highest-ranking employee position within the Commission, reporting directly to the Commissioners.

Given the Commission's standing as an independent department of government, the Commission should work with the Department of General Services and the Attorney General's Office to clarify all procurement rules as to what applies and what does not within the Act and Manual based on its independent department of government designation. The Commission should update its internal policies and procedures to reflect this clarification.

SCC eFile System Implementation

In October 2008, the Commission contracted with CGI Technologies and Solutions Inc. (CGI) to perform an analysis for recommendations on how to implement a web-based filing electronic payment application (SCC eFile) for the Clerk's Office and then to develop and implement SCC eFile, for which CGI continues to perform related system enhancements, maintenance, and support. SCC eFile allows users to perform the following activities online:

- form a Virginia stock corporation or LLC,
- perform registered agent changes and resignations,
- file corporate annual reports,
- pay corporate and LLC annual registration fees,
- obtain certificates of good standing for corporations and certificates of fact of existence or registration for LLCs,
- submit articles of amendment and restatement for Virginia corporations and LLCs and articles of cancellation for LLCs,
- file UCC financing statements and amendments,
- check business entity name distinguishability, and
- perform basic business entity searches.

The Commission attempted twice to implement similar systems over the past 15 years but was unsuccessful both times. The Commission decided in 2008 to try again. Because of its previous unsuccessful attempts and the pressing need to make these services available to the public, they considered this a high-risk, critical project. The Commission decided that the safest and most cost effective process was to use an approved vendor from the state contract for Advanced IT Resources and Supplier Managed Staff Augmentation. To be on state contract, the vendor has to go through a competitive procurement process. The Department of General Services and the Virginia Information Technologies Agency procure goods and services through state contracts and make them available to agencies as an efficient way to procure commonly used goods and services. This eliminates the need for each agency to go through the procurement process. CGI was one of five vendors on the Advanced IT Resources state contract. The Commission chose CGI because of their proven success in implementing IT projects for the Commonwealth.

The Advanced IT Resources state contract was set to expire in August 2009. Traditionally, practice has been for agencies to be able to complete work on any purchase order issued prior to expiration of the contract. However, early in 2009, VITA requested that agencies not issue any purchase orders that went past the expiration of the contract, without obtaining an exception from VITA. Since the Commission is not subject to VITA oversight, the Commission moved forward with issuing a purchase order, which went through September 2010, to implement the system. Therefore, when the state contract expired in August 2009, the Commission entered into a sole source contract with CGI to complete implementation. The Commission justified the use of a sole source contract because all work on the project was either in progress or near completion. It was impracticable to stop at that point and go out to bid and possibly lose time, knowledge, and money or have the project fail. The Commission did not include a price reasonableness justification because the costs were based on the original state contract, which had already been competitively procured.

The contract began at \$2,928,230, which included the original assessment, development, and implementation of the filing and payment application system for the Clerk's Office. The contract total increased to \$6,939,275 due to eight modifications. These modifications were for performing IT security assessments, factoring new technology into previously completed waves, and adding functionality that was not originally included in the scope. The added functionality originated from a stakeholder group of business and legal representatives that advised the Commission throughout the project on behalf of users as to necessary services and functionality. The Chief Administrative Officer approved any changes that increased the value of the contract by greater than 25 percent.

AUDIT FINDINGS AND RECOMMENDATIONS

Follow Procurement Rules and Best Practices (Compliance)

The Commission did not always follow, consider, or document compliance with procurement rules and regulations when making purchases. We found multiple instances in various areas described below.

SCC eFile Contract:

The Commission did not always document compliance with procurement rules or follow best practices in the procurement and management of the SCC eFile contract. Under the Advanced IT Resources state contract, users should develop a Statement of Work and submit to the vendor for a price. The Commission, instead, used a collaborative approach to developing the Statement of Work, working with CGI to write the Statement of Work. In addition, the Advanced IT Resources contract did not require, but encouraged users to submit the Statement of Work to multiple vendors on the contract to get the best value. Because of CGI's past success in implementing Commonwealth systems, the Commission chose to only submit the Statement of Work to CGI. Developing their own Statement of Work and submitting it to multiple vendors may have provided different solutions at varying prices. However, the solution that the Commission implemented was successful and the price paid was within the competitively procured rates on the original state contract.

The Commission did not always document decisions and agreements with the vendor.

- The original CGI contract included two phases. The initial phase was to assess the current state and develop a solution to implement a web based filing payment application system. The second phase was the implementation of the solution. The Statement of Work stated, "Phase 2 will not commence until the Commission has reviewed and assessed Phase 1 and determines how Phase 2 will be procured." The Commission did not clearly document its decision at the conclusion of Phase 1. It was reasonable for the Commission to continue with CGI, since there is no prohibition against it. The only prohibition in the VITA IT Procurement manual, which governs IT procurements, states "No person who, for compensation, prepares an invitation to bid or request for proposal for or on behalf of a public body shall (i) submit a bid or proposal for that procurement or any portion thereof or (ii) disclose to any bidder or offeror information concerning the procurement that is not available to the public." This was not an invitation to bid or a request for proposal and CGI did not receive compensation for this collaboration. Therefore, there is nothing to prohibit CGI from designing and implementing the system. This is often done in practice for IT implementations or in building construction through Design Build contracts.
- The Commission did not properly document decisions made affecting payments terms in the last modification to the contract. Prior to the last modification, terms of the fixed-price contract required CGI to provide 20 days of support after the final phase of the project went live for \$100,000. Due to numerous issues outside of the CGI team's control, the final implementation was delayed by three and a half weeks. The final modification extended the end date by two weeks at no additional cost. CGI agreed to provide 12 days of support and the remaining eight days was considered expended as part of the three and a half week delay. However, the Commission did not clearly document this in the modification.

The Commission should clearly document decisions and the justification within the contract file to ensure all decisions are properly supported. The Commission should clearly document all changes to payment terms. Review of documentation outside of the procurement file verified that the Commission received services in exchange for the \$100,000.

Other Contracts:

The Commission did not properly procure or extend multiple contracts reviewed.

- The Commission used a vendor for secure offsite data storage services for daily backups for mission critical data for over 15 years without a written contract. Without a contract, the Commission has no control or recourse over the terms and conditions or the handling of its data storage. The vendor would not agree to some of the Commonwealth's general terms and conditions. The Commission should have worked with its attorney to develop a contract for this service or found a different vendor.
- The Commission did not properly compete or negotiate all prices within a contract to provide property management services. The monthly management fee was competed. However, the Commission included the potential for miscellaneous project management services in the contract, but the fees for these services were to be agreed upon when they occurred. By not including these services within the original competition, the Commission cannot ensure that they paid competitive prices for these services. The Commission should not enter into contracts where there are services with undefined costs. The Commission should ensure that all potential costs are part of the competed price.
- The Commission extended a cafeteria contract for 12 months after exhausting all renewal options. The Agency Procurement and Surplus Property Manual Section 10.13 (b) states that "in exceptional or extenuating circumstances a contract may be extended by mutual consent for a limited period, not to exceed six (6) months." The Commission extended the contract to allow time to prepare a new Request for Proposal for the management of the cafeteria. However, this is not an extenuating circumstance and the extension was longer than the allowed six months; the Commission should have planned for the expiration of the contract and allowed time to put the contract out for bid.
- The Commission purchased items, such as electronics, printer toner, and reference materials, obtaining only one quote or bid, as required for purchases under the \$5,000 threshold. Individual divisions purchased these items throughout the year. However, when combining all similar purchases, they exceed the \$5,000 threshold for obtaining multiple quotes or bids. The Commission should take a global view of their purchases so that they can combine like items and purchase them competitively to ensure they receive the best price.
- The Commission did not include the cost to produce DVDs for distribution as part of a contract to produce a marketing video. They purchased the DVDs after obtaining a quote from the original contractor, but without obtaining quotes from other vendors. The Commission should have included the cost of the DVDs in the original contract procurement.

The Commission should work with the Department of General Services and the Attorney General's Office to clarify what procurement rules and regulations apply to them as an independent department of government. The Commission should assess their current policies and procedures and change them as needed to agree with this clarified understanding. The Commission should review its current contracts to ensure that they have all been properly procured. The Commission should review its current contracting policies and procedures and ensure that controls exist to properly procure contracts. As the Commission procures new contracts, they need to ensure that they comply with all applicable procurement requirements.

Properly Approve Human Resource Actions (Internal Control)

The Commission did not follow its own policies in requesting and approving two human resource actions, including one adjustment bonus and one position appointment. We reviewed various human resource actions over the past five years. In October 2009, an Assistant Director requested an adjustment bonus of 3.89 percent annually for one employee. Commission policy states that only a Division Director has the authority to request an adjustment bonus. In April 2011, the Chief Administrative Officer approved the appointment of the Human Resource Director, a grade 17. The Chief Administrative Officer did not document that he consulted with the Commissioners and received their verbal approval, as was his normal practice. Commission policy states that Commission approval is required for positions for grades 17 and higher. Not enforcing the policies over approving human resource actions increases the risk that inappropriate salary changes or employments could occur. The Commission should review and enforce its procedures over ensuring that human resource actions are properly approved.

Improve Internal Controls over Procurement Approval Workflow (Internal Control)

Some aspects of the Commission's procurement approval workflow are not operating effectively. The Commission's accounting system, eSCC, does not allow payment of expenses without invoice approval or that exceed the amount of an approved purchase order. However, in three instances, employees requested increases to the amount of existing purchase orders after ordering or receiving the services. Additionally, in one instance, an employee made a purchase without a purchase order, and the Office of the Commission Comptroller did not review the required purchase order approval before making payment.

In addition, the Commission's approval workflow design does not meet best practices. The Commission is highly decentralized to help facilitate the varying missions of its divisions. This structure requires operational supervision at the division level. Despite decentralized operations, the Office of the Commission Comptroller (OCC) approves requisitions centrally unless the requisition is over a significant threshold (typically \$1,000,000). Consequently, OCC is the only approver for the vast majority of expenses. Furthermore, eSCC access levels often allow the same employee to submit the purchase requisition and invoice and to deliver the payment for X-batches, which are typically used for registration fees and subscriptions. These access levels represent a lack of segregation of duties.

Procurement approvals are an essential internal control to protect the agency's resources against fraud, waste, and abuse. For procurement approval to be an effective internal control, however, it must be performed prior to the expense being incurred and must be approved by someone with knowledge of the related business activity. Allowing employees at the division level the ability to submit requisitions for OCC approval without division director approval for purchases up to \$1,000,000 unnecessarily increases the Commission's risk of waste and abuse. Moreover, allowing employees at the division level access to submit X-batch purchase requisitions and invoices and to remit payments increases the risk of misappropriated assets.

The Commission should enhance its internal controls to prevent incurring or paying for goods or services without an approved purchase order. The Commission should re-evaluate its approval workflow in

eSCC to determine the threshold at which division approval is required based on the level of risk it is willing to accept for individual purchases. Finally, the Commission should re-evaluate eSCC purchasing access levels to ensure proper segregation of duties between requesting, approving, and paying for goods and services.

Implement Consistent Procedures over Clerks Office Revenue Deposited for other Divisions (Internal Control)

The Commission is not depositing timely or reconciling some fines and penalties in the Literary Fund. The Commission does not have a consistent procedure for deposits made through the Clerk's Office on behalf of other divisions resulting in late and possibly incomplete deposits. Divisions that make deposits through the Clerk's Office for specific court cases sometimes send the funds directly to the Clerk's Office and sometimes funnel the funds through the Office of the Commission Comptroller and then to the Clerk's Office. The Commission's policy does not directly address the handling of these types of deposits. Additionally, the Clerk's Office only reconciles its divisional revenue to the agency accounting system (eSCC); they do not reconcile accounts within the Literary Fund. These funds are fines or penalties typically deposited on behalf of other divisions, amounting to over \$1.1 million during fiscal year 2012.

The Commission's collection of these fines and penalties is infrequent, and the individuals involved are not properly trained. For this reason, consistent procedures over revenue handling are essential for safeguarding funds received and for ensuring deposits are made intact and timely. Inconsistent revenue handling procedures, untimely deposits, and revenue that is not reconciled increase the risks of theft and improper revenue recognition.

The Commission should strengthen its policy to ensure consistent revenue handling procedures specifically over revenues deposited by the Clerk's Office on behalf of other divisions. The Commission should train the individuals processing these funds. The Commission should also take steps to ensure that all deposits are reconciled from divisional systems to eSCC.

Transfer Unclaimed Refunds to Unclaimed Property Division (Compliance)

The Commission is not complying with the Uniform Disposition of Unclaimed Property Act. The Clerk's Office receives a high volume of insignificant fee overpayments throughout the year. The Clerk's Office performs due diligence to locate the owners of unclaimed refunds greater than \$25, but owners do not always respond to these notifications. Weekly, the Clerk's Office transfers all refunds that have been unclaimed for at least a year to the General Fund rather than to Unclaimed Property. The Commission transferred over \$350,000 in unclaimed refunds to the General Fund in fiscal year 2012.

Prior to July 1, 1989, the Clerk's Office and the Division of Securities and Retail Franchising deposited all funds collected in the General Fund. On July 1, 1989, the Commission began recording the funds for these two divisions in a Special Revenue Fund. At that time, the Commission began transferring any overpayments remaining after performing due diligence to the General Fund.

The Commission is not reporting unclaimed property to the program administrator as specified in section 55-210.9 and 55-210.12 of the Code of Virginia, which states "*All intangible property held for the owner by any government or governmental subdivision or agency, public corporation, or public authority that has remained unclaimed by the owner for more than one year after it became payable is presumed abandoned. Every person holding funds or other property, tangible or intangible, presumed abandoned under this chapter shall report and remit to the administrator with respect to the property as hereinafter provided.*"

Transferring unclaimed refunds to the General Fund does not legally remove the Commission's liability to pay out refunds. When the Commission transfers unclaimed funds to the General Fund, those funds are no longer available to payout claims. Conversely, the Unclaimed Property Division holds funds in trust in the Literary Fund for pay out as claims occur. The Commission should comply with the Uniform Disposition of Unclaimed Property Act and report unclaimed property to the Unclaimed Property Division within the Department of the Treasury.

Improve Database Security (Compliance)

The Commission should strengthen controls over its administrative Database Management System. During our audit, we found that the Commission did not implement proper controls while addressing Database Administrator activity logs for the system audited.

We have communicated the details of this issue to management in a separate document marked Freedom of Information Act Exempt under Section 2.2-3705.2 of the Code of Virginia, due to their sensitivity and description of security controls.

We recommend that the Commission review its activity logging controls for the system audited and change the appropriate configurations to ensure the activity log's confidentiality, integrity, and availability. While implementing these controls, the Commission should reference the Center for Internet Security Oracle best practices and the Commonwealth's Information Security Standard, SEC501-07, to ensure compliance with best practices and standards.

Adhere to Policies and Procedures for Assigned Vehicles (Internal Control)

The Commission is not following some of the policies and procedures regarding the assignment and personal use of state-owned vehicles. Our review of assigned state vehicles being used for personal commuting noted the following:

- Since the 1990's, the Commission has reported mileage associated with personal commuting at \$1.50 per commute as a taxable fringe benefit, as specified by the IRS Commuting Rule, rather than having the employee reimburse the Commonwealth at the current IRS mileage rate, as required by the Office of Fleet Management Services (OFMS) Policies and Procedures Manual.
- The Commission did not require employees to maintain vehicle travel logs.

The Commission follows the Office of Fleet Management Services Policies and Procedures Manual for its use of state vehicles. Section 3, Part A, requires the approval of an appropriate agency head for assigned vehicles and, in the case of OFMS leased fleet vehicles, the State Fleet Administrator. Part C requires that all employees authorized to use a state-owned vehicle for commuting shall reimburse the state for mileage. Part E requires vehicle travel logs if the agency elects to use "actual days commute" in lieu of the standard 220 days per year.

The Commission has 63 state vehicles assigned to employees, of which 21 employees commute. These 21 employees submitted a total of 2,325 one-way commutes during fiscal year 2012. Since the Commission has no record of actual miles commuted for each employee, we cannot determine what each employee should have paid. However, using the actual number of commutes, we estimated the following: If the average one-way commute was 20 miles for 2,325 commutes at a reimbursement rate of \$0.555, the annual reimbursement forgone would be \$25,807.50.

The Commission should review the Office of Fleet Management Services Policies and Procedures Manual and ensure that it is adhering to the policies and procedures associated with assigned vehicles. The Commission should correct its process and have employees begin reimbursing the Commonwealth for commuting in state owned vehicles.

COMMISSION HIGHLIGHTS

The Commission is an independent department of government 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	Non-Regulatory Divisions
Clerk of the Commission	Commission Comptroller
Communications	Council to the Commission
Economics and Finance	General Council
Energy Regulation	Hearing Examiners
Financial Institutions	Human Resources
Insurance	Information Resources
Public Service Taxation	Information Security
Public Utility Accounting	Information Technology
Securities and Retail Franchising	Internal Audit
Utility and Railroad Safety	

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 2012, the Clerk's Office collected \$5.0 million in General Fund revenue and \$50.7 million in special revenue.

Division of Communications

The Division of Communications (Communications) regulates Virginia's traditional landline telecommunications industry. It assists the Commission in developing, implementing, and enforcing alternatives to traditional forms of regulation as competition evolves. Communications reviews rates and costs, assures compliance with tariff regulations and state law, enforces service standards, investigates consumer complaints regarding communications service, enforces payphone regulations, evaluates telephone companies' performance, and oversees and monitors 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) provides the Commission with technical support in its regulation of 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 and rate adjustment filings made by investor-owned utilities and/or member-owned cooperatives, analyzing certificate applications, monitoring utility construction projects, and responding to consumer complaints regarding electric, gas, water, and sewer utilities under the Commission's jurisdiction.

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 licenses and examines mortgage lenders and brokers, mortgage loan originators, money order sellers, consumer finance companies, industrial loan associations, payday lenders, motor vehicle title lenders, and credit counseling agencies. Check cashers are required to register with the Commission through the Bureau of Financial Institutions. Financial Institutions collects revenue from these entities for application fees, license fees, annual assessment fees, examination fees, and investigation fees, which totaled \$13.6 million in fiscal year 2012.

Bureau of Insurance

The Bureau of Insurance (Insurance) regulates over 1,575 insurance companies and 210,000 agents and agencies licensed to do business in Virginia. Insurance also licenses or administers other entities such as health plans, risk retention groups, and continuing care providers. Insurance approves forms for insurance policies and contracts and prescribes the standards and guidelines for insurance coverage. Insurance performs financial and compliance audits on the licensed insurance companies and approves a variety of insurance company transactions. Insurance staff assists consumers in resolving disputes with insurance companies.

Insurance collects a gross premium tax from insurance companies, which totaled \$390.2 million in General Fund revenue in fiscal year 2012. Insurance also collected \$25.7 million in fiscal year 2012 for the special revenue funds from maintenance assessments and fees from licenses, applications, and appointments. Insurance collected assessments in fiscal year 2012 for the following funds:

- Fire Programs Fund - \$30.9 million
- Flood Prevention and Protection Assistance Fund - \$193,000
- Help Eliminate Automobile Theft (HEAT) Fund - \$1.6 million
- Fraud Assessment - \$5.0 million

Insurance transfers the amount collected to the appropriate agency that administers the program, less an administrative fee to cover costs incurred.

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 \$5.1 million in fiscal year 2012.

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 2012, the Public Service Taxation collected \$87.6 million in General Fund revenue and \$26.0 million in special revenue.

Division of Public Utility Accounting

The Division of Utility Accounting and Finance provides the Commissioners with information and analysis on electric, gas, water, and wastewater utilities' accounting and financial positions. The work is primarily done through audits and investigations, both formal and informal, of the utilities. The Commissioners use this information when considering utility applications involving rates and services; financing; 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 securities, brokers-dealers, brokers-dealer agents, investment advisers, and their representatives and registers franchises and trademarks in Virginia. Security and Retail Franchising answers inquiries, handles complaints, provides investor education awareness, performs audits, and conducts investigations regarding Code of Virginia violations. Security and Retail Franchising collected \$9.8 million in fiscal year 2012.

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 procedures, tracks, and equipment. To promote natural gas and hazardous liquid pipeline safety, Utility and Railroad Safety conducts pipeline facilities inspections, reviews records and plans, and investigates incidents. Utility and Railroad Safety also investigates all reports of probable violations of the Underground Utility Damage Prevention Act and helps the Commission in the enforcement of the Act. The 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.

Below are some significant events that occurred after the end of fiscal year 2012.

Systems Development Improvements

On August 14, 2012, the Commission put out a Request for Proposal (RFP) for Commission 2.0: Business Process Improvement and Core System Replacement. This RFP is designed to form a long-term partnership with a single Contractor, working side by side with staff at the Commission, to replace the Clerk's Information System (CIS) and to improve and standardize business processes throughout the Commission. Business process improvement may or may not lead to replacement of existing systems, depending on the proposed solutions awarded. Additionally, if the Offeror's solution involves replacing or expanding SCC

eFile (in part or in its entirety), the solution shall provide at a minimum the existing functionality found in SCC eFile and any new functionality introduced before or during the project. The Commission expects Commission 2.0 to be a significant project in scope and cost. However, the Commission does not know the precise costs and performance period of services in that they are dependent on the solution and outcome of final negotiations and the awarded contract. The Commission has retained the services of a procurement specialist in the Office of the Attorney General to provide legal advice and guidance with regard to this procurement.

Cafeteria Operations

The Commission contracts with a vendor to run the cafeteria in the Commission building in downtown Richmond. The current vendor has operated the cafeteria since 1993 when the building opened. They are currently operating it under a renewal of a contract originally procured in 2001. The Commission procured the services through an RFP using competitive negotiation in 1991 and 2001. Each contract was for a four-year period with two three-year renewals. The contract provides the following terms:

The Vendor will provide:

- Full service breakfast and lunch;
- Partial service of beverages, snacks, and refreshments provided during all operating hours;
- Meals served on china provided by the Commission;
- All food available for takeout;
- Janitorial services and cleanup of the kitchen;
- All merchandise, food, food related supplies and expendable paper products;
- Vending services;
- Staff to operate the cafeteria; and
- Maintenance for 5 years of all financial, accounting, and inventory records, which shall be kept in accordance with GAAP.

The Commission will provide:

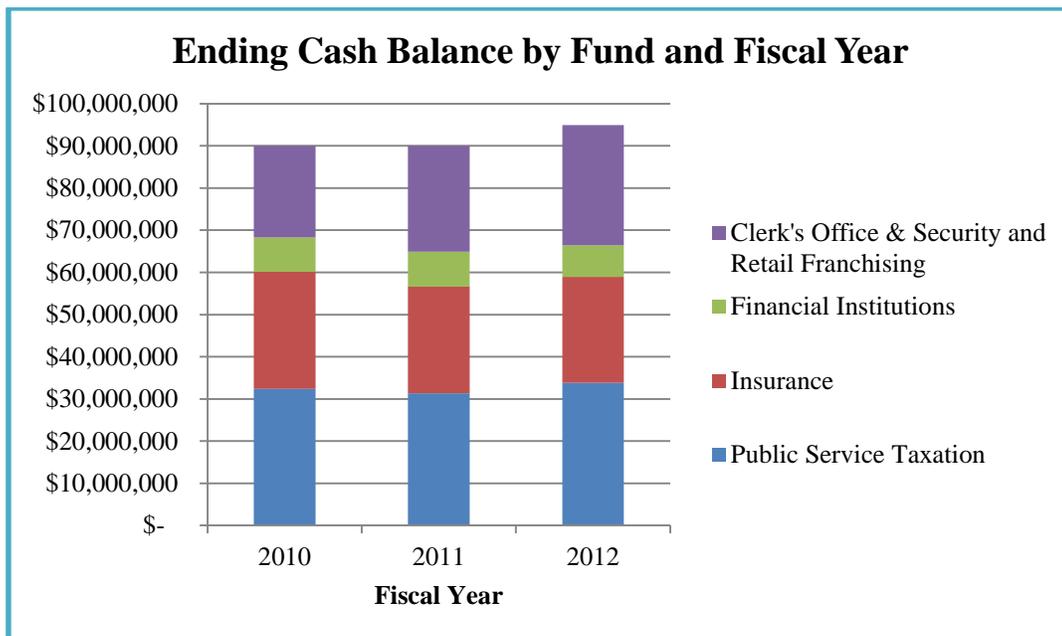
- Food service and kitchen equipment, cafeteria tables, seating, and vending machines;
- China, cutlery, crockery, dishes, cookware, tableware, serving trays, and kitchen utensils;
- All electricity, natural gas, water, sewage disposal, and trash disposal;
- Routine maintenance and repair of the food service and kitchen equipment;
- Limited janitorial services;
- A management fee of \$28,000 (this was reduced to \$20,000 in 2003);
- Final authority over setting food prices; and
- Payment for any operating expenses in excess of revenues collected.

The Commission has subsidized the cafeteria operations over the years through the contractual requirement that they pay the vendor for any operating expenses in excess of revenues collected. In the past five years, the subsidy has grown from \$102,313 in fiscal year 2007 to \$187,841 in fiscal year 2012. During fiscal year 2013, the Commission competitively procured a new vendor to operate the cafeteria. The Commission did not allow the payment of a subsidy in the new contract. Operations under the new vendor should begin July 2013.

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 maintains a cash balance in these special revenue funds as a reserve to prevent large fluctuations in rates. Additionally, management anticipates significant future costs associated with the implementation of Commission 2.0, which they intend to fund using some of these cash reserves. The total cash balance of special revenue funds increased from \$90.0 million in fiscal years 2010 and 2011 to \$95.0 million in fiscal year 2012. The following table shows the ending cash balances of the Commission special revenue funds for fiscal years 2010, 2011 and 2012.

Table 1



Source: Commonwealth Accounting and Reporting System

The Appropriation Act requires the Commission to transfer to the General Fund three-fourths of the revenue collected for registration fees for domestic and foreign corporations semi-annually. The Commission collected \$32.2 million in this area during fiscal year 2012, resulting in a required transfer of \$24.2 million to the General Fund. The Code of Virginia also requires the Commission to revert excess fees collected for Securities and Retail Franchising over costs to the General Fund. The Commission collected \$9.8 million in revenue for Securities and Retail Franchising and spent \$6 million for an excess of \$3.8 million. In addition, the Code of Virginia requires the Commission to pay the excess of domestic and foreign corporation registration fees collected over the projected costs of administration in the next fiscal year into the General Fund. However, the Commission does not project the costs of administering domestic and foreign corporation registrations. Instead, the Controller retains enough cash to pay anticipated bills and transfers the rest, resulting in a larger transfer than required. For fiscal year 2012, this transfer was \$8.3 million. The Commission transferred a total of \$36.3 million to the General Fund during fiscal year 2012 for these transfers.

The General Assembly also required one-time transfers from special revenue funds to the General Fund of \$12.0 million and \$11.2 million in fiscal years 2011 and 2012, respectively. This represented a

significant increase from \$1.25 million and \$1.75 million in fiscal years 2009 and 2010, respectively. The General Assembly gave the Commission the discretion of how to allocate the transfers across its available special funds. The following table shows a breakdown of Commission interfund transfers from special revenue funds to the General Fund, including the one-time transfers discussed above, for fiscal years 2011 and 2012.

Table 2

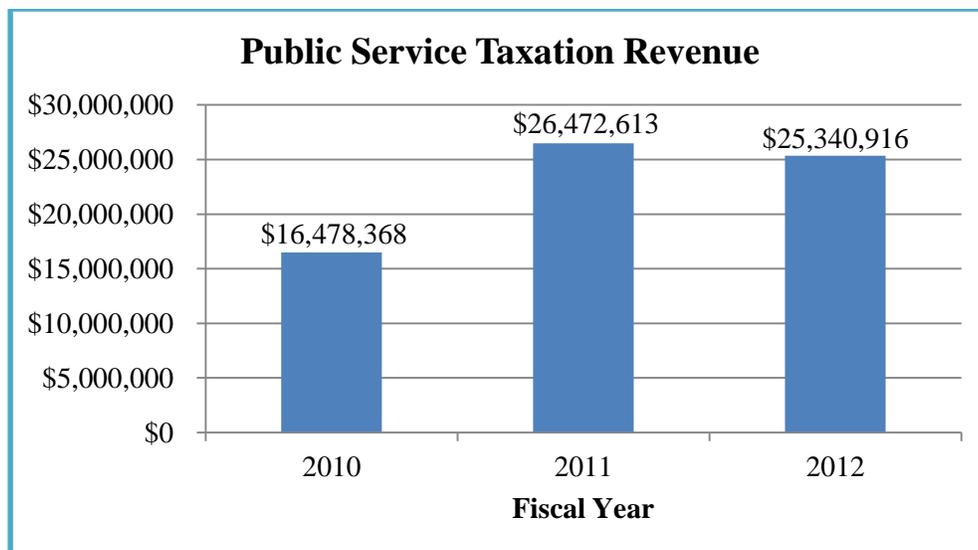
Special Revenue Transfers to the General Fund

Fund	2011	2012
Public Service Taxation	\$ 8,074,389	\$ 4,427,003
Insurance	4,129,052	3,236,126
Financial Institutions	68,733	1,497,332
Clerk’s Office and Security and Retail Franchising	82,059	2,375,399
Utility and Railroad Safety	<u>19,936</u>	<u>173,898</u>
Total	<u>\$12,374,169</u>	<u>\$11,709,758</u>

Source: Commonwealth Accounting and Reporting System

Various revenue increases have offset the increase in required special revenue transfers. Special regulatory taxes assessed by Public Service Taxation increased during calendar years 2010 and 2011 due to a change in the rate from 50 percent of the maximum amount to 100 percent in January 2010. The Commission increased this assessment in anticipation of \$10 million in new costs over five years associated with the EnergySense Program. The Commission has since significantly reduced the scope of the EnergySense program and, as a result, reduced the Public Service Taxation special regulatory taxes for calendar year 2012 to 80 percent of the maximum amount. The following table shows the revenues collected in the Public Service Taxation special revenue fund for fiscal years 2010, 2011 and 2012.

Table 3



Source: Commonwealth Accounting and Reporting System

The Commission collects a majority of its revenues for the General Fund. General Fund revenues decreased by 7.6 percent primarily as a result of a reduction in gross premium tax collections for insurance companies. Gross premium taxes reduced as a result of fewer premium collections being reported by insurance companies. Responsibility for collection of the gross premium tax collections transfers to the Department of Taxation on January 1, 2013. In fiscal year 2012, General Fund revenues accounted for 67 percent of the Commission's total collections. The following table shows the total revenues the Commission collected by fund for fiscal years 2011 and 2012.

Table 4

Revenue by Fiscal Year and Fund

Fund	2011	2012
General	\$374,661,256	\$346,043,803
Special Revenue	153,544,228	156,039,250
Trust and Agency	4,922,857	6,566,875
Dedicated Special Revenue	5,776,390	5,846,621
Federal Trust	<u>1,529,876</u>	<u>2,341,051</u>
Total	<u>\$540,434,607</u>	<u>\$516,837,600</u>

Source: Commonwealth Accounting and Reporting System

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 2011 and 2012 Commission's original and adjusted budgets with actual expenses.

Table 5

Budget to Actual Operating Expenses by Fiscal Year and Fund

2012

	Original Budget	Final Budget	Actual Expense
Special Revenue	\$78,866,998	\$81,881,451	\$70,351,541
Trust and Agency	6,856,941	6,856,941	5,533,585
Dedicated Special Revenue	1,776,551	1,462,098	1,351,121
Federal Grants	<u>750,000</u>	<u>2,880,290</u>	<u>2,201,645</u>
Total	<u>\$88,250,490</u>	<u>\$93,080,780</u>	<u>\$79,437,892</u>

2011

	Original Budget	Final Budget	Actual Expense
Special Revenue	\$78,866,998	\$82,570,513	\$71,546,624
Trust and Agency	6,856,941	6,856,941	6,539,851
Dedicated Special Revenue	1,776,551	1,762,935	1,606,980
Federal Grants	<u>700,000</u>	<u>2,050,160</u>	<u>1,219,991</u>
Total	<u>\$88,200,490</u>	<u>\$93,240,549</u>	<u>\$80,913,446</u>

Source: Commonwealth Accounting and Reporting System

Special Revenue original and final budgeted amounts remained relatively constant between fiscal years 2011 and 2012. Actual expenses experienced a slight decline in fiscal year 2012. The increase in the final budget each year was primarily due to the re-appropriation of prior year unexpended appropriations related to multi-year projects, such as maintenance improvement projects and the e-File project. Actual Special Revenue expenses were 13 percent and 14 percent less than the final budget in fiscal years 2011 and 2012, respectively. This difference in budget to actual expenses is primarily a result of the Commission operating at less than full employment and budgeting unknown potential costs associated with multi-year building maintenance and information technology projects. Fiscal year 2012 Trust and Agency expenses decreased due to revenues for the uninsured motorist fund being less than originally anticipated. The increase in federal budgeted amounts and expenses is primarily due to receipt of federal grants in the Bureau of Insurance for insurance rate reviews and consumer assistance programs.

Payroll costs, including fringe benefits, accounted for approximately 67.2 percent, or \$54.4 million, of the Commission's total expenses during fiscal year 2012. During fiscal year 2012, the Commission spent \$14.5 million, or 17.9 percent, on contractual services and an additional \$5.6 million, or seven percent, on transfer payments. Contractual Services cover a broad variety of services, such as systems development, marketing, and actuarial services. The Commission's transfer payments are primarily payments to insurance companies from the uninsured motorists program. Personal services decreased as a result of a one-time bonus in fiscal year 2011 not received in fiscal year 2012. Contractual services increased primarily as a result of the new federal grants awarded to the Bureau of Insurance. Transfer payments decreased as a result of less revenue received from the uninsured motorist fund. Table 6 details the Commission's operating expenses by major expense category.

Table 6

Operating Expenses by Fiscal Year and Major Category

Category	2011	2012
Personal services	\$55,205,255	\$54,411,046
Contractual services	13,852,521	14,505,427
Supplies and materials	514,462	512,294
Transfer payments	6,755,441	5,637,997
Rent and other continuous charges	990,818	1,154,726
Equipment	<u>3,594,949</u>	<u>3,216,403</u>
Total	<u>\$80,913,446</u>	<u>\$79,437,893</u>

Source: Commonwealth Accounting and Reporting System



Commonwealth of Virginia

Auditor of Public Accounts

Martha S. Mavredes, CPA
Auditor of Public Accounts

P.O. Box 1295
Richmond, Virginia 23218

May 21, 2013

The Honorable Robert F. McDonnell
Governor of Virginia

The Honorable John M. O'Bannon, III
Chairman, Joint Legislative Audit
and Review Commission

We have audited the financial records and operations of the **State Corporation Commission** for the year ended June 30, 2012. 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 objective was to evaluate the accuracy of the Commission's financial transactions as reported in the Comprehensive Annual Financial Report for the Commonwealth of Virginia for the year ended June 30, 2012. In support of this objective, we evaluated the accuracy of recording financial transactions in the Commonwealth Accounting and Reporting System and in the Commission's accounting records, reviewed the adequacy of the Commission's internal control, tested for compliance with applicable laws, regulations, contracts, and grant agreements, and reviewed 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, regulations, contracts, and grant agreements.

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.

Accounts payable
Revenue
Payroll expenses
Operating expenses
Procurement
Information 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, regulations, contracts, and grant agreements. Our audit procedures included inquiries of appropriate personnel, inspection of documents, records, and contracts, and observation of the Commission's operations. We tested transactions and performed analytical procedures, including budgetary and trend analyses.

We found that 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 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, regulations, contracts, and grant agreements that require management's attention and corrective action. These matters are described in the section entitled "Audit Findings and Recommendations."

The Commission has taken adequate corrective action with respect to audit findings reported in the prior year.

Exit Conference and Report Distribution

We discussed this report with management on May 24, 2013. Management's response to the findings identified in our audit is included in the section titled "Commission Response." We did not audit management's response and, accordingly, we express no opinion on it.

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

AUDITOR OF PUBLIC ACCOUNTS

DBC/clj

COMMONWEALTH OF VIRGINIA



MARK C. CHRISTIE
COMMISSIONER

JAMES C. DIMITRI
COMMISSIONER

JUDITH WILLIAMS JAGDMANN
COMMISSIONER

JOEL H. PECK
CLERK OF THE COMMISSION
P.O. BOX 1197
RICHMOND, VIRGINIA 23218-1197

STATE CORPORATION COMMISSION

May 28, 2013

Ms. Martha S. Mavredes, CPA
Auditor of Public Accounts
James Monroe Building
101 N. 14th Street
Richmond, Virginia 23219

Dear Ms. Mavredes:

The State Corporation Commission (“Commission”) appreciates the time and effort that your staff devoted to the review of the Commission’s financial records and operations for fiscal year 2012 (“Report”).

We welcome your findings that the Commission’s financial recording and reporting of all transactions are proper in all material respects and that the Commission has taken adequate corrective action with respect to findings in last year’s audit report.

We also welcome your finding that no evidence was found to substantiate allegations of fraud or abuse in some procurements. This finding is consistent with your letter to us in February 2012, in which you reported that allegations of improprieties were unfounded.

We fully agree with the recommendations in the Report for needed actions. We already have acted to implement each recommendation and will continue until all are implemented completely. Each recommendation will improve our operations, and we are appreciative for them.

Specifically, let us highlight a few of the recommended actions already underway:

Procurement Matters Generally

Recognizing the need to retain the services of a procurement specialist to provide legal advice and guidance to the Commission with regard to procurement matters, the Commission contacted the Office of the Attorney General (“OAG”) last December and in February of this year we entered into a memorandum of agreement. Under this agreement, the OAG will provide us with the continuing services of a procurement specialist who will advise the Commission and our employees on procurement matters. The OAG specialist has already provided the Commission with advice on specific procurements and will review and make recommendations for improvements to our procurement processes more generally, with the goal of ensuring that the Commission is always in compliance with all applicable procurement laws, regulations and guidelines. We also will seek the OAG’s guidance in clarifying how the Commission interacts with the Department of General

Services on procurement matters and which rules and regulations apply to the Commission as an independent department of government. We expect to utilize the OAG procurement specialist's services on a continuing basis in the future.

SCC eFile Contract

The Report noted that the Commission should clearly document decisions and the justifications to ensure that all decisions are properly supported. The Report confirmed that the Commission did receive services in exchange for the \$100,000 expended in the final modification but did not clearly document this in the modification. The Commission will modify its procedures to ensure proper documentation of decisions by staff for any project work related to new systems development contracts or contracts to change current systems.

Secure Offsite Data Storage Services

The Report found that for fifteen years these services were provided by a vendor who would not agree to a written contract. The vendor was under a purchase order; however, the Commission has addressed this finding. A new contract for these services was competitively negotiated and awarded in March 2013.

New Café Contract

The Report found that the Commission extended a contract with the vendor who had operated the Commission's café since 1993 by 12 months, rather than the correct length of 6 months. Since then, the Commission conducted a competitive bid process and a new vendor was awarded a contract in April 2013 to operate the café, beginning this summer. The new contract provides for no operating subsidy to the vendor.

Transfer Unclaimed Refunds to Unclaimed Property Division

Since July 1, 1989, following a change in law, the practice of the Clerk's Office of the Commission has been to deposit all unclaimed refunds into the Commonwealth's General Fund rather than to the Unclaimed Property Division of the Virginia Department of Treasury. This practice has not been the subject of a finding in prior audits of the Commission's financial records during the period since 1989. The Report indicates that this practice does not comply with the Uniform Disposition of Unclaimed Property Act. Accordingly, the Commission will change this practice. Beginning July 1, 2013, new procedures and system changes will be in place by which any refunds that remain unclaimed by the owner after more than one year will be transferred to the Unclaimed Property Division within the Department of Treasury.

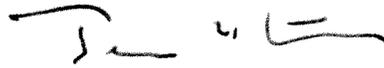
Other Matters

The Commission has also taken steps to implement other recommendations in the Report, including the need to document adequately human resource actions and to strengthen the procedures by which the Commission deposits some fines and penalties into the Literary Fund.

We appreciate the courtesies of the audit staff as well as staff's attention to our comments throughout the audit engagement.

Ms. Martha S. Mavredes
May 28, 2013
Page 3

Sincerely,

A handwritten signature in black ink, appearing to read "J. C. Dimitri". The signature is stylized with a long horizontal stroke at the beginning and a small flourish at the end.

James C. Dimitri, Chairman

A handwritten signature in black ink, appearing to read "Mark C. Christie". The signature is written in a cursive style with a prominent loop at the end.

Mark C. Christie, Commissioner

A handwritten signature in black ink, appearing to read "Judith Williams Jagdmann". The signature is written in a cursive style with a large loop at the end.

Judith Williams Jagdmann, Commissioner

STATE CORPORATION COMMISSION

As of June 30, 2012

COMMISSIONERS

Mark C. Christie, Chairman

James C. Dimitri

Judith Williams Jagdmann