VIRGINIA EMPLOYMENT COMMISSION

RICHMOND, VIRGINIA

REPORT ON AUDIT

FOR THE YEAR ENDED

JUNE 30, 2001

APA
Auditor of
Public Accounts
COMMONWEALTH OF VIRGINIA

AUDIT SUMMARY

Our audit of the Virginia Employment Commission for the year ended June 30, 2001, found:

- proper recording and reporting of transactions, in all material respects, in the Commonwealth Accounting and Reporting System and in the Commission's Tax and Benefits Systems;

- internal control matters that we consider reportable conditions, but not material weaknesses; and

- no material instances of noncompliance with applicable laws and regulations tested that are required to be reported.

We recommend that the Commission:

- implement controls for subrecipient monitoring of the activities of the Workforce Investment Act;

- institute internal controls over checks received in various departments; and

- update the Facilitated Risk Analysis Plan.

-TABLE OF CONTENTS-

SELECTED AGENCY INFORMATION

The Employment Commission's mission statement reads: "We provide workforce services that promote maximum employment to enhance the economic stability of Virginia." The Employment Commission accomplishes this goal through 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, established by the Social Security Act of 1935, makes benefit payments to laid-off workers, ensuring that they have minimal income during the course of a job search. The Employment Commission processes and pays benefit claims, and resolves any disputed claims through the Commission Appeals division. The Employment Commission also collects employers' taxes used to fund the Trust Fund that pays all benefit claims.

The Wagner-Peyser Act of 1933 created the Job Service program, which aims to provide public employment services to individuals. Such services include referrals for unemployed persons, recruiting for employers looking for qualified employees, and job search skill training.

The Workforce Investment Act is a federally funded program aimed at providing workforce training programs to adults, youth, and dislocated workers at the state and local levels. The key elements are the state workforce investment board, local workforce investment boards and their youth councils, and local one-stop delivery systems.

The Employment Commission also accumulates, collects, and reports labor market data through the Economic Information Services Division. The data, reported in cooperation with the Bureau of Labor Statistics, provides various information including employment statistics, wages, and layoffs. Staff can compile information upon request or users can arrange access to some data by using the Automated Labor Information on the Commonwealth's Economy system.

UNEMPLOYMENT TRUST FUND

When the Employment Commission collects unemployment taxes from employers, it deposits the collections into the Unemployment Trust Fund, for which the Employment Commission is the trustee. The Employment Commission then makes all benefit payments from the trust fund. State law requires that any individual receiving benefits must have earned a minimum amount of total wages in two of the first four of the last five calendar quarters, referred to as the base period. State law also dictates the minimum and maximum weekly benefit amounts that an individual can receive.

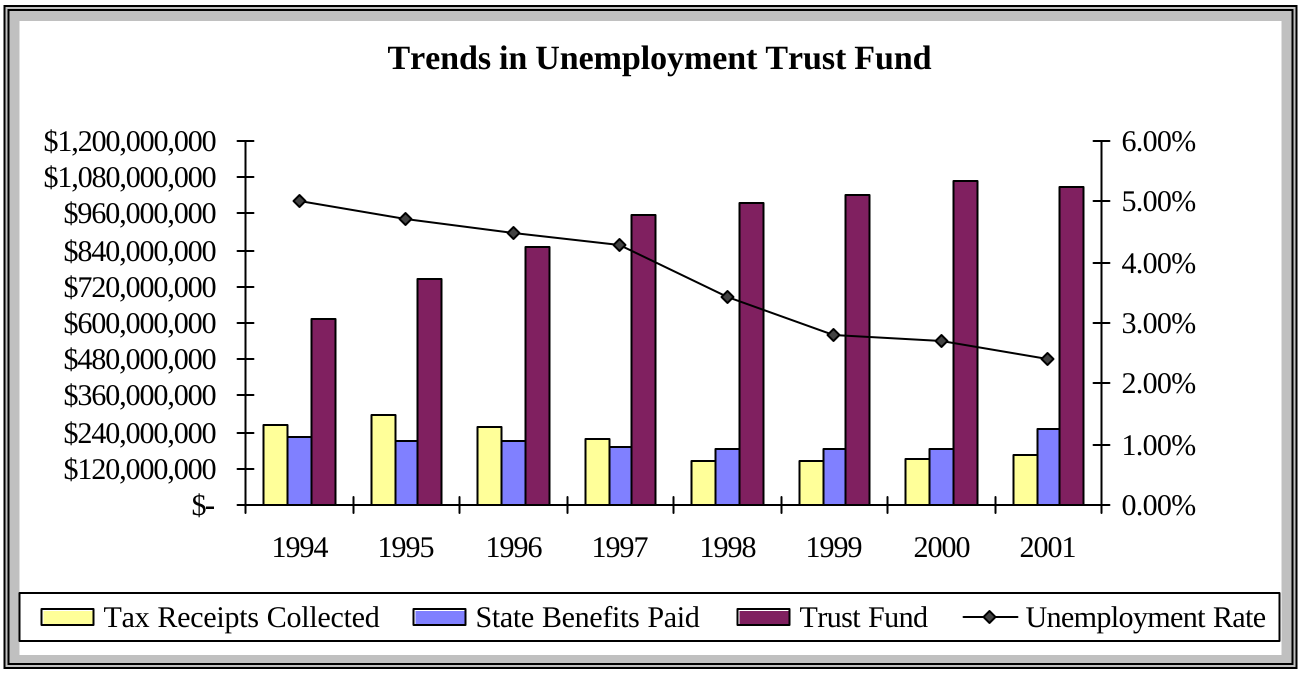
The Employment Commission levies taxes on employers' wages according to rates set by the General Assembly, which reflect the trust fund's solvency. The tax also includes an experience rating, based on past claims against an employer's payroll. This rating requires employers with a history of higher claims to pay a greater rate, and allows those with fewer claims to pay less. Under current law, employers only pay taxes on the first $8,000 of each employee's wages. The maximum rate that an employer can be required to pay on those taxable wages is currently 6.20 percent, while the minimum rate is 0 percent.

Unemployment Compensation Law Changes

In response to falling unemployment and an increasing balance in the Unemployment Trust Fund, the General Assembly revised the formula used to determine the trust fund balance factor in 1997. This resulted in lower employer tax rates for two years. However, as the Trust Fund solvency has decreased, the maximum employer tax rate has increased back up to 6.2 percent. The table below shows the change in the tax rates over the past few years.

	Maximum Tax
Prior to July 1, 1997	6.20% or $496 per employee
From July 1, 1997 - December 31, 1999	5.40% or $432 per employee
January 1, 2000 - December 31, 2000	5.58% or $447 per employee
January 1, 2001 - December 31, 2002	6.20% or $496 per employee

The balance in the trust fund remains above $1 billion, and for the fourth consecutive year, benefits paid out exceed collections. The interest that the fund earns offsets most of the deficit in tax revenue; however, the fund's balance has started to decline. The illustration below presents historical trends, which show the changes in tax collections, benefits payments, the trust fund balance, and the unemployment rate over the past several years.



Year	Tax Collections	Benefits Paid	Collections Over (Under) Benefits	Trust Fund Balance*	Trust Fund Solvency**	Unemployment Rate
1994	$263,715,851	$223,565,168	$40,150,683	$ 611,937,629	69.7%	5.0%
1995	295,673,218	208,808,361	86,864,857	743,233,179	79.3%	4.7%
1996	257,770,256	211,074,168	46,696,088	852,342,994	90.5%	4.5%
1997	217,171,263	188,615,553	28,555,710	955,948,173	123.0%	4.3%
1998	145,611,983	187,178,361	(41,566,378)	994,128,995	114.0%	3.4%
1999	143,501,663	181,424,022	(37,922,359)	1,024,275,741	107.0%	2.8%
2000	148,519,732	185,413,314	(36,893,582)	1,065,058,749	101.3%	2.7%
2001	164,694,068	248,503,150	(83,809,082)	1,046,104,532	100.3%	2.4%

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

** Trust Fund solvency is an indicator of the fund's ability to pay benefits during periods of high unemployment as experienced over the past 20 years. The solvency indicator compares the fund's actual balance to the calculated balance needed to pay these benefits for 16.5 months. The formula used to calculate the balance uses historical benefit and wages data. Trust Fund solvency does not directly relate to current year tax collections or benefits paid. Since June 1996, the computation of solvency uses a modified accrual basis as stipulated in §60.2-533 of the Code of Virginia.

The Trust Fund has remained above 100 percent solvent for the fifth consecutive year; therefore, many employers have a 0 percent tax rate. However, the unemployment rate as of October 2001 has increased to 3.5 percent as a result of the downturn in the economy and the aftermath of September 11, 2001 events. With the increase in unemployment, the Employment Commission will once again pay out more benefits than tax collections; therefore, reducing the Trust Fund Balance even more. Once the Trust Fund becomes less than 100 percent solvent, it is likely that the average employer tax rate will increase.

UPDATE ON THE WORKFORCE INVESTMENT ACT OF 1998

The Workforce Investment Act is a federally funded program aimed at providing workforce training programs to adults, youth, and dislocated workers at the state and local levels. This program makes major changes in the delivery of employment and training programs at the state and local levels. The Governor designated the Employment Commission as the lead agency in implementing the Workforce Investment Act and the federal law required implementation of the program by July 1, 2000. However, because the state did not have adequate time to meet all of the requirements, full implementation did not occur until July 1, 2001. For fiscal year 2001, Virginia received awards of $29,837,556. Total Workforce Investment Act expenses for fiscal year 2001 were $18,928,184. The Employment Commission expects to spend the remaining money by the end of fiscal year 2002.

The Employment Commission annually allocates funds received to the 17 Local Workforce Investment Areas. These allocations consider past unemployment in each area, along with any current situations that may require further assistance in training and education. Under the provision of the Act, the Employment Commission must conduct regular oversight and monitoring of its Workforce Investment Act activities of those that receive funding, called subreceipients. Subrecipient monitoring determines if the recipient complies with provisions of the Act and applicable laws and regulations.

Conduct Subrecipient Monitoring

The Employment Commission did not perform any annual on-site monitoring reviews of each local area's compliance with DOL uniform administrative requirements in accordance with Regulation 20 CFR Section 667.410(b). Without on-site monitoring reviews, the Employment Commission is unable to determine whether the subreceipient is in compliance with the grant requirements. Ultimately this could result in a reduction of future funding.

The Employment Commission has hired three of four Regional Consultants who will staff the Workforce Investment Act Unit's monitoring function. The Employment Commission should ensure this function adequately performs subrecipient monitoring in accordance with federal regulations.

CASH RECEIPTS

Various departments directly receive checks and the employees in many of these departments have access to a system that allows them to either bill or record how much someone owes the Employment Commission. Due to the large volume of mail received by the Employment Commission, the mailroom does not open the mail and separately remove and log the checks. Mailroom clerks deliver the mail to the department addressed on the envelope. Since department personnel often deal directly with the public, it is not unusual for a citizen or business to mail a check to the departmental person they have directly dealt with.

Institute Internal Controls Over Checks Received in Various Departments

Each department receiving checks has developed its own process for handling, controlling, and monitoring these checks. Many of the procedures do not consider the other duties of the individual receiving checks and their access to the system. The lack of proper separation of duties could result in the misappropriation of funds.

Internal Audit Services should conduct a review of the areas that receive checks on a regular basis and recommend appropriate controls for each area and management should appropriately respond to their findings. As long as the Employment Commission permits individual departments and their employees to receive checks, then the Employment Commission needs to compensate for this process by having controls that help prevent misappropriation of funds and that allow for the personal identification of who performed the work.

OTHER FINDING

Update Facilitated Risk Analysis Plan

The Employment Commission has not updated their Facilitated Risk Analysis Plan since November 14, 1997. The Facilitated Risk Analysis Plan combines the Employment Commission's Business Impact Analysis and Risk Assessment into one document. This plan identifies all data processing systems as well as any risks or threats to these systems. In 1998, the Employment Commission replaced its network and the Facilitated Risk Analysis Plan does not reflect this change in technology.

As a result of our prior year's recommendation, the Employment Commission scheduled the Facilitated Risk Analysis Plan update for September 30, 2001. Currently, due to other priorities, the Employment Commission has not updated the plan. The Employment Commission should finish updating the plan as soon as possible to ensure adequate security of critical and sensitive data, and compliance with the Department of Technology Planning standards.

Commonwealth of Virginia

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

Walter J. Kucharski, Auditor

December 3, 2001

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

The Honorable Vincent F. Callahan, 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, 2001. We conducted our audit in accordance with Government Auditing Standards, issued by the Comptroller General of the United States.

Audit Objective, Scope, and Methodology

Our audit's primary objectives were to evaluate the accuracy of recording financial transactions on the Commonwealth Accounting and Reporting System and in the Commission's Tax and Benefits Systems, review the adequacy of the Commission's internal control, and test compliance with applicable laws and regulations. We also reviewed the Commission's corrective actions of audit findings from prior year reports.

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

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

We obtained an understanding of the relevant internal control components sufficient to plan the audit. We considered materiality and control risk in determining the nature and extent of our audit procedures. We performed audit tests to determine whether the Commission's 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.

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

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

Audit Conclusions

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

We noted certain matters involving internal control and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of internal control that, in our judgment, could adversely affect the Commission's ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial records. Reportable conditions are described in the subsections titled "Update on the Workforce Investment Act of 1998," "Cash Receipts," and "Other Finding." We believe that none of the reportable conditions is a material weakness.

The results of our tests of compliance with applicable laws and regulations disclosed no instances of noncompliance that are required to be reported under Government Auditing Standards.

The Commission has not taken adequate corrective action with respect to the previously reported finding "Update Business Impact Analysis and Risk Assessment." Accordingly, we included this finding in the subsection entitled "Other Finding." The Commission has decided to accept the risk related to the prior year finding entitled "Eliminate Inappropriate Access to Automated Systems' Production Data Files." Therefore, this finding is not repeated in this report. The Commission has taken adequate corrective action with respect to the other audit findings reported in the prior year that are not repeated in this report.

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.

<u>EXIT CONFERENCE</u>

We discussed this report with management at an exit conference held on December 19, 2001.

AUDITOR OF PUBLIC ACCOUNTS

JHT:aom
aom:26