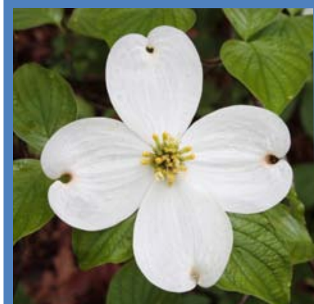

VIRGINIA EMPLOYMENT COMMISSION

REPORT ON AUDIT
FOR THE YEAR ENDED
JUNE 30, 2014

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, 2014, found:

- proper recording and reporting of all transactions, in all material respects, in the Commonwealth Accounting and Reporting System and in the Commission's Tax and Benefits Systems;
- two deficiencies which we consider to be material weaknesses in internal control;
- additional matters involving internal control and its operation necessary to bring to management's attention;
- instances of noncompliance with applicable laws and regulations or other matters that are required to be reported; and
- adequate corrective action to resolve the prior year audit findings titled "Improve Internal Controls over Small Purchase Charge Card Program" and "Follow Timekeeping and Payroll Procedures."

Over the last several years, the Commission has devoted a considerable amount of resources to several system development projects, all of which are still ongoing. To address the project needs, the Commission 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 within the Commission.

During our audit, we identified a number of internal control and compliance findings that we believe are either directly, or indirectly, related to a lack of resources available due to the system development project needs. While these resource issues affect operations across the Commission, we found a significant number of issues in the information systems security area. These are of particular concern given the sensitivity of information maintained in the Commission's information systems.

These system development projects have also affected the Commission's ability to transform their information technology (IT) infrastructure assets to the Commonwealth's IT Infrastructure Partnership with Northrop Grumman (IT Partnership). As a result of the delay in transformation, the Commission has had to allocate resources, both people and money, to support technologies that are not covered by the IT 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 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 their IT environment.

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INTERNAL CONTROL AND COMPLIANCE FINDINGS AND RECOMMENDATIONS

Over the last several years, the Commission has devoted a considerable amount of resources to several system development projects, all of which are still ongoing. These initiatives involve replacement of the Commission's two largest information systems, as well as a new financial reporting system. We discuss the status of these system development projects in more detail in the section entitled "Status of System Development Projects."

As part of these initiatives, 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 within the Commission. In some cases, this has resulted in a lack of resources in certain areas. During our audit, we identified a number of internal control and compliance findings that we believe are either directly, or indirectly, related to a lack of resources available due to the system development project needs. While these resource issues affect operations across the Commission, we found a significant number of issues in the information systems security area and these are detailed below. These are of particular concern given the sensitivity of information maintained in the Commission's information systems.

These system development projects have also affected the Commission's ability to transform their IT infrastructure assets to the IT Partnership. Currently, the Commission's transformation is approximately 60 percent complete; however, the remaining transformation efforts will require a substantial amount of resources. The Commission is one of only three executive branch agencies in the Commonwealth that have not fully transformed to the IT Partnership.

As a result of the delay in transformation, the Commission has allocated resources, both people and money, to support technologies that are not covered by the IT 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 has put additional resource strains on the Commission's IT staff and funding, further reducing the ability of the Commission to properly maintain critical aspects of their IT environment.

We have detailed our specific findings below in two sections, "Information Security Findings" and "Other Findings." We have designated certain findings in this report with an asterisk (*) to indicate a finding that is repeated from our prior report.

Information Security Findings

Allocate Adequate Resources to Reduce IT Security Risk

The Commission does not allocate the necessary resources to reduce IT security risk as required by the Commonwealth's Information Security Standard, SEC 501-08 (Security Standard). The Security Standard requires that agencies implement several minimum security controls to safeguard sensitive and mission critical data that is stored in their IT environment.

During our audit, we identified weaknesses in the Commission's information security posture that indicate a lack of dedicated resources. We discuss these weaknesses in detail in the recommendations entitled "Improve Organizational Placement of the Information Security Officer," "Maintain Oversight Over the Information Security Program," and "Upgrade Unsupported and Vulnerable Operating Systems."

As discussed above, 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, which has affected the resources available for maintaining certain aspects of the IT environment, including their information security program. Additionally, due to internally initiated IT infrastructure upgrades, the Commission allocated IT resources to implementing a non-standard high-end technology instead of using less costly and standard Ethernet desktop connectivity.

Without the allocation and appropriate organizational placement of the necessary resources to ensure the Commission adheres to the Security Standard, the Commission will not be able to maintain adequate 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 agency.

We recommend that Commission leadership evaluate its IT resource levels to ensure sufficient resources, both in terms of people and funding, are available to implement and maintain information security controls on current and future systems. We also recommend the Commission evaluate their current IT positions to ensure specific resources have the necessary time available to carry out their assigned responsibilities. Additionally, we recommend that the Commission dedicate the necessary resources to address the specific control deficiencies identified above and in other recommendations issued during the audit.

Improve Organizational Placement of Information Security Officer

The Commission does not position the Information Security Officer (ISO) in an organizationally independent unit from the Chief Information Officer (Information Officer). Section 2.4.1 of the Security Standard recommends the ISO report directly to the agency head, where practical, and should not report to the Information Officer. Currently, the ISO is reporting directly to the Information Officer. Having the ISO report to the Information Officer may limit the effective assessment and necessary recommendations of security controls in the organization due to possible competing priorities that sometimes face the Information Officer.

The Commission has not placed the ISO in an organizationally independent unit from the Information Officer because management indicates that it does not have the funding to establish an information security office. Additionally, the Commission does not find it suitable to assign the ISO outside the IT Division given that the ISO spends the majority of his time on IT related duties. Currently, the Commission estimates the ISO dedicates only 20 percent of his time to information security program duties because of the system development project resource allocation issues already discussed.

We recommend the Commission evaluate the organizational placement and time requirements of the ISO and consider placing the position outside of the Information Technology Division. This would eliminate any potential conflicts of interest in the implementation of their information security program and controls, and will more closely align their organizational structure with best practices. While it may not be feasible to have the ISO reporting directly to the agency head, the Commission should consider placing the ISO in a different organizational unit reporting to another executive-level position.

Maintain Oversight Over the Information Security Program

The ISO is not maintaining sufficient oversight over the information security program to ensure that it meets or exceeds the requirements of the Commonwealth's IT security policies and standards. During our audit, we identified the following weaknesses related to the information security program:

- The ISO did not confirm that the Commission enforced separation of duties within the Virginia Automated Benefits System (VABS) and Virginia Automated Tax System (VATS). The Commission granted 11 employees access to update claimant wage records in VABS and employer tax records within VATS. This level of access gives an individual the ability to bypass internal controls established by the Commission. The ISO did not detect these conflicts because he did not work with system owners to develop a procedure to detect and address separation of duty conflicts. Section 8.1 AC-5 of the Security Standard, requires the organization to separate duties of individuals as necessary to prevent unauthorized activity.

- The ISO did not confirm that the business managers for VABS and VATS, which support the Unemployment Insurance Program, are reviewing user accounts and privileges annually. Business managers use the Access Control Verification System to confirm user access electronically; however, the ISO has not implemented a procedure to ensure that business managers have reviewed all user accounts and privileges annually. Section 8.1 AC-2 of the Security Standard requires the Commission to review accounts and privileges at least annually.

- The ISO did not maintain sufficient oversight to confirm that its third-party providers (providers) are complying with the Security Standard. The Security Standard considers providers to be organizations that perform outsourced business 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. The ISO did not maintain appropriate oversight because the Commission failed to identify this requirement and implement appropriate procedures to maintain compliance. Section 1.1 of the Security Standard requires that agencies enforce the requirements outlined in the Security Standard through documented agreements with providers and oversight of the services performed.

- The ISO did not confirm that the Commission has periodically audited all information systems that contain sensitive information nor confirmed timely updates and reviews of risk assessments over these sensitive systems. The Commission has not completed these tasks due to a lack of resources. Section 2.5 of the Security Standard requires the ISO to develop and manage the agency's information security program. This includes the ISO confirming that audits are performed that evaluate the effectiveness of the program.

- The ISO did not exercise sufficient oversight to confirm that the Commission is maintaining physical security over information technology assets. We identified two internal control weaknesses that we communicated to management in a separate document marked Freedom of Information Act Exempt under Section 2.2-3705.2 of the Code of Virginia due to it containing descriptions of security mechanisms. Section 8.11 of the Security Standard requires the Commission to design safeguards, commensurate with risk, to protect against human, natural, and environmental threats.

Section 2.5 of the Security Standard requires the ISO to develop and manage an information security program that meets or exceeds the requirements of the Commonwealth's security policies and standards in a manner commensurate with risk. The ISO has not maintained adequate oversight because his time is not fully dedicated towards managing the Commission's information security program as discussed earlier in this section. Without allocating adequate time and resources, the ISO cannot ensure the Commission's information security program is sufficient to protect its IT systems.

These weaknesses are the result of management's resource allocation decisions, which resulted in not allocating sufficient resources to create and maintain the minimum information security controls outlined in the Security Standard. We recommend that Commission leadership evaluate its IT resource levels to ensure sufficient resources are available to implement and maintain information security controls on current and future systems. Additionally, we recommend the Commission evaluate their IT positions to ensure specific resources have the necessary time available to carry out their assigned responsibilities.

Upgrade Unsupported and Vulnerable Operating Systems

The Commission does not use vendor-supported operating systems as required by the Security Standard. We identified a weakness in internal control and compliance that we communicated to management in a separate document marked Freedom of Information Act Exempt under Section 2.2-3705.2 of the Code of Virginia due to it containing descriptions of security mechanisms.

Section SI-2 COV of the Security Standard prohibits the use of software products 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. The Commission significantly elevates its risk of exploitation of unpatched vulnerabilities by a malicious attacker by running on an outdated operating system.

We recommend the Commission work with the IT Partnership to develop an expedited timeframe to transform and refresh all devices that are not using vendor-supported operating systems. Transforming to a vendor-supported operating system will help ensure the Commission is compliant with the Security Standard while mitigating the risk of exploitation of unpatched vulnerabilities.

Other Findings

*Continue to Strengthen Internal Controls over Financial Reporting**

The Commission's financial reporting and review process did not identify a material error in its financial statements. The Commission reports significant non-general fund accounts receivable balances for employer tax payments, as well as benefit overpayments, in the Commonwealth's financial statements. During our review of year-end financial information, we found:

- The Commission used an incorrect beginning balance to estimate the allowance for doubtful accounts. As a result, the Commission understated accounts receivable for benefit overpayments by approximately $2.5 million.

- The Commission made several errors in the accounts receivable calculations related to payable vouchers, also called p-vouchers. The net impact of these p-voucher errors resulted in an understatement of accounts receivable for benefit overpayments of approximately $275,000.

Section 20505 of the Commonwealth Accounting Policies and Procedures Manual requires agencies to implement internal control procedures to assure that it periodically substantiates and evaluates accounts receivable balances. Since our prior audit, the Commission has improved their documentation of policies and procedures over their accounts receivable reporting; however, the reporting process remains very tedious and manual. As a result, the Commission did not detect these errors during their financial reporting and review process. Given the manual nature of the process and the lack of training, the Commission leaves itself prone to errors in its reporting processes.

We recommend the Commission continue to strengthen its internal controls over financial reporting. This includes training all individuals who prepare and review the financial statements. The Commission should consider developing a review checklist to assist in the review process.

Additionally, we recommend the Commission re-evaluate and simplify their reporting processes to minimize the risk of manual error.

Confirm VABS is Calculating Maximum Benefit Amount Consistently for All Claimants

The Commission needs to ensure VABS is calculating maximum benefit amounts in accordance with the Code of Virginia for all claimants. During our evaluation of all claimants who received a payment during the year, we determined VABS did not calculate the maximum benefit amount in accordance with the Code of Virginia for 58 claimants. As a result, the Commission overpaid 41 claimants and underpaid 17 claimants, respectively. Although these instances represent less than one percent of all benefit claims, the Commission should determine why VABS did not perform the maximum benefit amount calculation consistently for these claimants.

Section 60.2-607 of the Code of Virginia establishes the claimant's maximum benefit amount based on the "Benefit Table" in Section 60.2-602 of the Code of Virginia. Of the 58 claimants, VABS did not calculate the maximum benefit amount correctly for five claimants because the claimant filed for benefits for a new benefit year the same day the Commission applied a wage change to the claimant's profile for a previous benefit year. Due to system limitations, VABS cannot process two concurrent modifications and instead processes the request, which impacts the most recent benefit year. As a result, VABS did not recalculate the claimants maximum benefit amount for the previous benefit year based on the corrected wages. The Commission was unable to provide an explanation for the remaining 53 claimants. Without confirming the system's logic, the Commission cannot assure itself that claimants receive the proper amount of benefits based on the formula prescribed in the Code of Virginia.

We recommend the Commission analyze these claims to determine why VABS did not correctly perform the maximum benefit amount calculation in these instances. The Commission should determine which claimants identified are entitled to a benefit adjustment payment due to an underpayment and which need to have an overpayment established against their account. Additionally, the Commission is in the process of replacing VABS with a new system, and this issue needs to be addressed in the new system to ensure benefits will be properly calculated in all cases.

*Withhold Child Support Obligations from Benefit Adjustment Payments**

The Commission does not withhold child support obligations from benefit adjustment payments as required by the Code of Virginia. Although the Commission does deduct child support obligations from unemployment insurance payments, there are situations where the Commission has to generate an additional benefit adjustment payment to the claimant. In these cases, the Commission does not withhold child support from the benefit adjustment payment due to system limitations within VABS.

We reviewed a sample of 23 benefit adjustment payments, which included three payments where child support should have been deducted. The Commission did not deduct child support in any of these instances. Section 60.2-608 of the Code of Virginia requires the Commission to deduct and withhold the amount of child support obligations specified by an individual from unemployment compensation. By not withholding child support obligations from benefit adjustment payments and remitting withholdings 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.

The Commission is in the process of replacing VABS with a new system and they anticipate this issue will be addressed in the new system. Given the uncertain status of the new system, we recommend the Commission evaluate VABS to determine what modifications or procedures could be implemented to ensure child support obligations are withheld as required by the Code of Virginia.

*Continue to Strengthen Tax – Wage Reconciliation Processes**

The Tax Reconciliation Unit (Unit) needs to continue to improve compliance with its tax to wage reconciliation procedures. The Unit performs reconciliations between tax and wage records to confirm the accuracy of the Master Wage File. The Commission uses the Master Wage File as the basis for determining how much an individual should receive in unemployment insurance benefits.

We identified the following instances where the Unit did not follow its reconciliation procedures:

- Three of 25 reconciling items (12 percent) tested were not resolved within 90 days. According to the Unit's procedure, reconciling items must be resolved within 90 days.

- Thirteen of 25 reconciling items (52 percent) tested were not tracked and monitored in accordance with the Unit's procedure. The Unit's procedure requires personnel to log reconciling items on an internal spreadsheet for continued follow up if they are not resolved within one week.

The Unit uses VATS to perform reconciliations between tax and wage records; however, the system is antiquated and does not provide an adequate audit trail for managers to monitor compliance with procedures. To date, the Division of Information Technology has been unable to work with the Unit to develop automated management reports due to the lack of available resources. As a result, managers use ineffective manual processes to identify and track reconciling items.

Without maintaining sufficient oversight over the reconciliation process, the Commission cannot assure itself that the Master Wage File is accurate and places itself at risk of making inaccurate benefits payments. It is our understanding the Unit is currently working with the Division of Information Technology to develop automated management reports. These reports will provide managers with a mechanism to monitor compliance with the Commission's procedures and therefore ensure the accuracy of benefit payments. Along with these efforts, we recommend management continue to review staffing levels, responsibilities and training for staff in the Unit.

Review Policies over Benefit Overpayment Reviews

The Commission needs to review policies over benefit overpayment case reviews and ensure adequate resources are allocated to this process. Currently, the Benefit Payment Control Unit (Payment Control Unit) manager is not conducting these case reviews in accordance with policies and procedures. The Commission has not evaluated the current policy or resources in light of organizational changes and significant caseload increases. We believe this has impacted the manager's ability to conduct and document these reviews in accordance with policies and procedures.

Investigators staffed throughout the State review potential benefit overpayments cases identified by the Payment Control Unit. Under the current policy, the Payment Control Unit manager is responsible for reviewing ten benefit overpayment cases for each investigator monthly to ensure the investigators followed federal and state regulations. The Commission implemented this policy many years ago at a time when there were only four investigators and they reported to regional offices. Currently, there are ten investigators who report to the Payment Control Unit Manager. Although it is our understanding the Payment Control Unit Manager is performing these monthly case reviews, we could not confirm this because he does not maintain adequate documentation to support all reviews.

OMB Circular A-133 .300(b) requires auditees to maintain internal control over Federal programs that provides reasonable assurance that the auditee is managing Federal awards in compliance with laws, regulations, and the provisions of contracts or grant agreements. The Payment Control Unit Manager cannot demonstrate that the Commission has maintained proper oversight over overpayment investigations without maintaining documentation to support all of its reviews.

The Commission needs to evaluate the current policy over benefit overpayment case reviews and determine if the policy should be modified based on current operations, risks, and overpayment activity. Once the Commission has either implemented a new policy or reaffirmed existing policy, management should commit adequate resources to confirm that it implements the policy effectively and complies with federal and state regulations.

STATUS OF SYSTEM DEVELOPMENT PROJECTS

The Commission is currently involved in several system development initiatives, which will replace multiple outdated systems and significantly change the Commission's current business processes. We summarize these projects and their status below.

Unemployment Insurance Modernization (UI Mod) Project

In 2009, the Commission began efforts to replace their antiquated mainframe-based systems originally built in the 1980's. The solution, the Unemployment Insurance Modernization Project (UI Mod), would support payment of benefits to unemployed workers, collection of 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 federal Reed Act funds and the remaining $9.4 million coming from the Commission's penalty and interest fund.

The first phase of UI Mod, Imaging and Workflow, went into production successfully and under budget in December 2011. The Commission and HCLA, the UI Mod project vendor, originally scheduled the remaining phases of the project, Tax and Benefits, to go into production in December 2012 and May 2013. These dates were not achieved and the implementation dates for the remaining portions of the system have been extended multiple times. Work continues on the Tax phase; however, the Commission and HCLA currently cannot agree on a viable implementation plan.

The Commission, the Secretary of Commerce and Trade, the Attorney General's Office, and HCLA are currently working together to find a solution related to the project continuance and finalization that is feasible and in compliance with the contract. The Commission is working towards implementation of the Tax system in the spring or summer of 2015 and will reevaluate the Benefits solution at that point; however, there is no foreseeable implementation date for the Benefits solution.

The Commission has spent approximately $40 million as of October 2014, with over $23 million going to the vendor, HCLA.

Financial Management System

The Commission is implementing the Oracle Financial Management System to replace an outdated mainframe batch system and databases. The Commission contracted with Strategic Information Solutions (SIS) for implementation services in May of 2012 with implementation scheduled for October 2013. However, during the summer of 2013, the Commission and SIS realized that the aggressive schedule was not feasible. The Commission and SIS anticipates placing the financial management system into production at the end of December 2014.

The total project cost is $4.9 million with funding coming primarily from federal Reed Act funds and the Commission has spent approximately $4.1 million as of October 2014.

AGENCY 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 benefits comes from unemployment taxes collected from employers. The Commission deposits these taxes into the Unemployment Trust Fund (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 System Services and Economic Development Services. As shown in Table 1 below, the Workforce System 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.

Table 1 – Budget and Actual Activity for Fiscal Year

Program and Service Area	Original Budget	Final Budget	Expenses
Workforce Systems Services			
Job Placement Services	$ 34,724,500	$ 34,724,500	$ 25,455,165
Unemployment Insurance Services	573,022,771	810,532,771	706,605,889
Workforce Development Services	1,500,623	1,500,623	942,026
Economic Development Services	3,487,809	3,487,809	2,723,129
Total	$612,735,703	$850,245,703	$735,726,209

The largest service area in the Workforce System Service Program is Unemployment Insurance Services. The intent of this service area is to provide benefit payments to unemployed workers. During the year, the original budget for this program increased by approximately $238 million. Approximately $105 million of this increase is a result of the federal government's extension of emergency unemployment compensation benefits, effective January 2, 2013. This extension expired on January 1, 2014.

Unemployment Insurance Services Program

Unemployment Benefits

Under the Unemployment Insurance Services Program, the Commission makes unemployment benefit payments to unemployed workers who lost their employment through no fault of their own. 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 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 unemployment benefit amount increased to $60 effective July 6, 2014.

Table 2 – Minimum and Maximum Unemployment Benefit Amounts

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	$60	$378

The state's unemployment insurance program pays benefits for up to 26 weeks. However, the federal government has approved several benefit extensions that allow individuals to earn additional weeks of unemployment benefits. Table 3 below outlines the most significant state and federal benefit programs applicable during the fiscal year and the amount of additional benefit weeks authorized under each program.

Table 3 – Summary of Available Benefit Types in Fiscal Year 2014

State Unemployment Benefits	Federal Emergency Unemployment Benefits (Expired December 28, 2013)		
26	Tier 1	Tier 2	Tier 3
Maximum weeks in most states	Up to 14 weeks of benefits in every state	Up to 14 weeks of benefits in states with a 3-month seasonally adjusted total unemployment rate of at least 6.0%	Up to 9 weeks of benefits in states with a 3-month seasonally adjustment total unemployment rate of at least 7.0%

In fiscal year 2014, the Commission paid out more than $637 million in unemployment insurance benefits. Overall, benefit payments continued to decrease between 2013 and 2014 as unemployment rates decreased, extended benefits expired, and claimants began exhausting their benefits and became ineligible to file a new claim due to the length they've been unemployed. Table 4 below shows benefit payments by type made in fiscal years 2012, 2013, and 2014.

Table 4 – Unemployment Benefit Payments by Type
Fiscal Years 2012 - 2014

Type of Unemployment Benefit	2012	2013	2014
State Unemployment Insurance Benefits	$ 624,351,290	$586,662,335	$543,517,004
Federal Unemployment Insurance Benefits	37,022,653	34,852,843	26,797,393
Federal Emergency Unemployment Benefits – Tier I	255,722,859	183,821,273	65,699,141
Federal Emergency Unemployment Benefits – Tier II	126,986,137	15,384,518	724,862
Federal Emergency Unemployment Benefits – Tier III	111,127,601	4,709,662	551,203
Federal Extended Benefits and Additional Compensation	1,518,536	182,438	31,965
Total	$1,156,729,076	$825,613,069	$637,321,568

Unemployment Taxes

The Commission pays unemployment insurance benefit payments from unemployment taxes collected from employers within the Commonwealth of Virginia, if the employer meets certain criteria established in the Code of Virginia. The Commission classifies employers as one of two types: taxable or reimbursable employers. 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 202,000 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

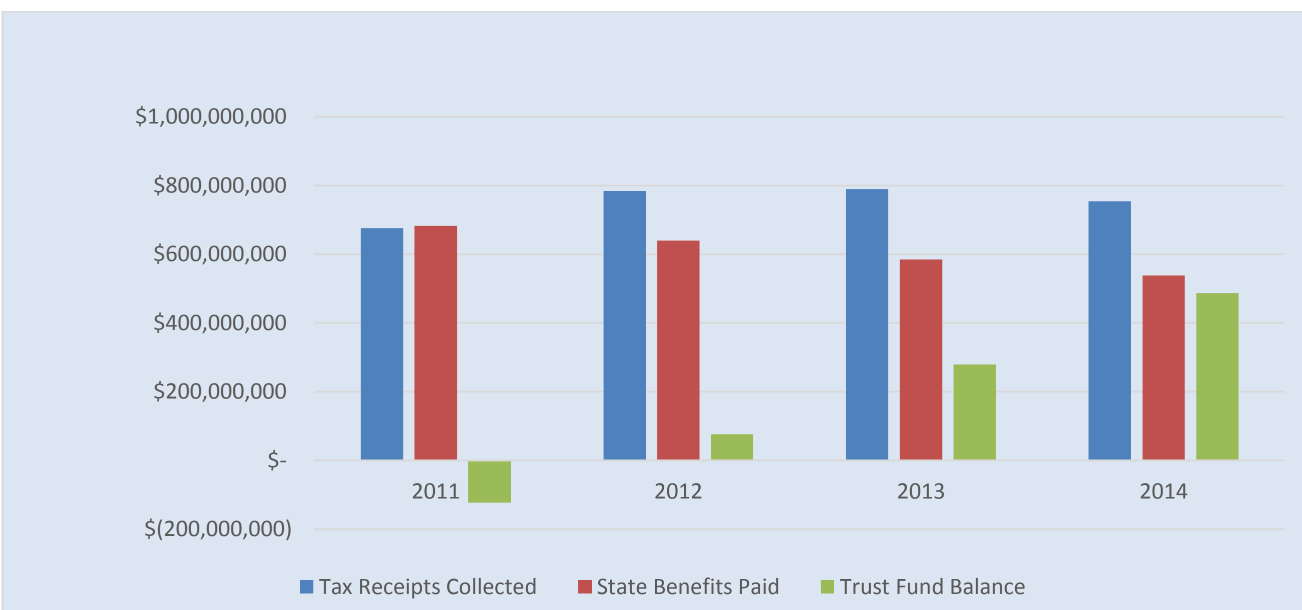
Trust Fund solvency is an indicator of the Trust Fund's ability to pay benefits during periods of high unemployment. The solvency indicator compares the Trust Fund's actual balance to the calculated balance needed to pay unemployment benefits for 16.5 months. During periods of high unemployment, the solvency rate is low; however, the solvency rate is high during periods of low unemployment. Table 5 below illustrates the inverse relationship between unemployment rates and solvency levels.

Table 5 – Unemployment and Solvency Rates

Fiscal Year	Unemployment Rate	Solvency Rate
2011	6.70%	-6.10%
2012	6.20%	9.90%
2013	5.80%	24.40%
2014	5.30%	40.30%

Generally, during times of low employment, the Trust Fund builds up a balance to pay benefits during times of high unemployment. Chart 1 below shows the relationship between benefits paid, taxes, collected, 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.

Chart 1 – Summary of Trust Fund Activity – Fiscal Years 2011 – 2014



During periods of high unemployment, benefits paid to the unemployed may exceed the amount of taxes collected from employers, which causes the Trust Fund to run a deficit. As illustrated in Chart 1, the Commission paid more in benefits than it collected in taxes during fiscal year 2011. As a result, the federal government issued the Commission a temporary loan to close the deficit in the Trust Fund.

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, interest income from the Trust Fund offsets pool costs; however, the 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 Commission annually sets the tax rates on a calendar year basis and the following table details the various tax rate components in effect for calendar years 2011 through 2014. As shown in Table 6 below, the tax rates for 2014 declined due to the Trust Fund solvency levels discussed above.

Table 6 – Unemployment Tax Rates by Calendar Year

	2011		2012		2013		2014	
	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	0.47%	0.47%	0.53%	0.53%	0.38%	0.38%	0.22%	0.22%
Fund-building tax	0.20%	0.20%	0.20%	0.20%	0.20%	0.20%	0.20%	0.20%
Total	0.77%	6.87%	0.83%	6.93%	0.68%	6.78%	0.52%	6.62%

Note: The Commission will calculate and publish the calendar year 2015 rates in December 2014 so these are not included in the table above.

Commonwealth of Virginia

Auditor of Public Accounts

Martha S. Mavredes, CPA
Auditor of Public Accounts

P.O. Box 1295
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December 12, 2014

The Honorable Terence R. McAuliffe
Governor of Virginia

The Honorable John C. Watkins
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, 2014. 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 Commission's financial transactions as reported in the Comprehensive Annual Financial Report for the Commonwealth of Virginia for the year ended June 30, 2014, 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 and in the Commission's Tax and Benefits Systems, 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.

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

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 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 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 Tax and Benefit Systems.

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 over financial reporting that we consider to be material weaknesses 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 will not be prevented, or detected and corrected on a timely basis. We consider the deficiencies entitled "Allocate Adequate Resources to Reduce IT Security Risk" and "Continue to Strengthen Internal Controls over Financial Reporting," which are described in the section titled "Internal Control and Compliance Findings and Recommendations" to be material weaknesses.

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

The results of our tests of compliance with applicable laws, regulations, contracts, and grant agreements disclosed instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards.* These instances are described in the section titled "Internal Control and Compliance Findings and Recommendations" in the findings entitled " Allocate Adequate Resources to Reduce IT Security Risk," "Improve Organizational Placement of Information Security Officer," "Maintain Oversight Over the Information Security Program," "Upgrade Unsupported and Vulnerable Operating Systems," "Continue to Strengthen Internal Controls over Financial Reporting," "Confirm VABS is Calculating Maximum Benefit Amount Consistently for All Claimants," "Withhold Child Support Obligations from Benefit Adjustment Payments," and "Review Policies over Benefit Overpayment Reviews."

The Commission has not taken adequate corrective action with respect to the previously reported findings "Improve Internal Controls Surrounding Employer Wage Discrepancies," "Improve Controls over Benefit Adjustment Payments," and "Strengthen Financial Reporting over Accounts Receivable." Accordingly, we included these findings as part of the current year findings "Continue to Strengthen Tax – Wage Reconciliation Processes," "Withhold Child Support Obligations from Benefit Adjustment Payments," and "Continue to Strengthen Internal Controls over Financial Reporting" 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 on January 14, 2015. Management's response to the findings identified in our audit is included in the section titled "Agency Response." We did not audit management'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

LCW/alh

COMMONWEALTH of VIRGINIA
Virginia Employment Commission

Ellen Marie Hess
Commissioner

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

January 14, 2015

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, 2014. 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, 2014.

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

Salvatore Lupica
Acting Commissioner

Miles E. Sparkman, III
Controller