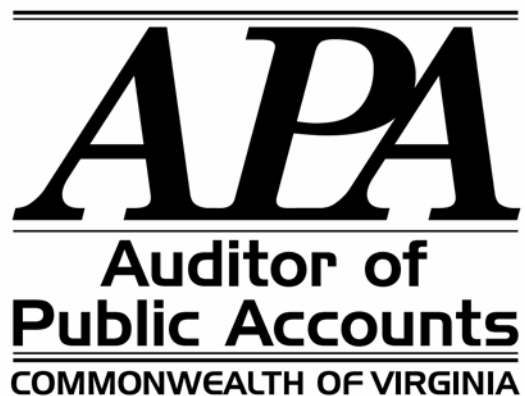


**VIRGINIA EMPLOYMENT COMMISSION**

**REPORT ON AUDIT  
FOR YEAR ENDED  
JUNE 30, 2006**



## **AUDIT SUMMARY**

Our audit of the Virginia Employment Commission for the year ended June 30, 2006, found:

- proper recording and reporting of transactions, in all material respects, in the Commonwealth Accounting and Reporting System and in the Employment Commission's Tax and Benefits Systems;
- internal control matters that require management's attention and corrective action; and
- noncompliance with applicable laws and regulations or other matters that is required to be reported.

### **Unemployment Trust Fund**

The Unemployment Trust Fund solvency factor continues to improve. For calendar year 2007, the solvency factor increased to 71.9 percent from 54.9 percent in calendar year 2006. Consistent with fiscal year 2005, taxes collected continued to exceed benefits paid, resulting in the Trust Fund balance increasing from \$479 million in the previous year to \$721 million at the end of fiscal year 2006.

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## AUDIT FINDINGS AND RECOMMENDATIONS

### Develop Information Security Program

The Employment Commission does not have a complete or current information security program; therefore they are not in compliance with the Commonwealth's Security Standards. The Employment Commission should have a security program that includes policies and procedures that management and staff are aware of and can apply. These policies and procedures should provide reasonable assurance that appropriate levels of confidentiality, integrity, and availability exist over data in their possession. A well-developed security program should include documented policies and procedures consisting of the following components.

- Information Security Responsibilities and Separation of duties
- Information Security Officer Role
- Risk Management
- IT Contingency Planning
- It Systems Security
- Logical Access Control
- Data Protection
- Facilities Security
- Personnel Security
- Threat Management
- IT Asset Management

A comprehensive information security program also provides the essential framework to protect the data on information systems and the data handled by employees. As an example, we found untimely deletions of access to both CARS and CIPPS. The Employment Commission should allocate the time and resources necessary to complete a comprehensive information security program that will meet industry best practices.

### Assurance of Infrastructure Security

The Commissioner at the Employment Commission has responsibility for the security and safeguarding of all databases, information, and information technology assets. Over the past three years, the Commonwealth has moved the information technology infrastructure supporting these databases and information to the Virginia Information Technology Agency (VITA). As part of this transfer, the agencies also transferred many of the staff who had the expertise to advise the agency heads on these matters.

Since VITA assumed responsibility for the information technology infrastructure, the agency heads must have VITA provide assurance that their infrastructure provides the safeguards to protect information and databases required by state policy. We believe that the agencies cannot solely ensure that their data has the proper level of security to protect it from unauthorized changes, disclosure, or loss now that VITA has these resources and authority.

The agency heads need to evaluate the agencies' capabilities for determining the level of assurance needed from VITA. Since the agencies retain ownership and maintain the application systems and databases that gather information, the agencies' internal staff has full responsibility for access controls to these systems. If these systems operate in a shared environment, the provider of the shared services would need to assure the agency heads of the adequacy of those controls. This shared environment is the same as the mainframe data center operation that VITA and its predecessors offered.

While the agencies and VITA have entered into a detailed memorandum of understanding (MOU) that defines service level responsibilities in this shared environment, the current MOU does not address the security levels required by the individual agencies. For the secure transmission of information to and from the database, the agency heads must address whether the agencies have the expertise to assess this issue. Inherent within this question is whether the agencies have the resources to maintain the level of expertise capable of adapting to the changing infrastructure environment.

There are two potential approaches to this issue. The first assumes the agencies have the expertise and the resources to understand the changing infrastructure and can therefore specifically address all security needs. The second approach requires that the agencies explain in detail, to VITA, the security needs for each of their systems and databases along with what access controls they currently provide. VITA then must provide the agency heads assurance that the infrastructure provides the level and depth of security necessary to meet state policy.

The Commissioner should continue developing an MOU with VITA to define the security levels required for the Commission's data and require that VITA provide, at least annually, written assurance so the Commissioner can fulfill her responsibilities related to security requirements.

#### Follow Established Procedures for Field Office Payment Logs

As was previously identified by the Employment Commission's Internal Audit Department, the field offices are not following the standard procedures for the Field Office Payment Log (log) in the Field Operations Manual for the Unemployment Insurance Service Program. The log records the miscellaneous collections by the Field Office staff.

Since Field Offices do not regularly collect money, the log is the primary record of collection. Lack of compliance with the procedures includes the untimely submission of the log and date inconsistencies between receipts, logs (including the Local Office Manager's signed date on the log), and money orders.

We believe the noncompliance results from a lack of procedural training or understanding of the internal controls within the field offices. Lack of adherence to this procedure understates cash collections and revenue and could allow for such assets to be more susceptible to misappropriation. We recommend that the Employment Commission review the status of compliance on a periodic basis and hold such offices accountable when non-compliance occurs.

### FOLLOW-UP ON PRIOR AUDIT FINDING

#### Continue Efforts to Improve Participant Data Entered into VWNIS

During fiscal year 2006, the Employment Commission administered the federal Workforce Investment Act (WIA) through seventeen Local Workforce Investment Areas (Local Areas). Each Local Area is a county, city, or a combination of localities, which cover the entire Commonwealth. Each Local Area receives federal Workforce Investment Act monies to promote workforce training and employment. The federal funding must comply with the WIA requirements and the budget established by the Local Workforce Investment Board. As stipulated in a November 2006 signed Memorandum of Understanding, the Employment Commission's role as administrator for WIA will change to providing fiscal oversight and program compliance. The Office of the Senior Advisor to the Governor for the Workforce will act as the WIA program administrator.

The Employment Commission performs annual reviews of the Local Areas' compliance with the Workforce Investment Act, Virginia Workforce Council (VWC) policies and Local Workforce Investment Board policies. These reviews identified that the Local Areas are not fully complying with the Employment Commission's internal guidance to enter participant data into the Virginia Workforce Network Information System (VWNIS) within five working days from completion of a transaction. While the reviews show some improvements especially where there were issues of inconsistencies during the prior year audit, the reviews show that some data elements continue to be entered incorrectly. The reviewers have found recurring issues since fiscal year 2004. Untimely and inaccurate submissions can adversely affect the Local Areas' reported performance to the state and, when summarized by the state, to the U.S. Department of Labor.

In fiscal year 2006, the Employment Commission made improvements by conducting more extensive compliance testing and requiring Local Areas prepare corrective action plans to correct issues found. In addition, the Employment Commission entered into a contract in September 2006 with Geographic Solutions for an information system to replace VWNIS. However, the implementation of this new system, anticipated for late 2007, will not correct prior entry issues and data entry problems will continue until the new system becomes fully functional. Until the replacement system is in place, the Employment Commission will continue to be noncompliant with internal requirements and will increase their risk of misstating their reports.

The Employment Commission, in collaboration with the Office of the Senior Advisor to the Governor for the Workforce, should continue making progress towards the implementation of the new system and continue to conduct compliance testing and require corrective action plans, as necessary. Continued focus in these areas will assist in improving the reporting of accurate performance statistics to the U.S. Department of Labor in accordance with the Workforce Investment Act.

#### SELECTED AGENCY INFORMATION

The Employment Commission's mission is to promote economic growth and stability by delivering and coordinating workforce services to include policy development, job placement services, temporary income support, workforce information, and transition and training services. The Employment Commission accomplishes this goal through a number of programs, including the Unemployment Insurance, Job Service, and Workforce Investment Act programs. The Employment Commission also compiles and provides labor market and economic information through the Economic Information Services Division.

The Unemployment Insurance program makes benefit payments to workers who are unemployed through no fault of their own, ensuring they have minimal income during the course of a job search. The Employment Commission collects unemployment taxes from employers and uses these taxes to pay benefit claims. The tax collections go into the Unemployment Trust Fund for which the Employment Commission is the trustee. The Employment Commission pays all unemployment insurance benefit payments from the Trust Fund.

#### UNEMPLOYMENT TRUST FUND

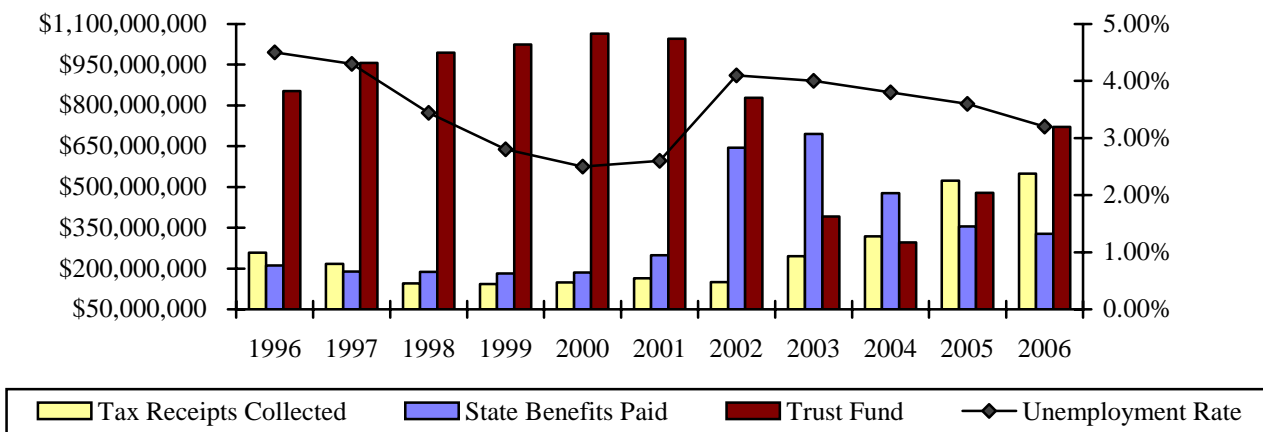
The Unemployment Trust Fund's solvency factor applicable for calendar year 2007 increased to 71.9 percent from 54.9 percent in calendar year 2006. The solvency factors for calendar years 2004 and 2005 were the only times the factor fell below 50 percent since 1984. Consistent with fiscal year 2005, taxes collected continued to exceed benefits paid, resulting in the Trust Fund balance increasing from \$479 million in the previous year to \$721 million at the end of fiscal year 2006.

As a result of the economic downturn in 2001, the Governor issued, on November 14, 2001, an Executive Order increasing all unemployment benefits by 37.3 percent for a six-month period starting September 9, 2001. In 2002, the General Assembly extended these benefit amounts through January 4, 2003, and, as the economy worked towards recovery, reduced the increased benefit levels over the next year and a half. Since 2003, the General Assembly has passed legislation increasing the benefit levels. The following chart summarizes these changes in the benefit amounts.

	<u>Minimum Weekly Benefit</u>	<u>Maximum Weekly Benefit</u>
September 9, 2001 - January 4, 2003	\$69	\$368
January 5, 2003 - July 5, 2003	59	318
July 6, 2003 - July 3, 2004	50	316
July 4, 2004 - July 2, 2005	50	326
July 3, 2005 - July 2, 2006	54	330
July 3, 2006 - current	54	347

The following illustration presents historical trends, which show the changes in tax collections, benefit payments, the Trust Fund balance, and the unemployment rate over the past several years.

Trends in the Unemployment Trust Fund



Note: The Trust Fund balance also includes interest credited to the account. The unemployment rate represents the average rate for the entire fiscal year.

Employer tax rates are inversely correlated to the Trust Fund's solvency level. As the Fund's solvency decreases, the tax rates increase. The Employment Commission levies taxes on employees' wages reported by employers according to rates set by the General Assembly. Under current law, employers only pay taxes on the first \$8,000 of each employee's wages. The tax rates imposed on employers consider the Trust Fund's solvency and the employment histories of individual businesses, referred to as the experience rating. This rating requires employers with a history of higher unemployment claims to pay a greater rate and allows those with fewer claims to pay less or nothing at all.

The Unemployment Compensation Act sets the lowest tax rate at zero as long as the Trust Fund solvency remains at or above 100 percent. Since fiscal year end 2002, the Trust Fund solvency has remained below 100 percent; therefore, all employers paid unemployment taxes during calendar years 2003 through 2006. For calendar year 2006, the minimum rate that an employer could be required to pay on taxable wages was 0.29 percent, while the maximum rate was 6.39 percent.

An additional adjustment to the tax rate for calendar years 2003 through 2006 was the inclusion of the pool tax. The pool tax represents a levy to recover benefits not chargeable to a specific employer, known as pool costs. Interest income earned from the Trust Fund can offset the total pool costs when the solvency is above 50 percent. Interest income did not exceed pool costs in fiscal year 2002; therefore, the Employment Commission added a pool tax rate of 0.03 percent to the employer tax rates for calendar year 2003. Because the Trust Fund solvency fell below 50 percent in calendar year 2004, the Employment Commission could not offset the total pool costs and employers paid the full tax rate. The pool tax rate increased to 0.14 percent and 0.22 percent for calendar years 2004 and 2005 (included in the minimum and maximum rates above), respectively. This rate decreased to 0.19 percent for calendar year 2006 and will continue to decrease to 0.07 percent for calendar year 2007.

State law requires a fund-building tax rate of 0.2 percent to the employer tax rates if the fund balance drops below 50 percent, which helps the Trust Fund to remain solvent. The Employment Commission calculated the Trust Fund solvency as 54.9 percent for calendar year 2006 and 71.9 percent for 2007. Since the Trust Fund solvency is above 50 percent for calendar years 2006 and 2007, the fund-building tax rate does not need to be included in these respective calendar years.

The following table compares the various taxes for calendar years 2006 and 2007.

	Calendar Year 2006		Calendar Year 2007	
	Tax Rates		Tax Rates	
	<u>Minimum</u>	<u>Maximum</u>	<u>Minimum</u>	<u>Maximum</u>
Tax rate	0.10%	6.20%	0.10%	6.20%
Pool tax	0.19%	0.19%	0.07%	0.07%
Fund-building tax	<u>0.00%</u>	<u>0.00%</u>	<u>0.00%</u>	<u>0.00%</u>
Total	<u>0.29%</u>	<u>6.39%</u>	<u>0.17%</u>	<u>6.27%</u>

Effective October 27, 2006, the United States Department of Labor issued a final rule about the confidentiality and disclosure of unemployment compensation information. This rule establishes uniform minimum requirements for the payment of costs, safeguards and data-sharing agreements when there is disclosure of unemployment compensation information. States have two years from the effective date to adopt conforming legislation. The Employment Commission is determining what changes it needs to comply with this ruling.

### WORKFORCE INVESTMENT ACT

The Workforce Investment Act of 1998 (WIA) authorizes funds for employment and training services in various programs and with organizations through a system of one-stop career centers. In Virginia, one-stop career centers are the Virginia Workforce Centers.

Each Virginia Workforce Center provides services required by federal legislation plus services to meet the needs of the local community. Most Employment Commission locations are Virginia Workforce Centers, and there are centers operated by other partner organizations and contractors offering employment services. Virginia's system of one-stop career centers is the Virginia Workforce Network. During fiscal year 2006, the Virginia Workforce Centers operated under the guidance of the Virginia Workforce Council and Workforce Investment Boards in seventeen Workforce Investment Areas. Effective July 1, 2006, the Employment Commission, as administrative agency for WIA, received, and on behalf of the Governor, approved a request from local elected officials to combine two local workforce investment areas into a single area.

The Virginia Workforce Council assists the Governor in meeting the workforce training needs of the Commonwealth. This Council serves as the State Workforce Investment Board for the federal Workforce Investment Act (WIA). The Council provides guidance on workforce training issues and operation of Virginia Workforce Centers.

The Workforce Investment Boards establish and operate the Virginia Workforce Centers. These Boards provide a forum to assure that workforce training and employment initiatives meet the economic development and business needs of each local area.

#### Workforce Investment Act Federal Expenditures

	<u>2004</u>	<u>2005</u>	<u>2006</u>
Adult Program	\$13,884,124	\$13,788,000	\$11,974,239
Youth Activities	15,263,943	13,979,784	11,973,139
Dislocated Workers	<u>20,992,570</u>	<u>19,129,872</u>	<u>13,681,019</u>
Total	\$50,142,641	\$46,899,661	\$37,630,403

Note: Programs for adults and dislocated workers seek to improve employment, retention, and earnings of WIA participants and increase their educational and occupational skill attainment. Youth activities seek to increase the attainment of basic skills, work readiness or occupational skills, and secondary diplomas or other credentials.

Effective July 1, 2006, the responsibility for the administration of the Workforce Investment Act programs moved from the Employment Commission to the Governor's Office of Workforce Development and Workforce Council Support (Office). Throughout fiscal year 2007, the transition of the Workforce Investment Act implementation activities will continue to occur between the Employment Commission and the Office. However, the Employment Commission will continue to be the fiscal agent for the Office and provide compliance reporting to the Senior Advisor of the Workforce Development.

#### EMPLOYMENT COMMISSION ADMINISTRATIVE FUNDING

The Employment Commission's funding comes entirely from federal funds, mostly from the Unemployment Insurance, Job Services, and Workforce Investment Act. This funding makes the Employment Commission susceptible to increases and decreases in funding based on the economy. When the economy is poor and unemployment is high, both benefits administered and funding increase. As the economy improves and unemployment decreases, the funding for the Employment Commission also decreases. Thus the Employment Commission funding reflects the cyclical movement of the economy, requiring the Employment Commission to either increase spending to support increased services or cut costs due to decreased services.

The Employment Commission continued to experience a downturn in their funding level as the economy continues to improve. During fiscal year 2006, funding for Unemployment Compensation Services decreased approximately \$25 million, primarily from reduced projected unemployment benefits of \$10.7 million and a reduction in the appropriated amount for a new Unemployment Insurance benefits system of \$14.2 million. As in fiscal year 2005, the Employment Commission laid off part-time and wage employees and combined several local offices to decrease costs.

## INFORMATION SYSTEMS

The Employment Commission is facing changes in their internal control and information technology environment. These changes include compliance with new data security standards, as previously mentioned and several major system development initiatives. The Employment Commission's management has recently hired a new Information Technology Director with a systems development background and training in project management best practices. The new Director has implemented a major IT department reorganization.

### Information Systems Development

The Employment Commission has initiated three major systems development projects. These projects will replace the Virginia Workforce Network Information System (VWNIS), the Virginia Automated Benefits System and the Virginia Automated Tax System. Employment Commission is also participating in the Commonwealth's Enterprise Application Initiative for a statewide financial management system. The Employment Commission has entered into a contract with Geographic Solutions to replace VWNIS during calendar year 2007.



# Commonwealth of Virginia

**Walter J. Kucharski, Auditor**

**Auditor of Public Accounts  
P.O. Box 1295  
Richmond, Virginia 23218**

December 8, 2006

The Honorable Timothy M. Kaine  
Governor of Virginia  
State Capitol  
Richmond, Virginia

The Honorable Thomas K. Norment, Jr.  
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, 2006. We conducted our audit in accordance with Government Auditing Standards issued by the Comptroller General of the United States.

### Audit Objectives

Our audit's primary objective was to evaluate the accuracy of the Virginia Employment Commission's financial transactions as reported in the Comprehensive Annual Financial Report for the Commonwealth of Virginia for the year ended June 30, 2006. In support of this objective, we evaluated the accuracy of recording financial transactions on the Commonwealth Accounting and Reporting System and in the Employment Commission's Tax and Benefits Systems, reviewed the adequacy of the Employment Commission's internal control, tested for compliance with applicable laws and regulations, and reviewed corrective actions of audit findings from the prior year report.

### Audit Scope and Methodology

The Employment 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 materiality and control 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.

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

We performed audit tests we deemed necessary to determine whether the Employment 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 Employment Commission's operations. We tested transactions and performed analytical procedures, including budgetary and trend analyses.

### Conclusions

We found that the Employment Commission properly stated, in all material respects, the amounts recorded and reported in the Commonwealth Accounting and Reporting System and in the Employment Commission's Tax and Benefit Systems. The Employment 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 and the Employment Commission's Tax and Benefit Systems.

We noted certain matters involving internal control and its operation and compliance that require management's attention and corrective action. These matters are described in the sections entitled, "Audit Findings and Recommendations" and "Follow-up on Prior Audit Finding." The audit findings reported in the prior year are repeated in this report because the Employment Commission has not taken adequate corrective action.

### Exit Conference and Report Distribution

We discussed this letter with management on February 13, 2007. Management's response is included at the end of this report.

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

AUDITOR OF PUBLIC ACCOUNTS

MSM:jab  
jab:XX



# COMMONWEALTH of VIRGINIA

## Virginia Employment Commission

Dolores A. Esser  
Commissioner

703 East Main Street

Post Office Box 1358  
Richmond, Virginia 23218-1358

February 20, 2007

Mr. Walter J. Kucharski  
Auditor of Public Accounts  
James Monroe Building  
101 North 14<sup>th</sup> Street  
Richmond, Virginia 23219

Dear Mr. Kucharski:

Thank you for the opportunity to offer our response to your audit report.

We concur with the findings and recommendations identified in your report, and have developed corrective actions to address the audit findings and recommendations. The following is a summary of our response to your findings:

1. Develop Information Security Program

VEC Response:

*We concur with this finding. We have assigned a team of IT, Security, and business staff, under the direction of a project manager, to update VEC's Security Program and incorporate the requirements and best practices of VITA Security policies and standards. VEC recognizes that additional staff time must be allocated to these security activities; and security is a primary goal for VEC IT in 2007.*

2. Assurance of Infrastructure Security

VEC Response:

*We concur with this finding. In 2006 VITA requested that VEC fill out the Customer Agency Information Security Template for input to their Information Security Assurance Program. On January 31, 2007, VEC completed this survey and sent to VITA a comprehensive report listing and defining all of its information systems and subsystems denoting the security needs/risks of each. VEC's application database was updated and expanded in order to complete this template and produce this report. This database and information will be utilized by VEC as it develops its IT Security Audit Plan, and will provide a basis for future requests for assurance from VITA/NG on the security over IT infrastructure.*

Mr. Walter J. Kucharski  
February 20, 2007  
Page Two

*In addition, VEC has received a letter of assurance from the state CIO, stating the security of the agency's infrastructure systems and networks is at least as good or better than when they were transferred to VITA. He also stated that VITA is in the process of establishing a formal Information Security Assurance Program.*

*VEC has requested and received VITA's current policies as related to security. VEC's Security Team is currently reviewing this policy, and the results of this review will be utilized to strengthen VEC's security policy – as well as informing VITA of any policy concerns.*

3. Follow Established Procedures for Field Office Payment Logs

VEC Response:

*We concur with this finding. The Chief of Benefits issued updated Field Office Payment Log Procedures on October 11, 2006, to all Field Operations staff. The Chief of Benefits will develop a guide that will be used to evaluate each field office, in order to ensure compliance. The Regional Directors will visit each field office in their region, and perform an audit of the Field Office Payment Log and associated processes to ensure compliance with Field Office Payment Log Procedures. The field offices audits will be completed by December 31, 2007. The audit findings will be discussed with each Field Office Manager, once the audit has been completed. The Regional Director will provide a final report to the Chief of Benefits after each audit has been conducted. Appropriate action will be taken to ensure compliance is maintained.*

4. Continue Efforts to Improve Participant Data Entered into VWNIS

VEC Response:

*We concur with this finding. This area has been an on-going concern, aggravated in part by recognized limitations in our current VWNIS system. We are in the process of obtaining and implementing a replacement system to alleviate these limitations. Also, Division monitors will continue to review files for compliance, issue appropriate findings, and require corrective action. We also acknowledge that in any information system, there are inherent risks of errors or omissions, and it may not be cost effective to obtain 100% accuracy of information in the system.*

Again, I appreciate the opportunity to provide the VEC's comments as part of your office's report of the VEC's financial records and operations for the year ended June 30, 2006.

Sincerely,



Dolores A. Esser

VIRGINIA EMPLOYMENT COMMISSION

Dolores Esser  
Commissioner

Nicholas Kessler  
Deputy Commissioner