VIRGINIA EMPLOYMENT COMMISSION

REPORT ON AUDIT

FOR THE YEAR ENDED

JUNE 30, 2010

APA
Auditor of
Public Accounts
COMMONWEALTH OF VIRGINIA

AUDIT SUMMARY

Our audit of the Virginia Employment Commission for the year ended June 30, 2010, 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;

- an internal control matter that requires management's attention and corrective action; and

- no instances of noncompliance with applicable laws and regulations or other matters that are required to be reported.

As part of our audit, we performed additional work related to unemployment benefit overpayment to address a legislative request we received in February 2010. We issued a separate report on this work in December 2010 entitled "Review of Unemployment Benefit Overpayments, Virginia Employment Commission."

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FINDING AND RECOMMENDATION

FOLLOW-UP ON PRIOR AUDIT FINDING

Strengthen Controls Over System Access

The Employment Commission should continue to strengthen procedures for granting and monitoring access to the Virginia Automated Benefit System (VABS) and the Virginia Automated Tax System (VATS). We identified this issue in our prior report and since then the Employment Commission has implemented a new Access Control Verification system to help managers review and monitor system access; however, the following issues remain:

- The Employment Commission does not have written procedures to document who has the 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 The form is outdated and does not reflect the current operating environment.

- According to their policy, the Employment Commission conducts a semi-annual management review of VATS and VABS access. They conducted their first review using the new system in May 2010; however, there is no way to tell if managers completed their review timely. In addition, as of June 1, 2010, there were 35 managers who had not completed their review.

VATS and VABS both contain sensitive information; therefore it is critical that only authorized Employment Commission staff have access to these systems. 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.

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 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 2010, the Employment Commission also received federal stimulus funds under the American Recovery and Reinvestment Act of 2009. These federal funds paid for unemployment benefit extensions approved by the federal government of approximately $646 million in fiscal year 2010. Some of these funds also paid administrative expenses.

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 2010. 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. The Job Placement Services area in the chart below has a negative final budget. This occurred because the Employment Commission recorded a $50 million budget adjustment in the wrong service area, which both the Employment Commission and the Department of Planning and Budget did not detect. This coding error did not adversely affect the operations of the Employment Commission.

Budget and Actual Activity for Fiscal Year 2010

Program and Service Area	Original Budget	Final Budget	Expenses
Workforce Systems Services:			
Job Placement Services	$ 37,376,662	$ (5,418,581)	$ 34,793,626
Unemployment Insurance Services	907,785,648	2,361,800,404	1,998,436,357
Workforce Development Services	5,400,000	5,400,000	1,652,663
Economic Development Services	3,258,552	3,258,552	2,684,069
Total	$953,820,862	$2,365,040,375	$2,037,566,715

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. 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.

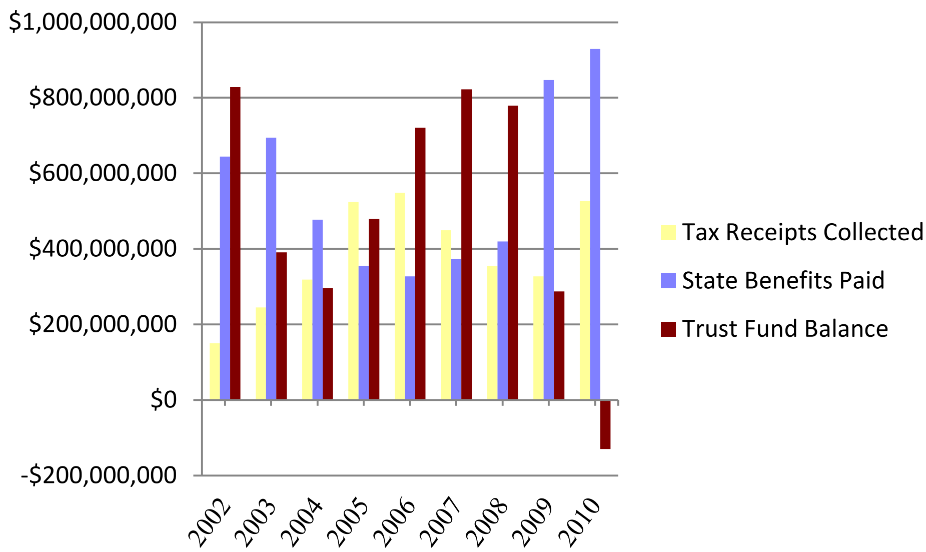
	Minimum Benefit	Maximum Benefit
July 6, 2003 - July 3, 2004	$50	$316
July 4, 2004 - July 2, 2005	$50	$326
July 3, 2005 - July 2, 2006	$54	$330
July 3, 2006 – June 30, 2007	$54	$347
July 1, 2007 – July 5, 2008	$54	$363
July 6, 2008 - Present	$54	$378

The Employment Commission pays unemployment insurance benefit payments from unemployment taxes collected from Commonwealth employers if the employer meets 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 State unemployment insurance benefit payments.

Generally, in times of low unemployment, the Trust Fund builds up a balance to pay benefits in times of higher unemployment. The unemployment rate has been increasing significantly over the last several years as shown below. The increasing unemployment rate and the impact of this on benefits paid, taxes collected, and the trust fund balance are in the chart on the following page.

Fiscal Year	**Unemployment Rate**
2002	4.00%
2003	4.20%
2004	3.90%
2005	3.60%
2006	3.20%
2007	3.00%
2008	3.30%
2009	5.60%
2010	7.00%

Summary of Unemployment Trust Fund Activity (fiscal year 2002 – 2010)



Note: The fiscal year 2010 Trust Fund balance is net of any borrowed funds.

Trust Fund Balance as June 30, 2010

The Trust Fund balance has decreased significantly over the last several years due to increased unemployed recipients causing the increased volume of unemployment benefits. During fiscal year 2010, the Employment Commission had to pay more in benefits than the Trust Fund contained. Therefore, the Trust Fund had a deficit.

When the Trust Fund incurs a deficit, Section 1201 of the Social Security Act (Act) provides for temporary loans from the federal government to ensure the continuation of benefit payments. The Act requires repayment of any loans from future employer contributions, but does not allow the Employment Commission to use employer contributions to pay any interest owed on the outstanding loan balance.

The Employment Commission began borrowing from the federal government in October, 2009. The process for obtaining a loan begins when the Employment Commission, with the approval of the Governor, requests a loan from the United States Secretary of Labor within 15 days of the needed funding. The Secretary of Labor then authorizes the establishment of a line of credit, which the Employment Commission has to request each quarter. The Employment Commission does not incur a penalty for requesting a larger line of credit than it needs.

As of June 30, 2010, the Employment Commission had borrowed $346,876,000 and the balance in the Trust Fund was approximately $217 million. Most of the balance on hand at the end of the year is from quarterly employer tax collections because the amount borrowed was already used to pay benefits during the year.

Trust Fund Solvency and Tax Rate

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 computed the trust fund solvency factor for calendar year 2010 to be 24.4 percent. This is a significant decrease from 2009 when it was 64.4 percent. The Employment Commission anticipates, due to the required borrowing of federal funds, that the trust fund solvency factor for calendar year 2011 will be negative.

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, 2009, and 2010. The Employment Commission will calculate and publish the calendar year 2011 tax rates in December of 2010. As result, these are not included in our table below.

	Calendar Year 2008 Tax Rates		Calendar Year 2009 Tax Rates		Calendar Year 2010 Tax Rates	
	Minimum	Maximum	Minimum	Maximum	Minimum	Maximum
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	-	-	-	-	0.20%	0.20%
Total	0.12%	6.22%	0.18%	6.28%	0.58%	6.68%

Discussion of Issues Impacting Future Years

There are a number of factors that are going to continue to significantly affect the Employment Commission's programs in fiscal year 2011 and beyond, and we discuss these issues below.

Trust Fund Borrowing and Repayment

Continuing high unemployment levels in Virginia will result in the need to continue to borrow money from the federal government to pay unemployment benefits. The Employment Commission expects it will need to borrow an additional $613 million at various times through fiscal year 2013 with the total amount borrowed equaling $960 million by the spring of 2013.

The federal government has waived interest payments on money borrowed though December 2010; however, the Employment Commission will begin to accrue interest on the money borrowed starting on January 1, 2011 unless the federal government extends the suspension of interest payments. Currently, the first interest payment will be due September 30, 2011 and the Employment Commission estimates interest payments will be $11.9 million due in fiscal year 2012 and $8.3 million due in fiscal year 2013.

As discussed above, the Employment Commission cannot use employer contributions to pay interest on any outstanding loan balance; therefore, the Employment Commission will need to determine alternative funding sources to repay the interest. Appropriation Act Chapter 874 of the 2010 Virginia Acts of Assembly requires the Employment Commission use penalties and interest, recorded in the Special Unemployment Compensation Administration Fund, to pay the interest to the federal government on loans for the Unemployment Insurance Fund before using these funds for other functions. While this is a potential funding source, it may not be sufficient to pay all of the interest and this may impact funding for system development projects discussed below.

Additionally, as the loans begin to accrue interest, the Employment Commission plans to begin using all remaining employer contributions at the end of each quarter to repay the loans. The Employment Commission estimates they will have the loans paid back in full by May 2012, but they also anticipate additional short term borrowing through the Spring 2013. A number of different factors including changes in the economic conditions, the unemployment rates, and any additional actions taken by the federal government can impact these projections.

System Development Projects

The Employment Commission has two system development initiatives that will replace multiple outdated systems over the next several years, the Financial Management Systems Project and the Unemployment Insurance Modernization Project (UI Mod).

The Financial Management Systems project is 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 both the needs of the Commonwealth and the Department of Labor (DOL) requirements. The Employment Commission has completed the request for proposal process and identified the top vendor for the project; however, the Employment Commission has not signed a formal contract with the vendor. VITA approved the project planning, however the Employment Commission has not received VITA development approval due to the risk identified below. The total cost of the project is $4.7 million and will span approximately 18 months.

In addition to the Financial Management System project, 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, UI Mod, will support payment of UI Benefits to unemployed workers, collection of UI Taxes from employers, and the accumulation of wage data.

The total budget for UI Mod is $58.5 million with $49.1 million coming from the Reed Act funds and the remaining $9.4 million coming from the Employment Commissions penalty and interest fund. The Employment Commission is in the development stages of the project and completion of the UI Mod project is to occur in June of 2013.

There are two issues that could affect the scope and success of these projects. Both project plans include partial funding from penalties and interest collected by the Employment Commission; however, it is not clear if these funds will be available. The Financial Management System project plan includes $1.5 million in penalties and interest funding while the UI Mod project plans includes $9.4 million. The Appropriation Act Chapter 874 of the 2010 Virginia Acts of Assembly requires the Employment Commission first use penalties and interest to repay federal loan interest as discussed earlier. The Employment Commission has not yet determined how they will repay the federal loan interest, but it is possible that this could impact funding available for these system development projects.

In addition, the Employment Commission and VITA have not come to an agreement on where the production environment for both the UI Mod and the Financial Management System will reside once the project is completed. This decision will potentially affect the budget for both projects because the Employment Commission did not factor the additional VITA costs into the current budgets. In addition, without an agreement on the hosting environment, the Employment Commission will not receive VITA development approval for the Financial Management System.

Commonwealth of Virginia

Walter J. Kucharski, Auditor

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

November 15, 2010

The Honorable Robert F. McDonnell
Governor of Virginia

The Honorable Charles J. Colgan
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, 2010. 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, 2010, 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	Information Security
Taxes and Cash Receipts	Accounts Receivable
Federal Grants Revenue and Expenses	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 a certain matter involving internal control and its operation that requires management's attention and corrective action. This matter is described in the section entitled, "Finding and Recommendation." The results of our tests of compliance with applicable laws and regulations disclosed no instances of noncompliance or other matters that are required to be reported under Government Auditing Standards.

The Employment Commission has taken adequate corrective action on prior year findings, but has not completely resolved the prior finding "Strengthen Controls over Systems Access." This is discussed in the section entitled "Finding and Recommendation."

Exit Conference and Report Distribution

We discussed this letter with management on November 22, 2010. 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/clj

COMMONWEALTH of VIRGINIA

Virginia Employment Commission

John R. Broadway
Commissioner

703 East Main Street

Post Office Box 1358
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November 23, 2010

Mr. Walter J. Kucharski
Auditor of Public Accounts
P.O. 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, 2010. 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.

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, 2010.

Sincerely,

John R. Broadway

John R. Broadway
Commissioner

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VIRGINIA EMPLOYMENT COMMISSION

John Broadway
Commissioner

Dr. Robert P. Leber
Deputy Commissioner