



MICHIGAN

OFFICE OF THE AUDITOR GENERAL

AUDIT REPORT



THOMAS H. McTAVISH, C.P.A.
AUDITOR GENERAL

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– Article IV, Section 53 of the Michigan Constitution

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Michigan
Office of the Auditor General
REPORT SUMMARY

Performance Audit

*Unemployment Insurance Benefit Overpayments
and Nonmonetary Eligibility Determinations*

Unemployment Insurance Agency

Department of Energy, Labor & Economic Growth

Report Number:
641-0315-10

Released:
March 2011

The Unemployment Insurance Agency's (UIA's) primary responsibility is to collect State unemployment taxes from employers and pay State and federal unemployment insurance (UI) benefits to eligible claimants. Eligible claimants can receive up to 99 weeks of UI benefits. For the three-year period ended September 30, 2010, UIA paid UI benefits totaling \$15.4 billion. UIA reported overpayment recoveries totaling \$89.7 million for calendar years 2007 through 2009. Prolonged high unemployment depleted UIA's funding reserves and required borrowing from the federal government to pay State UI benefits. As of September 30, 2010, the outstanding loans totaled \$3.8 billion.

Audit Objective:

To assess the effectiveness of UIA's efforts to prevent, detect, and recover UI benefit overpayments.

Audit Conclusion:

We concluded that UIA's efforts to prevent, detect, and recover UI benefit overpayments were not effective. We noted two material conditions (Findings 1 and 2) and five reportable conditions (Findings 3 through 7).

Material Conditions:

UIA needs to improve its controls to help ensure that it correctly classifies claimants' intentional misrepresentations or concealment of material facts to obtain UI benefits as fraud. As a result of the control weaknesses, we estimate that UIA did not assess fraud-related penalties totaling from \$81.5 million to \$191.8 million. ([Finding 1](#))

The Benefit Payment Control Unit (BPC) did not have effective controls to ensure that its claimant wage and UI benefit payment cross match process consistently detected overpayments to claimants. As a result, we estimate that during fiscal years 2007-08 and 2008-09, BPC may not have detected and recovered as much as \$55.7 million to \$61.3 million in UI benefit overpayments and associated penalties. ([Finding 2](#))

Reportable Conditions:

BPC did not properly investigate or document its investigation of potential false claims identified in its cross matches of new hire databases ([Finding 3](#)).

UIA had not established a reciprocal agreement with the U.S. Department of Labor to allow for a cross-program benefit offset process to recover UI benefit overpayments ([Finding 4](#)).

BPC did not consistently verify claimants' identities with the Social Security Administration. Also, BPC frequently did not document, retain documentation of, or timely complete its claimant identity verification efforts. ([Finding 5](#))

The Benefit Overpayment Collections Unit (BOC) did not consistently request the Department of Attorney General to obtain civil judgments against claimants who were delinquent in paying restitution for overpaid UI benefits. Also, BOC did not effectively monitor the employment status of those claimants with civil judgments obtained against them. ([Finding 6](#))

UIA had not established and implemented procedures to identify and recover UI benefits improperly paid to deceased claimants ([Finding 7](#)).

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Audit Objective:

To assess the effectiveness of UIA's efforts to complete nonmonetary eligibility determinations in a timely manner.

Audit Conclusion:

We concluded that UIA's efforts to complete nonmonetary eligibility determinations in a timely manner were not effective. We noted three reportable conditions (Findings 8 through 10).

Reportable Conditions:

UIA did not timely adjudicate nonmonetary issues regarding claimants' eligibility for UI benefits (Finding 8).

UIA did not ensure that alien claimants met federal and State eligibility requirements for receiving UI benefits (Finding 9).

UIA did not promptly issue new determinations holding claimants ineligible for UI benefits for those claimants strongly suspected of UI benefit fraud exceeding \$5,000 (Finding 10).

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Summary of Effects:

We estimate that UIA failed to identify and pursue recovery of UI benefit overpayments of up to \$72.5 million as identified in Findings 2, 4, 5, 7, 8, and 9:

Overpayments (in millions)

Claimant wage and benefit cross match process (Finding 2)	\$17.9
Cross-program benefit offset process (Finding 4)	12.1
Verification of claimant identity (Finding 5)	8.2
Deceased claimants (Finding 7)	0.4
Untimely nonmonetary eligibility determinations (Finding 8)	26.0
Ineligible alien claimants (Finding 9)	<u>7.9</u>
Total	<u>\$72.5</u>

We estimate that UIA did not assess fraud-related penalties ranging between \$120.0 million and \$236.6 million as identified in Findings 1, 2, and 7:

Unassessed Penalties (in millions)

Classification of claimants' misrepresentations (Finding 1)	\$ 81.5 - \$191.8
Claimant wage and benefit cross match process (Finding 2)	37.8 - 43.4
Deceased claimants (Finding 7)	<u>0.7 - 1.4</u>
Total	<u>\$120.0 - \$236.6</u>

For Findings 1, 4, 5, and 8, we estimated our results by projecting the results of our nonstatistical tests of randomly selected sample items to the population of items subject to testing. Although nonstatistical sampling does not provide an explicit level of confidence for the projection of test results to a population, it is a commonly used and industry-accepted audit sampling methodology. Our nonstatistical sampling methodology utilized randomly selected samples from the identified periods, thus attempting to ensure that the items tested provided true representations of the entire population.

For Finding 2, we estimated our results based on UIA's identified overpayments from other quarterly periods.

For Findings 7 and 9, the reported overpayments and unassessed penalties were derived from a full review of applicable UIA database records.

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Agency Response:

Our audit report includes 10 findings and 14 corresponding recommendations. UIA's preliminary response indicated that it agrees with 13 recommendations and partially agrees with 1 recommendation.

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A copy of the full report can be obtained by calling 517.334.8050 or by visiting our Web site at: <http://audgen.michigan.gov>



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March 22, 2011

Mr. Stephen M. Geskey, Director
Unemployment Insurance Agency
Department of Energy, Labor & Economic Growth
Cadillac Place
Detroit, Michigan
and
Mr. Steven H. Hilfinger, Director
Department of Energy, Labor & Economic Growth
Ottawa Building
Lansing, Michigan

Dear Mr. Geskey and Mr. Hilfinger:

This is our report on the performance audit of Unemployment Insurance Benefit Overpayments and Nonmonetary Eligibility Determinations, Unemployment Insurance Agency, Department of Energy, Labor & Economic Growth.

This report contains our report summary; description of agency; audit objectives, scope, and methodology and agency responses; comments, findings, recommendations, and agency preliminary responses; three exhibits, presented as supplemental information; and a glossary of acronyms and terms.

Our comments, findings, and recommendations are organized by audit objective. The agency preliminary responses were taken from the agency's responses subsequent to our audit fieldwork. The *Michigan Compiled Laws* and administrative procedures require that the audited agency develop a plan to address the audit recommendations and submit it within 60 days after release of the audit report to the Office of Internal Audit Services, State Budget Office. Within 30 days of receipt, the Office of Internal Audit Services is required to review the plan and either accept the plan as final or contact the agency to take additional steps to finalize the plan.

We appreciate the courtesy and cooperation extended to us during this audit.

AUDITOR GENERAL

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AND NONMONETARY ELIGIBILITY DETERMINATIONS
UNEMPLOYMENT INSURANCE AGENCY
DEPARTMENT OF ENERGY, LABOR & ECONOMIC GROWTH**

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Description of Agency

The federal Social Security Act of 1935 created the Unemployment Insurance Program as a joint federal-state partnership, with each state responsible for designing its own program within broad federal guidelines. In response to this Act, the Unemployment Insurance Agency (UIA), Department of Energy, Labor & Economic Growth, was originally created as the Michigan Employment Security Commission by the Michigan Employment Security Act of 1936, being Sections 421.1 - 421.75 of the *Michigan Compiled Laws*.

UIA helps jobless workers and their families by providing a temporary income while the workers are unemployed and seeking new employment. Unemployment insurance (UI) helps employers by keeping a skilled work force on hand until jobs become available. UIA administers the eligibility determination and benefit payment processes from its central office in Detroit and four regional claim centers. In addition, UIA has 10 problem resolution offices located throughout the State to assist claimants with questions or concerns regarding their claims.

For calendar years 2008 and 2009, UIA reported that it processed 2.5 million initial unemployment claims and 21.9 million continued unemployment claims. For the three-year period ended September 30, 2010, UIA paid UI benefits totaling \$15.4 billion. UIA reported overpayment recoveries totaling \$89.7 million for calendar years 2007 through 2009.

The State provides up to 26 weeks of UI benefits, which it funds with an employer payroll tax. Also, as of September 30, 2010, various federally funded programs provided up to 73 additional weeks of UI benefits. UIA's tax receipts and employer reimbursements are deposited in the State's Unemployment Compensation Fund. Also, the Internal Revenue Service levies a payroll tax on Michigan employers to fund the federal share of extended UI benefit programs and UIA administrative costs and to provide loans to eligible states that do not have sufficient financial resources to meet their UI obligations. As of September 30, 2010, the outstanding amount of such federal loans to Michigan totaled \$3.8 billion. Because of the poor national economy, the federal government waived interest on these loans through December 31, 2010. However, barring any legislative changes, interest will begin to accrue in 2011. UIA has estimated the interest charges for 2011 to be approximately \$117 million.

As of November 13, 2010, UIA had 950 permanent full-time employees and 284 limited-term employees.

Audit Objectives, Scope, and Methodology and Agency Responses

Audit Objectives

Our performance audit* of Unemployment Insurance Benefit Overpayments and Nonmonetary Eligibility Determinations, Unemployment Insurance Agency (UIA), Department of Energy, Labor & Economic Growth, had the following objectives:

1. To assess the effectiveness* of UIA's efforts to prevent, detect, and recover unemployment insurance (UI) benefit overpayments.
2. To assess the effectiveness of UIA's efforts to complete nonmonetary eligibility determinations* in a timely manner.

Audit Scope

Our audit scope was to examine the program and other records of the Unemployment Insurance Agency related to unemployment insurance benefit overpayments and nonmonetary eligibility determinations. We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives. Our audit procedures, conducted from May through November 2010, primarily covered the period October 1, 2007 through September 30, 2010.

Supplemental information was provided by UIA and is presented as Exhibit 1. Our audit was not directed toward expressing a conclusion on this information and, accordingly, we express no conclusion on it.

Audit Methodology

We conducted a preliminary review of UIA's operations to form a basis for defining our audit scope. Our preliminary review included interviewing various members of UIA management and staff; reviewing applicable State and federal laws, regulations, codes,

* See glossary at end of report for definition.

policies, procedures, and manuals; examining reports from various internal and external audits and reviews of UIA and similar organizations; identifying and examining pertinent management reports; conducting Internet research to identify industry standards, best practices, and headline events; and obtaining an understanding of and documenting UIA's internal control* related to eligibility determinations and UI benefit overpayment identification and recovery.

To accomplish our first objective, we identified the various cross matches that UIA used to discover UI benefit overpayments. We also identified those cross matches that resulted in the establishment of the most restitution and assessed the timeliness, completeness, and effectiveness of management's oversight of UIA's cross match and related investigatory processes. Also, we examined UIA's establishment of restitution and related recovery efforts, including its billing processes; use of the Michigan Department of Treasury's tax intercept program; referral of delinquent accounts to the Department of Attorney General for civil judgments*; monitoring of civil judgments for wage garnishment opportunities; referrals to UIA's Fraud Investigation Unit; and UI benefit offset. In addition, we reviewed UIA's use of its Benefit Accuracy Measurement Program* results to effect needed changes. Further, we assessed the appropriateness of UIA's classification of overpayments as either fraudulent or not fraudulent.

To accomplish our second objective, we calculated UIA's timeliness in completing nonmonetary eligibility determinations. Also, we calculated the financial impact of UIA's untimely processing of nonmonetary eligibility determinations on a randomly selected sample of nonmonetary eligibility determinations that resulted in the identification of UI benefit overpayments. In addition, we assessed UIA's compliance with State and federal requirements for determining the eligibility of noncitizen aliens* for UI benefits.

Our audit procedures included the use of both nonstatistical and statistical techniques. Findings 1 and 6 included statistical projections of error rates from attribute samples. Finding 1 also included a nonstatistical projection of the dollar value of unassessed penalties. Our nonstatistical projection applied an average dollar error per sampled item against the population subject to sampling. We did not complete a statistical projection of unassessed penalties because the total dollar value of the population subject to sampling, a required element for making such a projection, was not readily available. Findings 4, 5, and 8 also included nonstatistical projections derived by

* See glossary at end of report for definition.

applying the average dollar error or error rate for sampled items to the respective population. Although nonstatistical sampling does not provide an explicit level of confidence for the projection of test results to a population, it is a commonly used and industry-accepted audit sampling methodology. Our nonstatistical sampling methodology utilized randomly selected samples from the identified periods, thus attempting to ensure that the items tested provided true representations of the entire populations.

When selecting activities or programs for audit, we use an approach based on assessment of risk and opportunity for improvement. Accordingly, we focus our audit efforts on activities or programs having the greatest probability for needing improvement as identified through a preliminary review. Our limited audit resources are used, by design, to identify where and how improvements can be made. Consequently, we prepare our performance audit reports on an exception basis.

Agency Responses

Our audit report includes 10 findings and 14 corresponding recommendations. UIA's preliminary response indicated that it agrees with 13 recommendations and partially agrees with 1 recommendation.

The agency preliminary response that follows each recommendation in our report was taken from the agency's written comments and oral discussion subsequent to our audit fieldwork. Section 18.1462 of the *Michigan Compiled Laws* and the State of Michigan Financial Management Guide (Part VII, Chapter 4, Section 100) require UIA to develop a plan to address the audit recommendations and submit it within 60 days after release of the audit report to the Office of Internal Audit Services, State Budget Office. Within 30 days of receipt, the Office of Internal Audit Services is required to review the plan and either accept the plan as final or contact the agency to take additional steps to finalize the plan.

COMMENTS, FINDINGS, RECOMMENDATIONS,
AND AGENCY PRELIMINARY RESPONSES

EFFECTIVENESS IN PREVENTING, DETECTING, AND RECOVERING BENEFIT OVERPAYMENTS

COMMENT

Background: The funding mechanism for the federal-state unemployment system was designed to accumulate benefit reserves during periods of economic growth so that it could pay unemployment insurance (UI) benefits during periods of economic decline. However, because of Michigan's high unemployment rate over the past several years, employer contributions and reimbursements to the Unemployment Compensation Fund (UCF) fell significantly below the UI benefits paid from UCF and rendered UCF insolvent. To continue paying State UI benefits, the State requested and received loans from the federal Unemployment Trust Fund. As of September 30, 2010, the outstanding loans totaled \$3.8 billion. Because of the poor national economy, the federal government waived interest on these loans through December 31, 2010. However, barring any legislative changes, interest will begin to accrue in 2011. The Unemployment Insurance Agency (UIA) has estimated the interest charges for 2011 to be approximately \$117 million.

Audit Objective: To assess the effectiveness of UIA's efforts to prevent, detect, and recover UI benefit overpayments.

Audit Conclusion: **We concluded that UIA's efforts to prevent, detect, and recover UI benefit overpayments were not effective.** Our assessment disclosed two material conditions*. UIA needs to improve its controls to help ensure that it correctly classifies claimants' intentional misrepresentations or concealment of material facts to obtain UI benefits as fraud* (Finding 1). Also, the Benefit Payment Control Unit (BPC) did not have effective controls to ensure that its claimant wage and UI benefit payment cross match process consistently detected overpayments to claimants (Finding 2).

Our assessment also disclosed five reportable conditions* related to new hire cross matches, the cross-program benefit offset process, verification of claimant identity, civil judgments and wage garnishments, and UI benefit payments to deceased claimants (Findings 3 through 7).

* See glossary at end of report for definition.

Summary of Effects: We estimate that UIA failed to identify and pursue recovery of UI benefit overpayments of up to \$38,550,000 and did not assess fraud-related penalties ranging from \$120,000,000 up to \$236,600,000 as identified in Findings 1, 2, 4, 5, and 7.

For Findings 1, 4, and 5, we estimated our results by projecting the results of our nonstatistical tests of randomly selected sample items to the population subject to sampling. Although nonstatistical sampling does not provide an explicit level of confidence for the projection of test results to a population, it is a commonly used and industry-accepted audit sampling methodology. Our nonstatistical sampling methodology utilized randomly selected samples from the identified periods, thus attempting to ensure that the items tested provided true representations of the entire populations.

For Finding 2, we estimated our results based on UIA's identified overpayments from other quarterly periods.

For Finding 7, the reported overpayments and unassessed penalties were derived from a full review of applicable UIA database records.

FINDING

1. Classification of Claimants' Misrepresentations

UIA needs to improve its controls to help ensure that it correctly classifies claimants' intentional misrepresentations or concealment of material facts to obtain UI benefits as fraud. As a result of the control weaknesses, we estimate that UIA did not assess fraud-related penalties totaling from \$81.5 million to \$191.8 million.

When UIA employees determine that UIA overpaid a claimant, they designate whether the overpayment resulted from the claimant knowingly misrepresenting or concealing material facts. Numerous employees throughout UIA make these designations, generally with limited oversight. Although UIA provided these employees with some limited guidance on making fraud determinations based upon the available evidence, it did not provide appropriate guidance for obtaining all necessary evidence. When UIA discovered potentially intentional misrepresentations, it sent a request for pertinent information to the applicable claimant. However, in accordance with UIA procedures, when a claimant did not respond to UIA's initial request for information, UIA generally ceased its

investigation and issued a determination based upon the limited information that it had already assembled. In these instances, we noted that UIA generally classified the misrepresentation as unintentional, citing that it did not have sufficient information to determine otherwise.

Section 421.54 of the *Michigan Compiled Laws* provides for penalties of 200% and 400% for fraudulent overpayments totaling less than \$500 and fraudulent overpayments totaling \$500 or more, respectively. Also, claimants lose their right to UI benefits for the affected benefit year as of the date UIA receives notice of or initiates investigation of a possible fraud, whichever date is earlier. In addition, the statute of limitations for collection of the overpayment is increased from 3 years to 6 years.

From October 1, 2007 through August 21, 2010, UIA issued 1.3 million nonmonetary eligibility determinations. UIA records indicated that approximately 177,000 of these nonmonetary eligibility determinations were untimely and resulted in UIA establishing restitution for UI benefit overpayments. We reviewed 50 randomly selected nonmonetary eligibility determinations with benefit overpayments totaling \$40,726. We identified 10 (20.0%) instances that had strong indications of claimant fraud but were not classified as fraudulent by UIA employees or were not sufficiently investigated by them. Based on the population tested, there is a 95% probability that the actual incorrect classification and insufficient investigation rate ranges from at least 8.8% to as much as 31.2%.

Upon review of the 10 cases, UIA stated that it agreed that 4 cases involved claimant fraud. UIA also stated that additional information would have been useful for evaluating 3 other cases. However, UIA disagreed that there was claimant fraud or a need to obtain additional information for the 3 remaining cases. Relevant information regarding the 3 cases includes:

- (1) This claimant stated on his UI application that he was laid off because of a lack of work. The employer protested the claim stating that the claimant was on a military leave of absence during a specified four-week period and was not on layoff. Claimants on a military (voluntary) leave of absence do not qualify for UI benefits. In response to questioning, the claimant provided UIA with his orders to report for Army Reserve training during the contested four-week period and also twice mentioned or alluded to his "leave" in written

correspondence with UIA. Also, when the claimant made his biweekly certification for UI benefits, he committed a second potentially fraudulent act by stating that he was not working and was available for work during the contested four-week period. Because the claimant was not available for work, he did not qualify for UI benefits. The claimant committed another potentially fraudulent act in his biweekly certification by failing to report the wages earned for his Army Reserve training. These wages would have nullified his UI benefits.

UIA informed us that it did not consider the claimant's cited reason for being unemployed to be fraud because the claimant had been on layoff for approximately a week before and several days after his reserve training. Also, UIA informed us that it did not consider the claimant's failure to report that he was working to be fraud because the claimant may have looked at his Army Reserve training as service to his country and not a job. Finally, UIA informed us that it did not consider the claimant's failure to report his earnings to be fraud because he did not receive payment until his training had ended. However, UIA clearly instructs claimants to report wages earned (as opposed to received) during each week that they certify for UI benefits.

- (2) This claimant stated on his UI application that he was laid off for lack of work. The employer protested the claim stating that the claimant voluntarily quit because he was dissatisfied with the job. If the claimant had correctly stated that he voluntarily quit without good cause attributable to the employer, he would not be eligible to receive UI benefits related to this employment. When questioned about the discrepancy, the claimant admitted that he had quit his job because the business was being sold and he had no guarantee of continued pay or hours. UIA informed us that, because the claimant did not exhibit malice, it did not consider his actions to be fraudulent. However, this rationale is inconsistent with UIA's working definition of fraud, which includes the intentional misrepresentation of material facts to obtain UI benefits.
- (3) The 100% owner and president of a small company stated on his UI application that the business from which he laid himself off was not family employment. However, the UI application clearly describes family employment as employment in a business that is owned by the claimant or specified members of the claimant's family (see Exhibit 2, item 46, and

Exhibit 3, fourth question). The Michigan Employment Security Act limits UI benefits for claimants working in family employment to a maximum of 7 weeks as opposed to 26 weeks for other claimants.

UIA stated that it did not believe that the claimant intentionally provided false information because the claimant stated that neither he nor the Michigan Works! employee who reportedly helped the claimant complete his UI benefit application considered the claimant's 100% ownership in his business to be family employment. However, the claimant stated in his application for extended UI benefits that he had worked in family employment. In addition, there was no documented evidence that UIA had attempted to corroborate the claimant's statement with Michigan Works!. Notwithstanding, there should have been little or no ambiguity that the claimant's 100% business ownership constituted family employment. When asked about her disqualification for UI benefits for the same time period and reason, the claimant's wife stated that she also asked a Michigan Works! employee how to answer the family employment question because she (the claimant's wife) did not own any part of her husband's business. This statement indicates that the claimant's wife understood that ownership of the business constituted family employment. The claimant, as owner and president of the business, laying himself off for nearly a year was also somewhat suspicious and, together with the nondisclosure of family ownership, warranted a referral to, and investigation by, UIA's Fraud Investigation Unit. This referral and investigation was not made. After UIA established restitution for the UI benefit overpayment, the claimant requested that UIA waive his restitution because of financial hardship. The waiver request showed that the claimant was heavily indebted, a common motive for committing fraud.

If UIA had classified as fraudulent the 7 cases that, upon further examination, it either considered fraudulent or recognized the need for additional clarifying information, these 7 claimants would have been subject to penalties totaling \$23,044, an average of \$3,292 per claimant. Similarly, if UIA had classified as fraudulent the 3 cases that, based upon further examination, it still did not consider fraudulent or did not require clarifying information, these 3 claimants would have been subject to penalties totaling \$31,148, an average of \$10,383 per claimant. If our nonstatistical test results reflect the conditions present throughout the population of untimely nonmonetary determinations, and we do not assert that they

do, we estimate that there would be 35,400 (177,000 x 20%) misclassifications with unassessed fraud-related penalties totaling \$191.8 million (35,400 x \$5,419) derived from all 10 cases or 24,780 misclassifications with unassessed fraud-related penalties totaling \$81.5 million derived from the 7 aforementioned cases and 10,620 misclassifications with unassessed fraud-related penalties totaling \$110.3 million derived from the 3 aforementioned cases. We did not complete a statistical projection of unassessed penalties because the total dollar value of the population subject to sampling, a required element for making such a projection, was not readily available.

Not included within this estimate were penalties associated with approximately 62,000 nonmonetary eligibility determinations that UIA processed timely (unlike the 177,000 nonmonetary eligibility determinations that were not processed timely) and that had associated restitution but were not subject to testing. Nothing came to our attention to suggest that the misclassification rate for these 62,000 nonmonetary eligibility determinations would differ significantly from our calculated misclassification rate for the 177,000 nonmonetary eligibility determinations. However, the average unassessed penalty could be smaller because UIA made these 62,000 nonmonetary eligibility determinations timely.

RECOMMENDATION

We recommend that UIA improve its controls to help ensure that it correctly classifies claimants' intentional misrepresentations or concealment of material facts to obtain UI benefits as fraud.

AGENCY PRELIMINARY RESPONSE

UIA partially agrees. UIA informed us that some claimant misrepresentations were inappropriately misclassified and acknowledges that corrective action is needed. UIA also informed us that improved controls could help ensure appropriate classification of claimants' misrepresentations. However, UIA disagrees with the estimated amount of fraud-related penalties not assessed.

UIA stated that its management, with assistance from internal legal counsel, performed a thorough analysis and concluded that only 4 of the 10 cases cited should have been deemed fraudulent. According to UIA, the amount of fraudulent penalties that should have been assessed in these 4 cases is \$1,690 and, by extrapolating the value of these cases to the entire population, the cumulative

amount of missed fraud penalties totals \$5,982,600, thus significantly less than the reported \$191.8 million. UIA also stated that in making a judgment about fraud, or about any other adjudication issue, UIA staff must carefully consider the statements of the employer and the claimant. According to UIA, in reaching a conclusion about fraud or about any circumstance in which benefits are denied, longstanding Michigan unemployment insurance case law requires that UIA apply the law to the facts narrowly to deny benefits (and certainly narrowly when considering imposing a double, treble, or quadruple penalty) *Tomei v General Motors Corp*, 194 MichApp 180 (1992).

UIA informed us that it has made substantial progress identifying and addressing fraud. According to UIA, it has issued \$39.3 million in restitution and fraud penalties in 2010, another \$24.5 million in 2009, and another \$14 million in 2008. UIA responded that the 2010 data reveals a 60% increase over 2009 and a 180% increase over 2008.

UIA also informed us that it employs hundreds of unemployment insurance examiners (UIEs) who decide unemployment benefit issues, including fraud determinations. According to UIA, UIEs generally do not perform these adjudicatory functions until they have achieved three to five years of UIA experience and have undergone extensive adjudication and practicum training. UIA responded that, as a result of working on thousands of claims, staff become aware of, and quickly identify, the common mistakes and misconceptions that claimants make because of common issues that cause the claimants confusion, as the UIEs have been able to observe over time, rather than from the intent to defraud. UIA stated that ultimately, in every case, the claims examiner must exercise his/her professional judgment and discretion as to the disposition.

UIA further informed us that, collectively, these controls provide UIA with reasonable but not absolute assurance that correct classifications of claimants' intentional misrepresentations are made. UIA stated that it will continue to work to improve staff training by incorporating lessons learned from newly discovered fraud practices and schemes.

FINDING

2. Claimant Wage and UI Benefit Payment Cross Match Process

BPC did not have effective controls to ensure that its claimant wage and UI benefit payment cross match process consistently detected overpayments to claimants. As a result, we estimate that during fiscal years 2007-08 and 2008-09, BPC may not have detected and recovered as much as \$55.7 million to \$61.3 million in UI benefit overpayments and associated penalties.

UIA requires claimants to biweekly certify their employment status and report their gross wages for the week(s) that they claim UI benefits. Claimants who receive gross wages that are less than 150% of their full weekly benefit amount* are generally eligible for partial UI benefits. To verify that claimants accurately report their gross wages to UIA, BPC's procedures require it to cross match UIA's employer-reported quarterly wage records and UI benefit payment records to identify claimants who received UI benefits and had gross wages that may preclude their eligibility for part or all of the UI benefit. Also, the procedures require BPC to investigate identified claimants by comparing their respective employers' weekly wage records with the wages reported by the claimants during the biweekly certification process and to contact the claimants for additional information when it appears that they have not accurately reported their wages to UIA. Further, when BPC identifies unreported wages, BPC's procedures require it to calculate the corresponding UI benefit overpayment; assess penalties, if necessary; and establish restitution. Finally, the procedures require BPC to document its investigation activities.

Our review of BPC's implementation of these procedures disclosed:

- a. BPC did not conduct cross matches of UIA's employer-reported quarterly wage records and UI benefit payment records for 4 (50.0%) of the 8 quarters within fiscal years 2007-08 and 2008-09. Also, as of August 1, 2010, BPC had not conducted quarterly cross matches for fiscal year 2009-10. Near the close of our audit fieldwork, BPC conducted the cross match for the first quarter of fiscal year 2009-10. However, BPC informed us that it had no plan to conduct the four quarterly cross matches that it had not conducted in fiscal years 2007-08 and 2008-09 because of work load constraints.

* See glossary at end of report for definition.

For the 4 quarterly cross matches that it did conduct, BPC reported that it identified UI benefit overpayments totaling \$7.1 million, some of which BPC identified as fraudulent. Also, BPC referred an additional estimated \$5.8 million in UI benefit overpayments to UIA's Fraud Investigation Unit (FIU) for fraud determination. Fraud-related penalties associated with the \$7.1 million in overpayments would have ranged from \$4.1 million to \$8.1 million and fraud-related penalties related to the estimated \$5.8 million referred to FIU would have totaled up to \$23.2 million. If BPC had conducted cross matches for the remaining four quarters of fiscal years 2007-08 and 2008-09 with similar results, identified overpayments and fraud-related penalties would have increased by \$40.1 million to \$44.2 million during the two fiscal years.

- b. BPC did not identify for investigation and recovery of potential overpayments claimants who had UI benefits and employer-reported wages below established review thresholds. Prior to fiscal year 2008-09, BPC established a minimum quarterly threshold of seven weeks of benefit payments and \$7,000 in employer-reported quarterly wages before it would initiate an investigation of potential overpayments. To reduce its investigative work load, beginning with the third quarter of fiscal year 2008-09, BPC increased the UI benefit payment threshold from seven to nine weeks. Increasing the UI benefit payment threshold to nine weeks reduced the total number of claimants identified for investigation in the third and fourth quarters of fiscal year 2008-09 by 7,857, an average of 38.7% per quarter. If BPC's identified overpayments decreased proportionate to the reduction in claimant investigations, its annual overpayments and assessed fraud-related penalties identified for investigation potentially decreased by \$5.0 million and \$10.5 million, respectively, to \$5.0 million and \$12.1 million, respectively. A lack of readily available data precluded us from estimating the potential overpayments for claimants with UI benefits and employer-reported wages below the original thresholds. However, based on the change in potential overpayments using the original and revised thresholds, the amount is likely to be significant. At the time of our audit, BPC informed us that it was evaluating further threshold increases to further reduce BPC's work loads.
- c. BPC did not send follow-up requests for claimants' weekly wages to employers that failed to respond to BPC's initial requests for the information.

Also, BPC did not attempt to identify and contact employers that consistently failed to respond to BPC's wage data requests. When an employer did not respond to a wage data request, BPC ceased its investigative process without determining the appropriateness of UI benefit overpayments under investigation. Although we could not readily determine how often employers failed to respond to BPC's wage data requests, BPC estimated the frequency at approximately 60%. Considering the significant amount of overpayments that BPC identified in its completed investigations of cross match results, even a modest increase in the employer response rate could result in a significant increase in identified overpayments and assessed fraud-related penalties.

- d. BPC did not periodically perform a supervisory review of completed investigations of cross match results to ensure that they were accurate, timely, and sufficiently documented. We reviewed available documentation for 42 such investigations and found that BPC staff frequently failed to document their investigation activities, thereby precluding any determination about the appropriateness of the investigations. Also, BPC employees generally did not timely contact claimants or assess penalties and establish restitution, when necessary.

RECOMMENDATIONS

We recommend that BPC establish effective controls to ensure that its claimant wage and UI benefit payment cross match process consistently detects overpayments to claimants.

We also recommend that BPC recover overpayments and associated penalties related to claimants who received UI benefits for which they were ineligible.

AGENCY PRELIMINARY RESPONSE

UIA agrees. UIA informed us that the wage and benefit payment cross match has been completed for the third and fourth quarters of 2009 as well as for all quarters in 2010. UIA stated that BPC had begun performing the consecutive quarterly cross matches before this audit began and will continue to process the cross match each quarter. UIA also stated that wages are not retained in the UI system after eight quarters; therefore, it is not possible to complete cross matches from previous quarters.

FINDING

3. New Hire Cross Matches

BPC did not properly investigate or document its investigation of potential false claims identified in its cross matches of new hire databases. As a result, BPC potentially lost recovery of a significant amount of overpayments and associated penalties.

Title 42, Section 653a of the *United States Code* requires employers to promptly report the name, address, and social security number (SSN) of all newly hired, rehired, or recalled employees to the State Directory of New Hires* (SDNH), which is aggregated into the National Directory of New Hires* (NDNH). BPC's procedures require it to cross match UIA's benefit payment records with records of newly hired, rehired, or recalled employees included in SDNH and NDNH. The purpose of the cross matches is to identify claimants who continue to receive benefits after being hired, rehired, or recalled. The procedures require BPC to investigate these claimants by reviewing information already available at UIA; contacting the claimants' employers; and, if necessary, contacting the claimants. When a UI benefit overpayment is confirmed or when a claimant fails to provide BPC with requested information, BPC is required to pursue restitution of the overpayment plus associated penalties.

Our attempts to obtain and review SDNH and NDNH cross matches occurring between October 1, 2007 and June 30, 2010 and between October 1, 2007 and May 1, 2010 resulted in BPC informing us that it did not maintain documentation related to the SDNH cross matches conducted prior to March 2009. Also, BPC could not locate documentation related to the claimants and related investigations for 19 of the 67 SDNH cross matches occurring between March 3, 2009 and June 30, 2010 because BPC staff did not return them to the supervisor or the documentation was misplaced during an office move. From the remaining cross matches that were on file, we randomly selected and reviewed 20 claimants. Our review disclosed:

- a. BPC did not investigate 8 (40.0%) of the claimants identified in cross matches. BPC informed us that it lacked sufficient staffing to investigate many of the claimants identified in the SDNH cross matches, focusing instead on NDNH

* See glossary at end of report for definition.

cross matches because they should identify the same claimants as the SDNH cross matches, albeit at a later date. Thus, we expanded our testing to an analysis of the electronic records of NDNH cross matches, which disclosed that BPC had not investigated 4,356 (19.4%) of the 22,502 claimants identified in the NDNH cross matches conducted from October 1, 2007 through May 1, 2010. BPC informed us that it was unaware of its failure to investigate these claimants.

Although we did not make a determination of the amount of overpayments that may have resulted from BPC's failure to investigate claimants identified in its cross matches, the importance of such investigations is significant. For example, BPC reported that during the period January 1, 2008 through September 30, 2010, its investigations resulted in identification of UI benefit overpayments totaling \$2.4 million. In addition, fraud-related penalties associated with these overpayments ranged from \$818,000 to \$2.0 million. If BPC had investigated all claimants identified in the aforementioned cross matches, it is likely that BPC would have significantly increased these amounts.

- b. BPC did not follow up with employers that did not respond to BPC's original wage data requests. When an employer did not respond to a wage data request, BPC ceased its investigation, thus precluding the identification of potential overpayments.
- c. BPC did not document its investigation of 7 (35.0%) claimants identified by the cross matches. Without such documentation, BPC cannot ensure that the investigations were complete, accurate, and timely.

RECOMMENDATION

We recommend that BPC properly investigate and document its investigation of potential false claims identified in its cross matches of new hire databases.

AGENCY PRELIMINARY RESPONSE

UIA agrees. UIA stated that some of the 4,356 records identified encompass quarterly wage information that UIA agrees was not investigated but will now be investigated on a quarterly basis. UIA informed us that additional follow-up is needed when employers fail to respond to BPC's original wage requests. UIA also

informed us that better documentation should be maintained to ensure that investigations are complete, accurate, and timely. UIA will take immediate action to comply with these aspects of the finding.

UIA stated that the NDNH national database provides more accurate new hire information than the SDNH database because an employer-supplied W-4 is required as opposed to the undocumented new hire information supplied to the SDNH database. UIA also stated that the date of hire is a required field on the NDNH database but not on the SDNH database. UIA informed us that this data is essential to the investigation. UIA also informed us that, accordingly, it supports BPC's decision not to investigate cross matches identified on SDNH reports on a regular basis as these investigations tend to be unproductive and based on inaccurate and incomplete data.

FINDING

4. Cross-Program Benefit Offset Process

UIA had not established a reciprocal agreement with the U.S. Department of Labor (USDOL) to allow for a cross-program benefit offset process to recover UI benefit overpayments. As a result, we estimate that UIA did not recover \$12.1 million in UI benefit overpayments identified from October 1, 2007 through September 15, 2010 and a potentially significant but undetermined amount for benefit overpayments identified prior to but still outstanding (i.e., not written off) during this period.

Section 421.62 of the *Michigan Compiled Laws* authorizes UIA to recover UI benefit overpayments by offsetting (i.e., reducing) the UI benefits still payable to applicable claimants. Up to 100% and 20% of claimants' otherwise payable UI benefits can be offset to recover overpayments with and without associated claimant fraud, respectively. However, to offset UI benefit payments from one program (e.g., State-funded) to recover an overpayment made from another program (e.g., the federally funded Emergency Unemployment Compensation Program), the State must enter into a reciprocal agreement with USDOL. The reciprocal agreement guarantees to USDOL that the State will offset benefit payments from the State's UI benefit program when the related overpayments were made from a federal UI program and vice versa.

As of September 15, 2010, there were 19,296 claimants with outstanding UI benefit overpayments totaling \$37.6 million that UIA identified between October 1, 2007 and September 15, 2010 to whom UIA paid UI benefits after identifying their benefit overpayments and who were not seeking bankruptcy protection. We examined 16 of the claimants with outstanding overpayments totaling \$27,373 and noted that UIA could have recovered a total of \$8,783 (32.1%) for 11 (68.8%) claimants by using cross-program offset. If our nonstatistically derived percentage of outstanding overpayments collectible through cross-program offset (32.1%) is reflective of the conditions present throughout the population of overpayment cases identified during the aforementioned period (\$37.6 million), and we do not assert that they are, we estimate that UIA could have increased its overpayment recoveries by \$12.1 million (\$37.6 million x 32.1%).

UIA informed us that it did not enter into a reciprocal agreement with USDOL because UIA was waiting to implement a new electronic data system capable of conducting cross-program benefit offset. However, the cross-program benefit offset has been available since 1987.

RECOMMENDATION

We recommend that UIA establish a reciprocal agreement with USDOL to allow for a cross-program benefit offset process to recover UI benefit overpayments.

AGENCY PRELIMINARY RESPONSE

UIA agrees. UIA informed us that it has considered a method to implement the cross-program benefit offset; however, because of other information technology priorities and limited information technology resources, such implementation has not occurred. UIA stated that requirements for the new UI system include this provision. UIA also stated that it is in the early stages of updating its 25 year old computer system and that this cross-program benefit offset process is to be included within the project.

FINDING

5. Verification of Claimant Identity

BPC did not consistently verify claimants' identities with the Social Security Administration (SSA). Also, BPC frequently did not document, retain documentation of, or timely complete its claimant identity verification efforts. As a

result, we estimate that UIA paid UI benefits to ineligible claimants and failed to establish restitution for improper payments totaling as much as \$8.2 million.

Title 42, Section 1320b-7 of the *United States Code* requires UIA to obtain and use each claimant's SSN to help identify information needed for determining the claimant's eligibility for UI benefits. Also, UIA's procedures require it to provide SSA with each new claimant's reported SSN, date of birth, and first and last name for verification with SSA's records. SSA provided daily discrepancy reports to UIA identifying claimants whose information did not match, in whole or in part, the information on file with SSA. BPC's procedures require it to investigate the identified discrepancies for claimants who meet the unemployment program's other eligibility requirements by requesting supporting information from the claimants. Generally, BPC accomplished this by mailing a request for information to each applicable claimant. The procedures also require BPC to hold claimants ineligible for UI benefits and establish restitution, if applicable, when a claimant fails to answer BPC's request for information within 14 days or if the claimant-provided information fails to resolve the discrepancy. The procedures further require BPC to document its discrepancy investigation activities.

We requested the daily discrepancy reports for October 1, 2007 through June 1, 2010. However, BPC informed us that it discarded all discrepancy reports received prior to September 1, 2009. Also, BPC could not locate 44 (22.3%) of the 197 reports for September 1, 2009 through June 1, 2010 because BPC's investigative staff did not return the reports. Further, of the remaining 153 reports that were returned, BPC did not review them to ensure that all identified discrepancies were investigated.

Our review of 42 randomly selected discrepancies from the 153 returned reports disclosed:

- a. As of August 31, 2010, BPC had not investigated 2 (4.8%) discrepancies that SSA identified 196 and 234 days earlier. UIA overpaid the 2 claimants a total of \$15,754. BPC staff stated that they mistakenly overlooked 1 of the 2 discrepancies but intentionally dismissed the other discrepancy, and discrepancies similar to it, because it related to the extension of an existing claim and not to a new claim.

If the errors identified in our nonstatistical random sample are representative of those in the estimated population of discrepancies from October 1, 2007 through August 31, 2010, and we do not assert that they are, we estimate that BPC overlooked discrepancies with potential overpayments totaling \$7.1 million. We calculated this estimate by dividing the total number of discrepancies reported (409) for 14 randomly selected days by the total number of new claims filed (49,919) during these same days. We multiplied this quotient (0.0082) by the total new claims from the cited period (2,312,024) to estimate the total discrepancies reported during the period (18,959). Further, we multiplied this estimate (18,959) by the average potential overpayment per discrepancy for the 42 audited discrepancies (\$375).

- b. BPC did not initiate investigations timely for 10 (23.8%) claimants. Claimants who satisfy eligibility requirements will generally continue to receive UI benefits during a discrepancy investigation. Thus, it is imperative that BPC complete its investigations in a timely manner. Absent a timeliness standard, we considered an investigation initiation untimely if BPC initiated it more than 7 days after SSA reported the related discrepancy. BPC did not initiate the investigation for the 10 claimants until 8 to 121 days after SSA reported the discrepancies. In addition, BPC did not timely terminate 8 (19.0%) claimants' eligibility for UI benefits after the claimants failed to provide BPC with requested identity-related information within the required 14-day period. The requests for information were outstanding from 34 to 272 days before BPC either terminated the claimants' UI benefit eligibility or verified the claimants' identity.

As of August 31, 2010, UIA had overpaid 4 (40%) of these claimants a total of \$11,893. If BPC had timely investigated these cases and/or timely discontinued payments to claimants who did not respond to requests for identity-related information within the required 14 days, UIA could have avoided making \$2,490 (20.9%) of the overpayments. If the conditions identified in our nonstatistical sample testing are representative of the conditions present in the estimated population of discrepancies from October 1, 2007 through August 31, 2010, and we do not assert that they are, \$1.1 million in benefit overpayments could have been avoided, thereby negating the need for recovery. To calculate this estimate, we divided the \$2,490 in identified avoidable overpayments by the number of discrepancies

reviewed (42) to determine the average avoidable overpayment per discrepancy reviewed. We multiplied the product (\$59) by the estimated number of discrepancies for the cited period (18,959).

- c. BPC did not document when it requested and received identification-related information and/or resolved discrepancies for 18 (42.9%) claimants in accordance with BPC's procedure. Without this documentation, BPC could not prove that it appropriately and timely investigated identified discrepancies.
- d. BPC did not investigate discrepancies for claimants whose employers applied for UI benefits on the claimants' behalf through UIA's electronic employer-filed claims process. Rather, UIA relied on each employer to ensure the accuracy of its employees' identity-related information. Despite this, BPC did not notify employers when their employees' identity-related information disagreed with SSA's information. UIA informed us that there were approximately 151,000 new employer-filed claims during the three-year period ended September 30, 2010.

As of September 30, 2010, the State had outstanding federal loans to the Unemployment Compensation Fund (UCF) totaling \$3.8 billion. Consequently, to help repay the outstanding federal loans, it is imperative that UIA improve its overpayment identification efforts.

RECOMMENDATIONS

We recommend that BPC consistently verify all claimants' identities with SSA.

We also recommend that BPC document, retain documentation of, and timely complete its claimant identity verification efforts.

We further recommend that BPC identify and investigate all discrepancies that it did not previously investigate.

AGENCY PRELIMINARY RESPONSE

UIA agrees and informed us that it now verifies claimants' identities and is documenting its verification efforts. UIA also informed us that it is reviewing SSA investigations to ensure that all identity discrepancies are resolved.

UIA responded that it should be noted that every investigation does not result in a determination that an overpayment occurred. According to UIA, a discrepancy will occur if the name or numbers (on the SSN or date of birth) are transposed because of human error or if the claimant had not properly updated SSA records when a change of name occurred. UIA stated that, after reverification with SSA, these cases are no longer kept per SSA guidelines. UIA also stated that, for 2010, the percentage of discrepancies that resulted in an overpayment was approximately 6.5%.

FINDING

6. Civil Judgments and Wage Garnishments

The Benefit Overpayment Collections Unit (BOC) did not consistently request the Department of Attorney General to obtain civil judgments against claimants who were delinquent in paying restitution for overpaid UI benefits. Also, BOC did not effectively monitor the employment status of those claimants with civil judgments obtained against them. As a result, BOC missed opportunities for recovering claimant benefit overpayments from approximately 6,000 claimants via civil judgments, which extend time recovery periods and provide for the garnishment of future wages.

BOC's procedures require it to request the Department of Attorney General to obtain civil judgments against claimants who owe at least \$1,000 in restitution for overpaid UI benefits, have quarterly wages of \$5,000 or more, and have not paid restitution for two consecutive months. Civil judgments against claimants allow the Department to pursue recovery of UI benefit overpayments and related penalties through wage garnishment and, although not done, through attachment of liens to delinquent claimants' real and personal property. Also, civil judgments extend the time allowed for recovering UI benefit overpayments and related penalties on cases with and without claimant fraud from 6 years and 3 years, respectively, to 10 years. UIA stated that it did not use liens to enhance its collections because of the severe penalties imposed for not removing liens timely.

For the 35.5-month period ended September 15, 2010, we identified 80,725 claimants with active restitution accounts totaling approximately \$250 million. We analyzed UIA records for the 24-month period ended June 30, 2010 (a lack of readily available quarterly wage data prohibited an analysis of the entire

35.5-month period) and identified 2,691 claimants who had not paid any restitution and met all BOC civil judgment criteria. The 2,691 claimants owed restitution totaling \$18.0 million. We also identified 5,200 claimants owing a total of \$32.8 million in restitution who had paid some restitution and met all other BOC civil judgment criteria sometime during the period July 1, 2008 through June 30, 2010. Because we could not readily determine how many of these 5,200 claimants failed to make restitution payments during at least two consecutive months (and therefore met all 3 civil judgment criteria), we reviewed the detailed restitution payment data for 25 randomly selected claimants. Sixteen (64.0%) of the claimants failed to make restitution payments during two consecutive months. Based on our test results, we estimate that BOC could have pursued civil judgments for 3,328 (5,200 x 64.0%) of the 5,200 claimants. Using a statistical estimation methodology, there is a 95% probability that the true error rate (civil judgments not pursued) could range from a low of 44.84% to a high of 83.16%. Based on this range, we project that the number of civil judgments that BOC could have pursued ranges from at least 2,332 judgments to as many as 4,324 judgments.

Despite an estimated 6,019 (2,691 + 3,328) claimants qualifying for a civil judgment during the cited 24-month period, during the larger 35.5-month period ended September 15, 2010, BOC requested civil judgments for only 534 claimants. BOC stated that insufficient computing resources prohibited it from electronically identifying and referring all applicable claimants to the Department of Attorney General.

The Department of Attorney General informed us that when it obtains civil judgments against claimants, it first attempts to establish payment plans with the claimants and, when necessary, attempts to garnish the claimants' wages. When claimants do not make restitution payments in accordance with their agreed upon payment plans or are not working, the Department informed us that it sends the claimants' case files back to BOC. It then becomes BOC's responsibility to identify and notify the Department when claimants start working. To accomplish this, BOC informed us that it haphazardly reviews returned claimant case files to determine if the claimants are working. BOC also informed us that, after an undefined period of inactivity, it sends the claimant case files to its records warehouse. Once there, all efforts to recover the associated UI benefit overpayments through the Department are suspended.

We reviewed available documentation for 10 randomly selected claimants who, based on employer-reported quarterly wage data submitted to UIA, appeared to be working after the date of their civil judgments. We identified 1 (10.0%) claimant whom BOC should have, but did not, refer to the Department of Attorney General and 1 (10.0%) claimant who BOC did not refer to the Department until 10 months after UIA obtained the claimant's wage information. Also, BOC could not locate the case files for 5 (50.0%) claimants who were not eligible for garnishment at the time of our review but whose civil judgments were still effective for at least 8 more years. It is likely that BOC had sent these case files to its records warehouse.

During the three fiscal year period ended September 30, 2010, UIA informed us that it wrote off as uncollectible \$86.0 million in accounts receivable related to claimant UI benefit overpayments. With more civil judgments and wage garnishments, BOC could have recovered or greatly extended its recovery time for much of this amount.

RECOMMENDATIONS

We recommend that BOC consistently request the Department of Attorney General to obtain civil judgments against claimants who are delinquent in paying restitution for overpaid UI benefits.

We also recommend that BOC effectively monitor the employment status of claimants with civil judgments obtained against them.

AGENCY PRELIMINARY RESPONSE

UIA agrees. However, UIA informed us that there are several impediments to accomplishing its desired goal:

- The report used to determine the delinquent accounts that may meet garnishment criteria must be reviewed page by page and averages 2,500 pages per monthly report.
- Each case must be manually calculated.
- The manual assembly of documentation and media presentation to the Department of Attorney General.

- A lack of staff to work exclusively on judgment/garnishment case preparation.
- Additional attorneys will be necessary to process the increased number of judgments required for the garnishment process.

UIA informed us that as an alternative to the time and labor intensive processes currently in use, software with the ability to gather determinations of overpayment, employment data, and wage information into a comprehensive report would greatly reduce the time needed to find a case with all elements required for judgment/garnishment. UIA stated that it is working toward designing, developing, and implementing a new computer system that is expected to incorporate and enhance the administrative efficiencies in regard to this paper intensive process. UIA also stated that there are several software packages that it is exploring to assist in this effort.

According to UIA, in early 2011, the Internal Revenue Service (IRS) is expected to allow states to intercept federal income tax refunds from claimants who are delinquent in restitution repayments. UIA informed us that it is committed to participating in this program immediately upon permission being granted by the IRS. According to UIA, this additional source of monies will reduce the amount and number of restitution accounts and result in larger sums deposited into the UI Trust Fund. Also, UIA stated that the recently created Benefit Enforcement Unit's mission is to actively pursue collection of restitution through all means available, including assisting the Department of Attorney General in significantly increasing the number of judgments obtained and wage garnishments pursued through the various county courts in the State. UIA also stated that as the process is refined, it is anticipated that the number of garnishments will increase twofold in the coming year and continuously increase thereafter.

FINDING

7. UI Benefit Payments to Deceased Claimants

UIA had not established and implemented procedures to identify and recover UI benefits improperly paid to deceased claimants. As a result, UIA did not identify and recover improper UI benefit payments totaling up to approximately \$350,000 made from October 1, 2007 through June 30, 2010. Because most of the improper

payments would likely be fraudulent, additional fraud-related penalties would range from \$700,000 to \$1.4 million.

To obtain UI benefits, UIA requires otherwise eligible claimants to biweekly certify that they were able and available to work, seeking work, etc., during the prior two-week period. Claimants generally made these certifications by phone. To help reduce the incidence of fraud, UIA assigned claimants personal identifying numbers to use in their biweekly certifications. However, because claimants did not have to appear in person when certifying for benefits and because their personal identifying numbers could easily be known to family members or others, there is heightened risk of UI benefit fraud related to deceased claimants. Because it was not possible for UIA to immediately know when a claimant died, related UI benefit fraud was not readily detected.

To identify the deceased claimants who improperly received UI benefits, we cross matched UI benefit payment records covering the period October 1, 2007 through June 30, 2010 to the State's official death records. We found 115 deceased claimants for whom UIA continued to make UI benefit payments. The improper UI benefit payments ranged from 1 to 87 weeks and totaled as much as \$32,594 for a single claimant.

Section 421.54 of the *Michigan Compiled Laws* provides for penalties of 200% and 400% for fraud-related overpayments totaling less than \$500 and overpayments totaling \$500 or more, respectively. Consequently, fraud-related penalties for the \$350,000 in fraudulent overpayments would range from \$700,000 ($\$350,000 \times 200\%$) to \$1.4 million ($\$350,000 \times 400\%$).

RECOMMENDATION

We recommend that UIA establish and implement procedures to identify and recover UI benefits improperly paid to deceased claimants.

AGENCY PRELIMINARY RESPONSE

UIA agrees and acknowledges that benefit payments may have been issued to a small number of deceased persons, most of which UIA suspects were because of identity theft. UIA informed us that it plans to address this problem by implementing an automated cross match process (utilizing appropriate State or federal databases) on the proposed new UI system. UIA stated that, in the interim,

it will perform a manual cross match process to detect deceased claimants and will pursue legal remedies when appropriate.

EFFECTIVENESS IN COMPLETING NONMONETARY ELIGIBILITY DETERMINATIONS IN A TIMELY MANNER

COMMENT

Audit Objective: To assess the effectiveness of UIA's efforts to complete nonmonetary eligibility determinations in a timely manner.

Audit Conclusion: **We concluded that UIA's efforts to complete nonmonetary eligibility determinations in a timely manner were not effective.** Our assessment disclosed three reportable conditions related to nonmonetary eligibility determinations, alien claimants, and claimant fraud (Findings 8 through 10).

Summary of Effects: We estimate that UIA potentially made improper UI benefit overpayments of \$33,900,000 as identified in Findings 8 and 9.

For Finding 8, we estimated our results by projecting the results of our nonstatistical tests of randomly selected sample items to the population of items subject to sampling. Although nonstatistical sampling does not provide an explicit level of confidence for the projection of test results to a population, it is a commonly used and industry-accepted audit sampling methodology. Our nonstatistical sampling methodology utilized a randomly selected sample from the identified period, thus attempting to ensure that the items tested provided a true representation of the entire population.

For Finding 9, the reported overpayments were derived from a full review of applicable UIA database records.

FINDING

8. Nonmonetary Eligibility Determinations

UIA did not timely adjudicate* nonmonetary issues* regarding claimants' eligibility for UI benefits. As a result, we estimate that UIA may have made improper UI

* See glossary at end of report for definition.

benefit payments totaling \$26.0 million from October 1, 2007 through August 21, 2010.

To qualify for UI benefits, the Michigan Employment Security Act requires claimants to meet various earnings and nonmonetary eligibility requirements. The nonmonetary eligibility requirements include having a qualifying job separation reason, being able and available to work, seeking work, and registering for work with the State's workforce agency. When an issue arises as to whether a claimant meets one or more of the various nonmonetary eligibility requirements, UIA must obtain and weigh the relevant facts from the applicable employer, claimant, and/or third party and issue a nonmonetary eligibility determination. If a claimant has already begun receiving UI benefits when an issue arises, the claimant will continue to receive the UI benefits pending UIA's issuance of a determination on the issue. Thus, to limit potential overpayments, it is imperative that UIA timely complete its nonmonetary eligibility determinations. Recognizing the importance of timely nonmonetary eligibility determinations, USDOL's Employment and Training Administration established a performance standard requiring that at least 80% of nonmonetary eligibility determinations (excluding those resulting from an appeal) be completed within 21 days of the opening of the related issue.

From October 1, 2007 through August 21, 2010, UIA completed 1.3 million nonmonetary eligibility determinations. UIA records indicated that approximately 177,000 (13.6%) of these nonmonetary eligibility determinations were untimely and resulted in UIA establishing restitution for UI benefit overpayments. Not included within this amount were nonmonetary eligibility determinations that were subsequently appealed.

To assess the financial impact of untimely nonmonetary eligibility determinations, we randomly selected and reviewed 50 such determinations that resulted in UIA establishing restitution for UI benefit overpayments. The UI benefit overpayments associated with the 50 sampled items totaled \$40,726 for an average of \$815 per determination. If UIA had processed the nonmonetary eligibility determinations timely, it would have reduced the overpayments by \$7,359 (18.1%) for an average of \$147 per determination. Because the total restitution for the 177,000 nonmonetary eligibility determinations was not readily available, we could not statistically project our results. However, if our nonstatistical test results are reflective of the conditions present for the 177,000 nonmonetary eligibility

determinations previously noted, and we do not assert that they are, we estimate that UIA could have reduced its benefit overpayments during the cited period by \$26.0 million (177,000 x \$147).

UIA attributed its untimely processing of nonmonetary eligibility determinations to the significant increase in unemployment experienced during our audit period. While this may have exacerbated UIA's untimeliness, it is noteworthy that untimely determinations have been a persistent condition for many years. In our June 18, 1992 audit of the Unemployment Insurance Program, we noted a similar condition and recommended that nonmonetary eligibility determinations be processed on a timely basis.

RECOMMENDATION

We recommend that UIA timely adjudicate nonmonetary issues regarding claimants' eligibility for UI benefits.

AGENCY PRELIMINARY RESPONSE

UIA agrees and informed us that it has taken action to comply.

According to UIA, the audit period enveloped the Great Recession in its entirety during which Michigan experienced the highest national unemployment rate for 48 consecutive months (from May 2006 through April 2010). Beginning in July 2008 and ending in December 2010, an unprecedented nine separate federal unemployment benefit extensions were enacted into federal law, averaging just 3½ months between extensions. The historical circumstances of the Great Recession disrupted UIA operations in a variety of contexts, including the issuance of timely nonmonetary adjudications.

Also according to UIA, when the ninth unemployment extension was signed into law on or about Friday, December 17, 2010, it provided a continuous status-quo extension through 2011. Unlike the previous federal extensions, UIA now has the longest period of operational certainty and continuity since June 2007. To effectively leverage the strategic opportunity afforded by the 13-month extension, UIA quickly designed and executed a strategy to address and redress this finding.

Further according to UIA, the new strategy was launched on January 24, 2011 and, in three weeks' time, UIA produced a 15% net decrease in pending items, including nonmonetary adjudications. UIA informed us that, as a consequence, it fully expects that it will continue to make substantial progress on this finding in the months to come and, if production continues at the present pace, expects to be current within approximately six to eight months.

FINDING

9. Alien Claimants

UIA did not ensure that alien claimants met federal and State eligibility requirements for receiving UI benefits. As a result, from October 1, 2007 through June 30, 2010, UIA potentially made improper UI benefits payments totaling up to \$7.9 million to 1,201 alien claimants.

To qualify for UI benefits, the Michigan Employment Security Act requires that all claimants meet minimum earnings requirements during their base period* and be available for work during every week for which they certify for benefits. In addition, Section 3304(a)(14)(A) of the Internal Revenue Code requires alien claimants to be legally authorized to work in the United States during their base period and during any weeks for which they certify for benefits. Claimants' base period earnings are used to calculate their weekly benefit amount and their number of weeks of UI benefit eligibility. Claimants who are not legally authorized to work in the United States are not available to work in the United States and, consequently, do not meet the State's availability requirement for receiving UI benefits.

To help ensure that only eligible alien claimants receive UI benefits, the federal Social Security Act requires alien claimants to provide UIA with documentation supporting their identity and legal work authorization status. Although UIA verified that alien claimants were authorized to work in the United States on the date the claimants applied for UI benefits, UIA generally did not obtain and use the required documentation to determine if the alien claimants were authorized to work during their base period or during the weeks that they received UI benefits.

* See glossary at end of report for definition.

We quantified the potential improper payments by summing all payments made to alien claimants after their work authorization dates recorded in UIA's database had expired. It is possible that some of the 1,201 alien claimants previously noted had valid extensions to their work authorization dates and were eligible for UI benefits but had not submitted the related documentation to UIA or UIA had not updated the authorization date in its database.

UIA informed us that it did not obtain and use the required documentation from alien claimants because it relied on the employer community to verify the identity and legal work authorization status of the aliens during their base period and benefit year.

RECOMMENDATION

We recommend that UIA ensure that alien claimants meet federal and State eligibility requirements for receiving UI benefits.

AGENCY PRELIMINARY RESPONSE

UIA agrees. UIA informed us that it follows the instructions provided by USDOL in Unemployment Insurance Program Letter (UIPL) 07-98 for verification of aliens using the Systematic Alien Verification for Entitlement (SAVE) Program. UIA also informed us that the SAVE verification is always performed at the application for unemployment benefits. UIA stated that, in addition, since the beginning of the Emergency Unemployment Compensation program in 2008 and the payment of extended benefits in Michigan in 2009, SAVE verification has been performed for each claimant applying for benefits under those programs as well.

UIA informed us that it is considering procedures to re-verify work authorization after the document expiration date (for those documents that contain an expiration date). UIA also informed us that it is centralizing the SAVE process within one unit in order to more efficiently use its staff to better monitor all SAVE transactions to make sure that they continue to be handled correctly.

UIA stated that its procedures regarding alien claimants presenting documentation by entering the document number during the automated claim filing process are consistent with the instruction provided by USDOL in UIPL 05-97. UIA also stated that it only relies on employers to verify legal work authorization with employers

who have elected to use UIA's employer-filed claim process and have agreed to do so in order to file UI claims on behalf of their employees.

FINDING

10. Claimant Fraud

UIA did not promptly issue new determinations holding claimants ineligible for UI benefits for those claimants strongly suspected of UI benefit fraud exceeding \$5,000. As a result, UIA continued to pay UI benefits to ineligible claimants.

Section 421.27(a)(1) of the *Michigan Compiled Laws* states that UIA must issue a new determination holding a claimant ineligible for UI benefits before it can stop paying UI benefits to a previously eligible claimant. UIA informed us that when it strongly suspected that claimants fraudulently obtained UI benefits exceeding \$5,000, it referred the claimants to UIA's Fraud Investigation Unit (FIU). However, it was not until FIU completed its investigation and obtained a disposition from the court that UIA issued a new determination holding applicable claimants ineligible for UI benefits. For fraud cases totaling less than \$5,000, UIA claims examiners issue determinations without seeking prosecution through the courts.

FIU informed us that it received 3,636 fraud referrals in fiscal year 2009-10 and that, as of October 2010, it was approximately 12 months behind investigating new referrals. Also, FIU stated that its investigations, once started, typically take a month to complete and court proceedings last up to four months. Thus, up to 17 months may elapse before UIA stops claimants involved in UI benefit fraud from obtaining UI benefits. Such a time frame increases the risk for significant benefit overpayments.

Our audit procedures, though not specifically designed to identify situations such as this, identified one such case. On August 26, 2009, UIA referred a claimant to FIU who had worked full time while simultaneously certifying for and receiving 31 weeks of UI benefits totaling \$7,341. In a written statement to UIA, the claimant admitted to defrauding UIA because of personal financial difficulties. However, from August 27, 2009 through September 25, 2010, the claimant continued to work full time and fraudulently obtain UI benefits. In addition, on September 26, 2010, the claimant opened a new UI claim based on the wages earned during the period that the claimant reported being unemployed and received UI benefits. Under the

new claim, UIA inappropriately deemed the claimant eligible for continued UI benefits. From August 27, 2009 through December 25, 2010, the claimant fraudulently received additional UI benefits totaling \$19,462. As the claimant has already indicated that his actions were motivated by personal financial problems, the likelihood that UIA will fully recover the \$26,803 in UI benefit overpayments and \$107,212 in fraud-related penalties is significantly diminished.

UIA informed us that it did not issue new determinations on fraud-related cases before referring them for prosecution as many courts refuse to hear cases involving claimants who have already been assessed fraud-related penalties, an action that coincides with the issuance of a new determination. Notwithstanding, it is incumbent upon UIA to prioritize the issuance of new determinations for claimants who have committed UI benefit fraud and continue to receive UI benefits.

RECOMMENDATION

We recommend that UIA promptly issue new determinations holding claimants ineligible for UI benefits for those claimants strongly suspected of UI benefit fraud.

AGENCY PRELIMINARY RESPONSE

UIA agrees with the single case cited and has acknowledged that additional benefits were paid for this fraud referral case. UIA informed us that this case was being prosecuted in February 2011.

UIA stated that, in 2009, investigative caseloads increased because of the increase in unemployment claims. UIA informed us that there has always been a direct correlation between the number of claims filed and the number of fraud referrals. UIA stated that an insufficient number of trained investigative staff was in place to handle this increased work load. UIA also stated that the increased work load led to longer time frames before the investigation could be conducted. According to UIA, in fiscal year 2008-09, FIU closed 1,076 cases and, for fiscal year 2009-10, FIU closed 1,749 cases: a 62% increase. Also according to UIA, for fiscal year 2009-10, referrals were double the amount of closed cases.

UIA informed us that, for fiscal year 2010-11, UIA has closed 1,294 cases. UIA responded that by doubling the staff in FIU and by assigning 6 additional staff to triage referrals by gathering background information, it enabled additional production increases as investigative agents concentrated on prosecutions. UIA forecasts a reduction of 25% to the current caseload level this fiscal year. UIA

informed us that the addition of staff will decrease the time to case resolution. The UIA also informed us that the criminal conviction rate for UIA is 100%, with 16 convictions for fiscal year 2008-09, 175 convictions for fiscal year 2009-10, and 147 convictions for fiscal year 2010-11 to date.

SUPPLEMENTAL INFORMATION

Unemployment Insurance Agency's (UIA's)
Statement of Conditions Affecting Its Operations

The audit period (October 1, 2007 through September 2010) enveloped the Great Recession in its entirety (December 2007 through June 2009). In addition to unemployment rates (14.6%) not seen in nearly 30 years, the Great Recession produced an unprecedented number of federal unemployment extensions, which extended eligibility dates and added weeks to the federal unemployment extensions. From June 2008 through December 2010, there were nine separate federal laws extending unemployment benefits, with an average of just 3½ months between extensions. While each extension produced operational challenges (uncertainty as to duration, increased customer contacts, and increased claims activity), the most recent federal extension signed into law on or about December 17, 2010 established a 13-month extension providing the agency with the greatest operational certainty and continuity experienced since 2007.

In regard to collection activities recovering both overpayments and penalties, the UIA increased receipts in 2010 (\$45.7 million) by 84% over 2007 (\$24.8 million), 67% over 2008 (\$27.3 million), and 22% over 2009 (\$37.4 million); for a total amount recovered of \$135.2 million over the past 4 years.

For reasons both independent of and related to this report, the agency has already implemented a number of strategies designed to improve program performance. The deficiencies noted and areas of improvement identified strengthen the agency's resolve to improve Michigan's unemployment insurance system.

Source: Unaudited information obtained from the Unemployment Insurance Agency, Department of Energy, Labor & Economic Growth.

Application for Unemployment Insurance Benefits

UIA 1554-M (Rev. 6-04)

PLEASE PRINT CLEARLY OR TYPE - USE BLACK INK DO NOT WRITE IN SHADED AREAS



State of Michigan Department of Labor & Economic Growth UNEMPLOYMENT INSURANCE AGENCY



Authorized by MCL 421.1, et seq.

APPLICATION FOR UNEMPLOYMENT BENEFITS

Completion of this form is required to qualify for benefits.

UIA No. _____

Form 1: Personal information, employment history, and dependency status. Includes fields for Social Security Number, birth date, address, and various employment questions.

LIST EACH EMPLOYER YOU WORKED FOR DURING THE LAST 18 MONTHS, BEGINNING WITH YOUR LAST EMPLOYER. INCLUDE ANY WORK PERFORMED FOR FEDERAL, STATE, OR LOCAL GOVERNMENT, AND ANY WORK PERFORMED IN OTHER STATES. DO NOT WRITE IN SHADED AREAS. PLEASE PRINT CLEARLY OR TYPE. USE BLACK INK.

Form 2: Employer information table. Columns include Business Name, First Day Worked, Last Day Worked, Employer Account Number, Multi-Unit, Check Digit, Payroll Address, City, State, Zip Code, County/State Worked In, FIPS County, Area Code and Telephone No., Reason for Separation, Explain the Reason for Your Separation, Job Title, and Return to Work Expectations.

NOTE: IF YOU HAD MORE THAN 2 EMPLOYERS DURING THE PAST 18 MONTHS, ATTACH A SEPARATE SHEET. 47. YOUR CERTIFICATION: I HEREBY APPLY FOR A DETERMINATION OF MY UNEMPLOYMENT BENEFIT RIGHTS. I DECLARE THAT I AM A CITIZEN OF THE UNITED STATES OR I AM IN SATISFACTORY IMMIGRATION STATUS. I CERTIFY THAT ALL OF THE INFORMATION SUBMITTED BY ME ON THIS FORM IS TRUE AND CORRECT TO THE BEST OF MY KNOWLEDGE AND BELIEF. I UNDERSTAND THAT THE LAW PROVIDES PENALTIES OF FINE, AND/OR IMPRISONMENT, AND/OR COMMUNITY SERVICE FOR FALSE STATEMENTS TO SECURE BENEFITS.

MAIL IMMEDIATELY Allow 5 days for mail delivery. If not received by this Agency by the Friday following the week containing your last day of work, this claim will be effective with the week in which it is received. Mail to UIA, P.O. Box 169, Grand Rapids, Michigan 49501-0169.

Excerpt from Electronic Application for Unemployment Insurance Benefits

Eligibility

Wednesday, March 09, 2011

Quit

Are you working full-time this week? * Yes No

Are you attending school or training? * Yes No

Do you want state and federal taxes withheld from your unemployment benefits? * Yes No

Did you work in family employment? Family employment is defined as a business with more than 50% ownership by you, or you together with your son, daughter, or spouse, or any combination of these individuals. * Yes No

Click "Proceed" to continue.

Proceed

GLOSSARY

Glossary of Acronyms and Terms

adjudicate	A process by which UIA reviews evidence to come to a decision that determines rights and obligations of the parties involved.
alien	A person who is legally permitted to remain in a country that is foreign to him or her. This includes guest workers, tourists, legal permanent residents, and student visa resident aliens. Specifically, this kind of alien may be referred to as a legal alien of that country. An alien who is present in that country unlawfully or without authorization is known as an illegal alien of that country.
base period	A period of four consecutive completed quarters in which wages are considered to determine if an individual can establish a claim for unemployment benefits.
Benefit Accuracy Measurement Program	A program to determine the accuracy of paid and denied unemployment claims.
BOC	Benefit Overpayment Collections Unit.
BPC	Benefit Payment Control Unit.
civil judgment	A final court decision from a civil lawsuit often ordering a party to pay a certain sum of money to the other party.
effectiveness	Success in achieving mission and goals.
FIU	Fraud Investigation Unit.
fraud	A UI benefit overpayment that was caused by an intentional misrepresentation or concealment of a material fact by the claimant.
internal control	The plan, policies, methods, and procedures adopted by management to meet its mission, goals, and objectives.

Internal control includes the processes for planning, organizing, directing, and controlling program operations. It includes the systems for measuring, reporting, and monitoring program performance. Internal control serves as a defense in safeguarding assets and in preventing and detecting errors; fraud; violations of laws, regulations, and provisions of contracts and grant agreements; or abuse.

IRS	Internal Revenue Service.
issue	A matter that is in dispute concerning requirements for collecting UI benefits.
material condition	A reportable condition that could impair the ability of management to operate a program in an effective and efficient manner and/or could adversely affect the judgment of an interested person concerning the effectiveness and efficiency of the program.
National Directory of New Hires (NDNH)	A national repository of employment, unemployment insurance, and quarterly wage information. NDNH includes records from each state's SDNH, quarterly wage and unemployment insurance data from state workforce agencies, and new hire and quarterly wage data from federal agencies.
nonmonetary eligibility determination	A decision made by an initial authority based on facts related to an issue detected that has the potential to affect a claimant's past, present, or future benefit rights and for which a determination of eligibility was made. Nonmonetary eligibility determination criteria include having a qualifying job separation reason, being able and available to work, seeking work, and registering for work with the State's workforce agency.
performance audit	An economy and efficiency audit or a program audit that is designed to provide an independent assessment of the performance of a governmental entity, program, activity, or

function to improve program operations, to facilitate decision making by parties responsible for overseeing or initiating corrective action, and to improve public accountability.

reportable condition

A matter that, in the auditor's judgment, falls within any of the following categories: an opportunity for improvement within the context of the audit objectives; a deficiency in internal control that is significant within the context of the objectives of the audit; all instances of fraud; illegal acts unless they are inconsequential within the context of the audit objectives; significant violations of provisions of contracts or grant agreements; and significant abuse that has occurred or is likely to have occurred.

SAVE

Systematic Alien Verification for Entitlement.

State Directory of New Hires (SDNH)

A federally required directory of employers' new hires, rehires, and recalled employees.

SSA

Social Security Administration.

SSN

social security number.

UCF

Unemployment Compensation Fund.

UI

unemployment insurance.

UIA

Unemployment Insurance Agency.

UIE

unemployment insurance examiners.

UIPL

Unemployment Insurance Program Letter.

USDOL

U.S. Department of Labor.

weekly benefit amount

The amount payable to the claimant, if eligible, for each week of entitlement in a benefit year.

