

AUDIT REPORT

Oregon Employment Department Unemployment Insurance



Bill Bradbury, Secretary of State
Cathy Pollino, Director, Audits Division

Summary

PURPOSE

The purpose of this audit was to determine if opportunities existed for the Oregon Employment Department (department) to use existing data sources in administering the Unemployment Insurance (UI) program to increase the collection of taxes owed and the recovery of benefit overpayments.

RESULTS IN BRIEF

We found that the following data sources could help the department improve its procedures to identify tax underpayments and benefit overpayments:

- Corrections Data
- Social Security Administration Data
- Internal Revenue Service Data
- State Business Licensing Data

By increasing the collection of taxes due and recovery of overpayments, the department will maximize the UI trust fund balance and help control employer tax rates.

RECOMMENDATIONS

To enhance its monitoring efforts, the department should identify and arrange access to data from external information systems that could potentially be used to enhance monitoring of the UI program. In addition, the department should comply with federal guidelines to randomly select for audit 10 percent of all employer reports filed during a year.

AGENCY'S RESPONSE

The Oregon Employment Department agrees with four of five of the recommendations made by the audit team.

Introduction

The department administers Oregon's Unemployment Insurance (UI) program. This federally mandated program provides benefits to employees who have lost their jobs through no fault of their own. Oregon's unemployment rate during 2002 and continuing into 2003 was among the highest in the nation. In April 2003, Oregon's unemployment rate was 8 percent. The department reported that during calendar year 2002 Oregon paid unemployment insurance claims totaling \$1.2 billion to 263,000 claimants.

Background

When an individual becomes unemployed, he or she must file a claim with the department in order to receive UI program benefits. Unemployment benefits and department operations are funded with taxes paid by employers. These taxes are referred to as the

SUTA tax (State Unemployment Tax Act) and the FUTA tax (Federal Unemployment Tax Act).

States are responsible for collecting SUTA taxes and administering the program according to federal standards. Federal standards require timely and accurate payment of benefit claims, as well as effective monitoring of employers to ensure that taxes due are paid. The state transfers SUTA tax collections to the federal government, where they are held in the state's UI trust fund account. With rare exceptions, these funds may be used only to pay UI claims.¹

Oregon employer tax rates are set by statute.² The rate schedule to be used is based on calculation of the UI fund adequacy. Factors that impact that calculation include the trust fund balance and both

historical and recent UI payments. Minimizing benefit overpayments and ensuring that employers properly pay SUTA taxes owed contribute to maximizing the fund balance. Maximizing the fund balance helps control employer tax rates.

Audit Results

The department should consider using data from external information systems to increase its effectiveness in detecting claim overpayments and employer reporting violations.

Use Corrections Data to Detect Improper Payments to Inmates

Prison inmates are ineligible to receive unemployment benefits because they are not available to accept employment. As part of its ongoing work in auditing claims, the department should consider

¹ Federal Register Vol. 62, No. 232, Wednesday December 3, 1997

² ORS 657.462

targeted reviews of payments to incarcerated individuals.

For our audit, we obtained from the Department of Corrections (Corrections) the names of individuals incarcerated in Oregon state prisons from 1999 through 2002. Using computer analysis, we matched inmates' names and birth dates with UI claims. We then identified the claims paid for the periods when claimants were incarcerated. Our data match identified claims made by 37 inmates and about \$45,400 in questioned payments. In four instances, the department had denied the claims for reasons other than incarceration, or the check had been returned uncashed. In addition, the department had previously identified incarceration in six cases, including approximately \$8,400 paid to three inmates, for which overpayments had been set up. Payments to 27 inmates, however, valued at approximately \$37,000, had not been detected.

We recommend that the department enter into agreements with the Oregon Department of Corrections and Oregon counties that operate jails, where practical, for use in periodic reviews to detect improper UI payments to inmates.

Agency's Response:

We agree. The Secretary of State's recommendation regarding incarcerated individuals is useful. We currently monitor available information, mostly on websites, from various county and local corrections facilities. We are seeking further access and/or better data formats to more effectively pursue these potential cases. We will work with the Oregon Department of Corrections to seek an effective electronic cross match system.

The recent Secretary of State audit found several potential cases. However, this initial audit captured data reaching into the 1970s. It is

our position that future cross matches would garner less with only recent history since the last audit. Additionally, over half of the audit cases were either already discovered by our agency or were not actual improper payments. The Investigator who worked the cases has spent 46 hours (30 hours in actual investigation) and still has 11 cases to work. Overpayments total \$14,789, so far. The work totals do not count the work of those who set up and produced the data cross match.

This is not to say a corrections cross match would not provide valuable information. We will need to continue assessing the merit of sifting through all these cases while setting others aside, seeking to use our resources to best benefit the program and the State.

Use Social Security Administration Data to Detect Improper Payments

The department is currently involved in a project to gain online access to the Social Security Administration's data, providing access to date of birth and death records. The department intends to use the data to verify the identity of claimants when claims are initiated. Our audit identified additional uses for this data in verifying identities to detect improper UI payments.

During the audit we obtained date of death records from the State Health Division. Using social security numbers, we matched UI paid claims to recently deceased individuals. We identified approximately \$1,500 in apparent payments to deceased persons.

In addition, we noted reports of other uses of social security administration data. The U.S. Department of Labor has issued a report suggesting that social security numbers be verified to prevent UI payments to illegal aliens.

Further, California's UI program has issued a bulletin describing how to protect against imposter UI claims. In these cases, someone intentionally files a UI claim using another person's name, social security number, and employment information.

We recommend that the department consider additional uses for social security information in verifying personal identities when processing benefit applications and when monitoring UI payments.

Agency's Response:

We agree. Social Security Administration (SSA) data sharing has been our goal. We were successful in a Supplemental Budget Request to ease our efforts to attain this goal. Under an agreement with SSA, we will be able to access SSA data online when filing the Unemployment Insurance initial claim (embedded in the programming) and can also initiate stand alone transactions. The program will alert the claims taker, who can question the individual to resolve the discrepancy or establish an issue. It will validate SSN, date of birth, name, multiple SSNs, and death list information. We expect completion by August 2003.

Use Internal Revenue Service Data to Assess Accuracy of Employer Reports

During the course of our audit we learned that federal regulations regarding state use of IRS data had recently been liberalized.³ State taxing entities, such as the department, are now eligible to enter into agreements with the IRS. These agreements provide them with access to federal income tax data. By comparing its own data on

³ Federal Register Vol. 68, No. 13 Tuesday, January 21, 2003 Department of the Treasury, IRS, page 2695

claimants and employers to that obtained from the IRS, the department could substantially increase the reach and effectiveness of its monitoring and auditing efforts.

According to the U.S. Department of Labor, the most common violation occurs when a business avoids UI tax payments by incorrectly identifying workers as independent contractors when they are, in fact, employees. Unlike employees, independent contractors are not eligible for regular UI benefits because the employer has paid no UI taxes on their behalf. The department would typically discover this type of violation when a worker files for UI benefits. When the department investigates and finds that a worker was actually an employee, the employer may be assessed up to three years of back taxes as well as interest. This assessment would include all workers identified during the investigation as employees, not merely the UI claimant.

Payments to independent contractors are reported to the IRS on form 1099. No similar report is filed with the state. The federal government recently developed a form 1099 data extract specifically to aid state UI agencies. The extract is available about 17 months after the year-end. For example, the second data extract, from calendar year 2001, was available in May 2003. Having access to the data could substantially facilitate identification of employer reporting violations. Representatives from other states with whom we spoke indicated having some success using form 1099 information as a tool to identify employers not paying UI taxes.

In addition to the form 1099 data extract, the IRS can make available data from income tax files, results of completed IRS investigations, and ad hoc reports. Ad hoc reports contain the most current

information available to the IRS, rather than prior year information. All of this information could be useful to the department in carrying out its monitoring and auditing responsibilities.

We recommend that the department enhance its monitoring efforts by entering into an agreement with the IRS to obtain access to IRS data. In addition to using form 1099 information, the department should consider uses for other types of federal tax information available through agreement with the IRS.

During the course of our audit, the department officials expressed interest in using form 1099 data, and took preliminary steps toward entering into an information-sharing agreement with the IRS.

Agency's Response:

We agree in principle but request that this be revisited after the initial pilot to discuss the effectiveness of this process. Employment Tax is willing to investigate additional avenues for detecting inaccurate tax reports, especially with respect to the issue of potentially misclassified workers. Our only limitation is resources, including people and available technology within the department.

Tax is currently working with the IRS and the Department of Revenue to obtain data on 1099 filings in Oregon. If we are permitted access to that data, it will be turned over to the Secretary of State's office for purposes of analyzing the potential value of that data as a resource for detecting inaccurate tax reports filed by Oregon employers.

Tax is currently communicating with other states that have access to such data to determine the ways those states have used the data to identify potential misclassified workers.

Use State Business Licensing Data to Assess Appropriateness of Employer Tax Rates

Employers with high employee turnover are assigned higher UI experience ratings and pay a higher UI tax rate. Some employers may attempt to manipulate their experience ratings, resulting in lower state UI tax revenues. They might do so by purchasing a second company with a lower tax rate and transferring that experience rate, or by establishing an additional business entity and reporting a small number of employees there until a lower tax rate has been established. After the lower rate is set, the original entity could move most of its employee reporting to the new entity. These practices have been most often associated with industries with a high turnover in staff such as employee leasing companies, construction, and some service organizations.

We were told that business licensing data has proven useful to the department in detecting attempts to manipulate experience ratings. The Department of Consumer and Business Services (DCBS) licenses employee leasing organizations. Informal information sharing has been occurring between individuals in the department and DCBS. Auditors were told that this sharing had led to the successful identification of attempts to manipulate experience ratings. A formal arrangement would help to ensure the continuous flow of information.

In addition, there are many other state boards and commissions that provide licensing and monitoring for construction and service industries in the state. Among them are, for example, the Construction Contractor's Board, the Board of Cosmetology, and the Appraiser Certification and Licensure Board.

We recommend that the department consider entering into formal agreements to share business licensing information with DCBS and other state agencies that perform business licensing functions.

Agency's Response:

We disagree. There are literally thousands of licensed employee leasing companies, and thousands of other employers licensed for various purposes in the state of Oregon. We question the value of entering into formal information sharing agreements with other licensing agencies unless and until we determine a clear need and potential benefit associated with such sharing. The informal access that Employment Tax has currently to licensing records maintained by DCBS works effectively to allow Tax to investigate issues related to tax rate manipulation. All of the information we need to access is available on the public website for that agency. Other licensing information is generally public information and much of it is available on agency websites, as well. Tax can access that information on a case-by-case basis. Tax has yet to identify a potential methodology for detecting potential tax manipulators based upon licensing data, but is willing to investigate such.

Tax is currently working on crafting new rules to provide clarity for customers and Tax employees on how the statutory requirements for tax rates based upon experience ratings are to be applied. We expect the new rules will assist employers to comply with the word and spirit of the law and that Tax employees will receive additional training to more readily identify possible efforts at tax rate manipulation as a result of the rule changes. In addition, the Employment Department anticipates working with stakeholders throughout the state to

draft legislation related to the issue of tax rate manipulation.

Other Matters

Revise Audit Selection Methodology

Audits of employers are an important part of the UI program. In addition to auditing employers identified as high risk, federal guidelines encourage the department to select 10 percent of the employers randomly from the total universe of employers for audit. We found that the department's sampling methodology had excluded 80 percent of the state's employers from the source pool for random selection.

We recommend that the department comply with federal guidelines to randomly select for audit ten percent of all employers.

Agency Accomplishments

During the audit, after being informed of this issue the department reported that it had implemented the recommendation.

Agency's Response:

We agree. This error was detected during the audit and has already been corrected. We appreciate the assistance of the auditors in identifying this matter.

Objectives, Scope and Methodology

The purpose of this audit was to determine if opportunities existed for the Oregon Employment Department to use existing data sources in administering the Unemployment Insurance program to increase the collection of taxes owed and the recovery of overpayments.

We interviewed key program management and staff members to gain an understanding of program

operations. We researched federal and state rules and regulations, and performed survey work of other states' UI programs.

We obtained access to the department's UI claims for the calendar years 2001 and 2002, including employer Successorship data. We also received access to other state agency databases including:

- Incarceration data from the Department of Corrections;
- Worker leasing organization data from the Department of Consumer and Business Services; and
- Date of death records from the Department of Human Services, Health Division.

Using computer analysis, we performed data cross match procedures between the department's claims data and these other databases.

We facilitated two meetings with the Internal Revenue Service and the Oregon Department of Revenue regarding the process of the department obtaining federal tax information.

We conducted our fieldwork between December 2002 and April 2003. Our work was limited to the subjects identified in this report. We conducted our work according to generally accepted government auditing standards.

Oregon Employment Department's Response

I would like to commend your auditors for the work they have done on the audit of the Unemployment Insurance Division of the Employment Department. Tom Byerley, Assistant Director for Unemployment Insurance, and his staff were pleased with the working relationship developed with Darcy Johnson, Katrina Dummer and Ben McClelland and with the process used for this audit. Overall, this proved to be an effective information sharing process where all involved benefited. Please extend my thanks to Darcy and her staff for the way in which this audit was handled. I thank you for the thorough and informative audit report and for using an excellent process to develop these findings.

—Signed by Deborah Lincoln, Director

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The courtesies and cooperation extended by the officials and staff of the Oregon Employment Department were commendable and much appreciated.

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