AUDIT SUMMARY

Our audit of the Virginia Employment Commission for the year ended June 30, 1998, found:

- internal control matters that we consider reportable conditions, however, we do not consider these to be material weaknesses;
- material compliance with applicable laws and regulations tested;
- proper recording and reporting of transactions, in all material respects, in the Commonwealth Accounting and Reporting System; and
- the Commission has taken adequate corrective action with respect to audit findings reported in the prior year except as included in the finding entitled "Complete Internal Audit Reviews of Highest Risk Areas."

We have included the following issues we believe the Commission should address:

- Improve Administration of Contracts (See Page 6)
- Develop a Written Plan For Increased Demand on Job Service and Benefits (See Page 9)
- Complete Internal Audit Reviews of Highest Risk Areas (See Page 9)

January 16, 1999

The Honorable James S. Gilmore, III
Governor of Virginia
State Capitol
Richmond, Virginia

The Honorable Richard J. Holland
Chairman, Joint Legislative Audit
and Review Commission
General Assembly Building
Richmond, Virginia

INDEPENDENT AUDITOR'S REPORT

We have audited the financial records and operations of the **Virginia Employment Commission** for the year ended June 30, 1998. We conducted our audit in accordance with generally accepted government auditing standards.

Audit Objectives, Scope, and Methodology

Our audit's primary objectives were to review the Commission's accuracy of recording financial transactions on the Commonwealth Accounting and Reporting System and the Commission's Tax and Benefit Systems, adequacy of the internal control structure, and compliance with applicable laws and regulations. We also determined the status of audit findings contained in our prior year report.

Our audit procedures included inquires of appropriate personnel, inspection of documents and records, and observation of the Commission's operations. We also tested transactions and performed such other auditing procedures as we considered necessary to achieve our objectives. We reviewed the overall internal accounting controls, including controls for administering compliance with applicable laws and regulations over the following significant cycles, classes of transactions, and account balances:

Unemployment Benefit Payments
Taxes and Cash Receipts
Accounts Receivable
Accounts Payable
Federal Grants Management
Expenditures
Payroll and Compensated Absences

We obtained an understanding of the relevant policies and procedures for these internal accounting controls. We considered materiality and control risk in determining the nature and extent of our audit procedures. We performed audit tests to determine whether the Commission's policies and procedures were adequate, had been placed in operation, and were being followed. Our audit also included tests of compliance with provisions of applicable laws and regulations.

The Commission's management has responsibility for establishing and maintaining an internal control structure and complying with applicable laws and regulations. The objectives of an internal control structure are to provide reasonable, but not absolute assurance that assets are safeguarded and that transactions are processed in accordance with management's authorization, properly recorded, and comply with applicable laws and regulations.

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

Audit Conclusions

We found that the Commission properly stated, in all material respects, the amounts recorded and reported in the Commonwealth Accounting and Reporting System and the Commission's Tax and Benefit Systems. The Commission records its financial transactions on the cash basis of accounting, which is a comprehensive basis of accounting other than generally accepted accounting principles. The financial information presented in the "Selected Agency Information" section of our report came directly from the Commonwealth Accounting and Reporting System as well as the Commission's Tax and Benefit Systems.

We noted certain matters involving the internal control structure and its operation that we consider reportable conditions. Reportable conditions involve matters coming to our attention, relating to significant deficiencies in the design or operation of the internal controls, that, in our judgment, could adversely affect the Commission's ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial records. These reportable conditions are discussed in the sections entitled "Contract Administration," "Job Service," and "Internal Control."

The results of our tests of compliance disclosed no instances of noncompliance

The Commission has not taken adequate corrective action with respect to the previously reported finding entitled "Complete Internal Audit Reviews of Highest Risk Areas." Accordingly, we included this finding in the section entitled "Internal Audit." 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

We discussed this report with management at an exit conference held on March 22, 1999.

AUDITOR OF PUBLIC ACCOUNTS

JMS:jld
jld:37

SELECTED AGENCY INFORMATION

The Virginia Employment Commission provides temporary income to involuntarily unemployed workers through an unemployment insurance program. The Commission also accumulates and provides job, labor market, and economic information. The Commission provides services through the following programs.

- Unemployment Insurance Services include processing and paying benefit claims, administratively adjudicating contested benefit and tax liability claims, and ensuring the adequate funding of Unemployment Trust Fund. The Commission also collects employer taxes, which fund the program.

- Job Service makes job search assistance available to individuals. Services include job referral and placement, as well as referral to training and job search skill building activities. The program also provides recruiting and referral services to employers.

- The Economic Information Services Division accumulates the Commonwealth's labor market information and compiles and reports the data in cooperation with the U.S. Bureau of Labor Statistics. The Division provides economic and demographic information on request. Users may arrange access to selected data by using the Division's Automated Labor Information on the Commonwealth's Economy (ALICE) system.

- Commission Appeals serves as the agency's final adjudicative authority in disputed benefit and tax liability cases.

WORKFORCE INVESTMENT ACT OF 1998

The Workforce Investment Act (WIA), passed on August 7, 1998, makes major changes in the way employment and training programs will be delivered at the state and local levels. The key elements are the state workforce investment board, local workforce investment boards and their youth councils, and local one-stop delivery systems.

The state workforce investment board will assist the Governor in administering the workforce investment system and develop a five-year strategic plan which will be submitted to the U.S. Department of Labor for approval. The strategic plan will describe workforce investment activities to be undertaken in the state; how the state will implement key requirements of the WIA; and how special populations will be served. The plan will also incorporate state plans for administering employment service under the Wagner-Peyser Act.

Locally-elected officials will appoint workforce investment boards in local service delivery areas. Local boards must include representatives of business, education, labor organizations, community-based organizations, economic development agencies, and each of the one-stop partners. Boards will be responsible for developing and submitting to the Governor five-year plans for local workforce investment programs; designating local one-stop operators and eligible service providers; establishing performance measures for local employment and training activities; providing oversight to local one-stop delivery systems; and assisting in developing labor market information statewide statistics.

A youth council will be established in each local service delivery area and will be a subgroup of the local workforce investment board. The youth council will be appointed by the local board and will develop portions of the local plan relating to eligible youth; recommend providers of youth activities to be awarded grants by the local board; and coordinate youth activities in the local area.

The Workforce Investment Act requires that one-stop delivery systems be established in each local service delivery area which will directly deliver core employment services such as job search assistance and career counseling. The local centers will also provide access to more intensive services such as case management, short-term prevocational services, and training funded under WIA and other federal programs. The Act requires that services be provided through at least one center in each local service delivery area of the state.

The Commonwealth must implement provisions of the WIA by July 1, 2000, but will receive interim regulations from the U. S. Department of Labor in March 1999 and final regulation by December 31, 1999. The Governor has designated the Commission as the lead agency for the implementation of the WIA.

STATUS OF THE UNEMPLOYMENT TRUST FUND

The Commission is the trustee of the Unemployment Trust Fund. The Commission uses this fund to pay unemployment benefits. To qualify for benefits, unemployed Virginians must have earned a minimum amount of total wages in two of the first four of the last five calendar quarters (the base period.) State law establishes the weekly benefit minimum and maximum amounts.

Unemployment taxes collected from Virginia employers are deposited into the trust fund. Employers with one or more employees pay unemployment taxes on the first $8,000 of each employee's annual wages. The General Assembly sets the tax rates, which reflects the solvency of the trust fund. Taxes also include an "experience rating" for employers with higher levels of qualifying claims. Those employers with higher claims can expect to pay a higher tax rate. However, the maximum rate is 5.4 percent.

Tax Law Changes

In 1997, the General Assembly increased the maximum weekly benefit payment and decreased the minimum weekly rate. Legislators also decreased the minimum qualifying earnings. A summary of the changes follows.

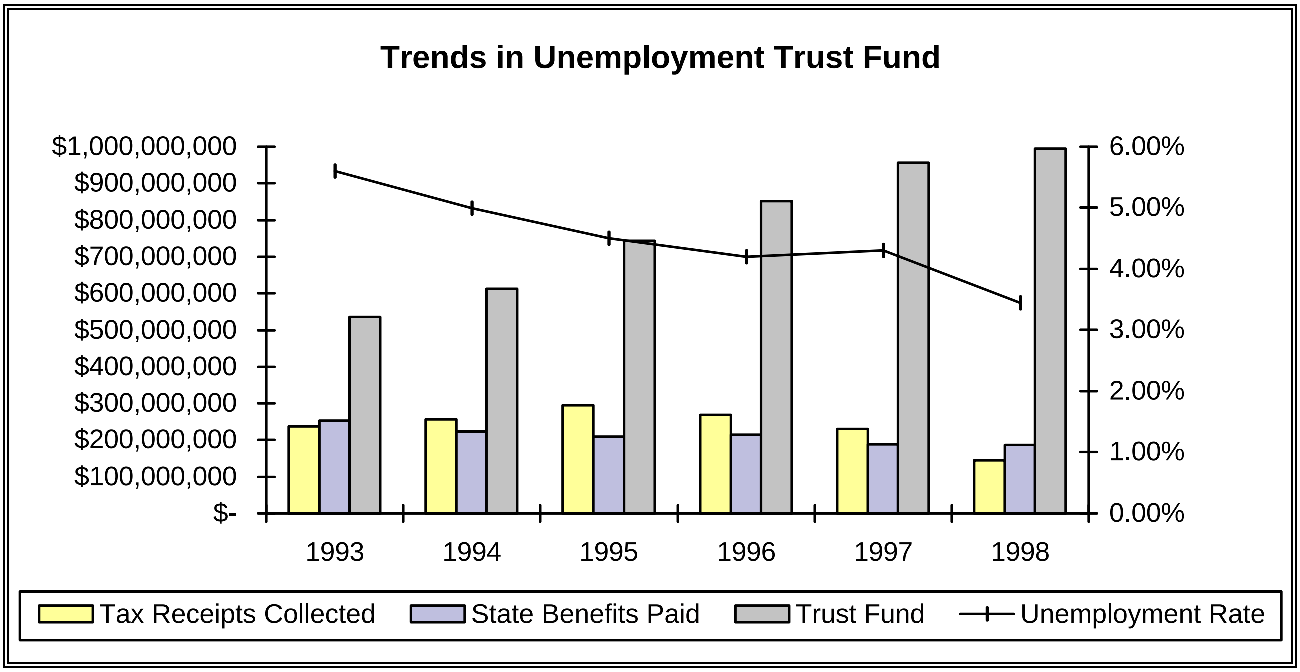
	Weekly Benefit		Minimum
Year	Maximum	Minimum	Qualifying Earnings
1996	$ 224	$ 65	$ 3,250
1997	226	60	3,000
1998	228	55	2,750
1999	230	50	2,500
2000	232	50	2,500

In 1998, for example, an eligible individual who earned at least $2,750 in the base period would receive a weekly benefit ranging from a minimum of $55 to a maximum of $228.

In 1997, the General Assembly passed legislation, which changed the formula used to determine the trust fund balance factor. This action reduced employer taxes. Interest earned on the trust fund balance offset the reduction in revenue resulting from reduced taxes. The following table illustrates how the legislation affected employer tax rates.

	Prior to July 1, 1997	**After July 1, 1997**
Minimum Tax	0.1 % or $8 per employee	0.0 % or $0 per employee
Maximum Tax	6.2 % or $496 per employee	5.4 % or $432 per employee
Taxable on first:	$8,000 of each employee's wages	$8,000 of each employee's wages

Presented below are historical trends, which show the changes in tax collections, benefits payments, trust fund balance and the unemployment rate over a period of years.



Year	Tax Collections	Benefits Paid	Collections Over (Under) Benefits	Trust Fund Balance*	Trust Fund Solvency**	Unemployment Rate
1993	$ 211,332,150	$ 254,476,292	$ (43,144,142)	$ 533,270,690	64.8%	5.7%
1994	263,715,851	223,565,168	40,150,683	611,937,629	69.7%	5.0%
1995	295,673,218	208,808,361	86,864,857	743,233,179	79.3%	4.7%
1996	257,770,256	211,074,168	46,696,088	852,342,994	90.5%	4.5%
1997	217,171,263	188,615,553	28,555,710	955,948,173	123.0%	4.3%
1998	145,611,983	187,178,361	(41,566,378)	994,128,995	114.0%	3.4%

* The Trust Fund Balance also includes interest credited to the account.

** Trust fund solvency is an indicator of the fund's ability to pay benefits during periods of high unemployment as experienced over the past twenty years. The solvency indicator compares the fund's actual balance to the calculated balance needed to pay these benefits for 16.5 months. The formula used to calculate the balance uses historical benefit and wages data. Trust Fund solvency does not directly relate to current year tax collections or benefits paid. Prior to June 1996, solvency was computed on a cash basis. Since then, solvency is computed on a modified accrual basis as stipulated in §60.2-533 of the Code of Virginia.

At June 30, 1998, the Trust Fund was 114% solvent, which was a decline from 123% from the previous year. The decline was a direct result of decreases in employer tax rates. Despite lower tax rates, the trust fund balance increased by approximately $38 million during the year. The Commission attributes this increase to more revenue from higher interest rates for the U.S. Treasury.

Although the unemployment rate dropped almost a full percentage point (from 4.3% in 1997 to 3.4%,) benefits payments did not decrease significantly. The Commission attributes this to an increased number of people in the overall labor force that helped keep the number of initial claims and first payments at about the same levels as 1997.

According to Bureau of Labor Force Statistics, unemployment benefits could be paid from Virginia's Trust Fund at current unemployment levels for approximately 5.5 years.

CONTRACT ADMINISTRATION

Improve Administration of Contracts

The Commission uses private companies to supplement reduced workforces and to improve service delivery quality. For example, the Commission contracts for facility maintenance at all of its field offices as well as the central office. Outside contractors also assisted with local area network installation at all locations. The Commission must provide adequate oversight to these contractors to ensure that the agency receives quality goods and services at fair prices. Management should address the following to improve contract administration.

- The purchasing department issued computer network wiring contracts whose costs were based upon time and materials but did not require contractors to provide estimates for specific jobs. We noted that the Commission only received estimates for 24 (of 42) specific wiring jobs. One contractor did work at 14 different job sites with no estimates for work. A second contractor did not provide estimates for three jobs and exceeded estimates on three others by as much as 130% without adequate justification. The Commission has spent over $858,000 on the wiring jobs at the 42 locations.

- The Commission has not provided contract administrators with adequate training to monitor the quality of goods and services provided by contractors. Additionally, management has not provided adequate guidance for monitoring costs and invoices from contractors before approving payment. We noted one administrator approved payment of invoices which exceeded the contractor's estimates, but did not document the reasons for the additional costs. We found that, in many instances, contract administration was not the employee's primary job responsibility. Failure to provide adequate guidance or training to contract administrators increases the risk that the Commission may not receive quality goods and services at reasonable prices.

- Management does not re-assign contract administration duties when staffing changes occur. In one instance, a new facility manager was unaware of his contract administration responsibilities, and therefore did not perform the work. When there is no assigned contract administrator, field offices do not always monitor contract services to ensure that these services meet minimal quality standards.

Recommendation:

Management should always require contractors to provide estimates and contract administrators should use estimates to monitor contracts. Management should provide contract administrators with adequate training to enhance their understanding of their responsibilities, so they understand the specific requirements of the contracts they administer. Management should re-assign contract administrator responsibilities when staffing changes occur.

YEAR 2000 STATUS

On October 12, 1998, the Commission completed corrections to their mainframe applications and successfully placed these corrected versions into production. Management deemed this task the most critical part of the Commission's Year 2000 compliance plans. The Information Technology Division devoted all of its programming resources to rewriting affected applications to accomplish this task. This resulted in a delay in addressing other information processing needs. For example, management has not yet replaced its old network or equipment that are not Year 2000 compliant. Management plans to upgrade network equipment and replace dumb terminals with personal computers. Also, management is now identifying those individual applications or user-based files on personal computers that require upgrades for Year 2000 compliance. The Commission is testing new versions of their critical applications.

The U.S. Department of Labor requires the Commission to provide independent validation and verification of their programming changes. They also require the Commission to develop contingency plans.

The following table summarizes critical Year 2000 events to date and the remaining tasks.

Summary of Y2K Events to Date

Project Event	**Estimated cost**
Programming to increase the date fields in all programs. Management planned the renovation to include redesigning file layouts, conversion programs, coding changes, coordination with outside users and unit testing by July 1998. Management completed validation activities that included planning and systems testing in December 1998.	$1,000,000
With coding and system renovation close to completion, testing of the unemployment insurance system began in April 1998. Parallel testing occurred from July through September to ensure the Year 2000 compliant system mirrored the regular production system.	- - -
Ensure non-traditional systems are Year 2000 compliant by December 1, 1998; make all personal computer users aware of possible problems; identify and correct personal computer-based applications; replace all non-Year 2000 compliant personal computers by September 1, 1999.	$2,170,000
Time warp testing to ensure that the system will accept claims dated in either 1999 or 2000 started on October 11, 1998 and is continuing.	- - -
Replace existing network with Wide Area Network by April 1999	See Below.
Develop contingency plan to ensure the continuance of critical unemployment insurance business functions and key support processes in case of Year 2000 failures. Contingency plans for UI Benefits were completed and submitted to the Department of Labor (DOL) in November 1998. Plans for UI Tax are due by June 4, 1999.	- - -
DOL requires independent verification and validation (IV&V) of Year 2000 compliance. The Commission submitted plans for providing this verification to DOL on September 30, 1998. IV&V certification for the UI Benefits system was due December 1, 1998 but has not been completed. IV&V of the UI Tax system is due July 1, 1999.	$ 75,000

Management still has several critical tasks to complete before the year 2000 including updating or replacing all non-compliant personal computers and related equipment. Management must also identify and upgrade user-level applications and complete and evaluate all testing of its mainframe systems revisions.

LOCAL AREA NETWORKS

The Commission began replacing their network during 1998. The plan includes replacing dumb terminals with personal computers at field offices. Each local office will then link its personal computers into a local area network. All local area networks will connect to the central office and the mainframe applications via high-speed telecommunications lines. The following table summarizes the key steps in the project and the estimated costs. The costs reflected below are direct budget or contract estimates and do not include indirect costs for the Commission's staff time and effort.

Project event	**Estimated cost**
Network wiring installation at field offices and central office completed in January 1999.	$ 854,000
Installation of Local Area Networks in the central and field offices (planned completion by August 1999.) Purchase four servers and Novell operating software. Install new hubs and routers. Convert network to Network Virginia.	Servers $ 72,000 Installation $ 95,000
Expand use of Internet within the agency for staff and customer use by August 1999.	$ 100,000
Implement PC based E-mail system with links to the Internet by August 1999.	$ 50,000
Install new and replacement PCs and servers in the central and field offices.	$3,765,000

JOB SERVICE

The Job Service program provides assistance to individuals seeking employment or a change in occupation and to employers who are seeking qualified applicants. Even in periods of low unemployment, Job Service receives a steady flow of job seekers. According to their figures, Job Service received listings for 181,118 job openings from employers and made 559,663 referrals in fiscal year 1998. 40,475 applicants used the service and found employment.

The Workforce Investment Act requires a new one-stop delivery system in local service areas. This approach will directly deliver core employment services such as job search assistance, career counseling, and labor market and job vacancy information. The Commission is exploring new ways to deliver services.

Common Intake:

Common Intake is a process where a single staff person will address all of an applicant's job service needs. Previously, applicants went to one staff for unemployment insurance benefits and another person for job service assistance. This new process requires the redesigning of field office layouts to facilitate the one-stop assistance approach. This new arrangement also requires the redesign of computer screens and applications. The Commission plans to complete the conversion to one-stop assistance in five field offices by March 31, 1999 and at another five locations by June 30, 1999.

The Commission is training employees to process unemployment insurance claims and to provide regular Job Service. Plans call for all field operations employees to have appropriate training by March 31, 1999. The Department of Personnel and Training approved a bonus incentive plan to encourage employees to complete the competencies required for Common Intake.

Career Connect:

The Commission is participating with the Department of Business Assistance and the Governor's Employment and Training Division in a three-year grant entitled "Career Connect" which will provide customers with integrated Job Service via the Internet.

<u>Develop a Written Plan For Increased Demand on Job Service and Benefits</u>

Dramatic changes in the economy or in unemployment levels could place a strain on the Commission's ability to provide job and benefits services if increased numbers of unemployed persons sought services. Management has no written plan to address dramatic increases in demands for services. Currently, the Commission relies on an experienced management team and employees to develop plans for increased service needs. These informal plans are based on past experience and include using temporary employees and shifting of employees between field offices. The absence of formalized written contingency plans could jeopardize the agency's ability to deliver services in periods of high unemployment in the future as the experience base decreases due to retirement or other factors.

<u>Recommendation</u>:

Management should develop formal written plans that address dramatic changes in unemployment levels and corresponding increases in the need for employee Job Service and unemployment benefits.

<u>INTERNAL AUDIT</u>

<u>Complete Internal Audit Reviews of Highest Risk Areas</u>

In last year's report, we noted that Internal Audit did not give highest priority to those activities identified as high-risk in their audit plan. We cited a shortage of staff as a contributing factor to their inability to adequately audit high-risk activities. We noted also that there was a vacant information systems audit position in the Internal Audit function. To date, the position remains vacant and Internal Audit may still not be able to meet its audit plan.

<u>Recommendation</u>:

Internal Audit should continue to try to fill the vacant information systems audit senior position. The Internal Audit Director should consider alternative solutions such as enhancing the training of existing staff or using contractors with specialized audit skills to ensure that high-risk activities are audited.