VIRGINIA EMPLOYMENT COMMISSION

REPORT ON AUDIT

FOR THE YEAR ENDED

JUNE 30, 2015

Auditor of Public Accounts
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AUDIT SUMMARY

Our audit of the Virginia Employment Commission (Commission) for the fiscal year ended June 30, 2015, found:

- proper recording and reporting of all transactions, in all material respects, in the Commonwealth Accounting and Reporting System, the Commission's Virginia Automated Benefits System (VABS) and Virginia Automated Taxation System (VATS), its Financial Management System, and its Attachment 10 and 15 submissions to the Department of Accounts (Accounts);

- three deficiencies which we consider to be material weaknesses in internal control;

- additional matters involving internal control and its operations necessary to bring to management's attention; and

- adequate corrective action to resolve the prior year audit findings titled "Improve Organizational Placement of Information Security Officer," "Continue to Strengthen Internal Controls over Financial Reporting," "Continue to Strengthen Tax – Wage Reconciliation Processes," and "Review Policies over Benefit Overpayment Reviews."

During the audit, we identified a number of internal control and compliance findings that we believe are either directly, or indirectly, related to a lack of available resources. Over the last several years, the Commission has devoted a considerable amount of resources to several system development projects, one of which is still ongoing. To address its project needs, the Commission has allocated a significant number of key personnel to these projects, which has caused reassignment of key job responsibilities to other staff and shifting of responsibilities at the Commission. However, the Commission has continued to experience issues of increased employee turnover as well as increased information technology (IT) maintenance costs and decreases in federal administrative funding over the last several years. This has significantly impacted its daily operations.

While these issues continue to impact operations across the Commission, lack of available resources continues to hinder the Commission's ability to maintain its information security program, which is of particular concern given the sensitivity of the information the Commission maintains within its information systems. In order to strengthen the Commission's information security program, a fully dedicated Information Security Officer (ISO) was hired during 2015. This position was reorganized to align with "best practices" and hence reports directly to the Commissioner. Additionally, the Commission applied for and was awarded additional federal funds from the United States Department of Labor (Labor) to strengthen its information security program.

Although the Commission has begun to take significant strides to reduce IT security risk, several of the weaknesses identified in our prior audit continue to exist. Additionally, new risks have

emerged as the Commission continues with its system development efforts. As such, we have re-issued several of the prior audit findings to encourage the Commission to continue evaluating its resource levels, both in terms of people and money, in order to reduce IT security risk.

REVIEW FOR POTENTIAL IMPROPER BENEFIT PAYMENTS

In addition to auditing the financial statement submissions to Accounts and the Unemployment Insurance program, our office conducted a special study, separate from this audit, to identify potential instances of improper payments to deceased individuals and gain an understanding of the Commission's processes for preventing and detecting these payments within the Unemployment Insurance program. We did not issue a separate report addressing this special study; instead we are reporting the results of our study in this report. During our review, we compared the unemployment insurance payment records to the Commonwealth's death registry, maintained by the Virginia Department of Health, to identify potential instances of improper payments. Our review encompassed unemployment insurance payments made between July 1, 2011, and June 30, 2014. Of the 454,429 individuals that received an unemployment insurance payment(s) between July 1, 2011, and June 30, 2014, we initially found 51 individuals who appeared to have received an unemployment insurance payment after death. However, the Commission explained how only eight of these individuals, receiving 57 payments in total, appear to be instances of potential improper payment(s) to deceased individuals. The Commission indicated that it is currently investigating these instances and establishing overpayments of benefits as appropriate.

As part of our study, we also determined how the Commission identifies improper payments going to deceased individuals. Although the Commission has not implemented continuous monitoring processes, it performs an initial match against Federal and State records to verify an individual's identity when they initially file for unemployment insurance. The Commission does not currently perform additional cross-checks after the initial determination of eligibility. The Commission is currently in the process of exploring options to implement a continuous cross-match against Federal and State records to detect payments going to deceased individuals. We encourage the Commission to continue with its efforts to implement a continuous cross-match.

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RISK ALERT

A risk alert differs from an internal control and compliance finding in that it represents an issue that is beyond the corrective action of the individual agency and requires the cooperation of others to address the risk.

Continue to Upgrade End-of-Life Operating Systems

The Commonwealth of Virginia's (Commonwealth) IT Infrastructure Partnership with Northrop Grumman (Partnership) provides agencies with installation, maintenance, operation, and support of IT infrastructure components such as workstations, servers, routers, firewalls, and virtual private networks. During our review, we found that the Partnership is not maintaining some of these devices according to the Security Standard and is exposing the Commonwealth's sensitive data to unnecessary risk.

The Partnership uses end-of-life and unsupported operating systems in its IT environment to support some of the Commission's personnel workstations. The Commission relies on the Partnership to provide current, supported, and updated operating systems that serve as the foundation for its workstations.

Section SI-2-COV of the Commonwealth's Information Security Standard, SEC501-09 (Security Standard) prohibits the use of products designated as "end-of-life" by the vendor. A product that has reached its end-of-life no longer receives critical security updates that rectify known vulnerabilities that can be exploited by malicious parties.

The Partnership maintains 745 workstations for the Commission as of September 21, 2015, that are officially designated as end-of-life per the vendor. The Partnership's use of unsupported operating systems increases the risk that existing vulnerabilities will persist in the operating systems without the potential for patching or mitigation. These unpatched vulnerabilities increase the risk of cyberattack, exploit, and data breach by malicious parties. Additionally, vendors do not offer operational and technical support for operating systems designated as end-of-life, which increases the difficulty of restoring system functionality if a technical failure occurs.

The Commission is aware of this issue and is currently working with the Partnership to upgrade the end-of-life operating systems. Until then, the Commission and the Partnership have installed additional security controls to attempt to reduce some of the risk that the end-of-life operating systems introduce into the IT Environment.

The Commission and Partnership should continue working to upgrade all of the end-of life operating systems before their remediation plan deadline. Doing this will further reduce the risk to the confidentiality, integrity, and availability of sensitive Commonwealth data and achieve compliance with the Security Standard.

INTERNAL CONTROL AND COMPLIANCE FINDINGS AND RECOMMENDATIONS

To differentiate between information security findings and other findings, we've separated the "Internal Control and Compliance Findings and Recommendations" section into two sub-sections: "Information Security Findings" and "Other Findings."

Information Security Findings

Continue to Effectively Allocate Resources to Reduce IT Security Risk – REPEAT

The Commission needs to continue determining how to allocate the necessary resources to reduce IT security risk, as required by the Security Standard. During the audit, we identified several weaknesses in the Commission's information security program, which stem from a lack of dedicated resources. We discuss these weaknesses in further detail within the recommendations entitled "Obtain Approval to Use End-of-Life Operating Systems," "Continue Improving Oversight over IT Risk Assessments and Security Audits," "Continue to Improve Physical and Environmental Security," "Document Separation of Duty Conflicts for Mission Critical Systems," "Maintain Oversight over Third-Party Service Providers," and "Improve Database Security."

The Commission has been involved in several system development projects, which have required a substantial amount of resources over the last several years. The Commission has allocated a significant number of IT resources to these projects that, in turn, affected the resources available for maintaining certain aspects of its IT environment, including its information security program. Additionally, the Commission continues to receive less administrative funding from the federal government to maintain its operations as a result of continued economic improvements.

Section 1.4 of the Security Standard requires each agency to document, implement, and maintain its information security program appropriate to its business and technology environment. Without the allocation of the necessary resources to assure compliance with the Security Standard, the Commission will not be able to maintain adequate internal controls to protect confidential and mission critical data. Inadequate information security controls may lead to significant deficiencies in critical areas that could affect the financial statements or potentially impact the operations of the Commission.

In September 2015, Labor awarded the Commission additional federal funds to strengthen its information security program. Additionally, the Commission hired an ISO in September 2015, whose time will be fully committed towards maintaining the Commission's information security program.

The Commission's executive leadership should continue to evaluate its IT resource levels, both in terms of people and money, to confirm that it appropriately allocates additional resources to implement and maintain information security controls on current and future systems, and maintain an information security program that meets or exceeds the requirements set forth within the Security Standard.

Obtain Approval to Use End-of-Life Operating Systems

The Commission has not obtained approval from the Commonwealth's Chief Information Security Officer (CISO) to continue to use computer operating systems that the software publisher has designated as end-of-life. Retired and unsupported operating systems no longer receive updates and patches to remedy recently discovered vulnerabilities. Hackers use discovered vulnerabilities to create computer viruses that exploit known weaknesses in the operating system to gain unauthorized access.

Section 1.5 of the Security Standard, requires the Agency Head to submit to the CISO and receive approval of a security standard exception request if the Commission determines that compliance with the provisions of the Security Standard or any related information security standard would adversely affect a business process of the Commission.

The Commission's IT environment is part of the Commonwealth's IT infrastructure for executive branch agencies. Therefore, any weaknesses or deviation from security controls at a particular agency need to be identified and compensating controls need to be approved by the Commonwealth's CISO. The approval includes the acceptance of temporary compensating controls that reduces the risk while the systems are being upgraded.

The Commission was unable to obtain an approved exception due to the lack of necessary resources during the fiscal year, as the Commission experienced transitions in internal personnel. Due to this, the Commission was unable to ensure it took the proper steps to submit a timely exception request to the CISO.

The Commission should work with the CISO to obtain an exception request approval required by the Security Standard as it continues to use software products that the software publisher has designated as end-of-life.

Continue Improving Oversight over IT Risk Assessments and Security Audits – REPEAT

The Commission continues to not develop and maintain an IT Security Program in accordance with the Security Standard. Specifically, the audit disclosed the following weaknesses:

- The Commission has incomplete risk assessments for sensitive IT systems and the risk assessment for the Financial Management System, which it implemented in January 2015, was not completed until October 2015. Section 6.2 of the Security Standard, requires the data-owning agency to conduct and document a risk assessment of the IT system as needed, but not less than once every three years. Additionally, Section 6.2 of the Security Standard requires the data-owning agency to conduct and document an annual self-assessment to determine the continued validity of the risk assessment.

- The Commissions' Internal Audit Division (Internal Audit) has not submitted an updated IT security audit plan that reflects significant changes to its IT environment. In January 2015, the Commission replaced its legacy financial systems with a modern Financial Management System, but the current IT security audit plan does not reflect this new system or have it scheduled for an audit review. Section 2.1 of the IT Audit Standard requires each agency to develop or review its IT security audit plan on at least an annual basis or more often as necessary.

- Internal Audit is not conducting IT security audits once every three years for all IT systems classified as sensitive. The Commissioner has delegated the responsibility for performing IT security audits to Internal Audit. Section 1.4 of the IT Audit Standard requires agencies to assess IT systems that contain sensitive data at least once every three years.

Without having complete risk assessments and not developing and maintaining an IT Security Audit program, the Commission increases the risk that existing weaknesses in sensitive systems will continue to remain undetected and unmitigated. These undetected weaknesses increase the risk of a system and data compromise by malicious parties, or system unavailability.

Since the last audit, the Commission has worked towards addressing these issues by hiring a full-time ISO and restructuring that role's placement in the organization. However, the full-time ISO only recently started in September 2015, and therefore the Commission has not addressed the issues identified above. Additionally, Labor awarded the Commission additional federal funds in September 2015 to strengthen its information system security program. The Commission should continue to use these additional resources effectively to strengthen its information security program.

Continue to Improve Physical and Environmental Security – REPEAT

The Commission continues to not have a sufficient physical and environmental security program in place to protect technical assets that support day-to-day business functions from human and environmental risks.

Section PE-1 of the Security Standard requires the agency to develop, document, and implement physical and environmental protection policies and procedures to ensure appropriate safeguards are in place to protect information systems from human and environmental risks. We communicated two essential control weaknesses during the prior year audit in detail to management in a separate document marked Freedom of Information Act Exempt (FOIAE) under Section 2.2-375.2 of the Code of Virginia due to the sensitivity and description of security controls. The Commission did not correct the weaknesses identified during the prior year audit in the current audit period, and an additional control weakness was identified during the current audit. All of these weaknesses were communicated to management in a separate document marked FOIAE.

By not requiring sufficient physical and environmental safeguards and supporting procedures, the Commission cannot properly protect information systems maintained on the premises from human and environmental risks. The Commission has made progress in corrective actions by changing the placement of and hiring of a new ISO to be fully dedicated to maintaining the Commission's information security program. However, the lack of resources contributed to the Commission not having fully corrected the weaknesses identified during our last audit.

The Commission should continue to allocate the necessary resources to further implement the controls discussed in the communication marked FOIAE to meet, at a minimum, the requirements in the Security Standard and industry best practices.

Document Separation of Duty Conflicts for Mission Critical Systems – REPEAT

The Commission continues to not document separation of duty conflicts for certain mission critical systems. The Commission used VABS and VATS, through November 2015, to administer the Unemployment Insurance program. Additionally, the Commission uses its Financial Management System to account for activity within the Unemployment Trust Fund (Trust Fund). Although the Commission maintained documentation defining each access level and group within the respective systems, it did not maintain documentation to indicate which access levels and groups create a separation of duty conflict(s).

Section 8.1 AC-5 of the Security Standard requires agencies to document separation of duties of individuals. The Commission did not identify and correct this weakness because it lacked the necessary resources to implement and maintain an information security program that meets or exceeds the requirements set forth within the Security Standard. When managers at the Commission request employee access to multiple mission critical systems concurrently, there is the risk that certain access levels and groups may conflict with one another and allow an individual to bypass the internal controls set forth by management. Without identifying and documenting separation of duty conflicts, the Commission cannot assure itself that appropriate safeguards are in place to mitigate the risk created by granting elevated levels of access.

To strengthen its information security program, the Commission hired an ISO in September 2015. The ISO is organizationally independent from the Commission's IT operations and will be fully committed towards maintaining the Commission's information security program. Going forward, the ISO should confirm that System Owners are identifying and documenting separation of duty conflicts for its mission critical systems. Additionally, the ISO should confirm that management is making all employees aware of this policy.

Maintain Oversight over Third-Party Service Providers – REPEAT

The Commission continues to not maintain oversight over Third-Party Service Providers (Providers) to gain assurance over outsourced operations. Providers are entities that perform outsourced tasks or functions on behalf of the Commonwealth. The Commission has outsourced several of its mission critical business functions related to the Unemployment Insurance program,

including hosting of its online claims portal and administration of electronic debit card operations for Unemployment Insurance benefit payments.

Topic 10305 of the Commonwealth Accounting Policies and Procedures Manual requires agencies to have adequate interaction with the Provider to understand its internal control environment and maintain oversight over the Provider to gain assurance over outsourced operations. The Commission can obtain assurance in several forms, including but not limited to, Service Organization Control reports or on-site reviews of the Provider's internal control environment. The Commission did not maintain oversight over Providers because it did not establish a framework for identifying Providers or develop procedures for gaining assurance over outsourced operations. Without maintaining oversight, the Commission cannot gain assurance that the Provider's internal control environment is sufficient to protect the Commonwealth's assets.

The Commission should dedicate the resources necessary to develop a framework for identifying Providers and implement procedures for gaining assurance over outsourced operations. After developing a framework, the Commission should review its contract listing to identify all vendors it considers to be a Provider and confirm that the contract language between the Commission and Provider clearly delineates the processes, procedures, and controls assigned to each party. Thereafter, the Commission should determine which method is best for gaining assurance over outsourced operations. Finally, the Commission should maintain oversight over this process to confirm that it is compliant with the provisions set forth within the Commonwealth Accounting Policies and Procedures Manual.

Improve Database Security

The Commission is missing several controls that secure data in a database that supports mission critical business functions. The Security Standard requires agencies to implement certain minimum controls to safeguard data that is stored in database systems. We identified 11 essential database control weaknesses and communicated the details of these control weaknesses to management in a separate document marked FOIAE under Section 2.2-3705.2 of the Code of Virginia due to its sensitivity and description of security controls.

The lack of appropriate policies and procedures outlining control requirements and procedures to properly secure the database contributed to the deficiencies identified above. Additionally, the Commission lacked the necessary resources to conduct a security audit before it placed the system into its production environment. By not ensuring that documented policies and procedures are in place and properly securing the database supporting the system, there is a higher risk for malicious users to compromise sensitive data.

The Commission should dedicate the necessary resources to define and implement the controls discussed in the communication marked FOIAE to meet, at a minimum, the requirements in the Security Standard and industry best practices.

Other Findings

Strengthen Process for Monitoring Automated Reports Supporting Timesheet Approvals

The Commission's Division of Finance (Finance) is not conducting frequent reviews to monitor and evaluate the business rules supporting the employee timesheet approval function within its Financial Management System. In January 2015, the Commission replaced its legacy financial systems with an Enterprise Resource Planning system, which includes a modernized time and labor module. During implementation, the Commission elected to give supervisors the ability to delegate their approval authority to other supervisors. To enforce separation of duties, the Commission requested that its vendor implement a control that would prevent an individual from being able to approve their own timesheet. Finance evaluated this control, within its test environment, and determined it was effective. However, this control was not replicated in the production environment and there was a defect that allowed supervisors to delegate approval authority to any individual who has access to the time and labor module. Shortly after implementation, there was one instance where an employee entered and approved their own timesheet because their supervisor delegated approval authority to them.

To maintain oversight over this process, Finance developed an automated report to monitor delegation of approval authorities. However, Finance did not conduct its first review of the automated report until July 2015, six months after it placed the system into production. Section 200.303 of the Code of Federal Regulations requires non-federal entities to establish and maintain effective internal control over the federal award that provides reasonable assurance that the non-federal entity is managing the federal award, in compliance with the federal statues, regulations, and the terms and conditions of the federal award. Without performing frequent reviews, the Commission cannot assure itself that supervisors are adhering to internal policies and complying with the federal statues, regulations, and terms and conditions of federal awards.

Finance is in the process of exploring technological solutions to correct this defect. Until it identifies and deploys a technological solution, Finance is reviewing the automated report on a more frequent basis and following up on exceptions as necessary. Additionally, Finance is providing supplemental training to supervisors to confirm they are aware of the policies related to delegation of approval authority. Finance should continue to pursue its current efforts to resolve this defect and perform ongoing monitoring until it has identified and deployed a technological solution to fix this defect.

Confirm VABS is Calculating Maximum Benefit Amount Consistently for All Claimants – REPEAT

The Commission continues to not confirm that VABS is calculating maximum benefit amounts in accordance with the Code of Virginia for all claimants. During the period under review, the Commission processed unemployment insurance payments to 150,781 individuals. Of these, VABS did not calculate the maximum benefit amount correctly for 43 claimants, or 0.03 percent of all claimants that received an unemployment insurance payment during the period under review.

To determine the claimant's maximum benefit amount, VABS first determines the claimant's weekly benefit amount and duration of benefits, based on the wages earned during the claimant's base period. VABS then multiplies the weekly benefit amount and duration of benefits to determine the claimant's maximum benefit amount. However, VABS did not calculate duration of benefits correctly, for the claims in question, due to a defect in the logic used to compute this figure. As a result, the maximum benefit amount was greater than what it should have been for 36 claimants and less than what it should have been for seven claimants. To date, the Commission has overpaid 11 of the 43 claimants in question because of this defect.

Section 200.303 of the Code of Federal Regulations requires that non-federal entities establish and maintain effective internal control over federal awards that provides reasonable assurance that the non-federal entity is managing the federal award in compliance with federal statutes, regulations, and the terms and conditions of the Federal award. Although these instances represent less than one percent of all unemployment insurance claims processed during the period under review, this miscalculation indicates a deficiency in the Commission's process for determining how much it should pay an individual. Without validating the system's logic, the Commission cannot assure itself that claimants receive the proper amount of benefits based on the regulations prescribed in the Code of Virginia.

The Commission performed an analysis shortly after the end of the period under review, using historical and current data, to identify the cause of the defect and develop a solution to remedy the problem going forward. After its analysis, the Commission developed an automated program to replace the logic previously used by VABS to calculate each claimant's maximum benefit amount. The Commission tested this program internally and placed this fix into production at the end of September 2015. The Commission will also use this program to detect miscalculations that have taken place after July 2014 but prior to the implementation date and automatically apply overpayments as necessary. The Commission should continue to monitor this program to confirm that it calculates maximum benefit amount in a manner consistent with the Code of Virginia.

Withhold Child Support Obligations from Benefit Adjustment Payments – REPEAT

The Commission continues to not withhold child support obligations from benefit adjustment payments. Although the Commission does deduct child support obligations from regular unemployment insurance payments, there are situations where the Commission has to generate an additional benefit adjustment payment to the claimant. Such situations include compensating an individual for differences in unemployment insurance benefits when the Commission adds additional wages to the claimant's base period wage profile.

During the period under review, the Commission processed benefit adjustment payments to 2,505 claimants. Of these, the Commission did not withhold child support obligations from the benefit adjustment payments paid to 158 individuals. The Commission did not withhold child support obligations from benefit adjustment payments because it suspended the programming

within its Benefit System supporting this withholding, due to the defects created by system limitations.

Section 303(2)(A)(iii)(1) of the Social Security Act of 1935 requires the State agency charged with the administration of State law to deduct and withhold, from any unemployment compensation otherwise payable to an individual, the amount specified by the individual to the State or local child support enforcement agency to be withheld and deducted. By not withholding child support obligations from benefit adjustment payments and remitting payment to the state child support enforcement agency, the Virginia Department of Social Services is unable to supply custodial parents with their full entitlement amount. This places the Commission at risk of incurring fines and penalties for being non-compliant with federal and state regulations.

To comply with this requirement, the Commission implemented a system fix within VABS in August 2015 to withhold child support obligations from benefit adjustment payments. Additionally, the Commission developed an automated report to monitor the withholding of child support obligations from benefit adjustment payments. The Commission's Benefit Payment Charge Unit will monitor this report to confirm withholdings are taking place at the proper amount. The Commission should continue to monitor the system fix to confirm the VABS is withholding child support obligations from benefit adjustment payments.

STATUS OF SYSTEM DEVELOPMENT PROJECTS

The Commission has recently completed several system development initiatives and is currently involved in one continuing system development initiative. These systems have replaced or will replace multiple outdated systems and significantly change the Commission's current business processes. We summarize these projects and their statuses below.

Financial Management System

The Commission implemented its Financial Management System in January 2015, which replaced its outdated mainframe batch system and databases. The Commission uses the Financial Management System in conjunction with other systems to account for activity within the Trust Fund and track time and labor charges to the Unemployment Insurance program. Total project costs amounted to $4.6 million, or $300,000 less than the total project budget of $4.9 million.

Unemployment Insurance Modernization (UI Mod) Project

In 2009, the Commission began efforts to replace its antiquated mainframe-based systems originally built in the 1980's. The solution, UI Mod, will support payments of benefits to unemployed workers, collection of taxes from employers, and the accumulation of wage data. The total project budget for UI Mod is $58.5 million.

The UI Mod project has three phases: Imaging and Workflow, Tax, and Benefits. The first phase of UI Mod, Imaging and Workflow, went into production successfully in December 2011. The Commission and HCLA, the UI Mod project vendor, originally scheduled the remaining phases of the project to go into production in December 2012 and May 2013. However, the Commission and HCLA did not achieve these dates, which resulted in multiple extensions. The Commission recently completed the second phase of the UI Mod project, Tax, in November 2015.

The Commission, the Secretary of Commerce and Trade, the Office of the Attorney General, and HCLA continue to work together to establish a plan for the completion of the UI Mod Benefits phase that complies with the provisions of the contract and takes new required system changes into account. However, the Commission and HCLA have not developed an implementation timeline and have been unable to establish a foreseeable go live date for the UI Mod Benefits phase.

The Commission has spent approximately $46 million as of November 2015, with over $25 million in contractual payments to HCLA. The remaining contracted Benefits milestone payments to HCLA amount to approximately $7.8 million. However, the project has reached the total project budget for both staffing and production hosting, and the Commission is using contingency funds to cover these shortfalls. The Commission has approximately $700,000 remaining in its contingency fund to complete the project; thereby, leaving minimal funds available for internal staffing or any contingencies that may arise while completing the Benefits phase.

COMMISSION BACKGROUND AND FINANCIAL INFORMATION

The Commission's mission is to promote economic growth and stability by delivering and coordinating workforce services that include policy development, job placement services, temporary income support, workforce information, and transition and training services.

The Commission's primary source of funding for unemployment insurance benefits comes from unemployment taxes collected from employers. The Commission deposits these taxes into the Trust Fund, which the United States Department of the Treasury maintains on behalf of state governments. The Commission also receives federal grants, which primarily fund administrative activities.

The Commission budgets its operational funding in two programs: Workforce Systems Services and Economic Development Services. As shown in Table 1 below, the Workforce Systems Services program is the Commission's primary program. For illustrative purposes, we have included Service Area to provide more detailed program information on operating budget and actual activity.

Budget and Actual Activity for Fiscal Year

Table 1

Program and Service Area	Original Budget	Final Budget	Expenses
Workforce Systems Services			
Job Placement Services	$ 28,410,181	$ 28,410,181	$ 23,417,469
Unemployment Insurance Services	564,110,466	573,610,466	513,244,733
Workforce Development Services	834,187	1,834,187	1,147,229
Economic Development Services	2,881,526	2,881,526	2,801,346
Total	**$596,236,360**	**$606,736,360**	**$540,610,777**

The largest service area in the Workforce Systems Service program is Unemployment Insurance Services. The intent of this service area is to provide benefit payments to unemployed workers. Between July 1, 2014 and June 30, 2015, the Commission provided unemployment insurance to 150,781 unemployed workers.

Unemployment Insurance Services Program

Unemployment Benefits

Under the Unemployment Insurance Services program, the Commission makes benefit payments to unemployed workers who lost their employment through no fault of their own. Unemployment benefit payments provide workers with temporary financial assistance during the course of a job search.

Generally, the amount and length of benefits an individual is eligible for is based on wages that an individual earned while employed. The State's unemployment insurance program pays benefits for up to 26 weeks. The Governor and General Assembly have the ability to adjust unemployment benefit payments. These amounts have not changed significantly over the last several years, as shown in Table 2 below. However, the minimum weekly unemployment benefit amount increased to $60 effective July 6, 2014.

Weekly Unemployment Benefit Amounts

Table 2

Effective Dates	Minimum Benefit	Maximum Benefit
July 1, 2007 – July 5, 2008	$54	$363
July 6, 2008 – July 5, 2014	54	378
July 6, 2014 – Present	60	378

In fiscal year 2015, the Commission paid out more than $455 million in unemployment insurance benefits. Overall, benefit payments continued to decrease as unemployment rates and exhaustion rates decreased and claimants became ineligible to file a new claim due to the length of time they have been unemployed. The federal government's extension of the emergency unemployment compensation program expired January 1, 2014. The amount, reflected in Table 3 below for 2015 federal emergency unemployment insurance benefits, represents recoupment of overpayments from benefit recipients. Table 3 below shows benefit payments by type in fiscal years 2013, 2014, and 2015.

Unemployment Benefit Payments by Type

Table 3

Type of Unemployment Benefit	2013	2014	2015
State Unemployment Insurance Benefits	$586,656,610	$543,516,313	$436,894,932
Federal Unemployment Insurance Benefits	34,852,842	26,797,323	20,484,821
Federal Emergency Unemployment Insurance Benefits	203,344,938	66,457,104	(1,685,306)
Total	**$824,854,390**	**$636,770,740**	**$455,694,447**

Unemployment Taxes

The Commission pays unemployment insurance benefit payments from unemployment taxes collected from employers within the Commonwealth, if the employer meets certain criteria established in the Code of Virginia. The Commission classifies employers as one of two types: taxable or reimbursable. Taxable employers pay an unemployment tax to the Commission based on a set tax rate; while reimbursable employers reimburse the Commission dollar-for-dollar for their proportionate share of benefits paid. There are approximately 208,000 taxable employers and 1,400 reimbursable employers in Virginia.

Under current law, employers pay taxes only on the first $8,000 of each employee's wages. The Commission collects these taxes, throughout the year, and transfers the amount collected to the Trust Fund, maintained by the United States Department of the Treasury as discussed earlier. The Commission is the trustee and uses the Trust Fund to pay state unemployment insurance benefit payments.

Trust Fund

Trust Fund solvency is an indicator of the Trust Fund's ability to pay benefits during periods of high unemployment. The solvency indicator compares the Trust Fund's actual balance to the calculated balance needed to pay unemployment benefits for 16.5 months. During periods of high unemployment, the solvency rate is low; however, the solvency rate is high during periods of low unemployment. Table 4 below illustrates the correlation between unemployment rates and solvency levels.

Unemployment Rate and Solvency Rates

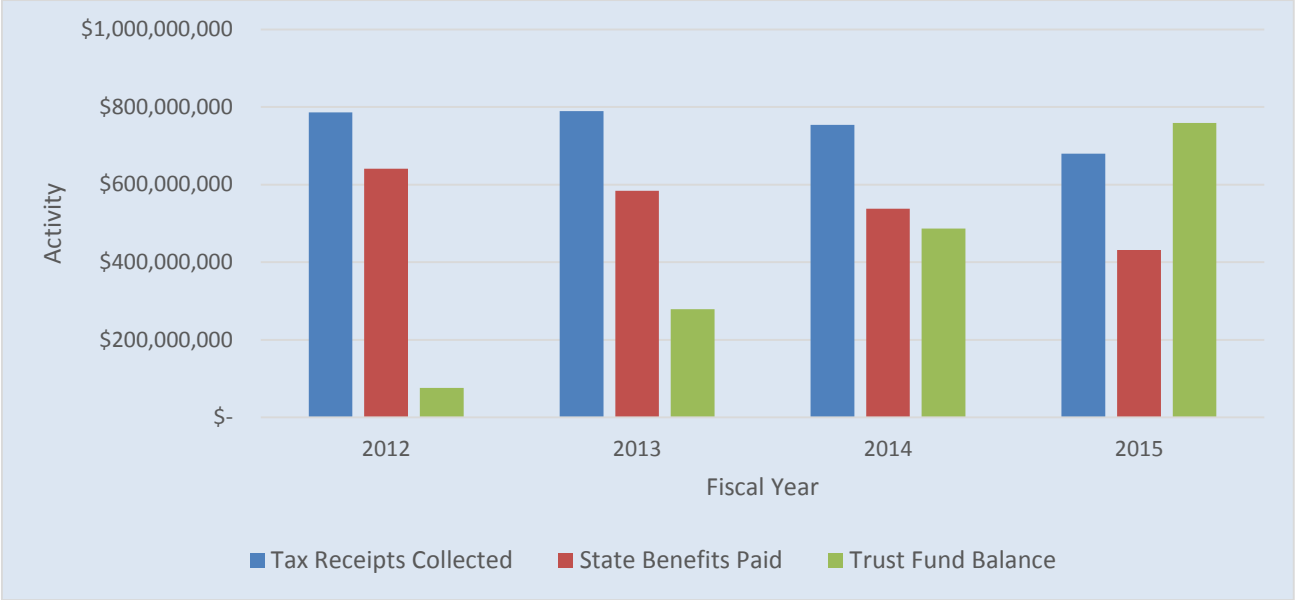
Table 4

Fiscal Year	Seasonally Adjusted Unemployment Rate	Solvency Rate
2012	6.30%	9.90%
2013	5.70%	24.40%
2014	5.40%	40.30%
2015	4.90%	57.00%

Generally, during times of low unemployment, the Trust Fund builds up a balance to pay benefits during times of high unemployment. Chart 1 below shows the relationship between taxes collected, benefits paid, and the Trust Fund balance over the last several years. Over the last several years, the Trust Fund balance has increased because of the decreasing unemployment rate.

Summary of Trust Fund Activity

Chart 1



Trust Fund activity, specifically significant changes in the Trust Fund balance, can in turn affect future tax rates paid by employers. When the Trust Fund solvency remains at or above 100 percent, state law sets the lowest tax rate at zero. If the solvency rate falls below 100 percent, all required employers must pay unemployment tax. The tax rates imposed on employers takes into account the solvency rate as well as the employment histories of individual businesses. Generally, employers with a history of higher unemployment claims pay greater rates, while those with few claims pay less.

State law requires additional adjustments to the tax rate when Trust Fund solvency declines. The pool tax is an adjustment to the tax rate that represents a levy to recover benefits not chargeable to a specific employer, known as pool costs. When Trust Fund solvency exceeds 50 percent, the Commission subtracts interest income from pool costs. The Commission includes pool tax, within the employer's tax rate, when interest income does not cover pool costs. Additionally, state law requires a fund-building tax rate of 0.2 percent to employer tax rates if the Trust Fund solvency rate drops below 50 percent. The Commission will not impose this tax against employers during calendar year 2016 because the solvency rate exceeded 50 percent, as illustrated in Table 4.

The Commission establishes tax rates for taxable employers on a calendar year basis annually. The following table details the various tax rate components in effect for calendar years 2012 through 2015. As shown in Table 5 below, the tax rates for 2015 declined due to the Trust Fund solvency levels discussed above.

Unemployment Tax Rates by Calendar Year

Table 5

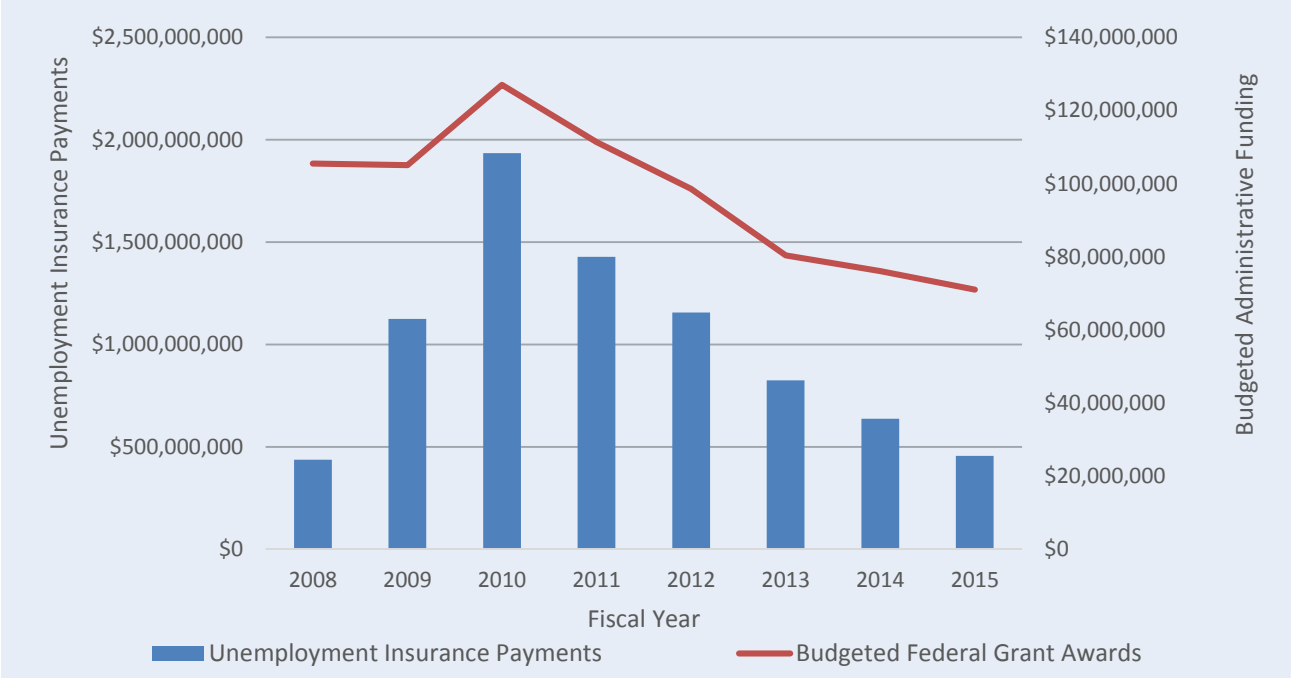
	2012		2013		2014		2015	
	Minimum	Maximum	Minimum	Maximum	Minimum	Maximum	Minimum	Maximum
Tax rate	0.10%	6.20%	0.10%	6.20%	0.10%	6.20%	0.10%	6.20%
Pool tax	0.53%	0.53%	0.38%	0.38%	0.22%	0.22%	0.14%	0.14%
Fund-building tax	0.20%	0.20%	0.20%	0.20%	0.20%	0.20%	0.20%	0.20%
Total	**0.83%**	**6.93%**	**0.68%**	**6.78%**	**0.52%**	**6.62%**	**0.44%**	**6.54%**

Administrative Funding

As mentioned above, the Commission receives federal grants to support its administrative operations. Annually, the United States Department of Labor awards the Commission federal grants to administer the Unemployment Insurance program. The amount of the grant is determined based on a formula that considers factors such as unemployment rates, employment growth, and inflation measures. Therefore, when the economy is strong, administrative funding is weak and vice versa. Chart 2 below illustrates the correlation between unemployment activity and administrative funding.

Unemployment Activity and Administrative Funding

Chart 2

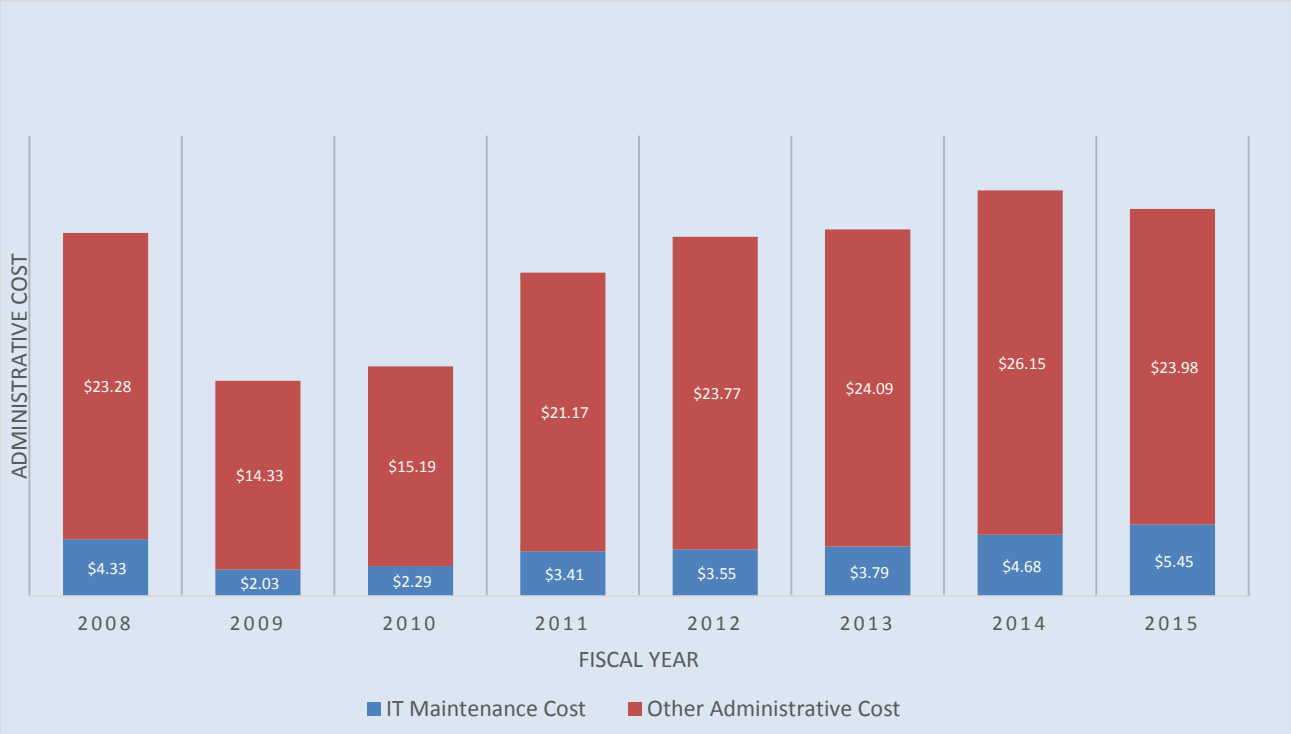


Additionally, the Commission has experienced increased costs to maintain its IT systems over the last several years. This increase is primarily attributed to the Commission's delay in fully transforming its IT infrastructure assets to the Partnership. As a result of the delay in transformation, the Commission has allocated resources, both people and money, to support technologies not covered by the Partnership. The transformation delay has also resulted in the Commission paying additional "legacy fees" to the IT Partnership to support its non-transformed technology

environment. This situation, coupled with reduced administrative funding, has put additional strains on the Commission's IT staff and funding, further reducing the ability of the Commission to properly maintain critical aspects of its IT environment, as identified within the section titled "Internal Control and Compliance Findings and Recommendations." Chart 3 below shows administrative costs per unemployment claim and illustrates the increase in IT maintenance costs over the last several years.

Administrative Cost per Unemployment Claim

Chart 3



Commonwealth of Virginia

Auditor of Public Accounts

Martha S. Mavredes, CPA
Auditor of Public Accounts

P.O. Box 1295
Richmond, Virginia 23218

December 15, 2015

The Honorable Terence R. McAuliffe
Governor of Virginia

The Honorable Robert D. Orrock, Sr.
Vice-Chairman, Joint Legislative Audit
and Review Commission

We have audited the financial records and operations of the **Virginia Employment Commission** for the year ended June 30, 2015. 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, 2015, and test compliance for the Statewide Single Audit. In support of this objective, we evaluated the accuracy of recording financial transactions in the Commonwealth Accounting and Reporting System, the Commission's Virginia Automated Benefits System and Virginia Automated Taxation System, its Financial Management System, its Attachment 10 and 15 submissions to the Department of Accounts, and reviewed the adequacy of the Commission's internal control, tested for compliance with applicable laws, regulations, contracts, and grant agreements, and reviewed corrective actions of audit findings from prior year reports.

Audit Scope and Methodology

The Commission's management has responsibility for establishing and maintaining internal control and complying with applicable laws and regulations. Internal control is a process designed to provide reasonable, but not absolute, assurance regarding the reliability of financial reporting, effectiveness and efficiency of operations, and compliance with applicable laws, regulations, contracts, and grant agreements.

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

Accounts Payable
Accounts Receivable
Cash and Cash Equivalents
Federal grant revenues and expenses
Information System Security
Taxes and Cash Receipts
Unemployment Benefit Payments

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, its Virginia Automated Benefits System and Virginia Automated Taxation System, its Financial Management System, and its Attachment 10 and 15 submissions to the Department of Accounts. 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 and the Commission's Virginia Automated Benefits System and Virginia Automated Tax System.

Our consideration of internal control was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies; and therefore, material weaknesses and significant deficiencies may exist that were not identified. However, as described in the section entitled "Internal Control and Compliance Findings and Recommendations," we identified certain deficiencies in internal control that we consider to be material weaknesses in internal control and other deficiencies that we consider to be significant deficiencies in internal control.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A material weakness is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial information or material non-compliance with provisions of major federal program(s) will not be prevented, or detected and corrected on a timely

basis. We consider the deficiency entitled "Continue to Effectively Allocate Resources to Reduce IT Security Risk," to be a material weakness. Additionally, we consider the deficiencies entitled "Improve Database Security" and "Strengthen Process for Monitoring Automated Reports Supporting Timesheet Approvals," to collectively create a material weakness.

A significant deficiency is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. We consider the deficiencies, other than those mentioned above, and described in the section titled "Internal Control and Compliance Findings and Recommendations," to be significant deficiencies.

The results of our tests disclosed instances of noncompliance or other matters that are required to be reported under Government Auditing Standards and which are described in the section titled "Internal Control and Compliance Findings and Recommendations" in the findings entitled "Continue to Effectively Allocate Resources to Reduce IT Security Risk," "Obtain Approval to Use End-of-Life Operating Systems," "Continue Improving Oversight over IT Risk Assessments and Security Audits," "Continue to Improve Physical and Environmental Security," "Document Separation of Duty Conflicts for Mission Critical Systems," "Maintain Oversight over Third-Party Service Providers," "Improve Database Security," "Strengthen Process for Monitoring Automated Reports Supporting Timesheet Approvals," "Confirm VABS is Calculating Maximum Benefit Amount Consistently for All Claimants," and "Withhold Child Support Obligations from Benefit Adjustment Payments."

As the findings noted above have been identified as a material weakness or significant deficiency for the Commonwealth, they will be reported as such in the "Independent Auditor's Report on Internal Control over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with Government Auditing Standards," included in the Commonwealth of Virginia Single Audit Report for the year ended June 30, 2015.

The Commission has not taken adequate corrective action with respect to the previously reported findings "Allocate Adequate Resources to Reduce IT Security Risk," "Maintain Oversight Over the Information Security Program," "Upgrade Unsupported and Vulnerable Operating Systems," "Confirm VABS is Calculating Maximum Benefit Amount Consistently for All Claimants," and "Withhold Child Support Obligations from Benefit Adjustment Payments." Accordingly, we included these findings as part of the current year findings entitled "Continue to Effectively Allocate Resources to Reduce IT Security Risk," "Continue Improving Oversight over IT Risk Assessments and Security Audits," "Continue to Improve Physical and Environmental Security," "Document Separation of Duty Conflicts for Mission Critical Systems," "Maintain Oversight Over Third-Party Service Providers," "Confirm VABS is Calculating Maximum Benefit Amount Consistently for All Claimants," and "Withhold Child Support Obligations from Benefit Adjustment Payments" in the section entitled "Internal Control and Compliance 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.

Exit Conference and Report Distribution

We discussed this report with management at an exit conference held on January 21, 2016. The Commission's response to the findings identified in our audit is described in the accompanying section titled "Agency Response." We did not audit the Commission'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

KJS/alh

COMMONWEALTH of VIRGINIA
Virginia Employment Commission

Ellen Marie Hess
Commissioner

Post Office Box 1358
703 East Main Street
Richmond, Virginia 23218-1358

January 20, 2016

Ms. Martha Mavredes
Auditor of Public Accounts
Post Office Box 1295
Richmond, Virginia 23218

Dear Ms. Mavredes:

Thank you for the opportunity to review the Auditor of Public Accounts' audit report for the year ended June 30, 2015. Your comments and recommendations are appreciated and are given the highest level of importance and consideration as we continue to review and improve our practices and procedures.

We are in general concurrence with the findings and recommendations identified in your report and we plan to take appropriate action to address them.

Again, we appreciate the opportunity to provide comments as part of your office's report of the financial records and operations of the Virginia Employment Commission for the year ended June 30, 2015.

Sincerely,

Ellen Marie Hess

Ellen Marie Hess
Commissioner

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VRC/TDD VA Relay 711
Equal Opportunity Employer/Program

VIRGINIA EMPLOYMENT COMMISSION OFFICIALS

Ellen Marie Hess
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Jeffrey Ryan
Chief Administrative Officer

Salvatore Lupica
Chief Operating Officer

Valerie Braxton-Williams
Confidential Assistant for Policy

Miles E. Sparkman, III
Controller