

An Audit Report on

The Unemployment Insurance Program at the Texas Workforce Commission

September 2005

Report No. 06-008



The Unemployment Insurance Program at the Texas Workforce Commission

Overall Conclusion

The Texas Workforce Commission (Commission) has done a good job of employing national best practices designed to prevent and detect unemployment insurance overpayments and to prosecute fraud. These best practices and other aggressive actions have resulted in the following:

- The Commission has increased the number of cases referred for prosecution from just 3 cases in 2000 to 223 cases in 2004.
- According to the U.S. Department of Labor, the Commission's overall overpayment rate dropped 4.4 percent between 2003 and 2004. The national overpayment rate increased by 0.6 percent during that time.

The Commission's efforts have resulted in the U.S. Department of Labor's considering Texas as a leader among state workforce agencies.

Furthermore, these best practices enable the Commission to comply with the Governor's Executive Order Relating to Preventing, Detecting, and Eliminating Fraud, Waste and Abuse.

The Commission has opportunities to further reduce and better track overpayments:

- Inadequate responses by many Texas employers to the Commission's information requests cost the Unemployment Insurance Trust Fund (Fund) approximately \$9.9 million in overpayments and appeals processing costs during calendar year 2004.
- The Commission's Benefits Payment Control System (BPC Subsystem) does not adequately track overpayments.

About the Unemployment Insurance Program

In the year ended September 30, 2004, the Commission reported it paid \$1.79 billion on 932,496 unemployment insurance claims. A payroll tax on Texas's employers is the primary source of funding.

Because of a large deficit in the Unemployment Insurance Trust Fund (Fund) in September 2003, the Commission sold bonds to help fund the program. At the time, the Fund had a balance of negative \$348 million. Issuing the bonds allowed the Commission to deposit \$1.38 billion into the Fund without significantly increasing the unemployment tax rate. As of June 28, 2005, the bonds outstanding totaled \$1.02 billion, and the Fund had a balance of \$1.3 billion. The bonds are scheduled to be paid off in 2009. See Appendix 2 for more information.

Summary of Management's Responses

The Commission generally agrees with our recommendations.



Summary of Information Technology Review

As mentioned above, the BPC Subsystem does not adequately track overpayments. In addition, a history of weak controls over direct changes to the Unemployment Insurance Benefits System's (UI Benefits System) database increases the risk that corrupt data may exist in the database. However, the UI Benefits System has adequate controls to ensure that it accurately calculates benefits.

The Commission has a sound process for granting outside entities their initial access to unemployment data, and it has taken action to address the number of inactive accounts with access to the data. However, it can further improve its ongoing administration of the access it gives to outside entities.

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Detailed Results

Chapter 1

The Commission Has Done a Good Job of Employing National Best Practices Designed to Prevent and Detect Overpayments and Prosecute Fraud

In July 2004, the Governor of Texas issued the Governor's Executive Order Relating to Preventing, Detecting, and Eliminating Fraud, Waste and Abuse

Excerpt from Governor's Executive Order RP36

The Commission shall assess the efforts to identify and implement national best practices for:

- Detecting and prosecuting fraudulent schemes,
- Identifying cost-effective strategies designed to eliminate fraud,
- Reducing benefit payment inaccuracies, and
- Increasing recovery of claims overpayments and employer delinquent accounts.

Appendix 3 contains the portion of the executive order that relates to the Commission.

(RP36; see text box). The Texas Workforce Commission (Commission) has done a good job of employing national best practices designed to prevent and detect overpayments and prosecute fraud since before the Governor's executive order was issued. Because of these best practices and other aggressive actions to reduce overpayments and eliminate fraud, the Commission increased the number of cases referred for prosecution from just 3 cases in 2000 to 223 cases in 2004 (see Figure 1).

Since implementing these changes, the Commission has seen a significant drop in overpayments caused by claimants failing to look for work. Estimates by the Commission's Statistical Sampling Department show that overpayments caused by work-search issues dropped from 39.2 percent of

all overpayments in 2003 to 22.3 percent in 2004. For the same period, the U.S. Department of Labor reports that the Commission's overall overpayment rate dropped 4.4 percent, while the national overpayment rate increased by 0.6 percent.

Figure 1: Since 2000, the Commission has increased the number of fraud cases referred for prosecution.



Source: Texas Workforce Commission

The Commission reports that in calendar year 2004, it made \$271 million in unemployment insurance overpayments. This represents approximately 16 percent of all unemployment benefits paid during 2004. However, overpayments caused by Commission errors represent only \$66 million, or 4 percent, of the total payments made.

To continue these and other efforts designed to detect fraud and prevent overpayments, the Commission stated in a March 2005 internal report that it had pursued and obtained \$1.2 million in supplemental budget grants from the U.S. Department of Labor. As a result of the Commission's efforts, Texas is considered a leader among state workforce agencies in implementing best practices. The Commission's best practices include participating in two national pilot projects and increasing its efforts to verify claimants' attempts to find work, which is a condition of receiving benefits.

National New-Hire Cross-Match Pilot Project. The Commission was one of three that participated in a federal pilot project comparing unemployment insurance recipients against the National Directory of New Hires (National Directory). The National Directory is a database of information on all newly hired employees, quarterly wage reports, and unemployment insurance claims in the country. According to the Commission, using the national cross-match along with the statewide cross-match helped detect 50 percent more cases of potential fraud in one quarter than it would have detected otherwise. The U.S. Department of Labor Inspector General states that this cross-match identifies overpayments earlier, reduces overpayment dollars, and increases the chance of overpayment recovery.¹ The purpose of these cross-matches is to identify people who work and draw unemployment insurance benefits at the same time. Although part-time workers may qualify for reduced benefits, full-time workers are not eligible to receive benefits.

Because this was a pilot project, the federal agencies responsible for the National Directory wanted the participating states to use the results only to formulate recommendations regarding the cross-match. Per its agreement with the federal agencies, the Commission could not pursue the potential fraud cases it identified using the cross-match during this pilot project. However, the U.S. Department of Labor would like all states to begin using the National Directory by October 2005. The responsible federal agencies are currently preparing a memorandum of understanding for participating states that will include provisions for charging states to access the information.

States currently use the National Directory to locate noncustodial parents and enforce child support orders. With the advent of the national new-hire cross-

¹ U.S. Department of Labor – Office of Inspector General, *Unemployment Insurance Benefit Payment Control - New Hire Detection Is a Better Method for Establishing UI Overpayments than the Wage/UI Benefit Crossmatch*, September 30, 2004 (Report Number: 05-04-002-03-315).

match, states will also be able to use the National Directory to detect unemployment insurance fraud. In addition to the National Directory, federal law requires states to operate state directories of new hires. Employers must report new hires to their respective state directories within 20 days; states then transmit their new-hire data to the National Directory. However, employers with locations in multiple states can report all new hires to the state of their choice. Until the Commission participated in the national new-hire cross-match pilot, it relied on cross-matches made against Texas's state directory, which left it unable to detect unemployment insurance claimants recently hired by companies that report to out-of-state directories.

State Unemployment Tax Dumping Pilot Project. Beginning in September 2004, the Commission participated in a national pilot program sponsored by the U.S. Department of Labor that tested new software designed to detect a type of potential fraud called State Unemployment Tax Act (SUTA) dumping. Through the pilot project, the Commission was able to identify more than \$63 million in potential savings per year.

“SUTA dumping” is the term used to describe some employers’ practice of manipulating state unemployment experience-rating systems so that they pay lower state unemployment taxes than their unemployment experience would otherwise allow. Under experience-rating systems, states base employers’ unemployment tax rates on the amount of unemployment compensation paid to former employees. The more unemployment compensation the Commission has paid to a company’s former employees, the higher the company’s tax rate, up to a maximum established by state law. Experience rating helps ensure an equitable distribution of unemployment insurance costs among employers and encourages employers to stabilize their workforces. SUTA dumping undermines these purposes.

Most frequently, SUTA dumping involves merger, acquisition, or restructuring schemes, especially those involving shifting of workforce or payroll. The following scenarios describe how an employer can escape its high unemployment tax rates caused by a history of former employees who have received unemployment insurance:

- An employer sets up a shell company. Once the shell company has earned a low unemployment tax rate, the employer transfers some or all of its workforce (and the accompanying payroll) to the shell company. The Commission then taxes the transferred payroll at the shell company’s lower rate.
- An employer that is just starting a business purchases an existing small business with a low unemployment tax rate. Instead of being assigned the higher rate for new employers, the entity receives the existing business’s lower rate.

The software used on the national pilot project has the capability to track employees and employers to determine whether employers are shifting employees to shell companies to receive a lower tax rate. The software even has the capability to track individual employees within a company. Once the software identifies a possible SUTA dumping transaction, the Commission can investigate further.

For example, the software helped the Commission identify a company with a tax rate of more than 2 percent that had shifted employees from its payroll to the payroll of a subsidiary that had a tax rate of 0.36 percent. However, the Commission could not take action against the company because, prior to September 1, 2005, Texas law did not prohibit SUTA dumping. To remedy this situation, the 79th Legislature passed House Bill 3250, which makes it a Class A misdemeanor for companies to participate in SUTA dumping and imposes penalties for violating the law. The Governor signed the bill into law, and it became effective September 1, 2005. Under the new law, a company that participates in SUTA dumping, such as the one in the above example, could face penalties in an amount equal to 2 percent of its wages for the year in which the violation occurred.

Work-Search Verifications. In December 2003, the Commission changed its rules to require unemployment insurance recipients to contact at least three employers per week in their efforts to find employment. Local workforce boards may adjust the number of required contacts based on the job markets in their regions. Under the rule, if claimants do not comply with the work-search requirements, they may lose their eligibility for continued benefits.

In February 2004, the Commission's executive director mandated that the Commission verify 1,000 claimants' efforts to find work each week. As of March 2005, the Commission had increased the verifications to 1,500 per week. To accomplish this, the Commission requests logs of work-search efforts from a random sample of unemployment insurance recipients. Employees from every division, including executive management, sample and verify one recipient's work-search efforts every week. The verification process includes calling employers listed on the claimant's log of work-search efforts to confirm application for employment. If the employer does not verify the claimant's work search, and the claimant cannot provide additional information proving he or she made the contact, then the Commission denies further benefits.

According to the Commission, from March to May 2005, its employees verified 18,500 contacts with employers that claimants had reported on work-search logs. The Commission found that 1,439 (7.8 percent) of the claimed work-search contacts were unacceptable, including 24 instances of potential fraud.

The Commission Can Further Reduce Overpayments

As discussed in Chapter 1, the Commission has reduced the number of overpayments that result when a claimant does not meet the Commission's work-search requirements. However, the Commission can further reduce overpayments by addressing employers' inadequate responses to the Commission's claim notices and by reporting to the Office of the Comptroller of Public Accounts (Comptroller's Office) those individuals who have not repaid their overpayments.

Chapter 2-A

The Commission Can Reduce Overpayments to Unemployment Insurance Claimants by Encouraging and Educating Employers to Respond Appropriately to Claims Notices

Inadequate responses by many Texas employers to the Commission's information requests cost the Unemployment Insurance Trust Fund (Fund) approximately \$9.9 million in calendar year 2004. Portions of the unemployment insurance taxes that nearly all Texas employers pay into the Fund cover these avoidable costs. There is no direct financial consequence for employers that provide incomplete or inadequate responses.

When an individual applies for unemployment insurance benefits, the Commission reviews why the claimant is no longer working and whether he or she is eligible for benefits. As part of the review, the Commission sends the claimant's last employer a notice of the claim. The Texas Labor Code requires the employer to respond to the claims notice within 14 days and include in the response any facts that may adversely affect the claimant's right to benefits. For example, a claimant may be ineligible for benefits if he or she:

- Was dismissed for misconduct on the job
- Voluntarily quit a job without good cause attributable to the employer

Overpayments often occur when an employer provides little or no information in its response to a claims notice to explain why it terminated the claimant. Inadequate information can lead the Commission to rule incorrectly in the claimant's favor and begin paying unemployment benefits. If the employer then appeals the ruling and provides the needed information to win a reversal, the Commission must attempt to collect from the claimant all the benefits he or she received before the reversal. Employers' failure to promptly provide needed information caused an estimated \$17.4 million in overpayments in 2004. Of that total, the Commission will collect only an estimated \$8.2 million, or 47 percent, leaving a \$9.2 million loss that all Texas employers must bear. In addition, the appeals process that led to reversals after

inadequate initial responses from employers cost approximately \$700,000 in 2004.

Employers have little incentive to report within the initial 14-day reporting period any facts that may adversely affect a claimant's right to benefits. If an employer does not respond at all within 14 days, it can lose its right of appeal. However, if it responds with a statement that it wishes to retain its right of appeal but provides no further information, the Commission allows it to retain that right.

The Commission has recognized that inadequate employer responses are a costly problem. In July 2005, the Commissioner Representing Employers wrote to 17 of the state's largest employers, encouraging them to provide all necessary information in their responses to claims notices. However, guidance for employers on the Commission's Web site still encourages employers to respond with a simple statement such as "We protest. More information to follow later." While such a statement preserves the employer's right to appeal, it does nothing to help the Commission avoid the appeals process.

Recommendations

The Commission should:

- Revise Commission rules or seek legislation that would allow it to hold individual employers financially liable for overpayments caused by inadequate or incomplete responses.
- Continue to educate employers through:
 - ♦ Correspondence targeted at employers with the worst records of responding to claims notices.
 - ♦ Training aimed at educating all employers of the need to respond promptly to claims notices with adequate information.
- Revise Commission rules or seek legislation that would allow it to encourage complete responses from employers by removing the right of appeal for those employers that choose to return incomplete responses that do not include facts that may adversely affect the claimant's right to benefits.

Management's Response

Management concurs with the recommendations with the following exceptions:

- *The Commission does not believe it can implement rules to hold individual employers financially liable for overpayments caused by inadequate or incomplete responses, because sufficient statutory authority does not currently exist upon which such rules could be based. The Commission believes that if it were to implement such rules, it would be unlikely to prevail in a legal challenge. Therefore, to implement this recommendation, statutory changes will be necessary. The Commission will consider this in their legislative packet for the next session.*
- *The Commission will continue to educate employers to the benefits of timely and complete responses to claims notices.*
- *The Commission does not believe it can implement rules encouraging complete responses from employers by removing the right to appeal for those employers that choose to return incomplete responses that do not include facts that may adversely affect the claimant's right to benefits, because statutory authority does not currently exist upon which such rules could be based. The Commission believes that if it were to implement such rules, it would be unlikely to prevail in a legal challenge. Therefore, to implement this recommendation, statutory changes will be necessary. The Commission will consider this in their legislative packet for the next session.*

Chapter 2-B

The Commission Is Not Reporting Individuals with Outstanding Overpayments to the Comptroller's Office as Required by State Law

The Commission is not taking advantage of "warrant hold" procedures offered by the Comptroller's Office to stop all payments from state agencies and universities to individuals with outstanding unemployment benefit overpayments. Using these warrant hold procedures, which are intended to help the State collect delinquent debts and taxes, would provide those individuals with an additional incentive to repay the Commission.

Texas Government Code, Section 403.055(f), requires state agencies to report to the Comptroller's Office the names of individuals who are indebted to the State. In addition, it requires agencies to use the procedures offered by the Comptroller's Office to ensure that the State does not make payments to individuals who already owe the State money.

The Commission states that it has not complied with Section 403.055(f) because the automated Benefit Payments Control System (BPC Subsystem) does not properly age outstanding overpayments. (See Chapter 3 for more information on the BPC Subsystem.) As a result, it does not automatically identify and report all overpayments outstanding for a set number of days, such as 120 days. In addition, the BPC Subsystem is not set up to report the information. The Comptroller's Office allows agencies to report the information by either electronic file transfer or online entry.

According to the Commission, it has undertaken a project to redesign the BPC Subsystem that will include making corrections allowing the BPC Subsystem to report outstanding overpayments to the Comptroller's Office.

Recommendations

The Commission should:

- Include procedures in its redesign of the BPC Subsystem to ensure that it will:
 - ♦ Age outstanding overpayments.
 - ♦ Electronically report outstanding accounts to the Comptroller's Office.

While it is completing the BPC Subsystem redesign, the Commission should implement a process that will allow it to comply with the requirements of Texas Government Code, Section 403.055(f), and report individuals with outstanding overpayments to the Comptroller's Office using online entry.

Management's Response

Management concurs with the recommendation to include in the BPC Subsystem redesign the ability to age outstanding overpayments and to electronically report outstanding overpayment accounts to the Comptroller's Office. This functionality is included in the requirements and scope approved for the subsystem redesign and is estimated to be in operation by December 2006.

Management concurs with the recommendation that until an automated process is created to report overpayments to the Comptroller, that another process should be implemented to report the overpayments. Therefore, on a go-forward basis, as overpayments are worked by collections staff, those accounts that meet the criteria for reporting to the Comptroller will be manually reported.

The Commission Should Continue Its Efforts to Correct Weaknesses and Inefficiencies in Its Automated Systems

A history of weak controls over direct changes to the Unemployment Insurance Benefits System's (UI Benefits System) database increases the risk that corrupt data may exist in the database. In addition, the Benefit Payment Control Subsystem (BPC Subsystem) does not adequately manage and track overpayments. However, the UI Benefits System has adequate controls to ensure that it accurately calculates benefits.

The Commission has a sound process for granting outside entities initial access to unemployment data, and it has taken action to address the number of inactive accounts that have access to the data. However, it can further improve its ongoing administration of the access it gives to outside entities.

Chapter 3-A

Weaknesses in the Commission's Automated Systems Limit Their Usefulness

There is a risk that corrupt data may exist in the UI Benefits System database without the Commission's knowledge. In addition, the BPC Subsystem, which is a part of the UI Benefits System, has not adequately managed unemployment benefit overpayments since the Commission implemented it in 1996. However, the UI Benefits System has adequate controls to ensure that it accurately calculates benefits.

The Commission has recognized the limitations in the BPC Subsystem and has taken the initiative to remedy the problems through a project to redesign the system. The new project is a joint effort between executive management, system users, and information technology personnel. The Commission is identifying system flaws, prioritizing their remediation, and developing a project plan.

The UI Benefits System's database is at risk of having corrupt data. The Commission is unable to identify or quantify the extent to which its history of direct modifications of operational data and weak "referential integrity" controls has compromised the UI Benefits System's underlying database. The Commission does have a process for quantifying the level of errors in data associated with unemployment insurance overpayments. However, it has not used available tools to identify all significant inconsistencies, including those not related to overpayments, among the records in the UI Benefits System's various database tables.

After the Commission implemented the UI Benefits System in 1996, some users were able to circumvent normal input controls and directly modify

operational data. This control weakness existed for five years before the Commission removed users' ability to modify operational data, thus leaving only programmers with this capability. Consequently, some changes made to the data during those years were not subjected to the edit checks and other controls built into the UI Benefits System, and those changes may still be in the data the Commission uses today. Edit checks include automated controls that prevent users from making errors such as entering letters in the telephone number field. Input controls such as this help maintain the integrity of information, which is essential to the Commission's operations.

Although the Commission limited users' ability to circumvent controls and modify operational data, the Commission's programmers continue to use this capability on a routine basis. Regularly allowing programmers to modify operational data increases the risk of data corruption and unforeseen side effects. Directly modifying operational data in this manner should occur only in emergencies. The Commission depends upon its operational data for making decisions regarding unemployment claimants and benefits.

Adding to the risk is the fact that the Commission does not use the UI Benefits System's built-in control features for ensuring that data is internally consistent. When these "referential integrity" controls are working as intended, deleting or updating a record in one database table triggers the same action to all records in other tables that are linked to the record that was changed. The Commission asserts that using the referential integrity controls

hinders the UI Benefits System's processing performance. To compensate, the Commission's programmers have added automated controls to the individual programs that interface with the UI Benefits System. However, this approach requires the Commission to depend on its programmers, rather than the UI Benefits System, to ensure that changes they make in one database table trigger the appropriate action in all related tables.

The BPC Subsystem does not properly track multiple overpayments. The BPC Subsystem has problems tracking the causes of overpayments when an individual claimant receives more than one overpayment (see text box). As a result, Commission investigators may not have correct information when trying to advise claimants and collect overpayments. Commission employees must use a cumbersome, manual process to track each overpayment separately.

Example of Multiple Overpayments to One Claimant

Initial overpayment: A claimant initially qualifies for benefits and receives a payment. The claimant's last employer appeals and, based on new evidence, the Commission finds the claimant ineligible for benefits. The initial payment is now considered an overpayment. The claimant appeals the ruling, which can take up to several months to resolve. The Commission cannot attempt to collect the overpayment until the claimant's appeal is finalized, so the overpayment is, in effect, on hold.

Subsequent overpayment: While the claimant appeals the decision regarding the initial payment, he or she applies for and receives additional benefit payments every two weeks. However, the Commission subsequently identifies that the claimant did not meet work search requirements during one of the two-week periods. The corresponding benefit payment is an additional overpayment that the Commission needs to collect from the claimant.

Recommendations

The Commission should:

- Complete a cost-benefit analysis comparing the cost of continuing with redesigning the BPC Subsystem with the cost of replacing the entire UI Benefits System. If, based on this cost-benefit analysis, the Commission chooses to move forward with the redesign project, it should ensure that the redesigned BPC Subsystem includes a separate table to handle multiple overpayments to a single claimant.
- Develop policies to ensure that Commission programmers rarely bypass system controls to perform direct data modifications in the UI Benefits System.
- Perform a complete assessment of the UI Benefits System's database integrity and, if necessary, take steps to improve its integrity.

Management's Response

Management concurs with the recommendation of completing a cost benefit analysis. The BPC subsystem is one of twelve subsystems that comprise the Benefits System. The BPC project is anticipated to:

- *Increase the number of cash refunds collected by automating workflow;*
- *Increase BPC staff efficiency by improving workflow; and*
- *Increase staff efficiency by eliminating excess time researching and updating overpayment data.*

Initial estimates indicate the payback period to be 3 years or less. A more fully developed cost benefit analysis will be prepared and placed on file.

The Benefits Re-write project in 1996 cost approximately \$20 million including both contractor and state costs. Other states' budgets for complete Benefits redesigns are \$30 million or more, not including agency staff time. Due to the fact that the other eleven subsystems in the Texas Benefits system work well, it appears that a total system rewrite would not be fiscally prudent.

Management concurs with the recommendation that the Commission develop policies to ensure that Commission programmers rarely bypass system controls to perform direct data modifications in the UI Benefits System.

Management concurs with the recommendation that the Commission perform an assessment of the UI Benefit System's database integrity and, if necessary, take steps to improve its integrity. TWC will create programs to compare data and identify any relationships that violate referential integrity. TWC will

write programs for areas where evidence of data integrity problems exists and will take corrective action to improve data integrity.

Chapter 3-B

The Commission Can Improve Its Administration of Access to Unemployment Insurance Data by External Users

The Commission can improve its ongoing administration of the accounts that external entities use to access its unemployment insurance data and its monitoring of these external entities' interactions with the data. Doing so will help limit access to only those who have a valid need. It will also protect the data, which contains confidential information about recipients of unemployment insurance, from unauthorized use. The Commission gives access to external entities, such as state, federal, and local governments, that need unemployment insurance data to carry out their operations. For example, the Texas Department of Insurance uses wage records and employer information when investigating insurance fraud.

While the Commission needs to improve some aspects of the access it provides to external entities, it has established a sound process for granting these entities their initial access. In addition, recent Commission actions have helped it reduce the number of dormant accounts held by external users.

The Commission can improve its ongoing administration of external entities' access to unemployment insurance data. Auditors noted the following weaknesses:

- External entities that have access to Commission data typically do not tell the Commission when their users terminate employment.
- The Commission does not periodically re-evaluate or review external entities' access rights to verify that they still need access.

These weaknesses could allow users and entities that no longer have a valid need for the data to gain unauthorized access to it. Accessing the Commission's information (such as wage records) for non-business reasons is a violation of law. Furthermore, Title 1, Texas Administrative Code, Section 202.25, requires that users' access be terminated or adjusted when the users terminate employment or change job duties. The section also applies to external entities that are given access to an agency's data.

The Commission can make better use of the log it keeps of the times that external users access its unemployment insurance data. The Commission does not regularly review this log. Rather, it reviews the log when investigating individual complaints of irregularities. These targeted reviews have helped it identify three cases since August 2004 in which individual external users abused their access rights.

Regular reviews of the log may not help the Commission identify additional cases of single access abuse because of the large number of times the data is accessed; however, it could help the Commission identify large-scale abuses. For example, while reviewing the log for another reason, the Commission identified that an external user had accessed the data more than would be expected. This activity turned out to be for valid business reasons, but this example illustrates the benefit of regularly reviewing the log.

The Commission has a sound process for granting external entities access to unemployment insurance data. Before they can access the Commission's data, external entities must sign a formal contract disclosing how they will use the data they want to access and citing their legal authority for obtaining the data. The contract also contains provisions that help protect data confidentiality, such as requiring external users to agree to:

- Sign an information security agreement and agree to confidentiality requirements.
- Comply with a data security policy.
- Use the data or access for official business only.

In addition, the Commission issues individual accounts to users within external entities instead of group accounts, which helps ensure that only authorized personnel have such access.

Recent Commission actions have helped reduce the number of inactive accounts with access to its data. In response to a March 2005 State Auditor's Office report (*State of Texas Financial Portion of the Statewide Single Audit Report for the Year Ended August 31, 2004*, SAO Report No. 05-555, March 2005), the Commission recently made the following improvements to the way it controls access to the sensitive automated data within its control:

- The Commission reviewed 32,110 user accounts that had non-expiring passwords and eliminated about 98 percent of the accounts. Some of these accounts had not been used since 1992.
- The Commission adopted a policy of disabling access for external users who have not used their account in 90 days, and deletes accounts that have not had activity for 180 days.

Recommendations

The Commission should:

- Confirm the access rights of external users with the external entities' management at least annually and make changes as needed. Also, require

that the external entities complete their confirmations of user access rights in a timely manner as a condition of continued access.

- Regularly review its log of external entities' accessing of unemployment insurance data, identify and investigate potential abuse, and report investigation outcomes.
- Require external entities with access to Commission data to notify the Commission when users terminate employment.
- Consider implementing an automated process to disable accounts held by users whose employment with external state agencies is terminated, based on records in statewide human resources systems.

Management's Response

Management concurs with the recommendation that TWC annually confirm external user's access rights. The following actions have been taken to implement this recommendation:

TWC is preparing reports for mainframe security "RACF" Managers that will facilitate the annual review of user access rights, including those of external users. As TWC renews agreements with external parties, the agency will add language that requires external entities to confirm user access rights in a timely manner.

Management concurs with the recommendation that a regular review of the log of external entities' accessing of unemployment insurance data, identify and investigate potential abuse, and report investigation outcomes be conducted. TWC is evaluating the tools necessary to identify and report on unusual and suspect activity that merits investigation. Due to the size of the log of external entities' access to unemployment insurance data, the agency does not believe that manual review would be feasible.

Management concurs with the recommendation that external entities with access to Commission data be required to notify the Commission when users terminate employment. TWC will add appropriate language to all agreements with external parties as the agreements are renewed. This contract language has already been added to the Resource Agreements with the Local Workforce Boards, which constitute a material percentage of external users.

Management concurs with the recommendation that an automated process be established to disable accounts held by users whose employment with external state agencies is terminated, based on records in statewide human resource systems. TWC is investigating the feasibility of implementing this recommendation. It should be noted that few external entities enter the user's

social security number into TWC's RACF security system, which will inhibit the agency's ability to identify the users whose employment has been terminated.

Appendices

Appendix 1

Objectives, Scope, and Methodology

Objectives

The objectives for this project were to:

- Assess the Texas Workforce Commission's (Commission) efforts to identify and implement national best practices for detecting and prosecuting fraudulent schemes, identifying cost-effective strategies designed to eliminate fraud, reducing benefit payment inaccuracies, and increasing recovery of claims overpayments and employer delinquent accounts, as directed by the Governor's executive order issued July 12, 2004, relating to preventing, detecting, and eliminating fraud, waste, and abuse.
- Determine if the Commission has implemented a comprehensive process that results in accurate benefit determination and avoidance of improper disqualification or denial of benefits.

Scope

The scope of this audit covered activities related to the Commission's unemployment insurance program during fiscal years 2004 and 2005, including the:

- Intake, investigation, and payment of unemployment insurance claims.
- Tracking and collection of overpayments to unemployment insurance claimants.
- Identification and implementation of best practices to reduce fraud in the unemployment insurance program.

The scope also included a review of the automated systems the Commission relies upon to take in, investigate, and pay unemployment insurance claims.

Methodology

Our methodology included collecting and reviewing information and documentation, performing selected tests, analyzing and evaluating the results of testing, conducting interviews with Commission management and staff, and conducting interviews with other government agency personnel.

Information collected and reviewed included the following:

- Texas Administrative Code and federal labor laws
- Texas Government Code
- Interviews with Commission management and staff, Governor's Office staff, and U.S. Government Accountability Office staff
- Commission policies and procedures and U.S. Department of Labor requirements
- External unemployment insurance Web sites, including those maintained by the American Federation of Labor and Congress of Industrial Organizations (AFL-CIO) and the U.S. Department of Labor
- Various Commission reports, including internal audit reports, Benefit Accuracy Measurement reports, and other reports related to unemployment insurance and state unemployment tax (SUTA) dumping

Procedures and tests conducted included the following:

- Tested input, processing, and output controls for information technology systems
- Tested the input, processing, and output controls for Unemployment Claim Services' at the Commission's Austin Tele-Center
- Tested the Benefit Accuracy Measurement Unit's testing of paid and denied claims
- Analyzed overpayments by cause
- Analyzed the national cross-match database pilot project results and the state monthly new-hire cross-match results
- Analyzed the results of the SUTA dumping detection program, which included viewing a demonstration of the software designed to identify potential SUTA dumping actions
- Attended weekly meetings of the Benefit Accuracy Measurement unit and the Commission's governing board

Project Information

This audit was conducted in accordance with generally accepted government auditing standards. Fieldwork was conducted from May to July 2005 by the following members of the State Auditor's staff:

- Walton Persons, CPA (Project Manager)
- Joe Curtis, CPA, CIA (Assistant Project Manager)

- Bev Bavousett, CPA
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Bonds Issued to Finance Unemployment Insurance Benefits

On September 25, 2003, the Texas Workforce Commission (Commission) issued \$1.38 billion in bonds to finance the unemployment insurance program. It deposited the proceeds into the Unemployment Compensation Trust Fund (Fund). As of June 28, 2005, the bonds outstanding totaled \$1.02 billion, and the Fund had a balance of \$1.3 billion. The bonds are scheduled to be paid off in 2009.

The Commission issued the bonds to:

- Replenish the Fund. Texas law requires the Commission to levy a deficit tax if the balance in the Fund falls below 1 percent of the State's total taxable wages, or approximately \$740 million. Before the sale of the bonds, the balance in the Fund was negative \$348 million.
- Repay advances received from the federal government. Upon receipt of the bond proceeds, the Commission returned \$292 million to the federal government that the Commission had borrowed to make unemployment insurance benefit payments. This repayment allowed the Commission to avoid \$7.8 million in interest charges that would otherwise have been due to the federal government on October 1, 2003.
- Prevent a significant increase in the unemployment tax rate. By issuing bonds, the Commission was able to increase employers' unemployment tax rate by only 0.4 percent, rather than an estimated 1.5 percent. If the Commission had not issued bonds, Texas law would have required it to levy a "deficit tax" of an estimated 1.5 percent on Texas employers. The deficit tax is an additional tax designed to replenish the Fund within one year. Instead, the Commission levied an "obligation assessment tax," which it will use to pay off the bonds over five years. The obligation assessment tax rate is 0.4 percent.

Excerpts from Executive Order RP36 - Relating to Preventing, Detecting, and Eliminating Fraud, Waste and Abuse (July 12, 2004)

The following text was taken from Executive Order RP36 (<http://www.governor.state.tx.us/divisions/press/exorders/rp36>). The excerpts are the portions of the executive order that specifically address Texas's unemployment insurance program.

By the Governor of the State of Texas

Executive Department; Austin, Texas; July 12, 2004

Introduction

WHEREAS, the United States Department of Labor estimates that during calendar year 2001, about \$2.4 billion in overpayments occurred in the unemployment insurance system nationwide, with about \$577 million (24 percent) attributable to fraud or abuse; and

WHEREAS, the immediate reduction in benefit fraud and claims overpayments would substantially impact the solvency of the Unemployment Insurance Trust Fund and would benefit employers and citizens by further promoting the goals of the unemployment insurance system; and

WHEREAS, effective and innovative state policies, system management, and operational practices can address and limit unemployment benefit fraud and claims overpayments, and the Texas Workforce Commission is uniquely qualified with the general powers and duties under Labor Code, Section 301.061, and Subchapter E to address these issues; and

NOW, THEREFORE, I, Rick Perry, Governor of Texas, by virtue of the power and authority vested in me by the Constitution and laws of the State of Texas do hereby order the following:

Section 2

Target Fraud in the Unemployment Insurance Program. The Texas Workforce Commission shall prioritize prevention, detection and elimination of fraud and abuse in the Unemployment Insurance Program.

- The Texas Workforce Commission shall identify any state policies, management and operational practices, weaknesses in existing computer cross-matching systems, and other appropriate factors that are ineffective in preventing and detecting fraud and abuse in the Unemployment Insurance Program.
- The Texas Workforce Commission shall develop innovative strategies to address benefit fraud and claims overpayments, identify any worker

misclassification resulting in underpayments to the Unemployment Insurance Trust Fund, and improve claimants' job search and placement strategies in order to reduce the percentage of claimants who exhaust unemployment compensation benefits.

- The Texas Workforce Commission shall identify and implement national best practices for detecting and prosecuting fraudulent schemes, identify cost-effective strategies designed to eliminate fraud, reduce benefit payment inaccuracies, and increase recovery of claims overpayments and employer delinquent accounts.
- The Texas Workforce Commission shall make recommendations on the benefit of authorizing the commission to enter into contractual arrangements with private collection agencies to assist in pursuing uncollected overpayments of unemployment benefits.
- The Texas Workforce Commission shall implement a comprehensive process to promote high quality benefit determination and avoid improper disqualification or denial of benefits.
- The Texas Workforce Commission shall increase the profile of its fight against fraud on its website.

Overview of Process for Qualifying for and Receiving Unemployment Insurance

Intake

Unemployed workers apply for benefits over the phone through the Commission's tele-centers. Unemployed workers provide some information to the Commission during the application process. The Commission enters the information into the Unemployment Insurance Benefits System and begins to collect the remainder of the information needed to determine eligibility.

Eligibility Determination

To be eligible, the unemployed worker must meet non-monetary and monetary requirements:

- **Non-monetary.** The unemployed worker must have lost his or her job through no fault of his or her own and must be able to, available for, and actively looking for work.
- **Monetary.** The unemployed worker must have (1) had wages of a particular amount and/or worked for a specified period of time and (2) not exhausted maximum benefits within a particular benefit period.

The Commission sends a claim notice to the unemployed worker's last employer to gather information about eligibility. As discussed in Chapter 2-A of this report, not all employers provide sufficient information within the established time frame to make an accurate determination.

If the Commission awards benefits, employers who responded to their claim notices within 14 days (even if the response was incomplete or inadequate) can appeal the award. If it denies benefits, the unemployed worker can file an appeal. Employers and unemployed workers have 14 days to file appeals.

Payment Process

Once an unemployed worker is determined to be eligible, he or she must request payments by filing a claim certification over the phone using Tele-Serve, the Commission's automated telephone response system. The claimant submits the first claim certification two weeks after applying for benefits, and each payment covers a two-week period. The claim certification documents whether or not the claimant met the continuing eligibility requirements during the two-week period in question. To maintain eligibility, claimants must be at least partially unemployed during one of the two weeks and must demonstrate that they are searching for work.

Copies of this report have been distributed to the following:

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The Honorable David Dewhurst, Lieutenant Governor, Joint Chair
The Honorable Tom Craddick, Speaker of the House, Joint Chair
The Honorable Steve Ogden, Senate Finance Committee
The Honorable Thomas “Tommy” Williams, Member, Texas Senate
The Honorable Jim Pitts, House Appropriations Committee
The Honorable Jim Keffer, House Ways and Means Committee

Office of the Governor

The Honorable Rick Perry, Governor

Texas Workforce Commission

Members of the Texas Workforce Commission

Mr. Diane Rath, Chair

Mr. Ronald G. Congleton

Mr. Ron Lehman

Mr. Larry Temple, Executive Director



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