VIRGINIA EMPLOYMENT COMMISSION

RICHMOND, VIRGINIA

REPORT ON AUDIT

FOR THE YEAR ENDED

JUNE 30, 2004

APA

Auditor of Public Accounts

COMMONWEALTH OF VIRGINIA

AUDIT SUMMARY

Our audit of the Virginia Employment Commission for the year ended June 30, 2004, in support of the Comprehensive Annual Financial and Statewide Single Audit Reports for the Commonwealth of Virginia, found:

- for the seventh consecutive year, Unemployment Trust Fund benefits payouts have exceeded collections. The fund balance, which totaled over $1 billion in 2000, dropped to a low of $111.8 million in March of 2004 but increased to $296 million at fiscal year end 2004. Starting at calendar year 2004, a fund building tax to employers was implemented by law to rebuild the fund;

- 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;

- no internal control matters that we consider to be material weaknesses;

- no instances of noncompliance or other matters that are required reporting under Government Auditing Standards; and

- adequate corrective action of prior year audit findings.

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SELECTED AGENCY INFORMATION

The Virginia 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 makes benefit payments to laid-off workers, ensuring they have minimal income during the course of a job search. The Employment Commission collects unemployment taxes from employers and uses these taxes to pay benefit claims. The tax collections go into the Unemployment Trust Fund, for which the Employment Commission is the trustee. The Employment Commission pays all unemployment insurance benefit payments from the Trust Fund.

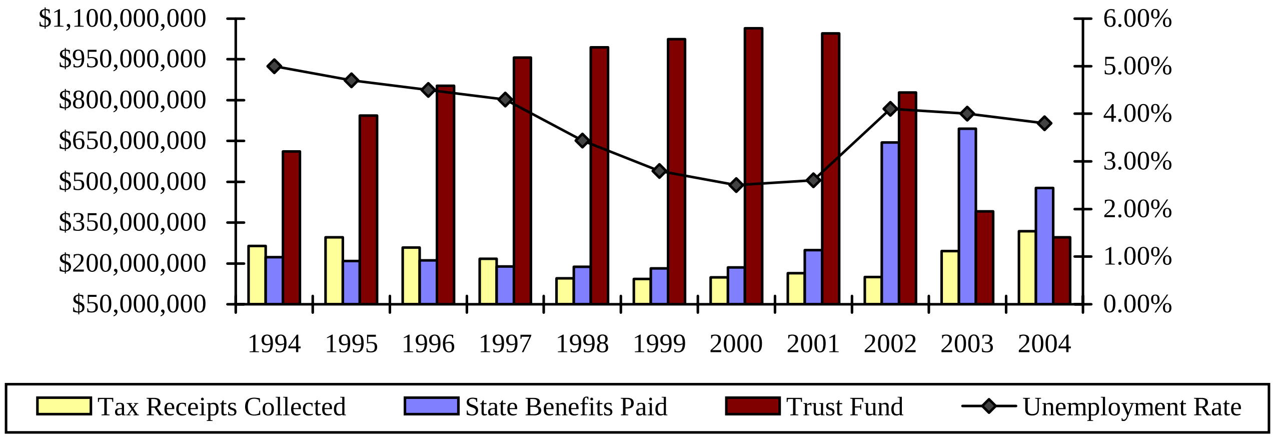
UNEMPLOYMENT TRUST FUND

The Unemployment Trust Fund's solvency factor applicable for calendar year 2005 remains below 50 percent for the second year in a row. The solvency factor for calendar year 2004 was the first time the factor fell below 50 percent since 1984. For the seventh consecutive year, benefits paid out have exceeded collections and the Trust Fund balance dropped to a low of $111.8 million in March 2004 before increasing to $296 million at the end of the fiscal year. The difference between payments and collections resulted in a net loss of nearly $95 million in fiscal year 2004; however, the most significant net losses have occurred in both 2002 and 2003 with a total net loss for the two years approaching $950 million. This net loss comes out of a starting fund balance of slightly over $1 billion in 2000.

As a result of the economic downturn in 2001, the former Governor issued an Executive Order increasing all unemployment benefits by 37.3 percent. This increased the minimum weekly benefit from $50 to $69 and the maximum weekly benefit from $268 to $368. These higher benefit amounts remained in effect through January 4, 2003. As the economy worked towards recovery, the General Assembly reduced the increased benefit levels. Legislation reduced minimum and maximum weekly benefits to $59 and $318, respectively, for the period January 5, 2003 to July 5, 2003. Additional legislation reduced the minimum and maximum weekly benefits to $50 and $316, respectively, beginning July 6, 2003 through July 3, 2004. Beginning July 2004, legislation increased maximum weekly benefits from $316 to $326, while the minimum weekly benefits remained at $50.

The illustration below 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



Notes: The Trust Fund balance also includes interest credited to the account. The unemployment rate represents the average rate for the entire fiscal year.

The Trust Fund's solvency and the employer tax rates are inversely related. As the Fund's solvency decreases, the tax rates increase. The Employment Commission levies taxes on employers' wages according to rates set by the General Assembly. Under current law, employers only pay taxes on the first $8,000 of each employee's wages. The tax rates imposed on employers consider the Trust Fund's solvency and the employment histories of individual businesses, referred to as the experience rating. This rating requires employers with a history of higher unemployment claims to pay a greater rate and allows those with fewer claims to pay less or nothing at all.

The Unemployment Compensation Act sets the lowest tax rate at zero as long as the Trust Fund solvency remains at or above 100 percent. Since fiscal year end 2002, the Trust Fund solvency has remained below 100 percent; therefore, all employers paid unemployment taxes during calendar years 2003 and 2004. For calendar year 2004, the minimum rate that an employer could be required to pay on taxable wages was 0.44 percent, while the maximum rate was 6.54 percent.

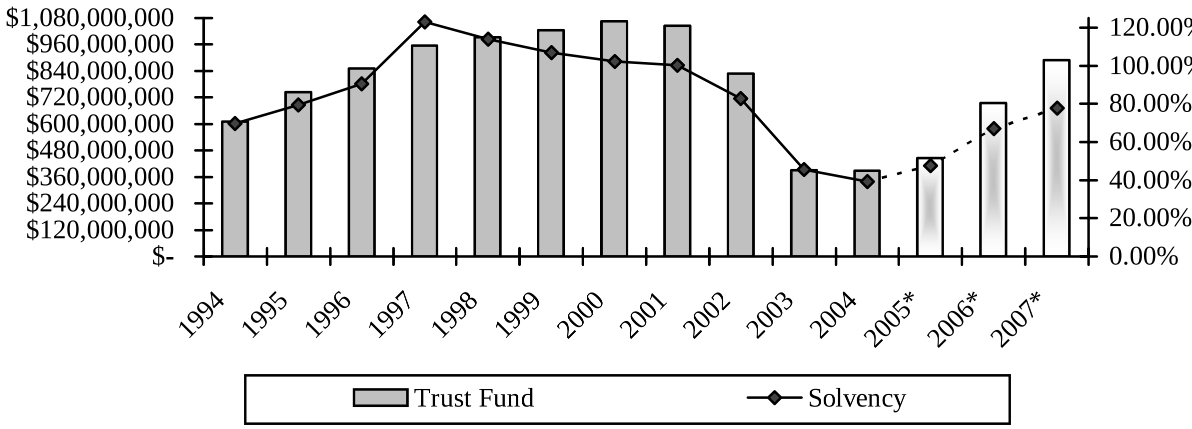
An additional adjustment to the tax rate for calendar years 2003 and 2004 was the inclusion of the pool tax. The pool tax represents a levy to recover benefits not chargeable to a specific employer, known as pool costs. Interest income earned from the Trust Fund can offset the total pool costs when the solvency is above 50 percent. Interest income did not exceed pool costs in fiscal year 2002; therefore, the Employment Commission added a pool tax rate of 0.03 percent to the employer tax rates for calendar year 2003. Because the Trust Fund solvency fell below 50 percent in calendar year 2004, the Employment Commission could not offset the total pool costs, and employers paid the full tax rate. The pool tax rate increased to 0.14 percent for calendar year 2004 (included in the minimum and maximum rates above). This rate will increase to 0.22 percent for calendar year 2005.

As mentioned above, the Trust Fund solvency is currently below 50 percent and should continue to decrease until leveling off in the coming year. State law requires a fund-building tax rate of 0.2 percent to the employer tax rates if the fund balance drops below 50 percent, which helps the Trust Fund to remain solvent. The minimum and maximum rates for calendar year 2005 are 0.52 percent and 6.62 percent, respectively. These rates include both the pool tax for calendar year 2005 and the fund-building tax. The following table breaks down and compares the various taxes for calendar years 2004 and 2005.

	Calendar Year 2004 Tax Rates		Calendar Year 2005 Tax Rates	
	Minimum	Maximum	Minimum	Maximum
Tax rate	0.10%	6.20%	0.10%	6.20%
Pool tax	0.14%	0.14%	0.22%	0.22%
Fund-building tax	0.20%	0.20%	0.20%	0.20%
Total	0.44%	6.54%	0.52%	6.62%

The Employment Commission calculated in 2004 the Trust Fund Solvency to be 39.3 percent for calendar year 2005. The Trust Fund has a projected balance of approximately $444.5 million by the end of fiscal year 2005, and the solvency rate at 47.7 percent. Due to the increasing pool tax and the fund-building rate addition, the Trust Fund balance should continue to increase. In the 2006 calculation for calendar year 2007, they anticipate that the solvency will increase to 67.1 percent. The Trust Fund balance at fiscal year end 2007 is expected to be $889 million. The following illustration presents the projections for the Trust Fund balance and solvency as projected by the Employment Commission.

Unemployment Trust Fund Balance and Solvency



* Projected figures

Note: 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 formula that calculates 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. Both the Trust Fund balance and solvency rate are calculated for the state fiscal year. Solvency rates at fiscal year end are used to determine tax rates for the next calendar year.

Commonwealth of Virginia

Auditor of Public Accounts
P.O. Box 1295
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Walter J. Kucharski, Auditor

December 3, 2004

The Honorable Mark R. Warner
Governor of Virginia
State Capitol
Richmond, Virginia

The Honorable Lacey E. Putney
Chairman, Joint Legislative Audit
and Review Commission
General Assembly Building
Richmond, Virginia

INDEPENDENT AUDITOR'S REPORT

We have audited selected financial records and operations of the **Virginia Employment Commission** for the year ended June 30, 2004, in support of the Comprehensive Annual Financial and Statewide Single Audit Reports for the Commonwealth of Virginia. 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 objective was to evaluate the accuracy of the Employment Commission's financial transactions as reported in the Comprehensive Annual Financial and Statewide Single Audit Reports for the Commonwealth of Virginia for the year ended June 30, 2004. 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 and regulations, and reviewed corrective actions of audit findings from prior year reports. Our review encompassed controls over the following significant cycles, classes of transactions, and account balances:

Unemployment Benefit Payments	Accounts Receivable
Taxes and Cash Receipts	Accounts Payable
Federal Grants Management	Expenditures

We reviewed and gained an understanding of the overall internal controls, both automated and manual, including controls for administering compliance with applicable laws and regulations, sufficient to plan the audit. We considered materiality and control risk in determining the nature and extent of our audit procedures. Our audit procedures included inquiries of appropriate personnel, inspection of documents and records, and observation of the following operations:

Unemployment Benefit Processing	Expenditures
Employment Tax Collections	Financial Reporting

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 tested transactions and controls and performed other 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 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 Results

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.

We noted no matters involving internal control and its operation that we consider to be material weaknesses relative to the Comprehensive Annual Financial and Statewide Single Audit Reports for the Commonwealth. Our consideration of internal control would not necessarily disclose all matters in internal control that might be material weaknesses. A material weakness is a reportable condition in which the design or operation of the specific internal control components does not reduce to a relatively low level the risk that errors or irregularities in amounts that would be material to financial operations may occur and not be detected promptly by employees in the normal course of performing their duties.

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.

The Employment Commission has taken adequate corrective action with respect audit findings reported in the prior year.

We discussed this letter with management on December 7, 2004.

AUDITOR OF PUBLIC ACCOUNTS

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