



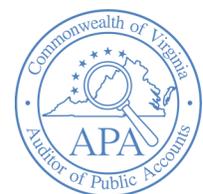
# STATE CORPORATION COMMISSION

## REPORT ON AUDIT FOR THE YEAR ENDED JUNE 30, 2014

Auditor of Public Accounts  
Martha S. Mavredes, CPA

[www.apa.virginia.gov](http://www.apa.virginia.gov)

(804) 225-3350



## AUDIT SUMMARY

Our audit of the State Corporation Commission (Commission) for the fiscal year ended June 30, 2014, found:

- proper recording and reporting of all transactions, in all material respects, in the Commonwealth Accounting and Reporting System and the Commission's accounting system;
- matters involving internal control and its operation 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;
- adequate corrective action with respect to four audit findings from the 2012 audit; and
- progress on corrective action for the other remaining finding from the 2012 audit.

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## AUDIT FINDINGS AND RECOMMENDATIONS

### **Establish an Independent Line of Reporting for the Chief Internal Auditor**

The State Corporation Commission (Commission) does not provide its Chief Internal Auditor organizational independence with respect to administrative operations. The Chief Internal Auditor is supervised by the Chief Administrative Officer, who is also responsible for supervising administrative operations. The Commission's organizational chart places the Chief Internal Auditor under the Chief Administrative Officer without any reporting line to the Commission's Commissioners; thus jeopardizing how others perceive the Chief Internal Auditor's objectivity when it comes to auditing and reporting on the areas within:

- Human Resources
- Information Technology
- Information Security
- Accounting
- Information Resources
- Business Continuity/Disaster Recovery

The Institute of Internal Auditors (IIA) International Standards for the Professional Practice of Internal Auditing, a best practice, states "The chief audit executive must report to a level within the organization that allows the internal audit activity to fulfill its responsibilities. The chief audit executive must confirm to the board, at least annually, the organizational independence of the internal audit activity." Although the Commission does not have a board, the Commissioners are its most senior oversight group. Additionally, the IIA standards states that "the audit charter should establish independence of the internal audit activity by the dual reporting relationship to management and the organization's most senior oversight group."

A lack of organizational independence could lead to management pressures affecting the objectivity of the Commission's Chief Internal Auditor. As a result of the Chief Internal Auditor only reporting to management, its assessments of management may appear to be influenced by this relationship. The Commission should establish a reporting line between the Chief Internal Auditor and the Commissioners for conducting risk assessments, establishing work plans, and issuing audit reports to protect the Auditor's objectivity.

### **Improve Information Security Program**

The Commission does not create and approve policies and procedures for certain required information security controls in its information systems security program. While the Commission conducts some controls in practice, there are no documented and approved requirements to ensure that the Commission's staff and contractors apply all the necessary controls to protect confidential and mission critical data. During our review, we determined that the Commission's security program does not contain documented policies and procedures for the following controls:

- IT Systems Hardening (Security Standard: Sections CM-3, CM-6, SA-3 COV-2, AC-17 COV)
- Systems Interoperability (Security Standard: Sections CA-3, CA-3 COV)
- Malicious Code Protection (Security Standard: Sections SI-3, SI-3 COV)
- Data Storage and Media Protection (Security Standard: Sections MP-1, MP-1 COV)
- Data Backup and Restoration (Security Standard: Sections CP-9, CP-9 COV, CP-10)

The Commonwealth's Information Security Standard, SEC 501-08 (Security Standard), section 1.1, requires agencies to develop a security program that includes documented policies and procedures for the required controls.

The absence of documented and approved policies and procedures for the controls mentioned above increases the risk of a control failure that may cause data to be compromised, inaccurate, or lost. Information security policies and procedures are mechanisms for the Commission to evaluate the appropriate data safeguards and allows the Commission to communicate these clearly to the staff responsible to protect sensitive data. The complexity of consistent implementation of security controls is greatly increased without policies and procedures that complies with the Security Standard and any individual controls needed due to the Commission's unique business requirements.

The Commission recently hired a replacement for their Information Security Officer (ISO) position, which remained vacant for over a year. The lack of an ISO directly impacted the Commission's ability to update and maintain its information security program to ensure compliance with the Security Standard.

We recommend that the Commission dedicate the necessary resources to improve their information security program and establish processes to reduce the impact of potential future transitions in the ISO position. The Commission should also develop the specific lacking policies and procedures as noted in the finding above. This process should include a gap analysis between the Commission's current information security program and the Security Standard.

### **Status of Prior Findings**

Our fiscal year 2013 report included updates on various 2012 findings related to improving internal controls that management was in progress of resolving. As part of this year's audit, we followed up with management on the status of findings not resolved in 2013 and summarized their progress in the following table.

2012 Findings	Status of Corrective Action
<b>Follow Procurement Rules and Best Practices</b>	<b>In Progress</b>
<b>Properly Approve Human Resource Actions</b>	<b>Resolved</b>
<b>Improve Internal Controls over Procurement Approval Workflow</b>	<b>Resolved</b>
<b>Implement Consistent Procedures over Clerks Office Revenue Deposited for Other Divisions</b>	<b>Resolved</b>
<b>Transfer Unclaimed Refunds to Unclaimed Property Division</b>	<b>Resolved</b>
<b>Adhere to Policies and Procedures for Assigned Vehicles</b>	<b>Resolved</b>

We discuss the status of the in progress finding in more detail below. The Commission did complete its corrective action plan before the end of fiscal year 2014. Therefore, the corrective actions taken to address this 2012 finding were followed up during the fiscal year 2014 audit.

*Follow Procurement Rules and Best Practices*

During the 2012 audit, it was found that the Commission did not always follow, consider, or document compliance with procurement rules and regulations when making purchases. The Commission did not always document decisions and agreements with the vendor of their SCC eFile contract. The Commission did not properly procure or extend multiple contracts reviewed. It was recommended that the Commission 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, and to assess the current policies and procedures and change them as needed to agree with this clarified understanding. It was also recommended that the Commission review its current contracts to ensure that they were properly procured.

The Commission has met with the Department of General Services and is working with the Attorney General’s Office to determine which state procurement laws and guidelines apply to them. The Attorney General’s Office completed the initial review of the Commission’s policies and procedures on September 20, 2013. As of April 1, 2014, the Commission hired a senior level counsel with Commonwealth of Virginia procurement experience to, among other administrative matters, review and provide legal advice on revising and updating procurement policies and procedures. This individual will also provide legal advice on an ongoing basis regarding procurement matters. The review is currently in process, and an expected completion date is not yet known.

## 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 regulatory 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 administrative divisions report to the Chief Administrative Officer.

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 revenues funds, localities, and other state entities.

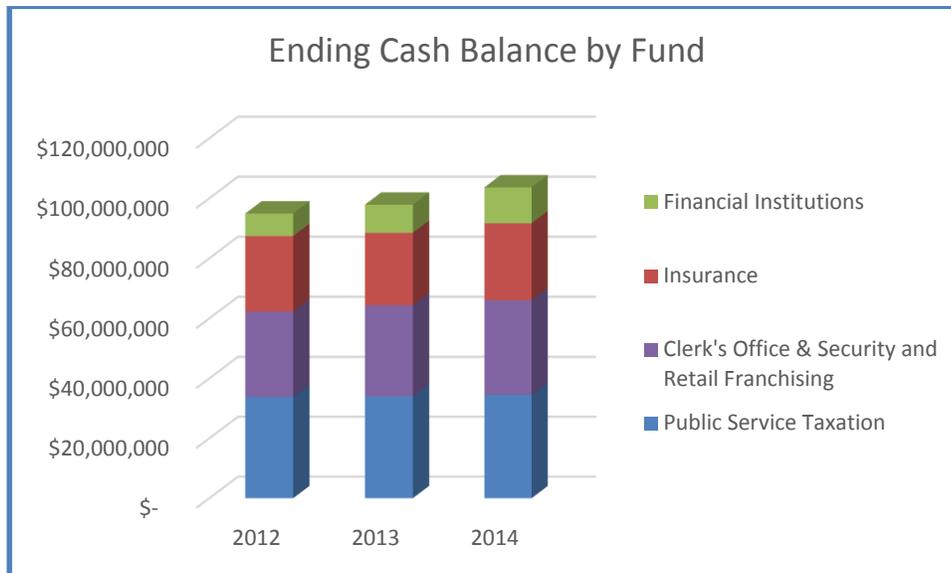
Below is a listing of the regulatory and non-regulatory divisions.

Regulatory Divisions	Non-Regulatory Divisions
Clerk of the Commission Communications Energy Regulation Bureau of Financial Institutions Bureau of Insurance Public Service Taxation Securities and Retail Franchising Utility Accounting and Finance Utility and Railroad Safety	<b>Legal:</b> General Counsel Hearing Examiners <b>Administrative:</b> Commission Comptroller Human Resources Information Security Information Technology Internal Audit Business Continuity/Disaster Recovery

### Financial Information

The Commission funds its operations from certain regulatory assessments and fees set by statute. It records this activity primarily in four special revenue funds. Depending on the revenue source, the Commission collects revenue annually, quarterly, or monthly. It 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 business process improvements and the new correspondence and records system used by the Clerk’s Office, Commission 2.0, which they intend to fund using some of these cash reserves. The total cash balance

of special revenue funds increased from \$97.0 million at the end of fiscal year 2013 to \$103.6 million at the end of fiscal year 2014. The following table shows the ending cash balances of the Commission’s special revenue funds for fiscal years 2012, 2013, and 2014.



Source: Commonwealth Accounting and Reporting System

The Commission second largest collections are for the General Fund. The Commission’s General Fund revenues decreased by 33 percent due to the gross premium tax collections being eliminated for the entire fiscal year. Responsibility for collection of the gross premium tax collections transferred to the Department of Taxation on January 1, 2013; therefore, fiscal year 2014 is the first year the Commission made no collections. The following table shows the total revenues the Commission collected by fund for fiscal years 2013 and 2014.

Revenue by Fund		
Fund	2013	2014
Special Revenue	\$152,855,181	\$162,166,485
General	143,996,337	96,333,469
Trust and Agency	8,959,892	6,253,039
Dedicated Special Revenue	6,331,955	6,718,410
Federal Trust	574,992	2,211,699
<b>Total</b>	<b>\$312,718,357</b>	<b>\$273,683,102</b>

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 schedules shows for fiscal years 2013 and 2014 the Commission’s original and adjusted budgets with actual expenses.

## Budget to Actual Operating Expenses by Fund

### 2014

Fund	Original Budget	Final Budget	Actual Expense
Special Revenue	\$79,509,495	\$80,023,131	\$72,988,278
Trust and Agency	6,856,941	6,556,941	5,101,000
Federal Grants	1,350,000	3,134,402	2,202,154
Dedicated Special Revenue	1,782,167	1,268,531	768,562
General Fund	<u>1,200,000</u>	<u>98</u>	<u>-</u>
<b>Total</b>	<b>\$90,698,603</b>	<b>\$90,983,103</b>	<b>\$81,059,994</b>

### 2013

Fund	Original Budget	Final Budget	Actual Expense
Special Revenue	\$79,422,495	\$81,352,101	\$72,309,566
Trust and Agency	6,856,941	6,856,941	5,369,078
Federal Grants	1,350,000	2,187,000	1,839,852
Dedicated Special Revenue	1,782,167	1,268,531	888,013
General Fund	<u>-</u>	<u>200,000</u>	<u>200,000</u>
<b>Total</b>	<b>\$89,411,603</b>	<b>\$91,864,573</b>	<b>\$80,606,509</b>

*Source: Commonwealth Accounting and Reporting System*

Special revenue original and final budgeted amounts remained relatively constant between fiscal years 2013 and 2014. Actual special revenue expenses experienced a slight increase in fiscal year 2014. Actual special revenue expenses were nine percent and 11 percent less than the final budget in fiscal years 2014 and 2013, 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 2014 trust and agency expenses decreased slightly 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 federal funds not expended in the prior year being re-appropriated for fiscal year 2014.

Payroll costs, including fringe benefits, accounted for approximately 71 percent, or \$57.9 million, of the Commission's total expenses during fiscal year 2014. During fiscal year 2014, the Commission spent \$12.9 million, or 16 percent, on contractual services. Contractual services cover a broad variety of services, such as systems development, software maintenance, and public relations. Contractual services decreased primarily due to CAFÉ and Gross Premium Tax Project costs incurred in fiscal year 2013, but not incurred in fiscal year 2014. Transfer payments, the Commission's third largest expense, in fiscal year 2014 were \$5.2 million, or six percent of the Commission's total expenses. Transfer payments are primarily payments to insurance companies from the uninsured motorists program. The table below details the Commission's operating expenses by major expense category.

### Operating Expenses by Major Category

Category	2013	2014
Personal services	\$57,034,459	\$57,932,210
Contractual services	13,395,464	12,926,004
Transfer payments	5,407,634	5,150,824
Equipment	3,006,875	3,369,615
Rent and other continuous charges	1,293,025	1,262,771
Supplies and materials	<u>469,052</u>	<u>418,571</u>
<b>Total</b>	<b>\$80,606,509</b>	<b>\$81,059,995</b>

Source: Commonwealth Accounting and Reporting System



Martha S. Mavredes, CPA  
Auditor of Public Accounts

# Commonwealth of Virginia

*Auditor of Public Accounts*

P.O. Box 1295  
Richmond, Virginia 23218

December 12, 2014

The Honorable Terence R. McAuliffe  
Governor of Virginia

The Honorable John C. Watkins  
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, 2014. 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, 2014. In support of this objective, we evaluated the accuracy of recorded financial transactions in the Commonwealth Accounting and Reporting System and in Commission's accounting system, 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.

Revenues  
Public Service Taxation  
Bureau of Insurance  
Clerk's Office  
Expenses

Payroll  
Travel  
Voucher processing  
Information System Security  
System Access

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.

### **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 Commission's accounting 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 that are not repeated in this letter. Progress on other prior year findings is discussed in the section titled "Audit Findings and Recommendations."

### **Exit Conference and Report Distribution**

We discussed this report with management on December 17, 2014. 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, management, and the citizens of the Commonwealth of Virginia and is a public record.

AUDITOR OF PUBLIC ACCOUNTS

GDS/clj

MARK C. CHRISTIE  
COMMISSIONER

JAMES C. DIMITRI  
COMMISSIONER

JUDITH WILLIAMS JAGDMANN  
COMMISSIONER

# COMMONWEALTH OF VIRGINIA



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

## STATE CORPORATION COMMISSION

December 18, 2014

Ms. Martha S. Mavredes  
Auditor of Public Accounts  
P. O. Box 1295  
Richmond, Virginia 23218

Dear Ms. Mavredes:

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 year 2014. The Commission welcomes the comment that the financial recording and reporting of all transactions were proper in all material respects. The report also noted that corrective action was taken on four findings in the fiscal year 2012 audit and it recognized progress on the remaining finding from the 2012 audit.

With regard to the finding in this audit and as discussed with staff during the audit engagement, the Commission has already realigned its organizational structure to include a reporting line to the Commissioners for the Chief Internal Auditor, and is in the process of improving the information security program to include developing the necessary policies and procedures.

Thank you for the opportunity to review the draft audit report. We appreciate your staff's attention to the information which we provided throughout the audit engagement. The Commission is in agreement with the audit report and has already taken corrective action to address the findings. Therefore, an exit meeting is not necessary.

Sincerely,

Handwritten signature of Judith Williams Jagdmann in black ink.

Judith Williams Jagdmann, Chairman

Handwritten signature of James C. Dimitri in black ink.

James C. Dimitri, Commissioner

Handwritten signature of Mark C. Christie in black ink.

Mark C. Christie, Commissioner

TYLER BUILDING, 1300 EAST MAIN STREET, RICHMOND, VA 23219-3630 PHONE (804) 371-9608  
• <http://www.scc.virginia.gov> • TDD PHONE (804) 371-9206

## COMMISSION OFFICIALS

### STATE CORPORATION COMMISSION

As of June 30, 2014

#### COMMISSIONERS

Judith Williams Jagdmann, Chairman

Mark C. Christie

James C. Dimitri