SUMMARY

A Management Review of the Department of Employment and Workforce

INTRODUCTION

Section 112 of Act 146 of 2010 requires the Legislative Audit Council to conduct periodic management audits of the Department of Employment and Workforce (DEW). This report is the last of three audits required by the Act.

OBJECTIVES

- Review revenue and expenditures from the Unemployment Insurance (UI) Trust Fund.
- Determine the adequacy of notifying state officials about the solvency of the UI Trust Fund.
- Examine the unemployment eligibility process.
- Evaluate DEW's programs for returning claimants to work.
- Review the contingency assessment expense account for propriety.
- Evaluate DEW's fraud and overpayment process.
- Review human resources issues.

JULY 2019

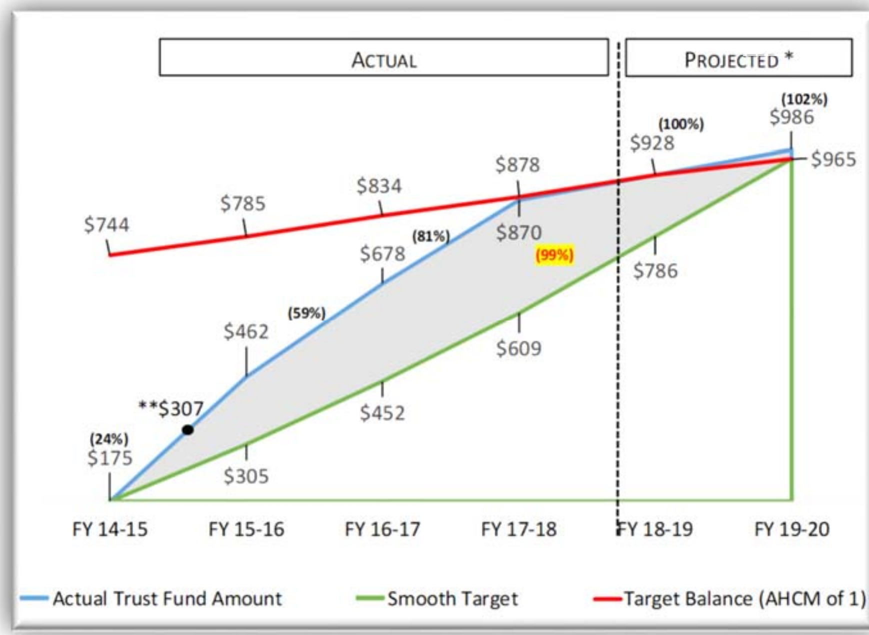
SOLVENCY OF THE UNEMPLOYMENT INSURANCE TRUST FUND

UI TRUST FUND CURRENT STATUS

The UI Trust Fund is at 99% of its target solvency amount, three years into the official rebuild period of five years. South Carolina statute requires the rebuild period of 2016 through 2020 and specifies the balance required.

The goal to achieve solvency required the agency to accumulate the statutorily-mandated reserve that would provide sufficient funds to weather a "moderate" recession. This is, in essence, the ability to pay claims for 12 months based on the state's historical claims payments, using an average of prior benefits paid during recessionary times.

ACTUAL VERSUS SMOOTHED TRUST FUND AMOUNT AND TARGET BALANCE (IN MILLIONS)



AHCM (Average High Cost Multiple) of 1.0 is the amount of Trust Fund reserves that would be required to withstand a "moderate" recession. The target balance (AHCM=1) increases as projected wages increase. Wage increases bring a potential commensurate increase in unemployment benefits.

Chart 4.3 of our report contains footnotes and sources.

Rate of Trust Fund Rebuild

DEW collected most of the funds needed for solvency in the first three years of the rebuild period without analyzing the effect it might have on employers. One and one-half years into the rebuild period at the end of FY 16-17, the fund was at 81% of its target solvency amount, with three and one-half years to go. Employers may have been charged more taxes than necessary, which could have negatively affected employers, resulting in reduced employer capital. This could have affected business plans and operations.

The actual effect, in an aggregated, meaningful way, is unknown—we could find no government or public body with such information. However, this did put the state in a somewhat better position to be able to respond to a recession, should one have occurred in 2018 or 2019.

Lower Taxes

Although tax rates decreased throughout the period—approximately 10%–12% each year (in 2018 taxes were 17% lower)—this was mainly because unemployment decreased and the federal loans that were used to pay benefits during the Great Recession beginning in 2008 were paid off in mid-2015.

Smoothed Trust Fund Solvency Rebuild

The Lucas Group, an outside consultant, and the USDOL recommended a smoothed, five-year rebuild period.

Taxes could have been less during this period if DEW had selected a smoothed approach to rebuilding the Trust Fund. Taxes could have been:

$157 million less in FY 15-16 (55%)
$70 million less in FY 16-17 (32%)
$34 million less in FY 17-18 (18%)

Trust Fund Solvency Rebuild—Actual Taxes Collected
Compared to Taxes that Would Have Been Levied for a Smoothed Trust Fund Rebuild

Tax Method	(In Millions)		
	FY 15-16	FY 16-17	FY 17-18
Amount Collected in Accelerated Taxes	$286	$217	$192
Amount Collected in Smoothed Taxes	$130	$147	$158
Increase Over Smoothed Amount	$157	$70	$34

Problems With FARS and SCEIS

DEW uses the Financial Accounting and Reporting System (FARS) for grant tracking—the financial system that is the source of the audited financial statements. DEW also keys the same data into the South Carolina Enterprise Information System (SCEIS)—the official state accounting system—in an attempt to be in compliance with state law. However, we found DEW could not provide a reconciliation to account for the variance between FARS and SCEIS for the contingency assessment expenses, which indicates data is being omitted from SCEIS.

A DEW official stated it costs millions every year to operate FARS, but DEW has not sought a solution to the problem since 2016. Officials at the Department of Administration (DOA) indicated to DEW that DOA could incorporate FARS functionality into SCEIS. A customized module in SCEIS would decrease the likelihood of errors by eliminating the keying of double accounting entries and would eliminate mainframe costs.

Contingency Assessment

Funding

The contingency assessment tax on employers increased 100% from 2010 to 2015, \$4.20 to \$8.40 per employee, respectively, resulting in a fund balance increase from \$9.6 million in FY 12-13 to \$26 million in FY 16-17. During fieldwork, DEW was unable to provide us with its next two years of planned expenditures, but DEW provided planned expenditures in its response to LAC's draft report, which indicates upgrades to the Harper Building (used for appeals, not reemployment activities—the intended use of the funds as specified by law) and for office and grounds upgrades.

Reemployment Services

Although the agency has continued to use some contingency assessment funds for reemployment activities, DEW does not have adequate metrics for measuring the effectiveness of the reemployment services it provides. The law is broad and it appears that DEW is broadening its use of the funds to include paying for routine maintenance of buildings, purchasing maintenance trucks, etc., rather than items more directly related to its reemployment goal. We recommend more specificity in the law regarding use of the funds.

Options for Change

In addition to recommending more spending restrictions in the law, the General Assembly could curtail the growth of the funding by a number of means, such as setting the taxable wage base back to \$7,000, which it was in 2010, and tie future increases to an index, such as the Consumer Price Index (CPI). In our report, we identify a number of options to reduce the tax. We found that 21 states do not have a contingency assessment tax or similar administrative tax.

Expenditures

Our review of \$7.6 million, out of \$8.5 million of contingency assessment expenditures for FY 16-17, revealed the following:

Detailed Expenses

The list of expenses from DEW's accounting system were not detailed enough for us to determine the exact nature of the expense based on the brief description on the general ledger list.

Source Documents

DEW did not provide enough detailed source documentation, in most cases, for us to conclude with reasonable certainty the expenses were necessary business expenses. For example, we reviewed purchased computer equipment, but DEW did not verify where the equipment was being used nor by whom.

Unaccounted Funds

DEW did not provide documentation to show which reemployment services it funds with contingency assessment revenues. Since a proviso went into effect several years ago that required DEW spend 30% of its contingency assessment funds on "reemployment activities," DEW has booked an internal transfer of funds (an accounting adjustment) without any specificity, rather than identifying the actual expenditures. Therefore, there is no assurance that the \$4.2 million in funds were spent on personnel and systems engaged in putting claimants back to work. Our May 2014 audit of DEW included the same finding—that DEW could not identify the details of the expenditures.

Internal Audit

We found internal audit was not given sufficient authority to audit and pursue reviewing the highest risk areas, and only reviewed those areas mandated by USDOL. Risk assessments of agency operations usually provides the proper basis for selections of audit subject matter.

The internal audit department reported to the chief financial officer, rather than the Executive Director, which contributed to less than optimum independence. During the audit, we found there was no internal audit manager and no internal audit staff with all positions vacated between August and November 2018.

Taxes

Proportionality of Rate Classes

Trust Fund tax rates may not be proportional in how they are set relative to the unemployment benefits paid out by tax rate class and contributions to rebuild the Trust Fund. It is unclear if certain rate classes, mainly rate classes 13 through 20, are disproportionate to the benefit and rebuild needs calculated for those rate classes or the risk they pose to the Trust Fund. By law, the tax rate for rate class 13 is 120% of rate class 12, whereas rate classes 2 to 12 are all approximately 10% to 12% greater than the one before it, being relatively proportionate increases, lower to higher. Rate classes 14 through 20 range from 76% to 339% more than rate class 13.

2018 Tax Analysis

Rate Class	Tax Rate	% Increase Between Rate Classes	Compare Tax Rate to Rate Class 13	Scenario Based on Employee Making at Least $14,000 Per Year
13	1.230%	19%	---	$172.20
14	2.160%	76%	76%	$302.40
15	2.400%	11%	95%	$336.00
16	2.660%	11%	116%	$372.40
17	2.960%	11%	141%	$414.40
18	3.290%	11%	167%	$460.60
19	3.650%	11%	197%	$511.00
20	5.400%	48%	339%	$756.00

Table 4.1 of our report contains a complete listing of all rate classes.

South Carolina law mandates how the rates are set for each class. We found DEW has not attempted to determine if the rate classes' tax rates are disproportionate to the amount each employer contributes to pay benefits and to replenish the Trust Fund. DEW indicated it does not accumulate the amount of benefits paid by rate class. This prevents DEW and others from comparing benefits paid with taxes collected and comparing the remainder of taxes collected by rate class with the amounts needed to reach Trust Fund solvency.

We recommend DEW accumulate data on the proportionality of UI tax rate classes, perform analysis, and provide the General Assembly with recommendations of possible changes to the tax rate methodology.

Ratio of Contingency Assessment to Trust Fund Contributions

As information to the General Assembly, we compiled the ratio of contingency taxes levied to Trust Fund taxes levied. We present ratios for a relatively wide range of taxes, by rate class. Appendix A of our report contains the full range of all rate classes for calendar years 2015–2019.

Ratios by Rate Class

Rate Class	Contingency	Trust Fund				
		2019	2018	2017	2016	2015
1*	$0	$0	$0	$0	$0	$0
2	$1	$5	$6	$7	$8	$9
10	$1	$11	$14	$16	$18	$20
12	$1	$14	$17	$20	$22	$25
13	$1	$16	$21	$23	$27	$48
19	$1	$50	$61	$67	$73	$90
20	$1	$90	$90	$90	$90	$100**

* Rate class 1 employers pay no Trust Fund tax; however, it is subject to the contingency assessment tax of 0.06%.

** Total taxes were higher in CY 2015; Trust Fund tax rate for rate class 20 was 5.97%, which is greater than the minimum state requirement of 5.4%, S.C. Code §41-31-50(1)(c). All years except 2015 were taxed at the minimum rate for rate class 20.

Treatment and Policy of Uncollectible Tax

DEW's policy for determining when a debt is uncollectible and booked as an allowance for doubtful accounts appears to have changed three times from FY 14-15 through FY 17-18, as indicated in the audited financial statements and a statement from a DEW official. The independent financial auditors issued the FY 17-18 statements citing:

- Incomplete records.
- Improper computing of the allowance for doubtful accounts.
- Unrecognized revenue from collection of bad debts.

The Office of State Auditor's reports on the Unemployment Compensation Fund for FYs 13-14, 14-15, 15-16, and 16-17 all made significant corrective adjustments to the allowance for doubtful accounts. This could help explain the increasing variances, which increased, then decreased only to increase again, as depicted in the table below.

Allowance for Doubtful Accounts and Amounts Written Off as Uncollectible

Fiscal Year	Gross Taxes Receivable	Allowance for Doubtful Accounts	Uncollectible Taxes Written Off *	Unemployment Rate in June
13-14	$161,999,288	$36,955,064	$3,834,066	6.4%
14-15	$162,233,383	$49,350,550*	$4,226,967	6.0%
15-16	$145,808,939	$33,399,262	$9,932,639**	5.1%
16-17	$142,859,858	$36,613,827	$5,257,201	4.3%
17-18	$142,327,444	$29,373,688	**	3.3%

* DEW was unable to account for the significant increase from the prior year.
** DEW did not provide documentation to demonstrate, with specificity, that the increase in write-offs was due to higher taxes in earlier years or for other reasons. Write-offs increased from $4.2 million in the previous year to $9.9 million.

Indicators of a Problem With Collections

The allowance for doubtful accounts increased by 10% from FY 15-16 to FY 16-17 at a time when the unemployment rate decreased 16% from 5.1% to 4.3%.

DEW has failed the collections portion of the tax performance system (TPS) audit since 2011, requiring a federally reported corrective action plan since 2013.

DEW's percentage of uncollectable receivables has exceeded the national aggregate by 2% or more from 2015 to 2018, as depicted in the chart.

DEW's tax receivables have been relatively stable from FY 15-16 through FY 17-18, as depicted in the table above, even though the UI rate has decreased 35% from 5.1% to 3.3% for that same period.

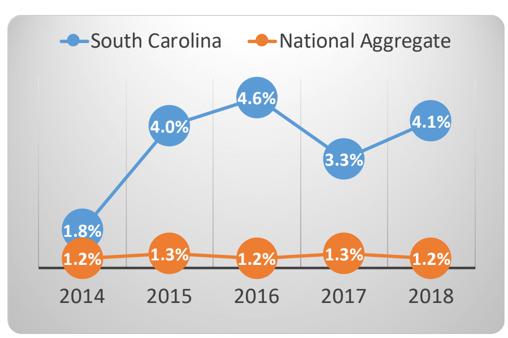
Also, Trust Fund taxes decreased:

14% 2015–2016
9% 2016–2017
9% 2017–2018

If the unemployment rate is decreasing, generally the economy is improving, it seems tax receivables would also decrease.

DEW came closest to meeting the national aggregate for accounts receivable collections in 2014.

Percentage of Uncollectible Receivables



Unemployment Overpayments and Fraud

Overpayments Collected

We found that, while the state's unemployment rate has decreased 34% from 6.5% in 2014 to 4.3% in 2017, DEW has had much larger decreases in its efforts to identify, and thus collect, overpayments. DEW has no documentation or meaningful analysis to demonstrate why these decreases have occurred. These decreases include:

- 93% in fraud overpayment cases identified from FY 14-15 to FY 17-18.
- 46% in non-fraud overpayment cases identified from FY 14-15 to FY 17-18.
- 65% in fraud alerts identified by its main in-house fraud software system from calendar years 2014 to 2017.
- 67% in non-fraud alerts identified by its main in-house fraud software system from calendar years 2014 to 2017.

DEW indicated the reductions were due to the agency's more effective case management and the use of technology and resource allocation.

Fiscal Year	Non-Fraud Overpayments	
	Number	Amount
14-15	13,538	$4,758,281
15-16	13,757	$4,952,845
16-17	8,441	$4,233,408
17-18	7,243	$4,391,190

Fiscal Year	Fraud Overpayments		
	Number	Amount	Change from Previous Year
14-15	13,436	$9,933,776	---
15-16	8,317	$6,977,036	-38%
16-17	5,459	$5,429,615	-34%
17-18	954	$1,298,993	-81%

However, it could provide no meaningful documentation such as before and after workload reports, overpayments averted, how the better technology works, better or more personnel deployment, etc.

Overpayments Discovered by DEW's Internal Computer System

Overpayment cases discovered declined 65.8% from 2014 to 2017, while the UI rate decreased 34%.

	Fraud		Non-Fraud		TOTAL	
	Number	Amount	Number	Amount	Number	Amount
2014	251	$517,393	156	$51,246	407	$568,639
2015	328	695,120	124	45,565	452	740,685
2016	299	468,602	160	62,909	459	531,511
2017	88	165,348	51	36,615	139	201,963
TOTAL	966	$1,846,463	491	$196,335	1,457	$2,042,798

Overpayments Recovered

DEW experienced significant declines in fraud and non-fraud overpayments recovered, 62.8% and 64.3%, respectively in FY 17-18 from FY 14-15 levels. Both fraud and non-fraud write-offs were significant in FY 14-15, with non-fraud write-offs totaling just over $262,000, and fraud totaling nearly $320,000.

DEW indicated it followed its policy when writing off the debt, which does not explain why the subsequent years' write-offs decrease to just a fraction of that amount in the next three years.

Fiscal Year	Non-Fraud Overpayments		
	Recovered	Waived	Written Off
14-15	$4,962,503	$85,717	$262,056
15-16	$5,174,203	$64,335	$3,736
16-17	$3,555,082	$76,340	$5,136
17-18	$1,772,390	$60,009	$1,219
DEW can waive cases that are no fault of the claimant.			

Fiscal Year	Fraud Overpayments	
	Recovered	Written Off
14-15	$7,714,473	$319,867
15-16	$9,850,064	$7,814
16-17	$7,388,552	$4,795
17-18	$2,873,967	$1,982

Lack of Prosecutions

DEW prosecuted 2 of 166 fraud cases in the last 4 years.

FY 14-15 = 0

FY 15-16 = 0

FY 16-17 = 2

FY 17-18 = 0

A DEW official stated DEW would rather focus its effort on collecting the money owed to the agency. However, collections have steadily diminished over the last three years. We think that increased and publicized prosecutions could have a better deterrent effect on unemployment fraud.

Status of Prior LAC Recommendations

DEW implemented 2 of 7 recommendations from our 2014 report that are relevant to DEW's reemployment activities for the purpose of putting people back to work. See our report for recommendations that were not implemented.

Recommendations Implemented

Recommendation 11

The Department of Employment and Workforce should promulgate regulations pursuant to the South Carolina Administrative Procedures Act regarding its minimum work search requirements.

Recommendation 27

The Department of Employment and Workforce should develop policies and procedures governing its redesigned Wagner-Peyser service delivery model that allows users in the workforce center and in the main office to access key information necessary for implementation. At a minimum, the manual should include information on staffing and procedures for identifying and assisting those with barriers to employment.

UMEMPLOYMENT INSURANCE PROGRAM

We reviewed DEW's seven core federal Unemployment (UI) performance measures. We found DEW consistently met all of them, except one, for federal fiscal years (FFY) ended September 2016 and September 2017. However, after the implementation of the Southeastern Consortium Unemployment Benefit Initiative (SCUBI), DEW's new UI system, the agency missed several timeliness and quality performance standards for FFY September 2018 and several more in the 2nd and 3rd quarters of 2018.

DEW attributed the missed standards to the implementation of SCUBI. We found DEW has no adequate system in place to address improving performance—no comprehensive plan that provides analysis and remedial action steps nor training designed to address missed performance measures.

Also, DEW did not document potential savings resulting from the implementation of SCUBI despite its claims savings would be realized in FY18-19, according to the agency budget plan.

FEDERAL UI PERFORMANCE MEASURES NOT MET

FIRST UI CLAIMS PAYMENT PROMPTNESS
87.0% Federal Standard
82.1% DEW Performance (FFY 9-30-2018)

TIME LAPSE OF NONMONETARY UI DETERMINATIONS
80.0% Federal Standard
75.4% DEW Performance (FFY 9/30/18)
73.8% DEW Performance (2nd quarter 2018)

QUALITY OF NONMONETARY EMPLOYMENT SEPARATIONS
75.0% Federal Standard
71.6% DEW Performance (FFY 9/30/18)
71.0% DEW Performance (2nd quarter 2018)
62.1% DEW Performance (3rd quarter 2018)

AVERAGE AGE OF PENDING LOWER AUTHORITY APPEALS
30 days Federal Standard
37 days DEW Performance (2nd quarter 2018)

DISCHARGE FOR CAUSE

There are insufficient criteria, in state law and in DEW's policy, for determining discharge for cause that does not rise to the level of the other misconduct categories—misconduct and gross misconduct. Approximately 66% of reversals that occurred during the appeals process to the Administrative Law Court involved disagreements between the appellate tiers regarding terminations for cause. Better criteria could result in fewer appeals and workload for DEW as well as more consistent decisions provided, which may improve fairness to claimants.

MISCONDUCT PENALTIES

Employee discharges for misconduct carry greater unemployment disqualification penalties than gross misconduct, although the terms imply the opposite.

To requalify for benefits, an employee discharged for misconduct has a penalty that requires a minimum of 12 *months* to requalify for benefits. An employee discharged for gross misconduct has a penalty that requires a minimum of 8 *weeks* to requalify for benefits. We recommend penalties be more consistent with the severity of the infractions and the related terminology.

Repeat Operational Issues

We are in a position to evaluate some of the operational issues that we repeatedly encountered having conducted three previous management reviews of DEW.

A Management Review of the South Carolina Employment Security Commission (2010)

A Management Review of the Department of Employment and Workforce (2012)

A Management Review of the Department of Employment and Workforce (2014)

Below we list repeat fundamental operational issues where some deficiencies persist.

Fraud Prosecution

2010

ESC referred for prosecution approximately $98,000 (less than 1%) of approximately $10.2 million in fraudulent overpayments from FY 06-07 and FY 07-08. ESC had stopped referring claimants for criminal prosecution and the last cases referred for prosecution were in February 2008. Claimants defrauded the agency out of $7.3 million.

2019

DEW has essentially stopped prosecutions for fraud, having prosecuted only 2 cases from FY14-15 through FY 17-18.

> We found a myriad of process, organizational, or operational problems that may not appear of great importance at this time of low unemployment. However, when the agency is under stress during periods of high unemployment or full economic recession, these deficiencies may affect operations and contribute to failures in the delivery of timely and quality service.

Reemployment Activity

2010

ESC does not track claimants who are most likely to exhaust benefits to determine if they have obtained employment. Also, DEW has not measured the effectiveness of its federally required Worker Profiling and Reenactment Services system, which requires agencies to use a system to identify claimants who are most likely to exhaust benefits.

2019

The performance measures used by DEW do not capture the effectiveness of its reemployment programs.

Accounting Issues

2010

External auditors cited ESC for not maintaining accounting records in accordance with Generally Accepted Accounting Principles (GAAP) and considered it a "material weakness." The weaknesses cited by the auditors included that the agency did not properly post adjusting entries, maintain complete trial balances, and recognized revenue in the wrong year.

2019

External auditors identified six material weaknesses in the audit of the unemployment Trust Fund for FY 17-18. DEW has failed its Tax Performance System reviews since 2011, requiring corrective action plans for USDOL. Also, DEW has not implemented recommendations from an independent consulting firm for improvement of financial operations and has stated it has no interest in doing so. Lastly, DEW is double keying some of its financial information into both SCEIS, the states accounting system and FARS, its legacy accounting system, and has not sought a solution to this problem since 2016. The Department of Administration has indicated it could create software to solve the assertion by DEW that SCEIS does not properly handle grant spending.

FOR MORE INFORMATION

Our full report,
including comments from
relevant agencies,
is published on our website.
Copies can also be obtained by
contacting our office.

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SCOPE IMPAIRMENT

Generally Accepted Government Auditing Standards (GAGAS), as listed in the U.S. Government Accountability Office's (GAO) Government Auditing Standards publication, requires that we report significant constraints imposed upon the audit approach that limit our ability to address audit objectives. The limitations noted in this audit that constituted a scope impairment include:

- Both denials and excessive delays of access to records, particularly source documents, and cogent, on-point explanations.
- Significant delays in receiving information that should be readily available.
- Responses to inquiries that were unclear, vague, or otherwise insufficient.
- Multiple requests for one piece of information.

We experienced significant delays in receiving the documentation we needed to conduct the audit. The average turnaround time for data requests was 37 days from request to receipt.

TIME TO FULFILL REQUESTS FOR INFORMATION	NUMBER OF INSTANCES
0–9 days	33
10–29 days	34
30–99 days	30
100+ days	10

Although we were eventually able to complete most of the work necessary to meet the audit objectives, these constraints significantly delayed the completion of the report.