

VIRGINIA EMPLOYMENT COMMISSION

**FOR THE YEAR ENDED
JUNE 30, 2009**



AUDIT SUMMARY

Our audit of the Virginia Employment Commission for the year ended June 30, 2009, found the following:

- 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 that is required to be reported.

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FINDINGS AND RECOMMENDATIONS, AND OTHER MATTERS

FINDINGS AND RECOMMENDATIONS

Review, Approve, and Disseminate Information Technology Disaster Recovery Plan

Since our last audit, the Virginia Employment Commission (Employment Commission) has updated and modified their Information Technology (IT) disaster recovery plan to more closely align with the Commonwealth's guidance and standards. The IT disaster recovery plan is still in draft form, but it is management's intent that the draft plan be implemented in the event of a disaster, because they believe it is more relevant than the old plan. There are several issues surrounding this draft plan that could impact the Employment Commission's ability to successfully implement this plan, and management needs to consider the following.

First, management has not distributed the IT disaster recovery draft plan to the disaster recovery team, and the only copy of the plan is on the agency network. To be effective, management should have the plan stored at various locations and all appropriate disaster recovery team personnel should have either partial or complete copies of the plan.

Second, management has not tested the draft plan. The Employment Commission tested the original plan in April of 2008, and management decided not to retest the old plan during the creation of the draft plan. Although the Employment Commission's procedures require annual testing of the data recovery plan, management decided to accept the risk associated with not testing during fiscal year 2009.

Lastly, neither the IT Director nor upper management has reviewed or approved the draft plan. The Information Technology Division plans to review and test the plan in January 2010 and upper management will review the plan in February 2010.

We recommend that the Employment Commission management consider the best approach for dealing with a disaster in the interim period. There is risk to using an IT disaster recovery plan that has not been completely reviewed and approved or tested. At a minimum, the IT Director should immediately disseminate copies of the draft plan to the personnel critical to the recovery of the Employment Commission's operations in case of a disaster. The draft plan should be reviewed and tested as soon as possible to ensure the Commission has an effective means of recovering operations in the event of a disaster.

Strengthen Controls Over System Access

The Employment Commission should strengthen procedures for granting and monitoring access to the Virginia Automated Benefit System (VABS) and the Virginia Automated Tax System (VATS). Both of these systems are critical to the Employment Commission's activities, and we identified the following issues related to system access.

- The Employment Commission does not have written procedures to document who has authorization to grant access or the process required for granting access.
- The Automated System Access Request (ASAR) form documents system access requests, but it does not clearly identify which level of access users receive. The form is outdated and does not reflect the current operating environment.

- No one is performing the semi-annual management review of VATS and VABS user access as required in the policies and procedures dated February 2004. Instead, there is a more limited annual review that does not include a review of all access levels.

We recommend the Employment Commission update, implement, and follow policies and procedures over granting and monitoring system access to VATS and VABS. This should include a review of the ASAR form to ensure it is up to date and reflects the current operating environment.

FOLLOW-UP ON PRIOR AUDIT FINDING

Properly Complete Employment Eligibility Verification Forms

The Employment Commission should properly complete the Employment Eligibility Verification Forms (I-9) in accordance with guidance issued by the U.S. Citizenship and Immigration Services of the U.S. Department of Homeland Security in its Handbook for Employers. The guidance requires the employee to complete, sign, and date Section 1 of the I-9 form on or before the first day of employment. We followed up on this issue from our previous audit and found that six of the twenty-four I-9 forms reviewed did not have the new employee signature on the first day of employment.

U.S. Department of Homeland Security regulates the process for completing I-9 forms and failure to complete the forms properly can result in significant penalties to both the employee and employer. Because of the potential sanctions, we recommend that the Employment Commission continue to work to improve documentation so that they comply with the guidelines set out by the Department of Homeland Security.

OTHER MATTERS

The Employment Commission has several system development initiatives that will replace multiple outdated systems over the next several years. One initiative is the implementation of a modern, integrated financial management system to replace their outdated mainframe batch system. The Employment Commission plans to procure an off-the-shelf solution and modify it to meet the needs of both the Commonwealth and the Department of Labor (DOL) requirements. The Employment Commission is currently evaluating vendor proposals and expects to begin the project in early 2010, with an estimated completion date of December 2011.

In addition, the Employment Commission is in the process of developing an Unemployment Insurance (UI) system which will replace VATS, VABS, and the Wage Record System. This system development initiative is the "UI Modernization" project and will support payment of UI Benefits to unemployed workers, collection of UI Taxes from employers, and the accumulation of wage data.

The Employment Commission plans to use \$45 million from the UI Trust Fund under provisions of the Reed Act to pay for the UI Modernization project. Some additional funding is available through the American Recovery and Reinvestment Act of 2009. The Information Technology Investment Board granted the Employment Commission development approval for the project in September 2009. The Employment Commission plans to begin the development in early 2010 with an estimated completion date of September 2013.

AGENCY BACKGROUND AND FINANCIAL INFORMATION

The Employment Commission's mission is to promote economic growth and stability by delivering and coordinating workforce services that include job placement services, temporary income support, workforce information, and transition and training services. The Employment Commission currently has nearly 1,300 employees working at various offices throughout Virginia. Of these employees, approximately 450 are temporary wage employees.

The Employment Commission funding comes primarily from unemployment taxes collected from employers, which go into the Unemployment Trust Fund, which we discuss in more detail later in this report. The Employment Commission also receives some federal grants used primarily to fund administrative activities. In fiscal year 2009, they also received federal stimulus funds, which paid specific unemployment benefits and some administrative costs.

The Employment Commission budgets its funding in two programs: Workforce Systems Services and Economic Development Services. The Workforce Systems Services program is the Commission's primary program, as shown in the following table of budget and actual activity for fiscal year 2009. For purposes of this table, we present the Workforce Systems Services program by service area, to provide more detailed information on what makes up this program.

Budget and Actual Activity for Fiscal Year 2009

Program and Service Area	Original Budget	Final Budget	Expenses
Workforce Systems Services:			
<i>Job Placement Services</i>	\$ 34,876,661	\$ 37,880,676	\$ 24,972,989
<i>Unemployment Insurance Services</i>	536,685,648	1,392,966,169	1,182,500,267
<i>Workforce Development Services</i>	5,400,000	5,400,000	5,128,372
<i>Workforce Sys. Organization Services</i>	-	-	1,452,043
Economic Development Services	<u>3,258,552</u>	<u>3,258,552</u>	<u>2,600,976</u>
Total	<u>\$580,220,861</u>	<u>\$1,439,505,397</u>	<u>\$1,216,654,647</u>

The largest of these program service areas is the Unemployment Insurance Services, under which the Employment Commission makes benefit payments to unemployed workers. The budget and expenses increased significantly due to high levels of unemployment, causing the significant increases in benefits paid out. The report discusses the Unemployment Insurance Services program below.

Unemployment Insurance Services

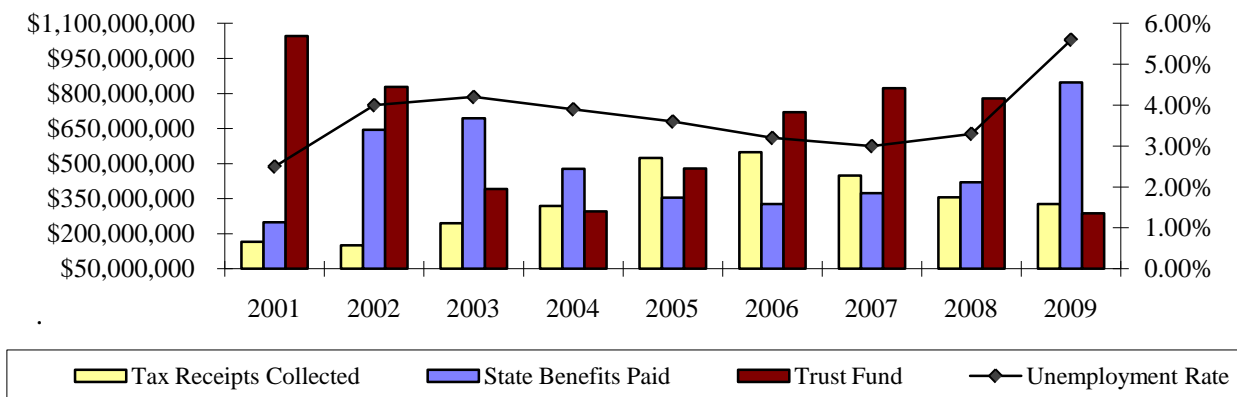
Under the Unemployment Insurance Services program, the Employment Commission makes unemployment benefit payments to unemployed workers who lost their employment through no fault of their own. The unemployment benefit payments provide workers with minimal income during the course of a job search. Generally, the amount and length of benefits an individual is eligible for is based on wages an individual earned while employed. The Governor and the General Assembly have the ability to adjust unemployment benefit payments and the following is a history of minimum and maximum weekly benefit amounts since 2003.

	<u>Minimum Benefit</u>	<u>Maximum Benefit</u>
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 – June 30, 2007	\$54	\$347
July 1, 2007 – July 5, 2008	\$54	\$363
July 6, 2008 - Present	\$54	\$378

The Employment Commission pays unemployment insurance benefit payments from unemployment taxes collected from Commonwealth employers if they meet certain criteria set forth in the Code of Virginia. Under current law, employers pay taxes only on the first \$8,000 of each employee's wages. The Employment Commission collects these taxes throughout the year and transfers the amount collected to the federal government, which maintains the Federal Unemployment Trust Fund (Trust Fund). The Employment Commission is the trustee and uses the fund to pay all unemployment insurance benefit payments.

Generally, in times of low unemployment, the Trust Fund builds up a balance which, in times of higher unemployment pays benefits. 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.

In fiscal year 2009, the Trust Fund balance decreased significantly due to high unemployment that resulted in increased benefit payments. The Trust Fund balance as of June 30, 2009 was approximately \$287 million, which is a \$500 million decrease from the previous year. This is the lowest balance since the mid 1980's.

Trust fund solvency is an indicator of the fund's ability to pay benefits during periods of high unemployment. The solvency indicator compares the fund's actual balance to the calculated balance needed to pay these benefits for 16.5 months. The Employment Commission recently computed the trust fund solvency factor for calendar year 2010 to be 24.4 percent. This is a significant decrease from the prior year when it was 64.4 percent.

The Trust Fund's solvency rate has an inverse relationship to employer tax rates, meaning, as the solvency decreases, the unemployment tax rates generally increase. 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 take into account the solvency rate as well as the employment histories of individual businesses. Generally, employers with a history of higher unemployment claims pay a greater rate, while those with fewer claims pay less or nothing at all.

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, interest income from the Trust Fund offsets pool costs; however, the Employment Commission adds the pool tax to the tax rate when interest income does not cover pool costs. In addition, state law requires a fund-building tax rate of 0.2 percent increase to employer tax rates if the Trust Fund balance drops below 50 percent.

The following table details the various tax rate components in effect for calendar years 2008 and 2009, as well as those calculated for 2010.

	Calendar Year 2008 Tax Rates		Calendar Year 2009 Tax Rates		Calendar Year 2010 Tax Rates	
	<u>Minimum</u>	<u>Maximum</u>	<u>Minimum</u>	<u>Maximum</u>	<u>Minimum</u>	<u>Maximum</u>
Tax rate	0.10%	6.20%	0.10%	6.20%	0.10%	6.20%
Pool tax	0.02%	0.02%	0.08%	0.08%	0.28%	0.28%
Fund-building tax	<u>0.00%</u>	<u>0.00%</u>	<u>0.00%</u>	<u>0.00%</u>	<u>0.20%</u>	<u>0.20%</u>
Total	<u>0.12%</u>	<u>6.22%</u>	<u>0.18%</u>	<u>6.28%</u>	<u>0.58%</u>	<u>6.68%</u>

There are a number of factors that are going to continue to significantly affect the Employment Commission's programs in fiscal year 2010 and beyond, and we discuss these issues in the following section.

Discussion of Issues Impacting Fiscal Year 2010

Continuing high unemployment levels in Virginia will result in the depletion of the Trust Fund in fiscal year 2010. When this occurs, Section 1201 of the Social Security Act (Act) provides for temporary loans from the Federal Unemployment fund to ensure the continuation of benefit payments. The Act requires repayment of such loans from future employer contributions. The Act also requires that interest accruing on outstanding loan balances come from the state's General Fund revenues each September 30. The American Recovery and Reinvestment Act of 2009 temporarily suspended interest on these loans through December 31, 2010.

The following table lists the forecasted activity, including the projected solvency rates for calendar years 2010 through 2012. This information uses the November 2009 projections prepared by the Employment Commission.

	Fiscal Year		
	<u>2010</u>	<u>2011</u>	<u>2012</u>
July 1 Trust Fund Balance	\$287.2	(\$286.1)	(\$341.2)
Tax Revenue	505.8	746.0	921.7
Interest Revenue	2.8	-	-
Benefits Paid	<u>(1,081.9)</u>	<u>(801.1)</u>	<u>(622.9)</u>
June 30 Trust Fund Balance	(\$286.1)	(\$341.2)	(\$42.4)
Solvency Level at June 30	(20.1%)	(21.3%)	5.6%

Note: Amounts presented above are in millions and are on the cash; however the solvency level is computed on an accrual basis.

The Employment Commission expects it will be necessary to have temporary loans at various times through 2014 totaling an estimated \$1.3 billion. They also estimate interest payments on these loan balances will be approximately \$22 million in 2011 and \$15 million in 2012. As of November 24, 2009 the Employment Commission had depleted the Trust Fund and borrowed \$29.6 million so far.

The forecasted activity above includes benefit reductions that go into effect in January 2010 for individuals also receiving social security and railroad retirement pension benefits. State law requires this reduction when trust fund solvency falls below 50 percent. In addition in October 2009, the federal government approved another benefit extension, funded through American Recovery and Reinvestment Act funds, which will extend some benefits depending on the state's overall unemployment rate. These extensions are not reflected in the chart above since they will be funded with ARRA funds.



Walter J. Kucharski, Auditor

Commonwealth of Virginia

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

December 1, 2009

The Honorable Timothy M. Kaine
Governor of Virginia

The Honorable M. Kirkland Cox
Chairman, Joint Legislative Audit
and Review Commission

INDEPENDENT AUDITOR'S REPORT

We have audited the financial records and operations of the **Virginia Employment Commission** for the year ended June 30, 2009. 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 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, 2009, and test compliance for the Statewide Single Audit. 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, regulations, contracts, and grant agreements, and reviewed corrective actions of audit findings from prior year reports.

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, automated and manual, sufficient to plan the audit. We considered materiality 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.

Unemployment Benefit Payments
Taxes and Cash Receipts
Federal Grants Revenue and Expenses

Information Security
Accounts Receivable
Accounts Payable

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 with applicable laws and regulations that require management's attention and corrective action. These matters are described in the section entitled, "Findings and Recommendations, and Other Matters."

The Employment Commission has taken adequate corrective action on one prior year finding, but has not completely resolved the prior finding regarding Employment Eligibility Verification forms. This is discussed in the section entitled "Findings and Recommendations, and Other Matters."

Exit Conference and Report Distribution

We discussed this letter with management on December 16, 2009. Management's response has been 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

LCW/alh



COMMONWEALTH of VIRGINIA

Virginia Employment Commission

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*Dolores A. Esser
Commissioner*

*Post Office Box 1358
Richmond, Virginia 23218-1358*

December 18, 2009

Mr. Walter J. Kucharski
Auditor of Public Accounts
Post Office Box 1295
Richmond, Virginia 23218

Dear Mr. Kucharski:

Thank you for the opportunity to review and respond to the Auditor of Public Accounts' audit report for the year ended June 30, 2009. 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.

In general, we concur with the findings and recommendations identified in your report. We will be developing a corrective action plan to address the audit findings and recommendations. With regards to the IT disaster recovery plan, the draft plan has now been distributed to all IT staff for feedback. A contractor will come on board in January to update/enhance it. It will then be reviewed by the COOP Committee and the Executive Team for finalization. An initial test of the plan will occur in January 2010 with major testing to take place the following spring.

Again, we appreciate the opportunity to provide the Virginia Employment Commission's 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, 2009.

Sincerely,

A handwritten signature in black ink that reads "Dolores A. Esser".

Dolores A. Esser

VIRGINIA EMPLOYMENT COMMISSION

Dolores Esser
Commissioner

Nick Kessler
Deputy Commissioner