

STATE CORPORATION COMMISSION

**REPORT ON AUDIT
FOR THE TWO-YEAR PERIOD ENDED
JUNE 30, 2011**

APA

**Auditor of
Public Accounts**

COMMONWEALTH OF VIRGINIA

AUDIT SUMMARY

Our audit of the State Corporation Commission, for the two-year period ended June 30, 2011 found:

- proper recording and reporting of all transactions, in all material respects, in the Commonwealth Accounting and Reporting System and the Commission's accounting records;
- certain matters involving internal control and its operations necessary to bring to management's attention; and
- no instances of noncompliance with applicable laws and regulations or other matters that required reporting.

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AUDIT FINDINGS AND RECOMMENDATIONS

Continue to Evaluate Finance and Revenue Processes

The State Corporation Commission (the Commission) should continue to evaluate its finance and revenue processes as recommended in our prior report. The Commission collects a wide variety of fees and taxes in five different divisions in a decentralized environment. In response to our prior recommendation, the Commission implemented some standard policies and procedures across all divisions collecting revenue to ensure adequate and consistent controls are in place. In addition, the five divisions need to obtain the prior written approval of the Commission Comptroller to make operational changes to their financial procedures.

The Commission also completed a preliminary analysis of its revenue streams to evaluate current collection methods and the feasibility of alternative methods. The Commission plans to perform a detailed study during fiscal year 2012 to determine the feasibility of centralizing its revenue processes and possibly some of its information systems in order to strengthen its financial management processes, gain efficiencies, and improve internal controls.

We understand that performing the necessary analysis will take time and careful scrutiny and planning. We encourage the Commission to continue with their study plans.

Improve Systems Access Controls

The Commission needs to improve system access controls over the Commission's systems. Managers and supervisors request system access by completing a Security Access Request form; however, the form does not contain detailed information that specifies the type of access that the employee needs for some of the agency's systems. This lack of information about the employee's need for access requires system administrators to communicate with the employee's supervisor to determine what type of access individuals require.

This communication may take place through different methods and system administrators do not always document these communications. The Commission should also improve its policy over terminating access to the agency's systems. The Commission should consider an agency-wide process that Personnel initiates upon termination of any employee notifying all system administrators of the termination and the process should address the need to terminate system access within a defined time frame. Currently, the Commission's policy does not specify a time frame for disabling or deleting system's access.

Not including the specific access on the Security Access Request form and not specifying a time frame for deleting or disabling system access in the agency's policies increases the risk of employees having unnecessary access to sensitive and high risk applications. Therefore, the Commission should establish a policy that documents the specific access needed by agency employees and a policy that defines a reasonable time frame for disabling and deleting systems access.

AGENCY HIGHLIGHTS

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

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

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

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

<i>Regulatory Divisions:</i>	<i>Non-Regulatory Divisions</i>
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 2010, the Clerk's Office collected \$5.3 million in General Fund revenue and \$47.5 million in special revenue. In fiscal year 2011, the Clerk's Office collected \$5.0 million in General Fund revenue and \$50.0 million in special revenue.

Division of Communications

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

Division of Economics and Finance

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

Division of Energy Regulation

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

Bureau of Financial Institutions

The Bureau of Financial Institutions (Financial Institutions) regulates and examines state-chartered banks, trust companies, savings and loans, and credit unions. Financial Institutions also provides licenses and examines mortgage lenders and brokers, and licenses and regulates money order sellers, consumer finance companies, industrial loan association's payday lenders, and credit counseling agencies. Financial Institutions collect revenue from these entities for application fees, license fees, annual assessment fees, examination fees, and investigation fees, which totaled \$12.6 million in fiscal year 2010 and \$13.2 million in fiscal year 2011.

Bureau of Insurance

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

Insurance collects a gross premium tax from insurance companies, which totaled \$391.4 million in General Fund revenue in fiscal year 2010 and \$412.2 million in fiscal year 2011. In addition, Insurance collected \$25.0 million in fiscal year 2010 and \$24.6 million in fiscal year 2011 in special revenue comprised of assessments and license, application, appointment, and other fees. Insurance also collects an assessment from property and casualty insurance companies, which it transfers to the Department of Fire Programs; this totaled \$29.2 million in fiscal year 2010 and \$29.6 million in fiscal year 2011.

In addition, Insurance collects special assessments for the Virginia State Police to investigate insurance fraud. Each licensed insurer doing business in the Commonwealth, by writing any type of property and casualty insurance, except title insurance, pays a special assessment fee equal to a percentage of its direct gross premium income during the preceding calendar year. Insurance can impose a late payment penalty of ten percent of the assessment and retains a portion of the special assessment to cover its administrative expenses. Insurance transferred \$5.0 million in fiscal years 2010 and 2011 to the Virginia State Police.

Insurance also receives uninsured motorist fees collected by the Department of Motor Vehicles (Motor Vehicles). In accordance with the Code of Virginia, Insurance distributes these funds to the insurance companies who write automobile liability insurance. Motor Vehicles transferred uninsured motorist fees to Insurance totaling \$7.3 million in fiscal year 2010 and \$6.2 million in fiscal year 2011.

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 2010, the Public Service Taxation collected \$91.0 million in General Fund revenue and \$16.5 million in special revenue. In fiscal year 2011, Public Service Taxation collected \$87.8 in General Fund revenue and \$26.3 million in special revenue.

Division of Public Utility Accounting

The Division of Public Utility Accounting provides the Commissioners with information and analysis on utilities and other entities' accounting and financial information. The Commissioners use this information when considering utility cases involving rates and services; affiliate transactions, mergers and acquisitions; certificates of public convenience and necessity; alternative regulatory plans; and the restructuring of utility markets.

Division of Securities and Retail Franchising

The Division of Securities and Retail Franchising (Security and Retail Franchising) regulates security brokers and investment advisors in Virginia, registers security industry professionals, and investigates complaints about particular securities, practices, or events. Security and Retail Franchising also registers franchises and trademarks in Virginia and investigates any reports of securities or franchising law violations or misconduct. This division determines what is required under the Virginia Securities Act to register public offerings and conducts private security offerings, reviews offering documents, and approves offers and sales of securities in Virginia. Security and Retail Franchising collected \$9.1 million in special revenue during fiscal year 2010 and \$9.8 million in fiscal year 2011.

Division of Utility and Railroad Safety

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

FINANCIAL INFORMATION

The Commission funds its operations from certain regulatory assessments and fees set by statute and records this activity primarily in four special revenue funds. Depending on the revenue source, the Commission collects revenue annually, quarterly, or monthly and will maintain a cash balance in these special revenue funds as a reserve to prevent a large fluctuation in rates. The Commission also collects a majority of its revenues for the General Fund. In fiscal years 2010 and 2011, General Fund revenues accounted for 69.3 percent of the Commission's total collections. The following table shows the total revenues the Commission collected by fund for fiscal years 2010 and 2011.

Table 1

<u>Revenue by Fiscal Year and Fund</u>		
<u>Fund</u>	<u>2011</u>	<u>2010</u>
General	\$374,661,256	\$358,668,522
Special Revenue	153,544,228	139,997,098
Trust and Agency	4,922,857	11,792,748
Dedicated Special Revenue	5,776,390	5,969,022
Federal Trust	<u>1,529,876</u>	<u>913,595</u>
Total	<u>\$540,434,607</u>	<u>\$517,340,985</u>

The Department of Planning and Budget establishes an original expense budget based on the prior biennium budget amount and adjusts for certain items. The following schedule compares the fiscal years 2010 and 2011 Commission's original and adjusted budgets with actual expenses.

Table 2

<u>Budget to Actual Operating Expenses by Fiscal Year and Fund</u>			
<u>2011</u>			
	<u>Original Budget</u>	<u>Final Budget</u>	<u>Actual Expense</u>
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>
<u>2010</u>			
	<u>Original Budget</u>	<u>Final Budget</u>	<u>Actual Expense</u>
Special Revenue	\$77,655,493	\$87,563,949	\$71,556,096
Trust and Agency	6,856,941	7,841,316	7,754,680
Dedicated Special Revenue	1,776,551	1,951,551	1,557,214
Federal Grants	<u>-</u>	<u>499,134</u>	<u>462,802</u>
Total	<u>\$86,288,985</u>	<u>\$97,855,950</u>	<u>\$81,330,792</u>

Special Revenue original budgeted amounts increased; however, final budgeted amounts decreased while expenses remained relatively constant between fiscal year 2010 to 2011. The increase in the final budget each year was primarily due to the reappropriation of prior year unexpended appropriations related to multi-year projects, such as maintenance improvement projects and the e-commerce project. Actual expenses each year were less than the final budget due to the nature of multi-year projects and continual carry forward of funds until completion of each project. The fiscal year 2010 original budget for Trust and Agency amounts increased to reflect receipt of revenues for the uninsured motorist fund not originally anticipated. The increase in Federal budgeted amounts and expenses from fiscal year 2010 to 2011 is primarily due to receipt of a federal grant to develop and maintain a gas and hazardous liquid pipeline safety program.

Payroll costs, including fringe benefits, accounted for approximately 68.2 percent, or \$55.2 million, of the Commission’s total expenses during fiscal year 2011. During fiscal year 2011, the Commission spent \$13.9 million, or 17.1 percent, on contractual services and an additional \$6.8 million, or 8.3 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. There were only minor changes in expenses between fiscal years, with the primary increase in personal services due to the three percent bonus paid to employees in fiscal year 2011. Table 3 details the Commission’s operating expenses by major expense category.

Table 3

Operating Expenses by Fiscal Year and Major Category

Category	<u>2011</u>	<u>2010</u>
Personal services	\$55,205,255	\$52,750,015
Contractual services	13,852,521	14,654,203
Supplies and materials	514,462	535,066
Transfer payments	6,755,441	7,957,668
Rent and other continuous charges	990,818	1,052,734
Equipment	<u>3,594,949</u>	<u>4,381,106</u>
Total	<u>\$80,913,446</u>	<u>\$81,330,792</u>



Commonwealth of Virginia

Auditor of Public Accounts

Walter J. Kucharski
Auditor of Public Accounts

P.O. Box 1295
Richmond, Virginia 23218

January 6, 2012

The Honorable Robert F. McDonnell
Governor of Virginia

The Honorable Charles J. Colgan
Chairman, Joint Legislative Audit
and Review Commission

We have audited the financial records and operations of the **State Corporation Commission** for the two year period ending June 30, 2011. 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 two year period ending June 30, 2011. In support of this objective, we evaluated the accuracy of recording financial transactions in the Commonwealth Accounting and Reporting 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 and regulations.

We gained an understanding of the overall internal controls, both automated and manual, sufficient to plan the audit. We considered significance and risk in determining the nature and extent of our audit procedures. Our review encompassed controls over the following significant cycles, classes of transactions, and account balances.

- Revenue
- Payroll expenses
- Operating expenses
- Systems security

We performed audit tests to determine whether the Commission's controls were adequate, had been

placed in operation, and were being followed. Our audit also included tests of compliance with provisions of applicable laws and regulations. Our audit procedures included inquiries of appropriate personnel, inspection of documents, records, and contracts, and observation of the Commission's operations. We 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. The Commission records its financial transactions on the cash basis of accounting, which is a comprehensive basis of accounting other than accounting principles generally accepted in the United States of America. The financial information presented in this report came directly from the Commonwealth Accounting and Reporting System.

We noted certain matters involving internal control and its operation and compliance with applicable laws and regulations that require management's attention and corrective action. These matters are described in the section entitled "Audit Findings and Recommendations." The results of our tests of compliance with applicable laws and regulations disclosed no instances of noncompliance or other matters that are required to be reported under Government Auditing Standards.

The Commission has taken adequate corrective action with respect to audit findings reported in the prior year that are not repeated in this report.

Exit Conference and Report Distribution

We discussed this report with management on January 12, 2012. Management's response to the findings identified in our audit is included in the section titled "Agency 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

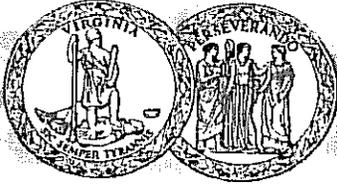
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MARK C. CHRISTIE
COMMISSIONER

JAMES C. DIMITRI
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COMMONWEALTH OF VIRGINIA



JOEL H. PECK
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P.O. BOX 1197
RICHMOND, VIRGINIA 23218-1197

STATE CORPORATION COMMISSION

January 12, 2012

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

Dear Mr. Kucharski:

The State Corporation Commission (Commission) appreciates the time and effort that your staff devoted to review the Commission's financial records and operations for fiscal years 2010 and 2011. The Commission is in agreement with the audit report and has already taken corrective action to address the findings.

As you stated in your audit report, the Commission has completed its preliminary analysis of its revenue processes since the last audit and has implemented standard policies and procedures for collecting and processing revenues to ensure adequate and consistent controls are in place.

Thank you for the opportunity to review and comment on the draft audit report, and we appreciate your staff's attention to our comments throughout the audit engagement.

Sincerely,

Handwritten signature of Judith Williams Jagdmann in cursive script.

Judith Williams Jagdmann, Chairman

Handwritten signature of Mark C. Christie in cursive script.

Mark C. Christie, Commissioner

Handwritten signature of James C. Dimitri in cursive script.

James C. Dimitri, Commissioner

STATE CORPORATION COMMISSION

As of June 30, 2011

COMMISSIONERS

Judith Williams Jagdmann, Chairman

Mark C. Christie

James C. Dimitri