

Unemployment System Findings

as reported in

Statewide Single Audit of Kentucky

Volume 1 and Volume 2
Fiscal Year 2020



Office of Auditor Mike Harmon

Scope of Auditor Harmon's Testimony

- ▶ The focus on today's testimony is the audits findings reported in FY 2020 reports released by APA.
- ▶ I want to be clear from the outset that I am not here to discuss FY 2021 audit work that is currently underway.
 - ▶ Auditing standards place restrictions on what can be discussed regarding an ongoing audit so as not to impair the audit work.
 - ▶ Also, I am not personally involved any ongoing audits of state agencies.
 - ▶ Our office is careful to ensure strong safeguards are in place to maintain the office's objectivity and independence under auditing standards.



Mike Harmon
State Auditor

Annual Comprehensive Financial Report (ACFR)

- ▶ Per KRS 43.060, the Auditor of Public Accounts (APA) does an annual audit of the Commonwealth of Kentucky's Annual Comprehensive Financial Report (ACFR) in accordance with generally accepted accounting principles.
- ▶ In December 2020, APA issued a Qualified Audit Opinion on the UI Fund because of the internal control environment and unknown amount owed to those who filed for UI benefits during FY 2020.



Mike Harmon
State Auditor

Statewide Single Audit of Kentucky (SSWAK) for FY 2020, Vol. I

- ▶ APA conducts the SSWAK to meet the Federal Single Audit Act requirement that applies to all state & local governments expending federal awards of \$750,000 or more.
- ▶ Volume I of the SSWAK reports the financial & internal control findings from the ACFR audit.
 - ▶ 25 findings for FY 2020, and more than half involved the Office of Unemployment Insurance (OUI) and the Unemployment Insurance (UI) fund.
- ▶ SSWAK, Volume I was released in February 2021.



Mike Harmon
State Auditor

Statewide Single Audit of Kentucky (SSWAK) for FY 2020, Vol. II

- ▶ Volume II of the SSWAK reports on compliance with federal requirements for federal awards.
 - ▶ 21 findings for FY 2020, and 8 of those involved the Office of Unemployment Insurance (OUI) and the Unemployment Insurance (UI) fund.
 - ▶ KY spent over \$17.5 billion in federal awards, up \$4.7 billion from FY 2019.
- ▶ Audit identified \$670.7 million in questioned costs, including the \$655 million in UI benefits paid during FY 2020.
- ▶ SSWAK, Volume II was released in April 2021.

Onset of the COVID-19 Pandemic: An Unprecedented Challenge for OUI

- ▶ Business closures due to COVID-19 led to thousands of Kentuckians becoming unemployed.
- ▶ The UI system was flooded with claims.
- ▶ 49,023 new unemployment claims filed during the week ending March 21, 2020.
- ▶ An additional 113,149 new claims filed during the week ending March 28, 2020.



Mike Harmon
State Auditor

New Federal Unemployment Programs Created by CARES ACT

- ▶ Pandemic Unemployment Assistance (PUA).
- ▶ Pandemic Emergency Unemployment Compensation (PEUC).
- ▶ Federal Pandemic Unemployment Compensation (FPUC).



Mike Harmon
State Auditor

www.auditor.ky.gov

Pandemic Unemployment Assistance (PUA)

- ▶ PUA funded unemployment benefits for claimants who historically have not been eligible for traditional UI, such as self-employed individuals or “gig” workers.
- ▶ In order to pay claims as quickly as possible, OUI determined that anyone who applied for PUA benefits and was deemed eligible, would receive the minimum PUA benefit.
 - ▶ From program initiation until mid-May 2020, OUI assigned a minimum weekly PUA claim amount of \$180 instead of the correct amount of \$176.
 - ▶ Individuals were not initially given the opportunity to submit documentation of their earnings that might have entitled them to a higher benefit amount.



Mike Harmon
State Auditor

Pandemic Unemployment Assistance (PUA), cont.

- ▶ In addition, when PUA was initially launched, OUI management determined that all PUA claims would be automatically backdated to March 1, 2020.
 - ▶ As a result, claimants could be paid for weeks in which they were still employed.



Mike Harmon
State Auditor

www.auditor.ky.gov

Pandemic Emergency Unemployment Compensation (PEUC)

- ▶ PEUC provided 13 weeks of additional unemployment benefits to eligible individuals whose traditional unemployment benefits have been exhausted.



Mike Harmon
State Auditor

Federal Pandemic Unemployment Compensation (FPUC)

- ▶ FPUC provided an additional \$600 of benefits per week to all eligible claimants receiving at least \$1 of traditional unemployment compensation, PUA, or PEUC.
- ▶ For claimants receiving the maximum weekly benefit for traditional unemployment compensation, this would amount to \$1,152 per week. For claimants receiving PUA, and initially receiving the minimum of \$176 per week, this would amount to \$776 per week.



Mike Harmon
State Auditor

High-Risk Decision: Implementing an “Auto-Pay” Policy

- ▶ OUI leadership made decisions that led to federal law violations & sacrificed program integrity in an attempt to more quickly get payments to unemployed individuals.
 - ▶ Good intentions, bad results.
- ▶ “Auto-Pay” allowed UI benefits to be automatically paid without requiring claimants to report the weekly wage information needed to determine whether they were actually eligible for benefits.
 - ▶ Seasoned OUI and Commonwealth Office of Technology (COT) staff expressed concerns about Auto-Pay, but it was implemented anyway.
- ▶ Auto-Pay was in effect two weeks for traditional UI and eight weeks for PUA.



Mike Harmon
State Auditor

Payments During Auto-Pay

- ▶ While Auto-Pay was in effect:
 - ▶ \$17.8 million was paid in traditional UI benefits;
 - ▶ \$129.9 million was paid in PUA benefits; and
 - ▶ \$507.7 million was paid in FPUC benefits.
- ▶ While not all of these payments were improper, they were all paid in a control environment highly conducive to improper or even fraudulent payments.
 - ▶ A good illustration of the problems caused by Auto-Pay is the example of full-time state employees receiving UI payments.



Mike Harmon
State Auditor

Full-Time State Employees Improperly Received UI Payments

- ▶ Auditors selected a sample of 37 state employees who filed for and received UI benefits.
 - ▶ 16 full-time state employees were paid traditional UI & FPUC for the loss of part-time jobs despite still being employed by the state.
 - ▶ One employee who had resigned from the state & lost a part-time job was underpaid by \$1,030
- ▶ Net overpayment in the sample of 37 employees = \$116,978.



Mike Harmon
State Auditor

How Auto-Pay Contributed to the Improper State Employee Payments

- ▶ Claimants are required to report any earnings during the week for which they are claiming benefits, and their full-time state wages would have made these employees ineligible for benefits.
- ▶ However, the adoption of the “Auto-Pay” policy eliminated the system control that asked claimants to report their weekly earnings, and so the system did not take into account wages from their full-time state employment.
 - ▶ Seven of the state employee claimants did not report full-time wages even when the Auto-Pay period ended.



Mike Harmon
State Auditor

OUI Employees Accessing Their Own Claims

- ▶ At least 10 OUI employees had accessed their own UI claims within the system and had the ability to make changes.
 - ▶ This is a significant internal control risk & OUI didn't follow its own policies to take preventing steps to ensure employees made no changes to their accounts.
- ▶ Auditors weren't able to determine whether the employees had lifted stops on their own accounts, but given the potential for wrongdoing, this finding was referred to the Office of Attorney General & Executive Branch Ethics Commission.

Pervasive Errors & Miscalculations

- ▶ Auditors reviewed a random sample of 99 claim weeks.
- ▶ For 31 claim weeks, incorrect amounts were posted to employer accounts. For traditional UI, these charges are used to calculate employer contribution rates.
- ▶ For 31 claim weeks, benefits were not calculated correctly.
- ▶ These errors cumulatively amounted to \$17,830 in overpayments and \$1,926 in underpayments.
- ▶ Additionally, \$18,867 was overpaid because of OUI backdating PUA & FPUC claims to March 1, to individuals who were still employed during weeks for which benefits were paid.



Mike Harmon
State Auditor

Questioned Costs

- ▶ 2 CFR 200.84 defines “questioned cost” as:
 - ▶ When a cost is questioned by the auditor because of an audit finding that resulted from a **violation of federal law or the terms of a federal award**.
- ▶ Auditors identified all of the **\$655 million** that was paid during Auto-Pay as questioned costs.
 - ▶ There were no controls in place to properly determine and certify claimants’ eligibility during this time period, which violated federal law.



Mike Harmon
State Auditor

Adverse Opinion

- ▶ APA issued an Adverse Opinion on Kentucky’s compliance with federal unemployment insurance program requirements based on the findings in SSWAK, Vol. II.
 - ▶ The OUI findings were significant enough to indicate the Commonwealth did not materially comply with the federal requirements for the UI program.
- ▶ In common terms, “adverse” is the worst opinion that can be issued for an audit.
- ▶ All SSWAK findings are uploaded to a clearinghouse that reports the information to federal oversight agencies.



Mike Harmon
State Auditor

Accounting Errors

- ▶ A \$418.9 million error resulted from understating funds owed to Kentucky from the federal government.
- ▶ A \$7.1 million error occurred in the Commonwealth's Schedule of Expenditures of Federal Awards (SEFA) due to not properly separating CARES from non-CARES expenses.
- ▶ A \$96.6 million error resulted from OUI included two expenses already paid in its accounts payable balance.
- ▶ A \$271.1 million error resulted from not including expenses incurred but not paid in FY 2020 in the accounts payable balance.



Mike Harmon
State Auditor

IT Security & Data Processing Issues

- ▶ Federally mandated and state required monthly system security checks were not performed.
- ▶ The UI mainframe performed various tasks that were undocumented and for which no one at UI or COT could provide an explanation.
- ▶ System updates and software changes were pushed through with improper and missing documentation, lack of testing, and implementation in contravention of the agency's own policies.
- ▶ OUI failed to report data breaches as required by KRS.



Mike Harmon
State Auditor

OUI Improperly Suspended Treasury Offset Program (“TOP”) Collections

- ▶ OUI suspended TOP collections on April 6, 2020 and had not resumed as of February 17, 2021.
 - ▶ States are required to use TOP to collect unemployment compensation debts that remain uncollected a year after becoming due.
- ▶ In May 2020, U.S. Dept. of Labor told OUI that TOP collections could not be suspended and told them again in Feb. 2021.
 - ▶ Nationwide, TOP recovered \$226.9 million for states that participated in the UI program in federal FY 2020.



Mike Harmon
State Auditor

OUI Did Not Provide a Reliable Estimate Accounts Payable as of the end of FY20

- ▶ This led to a qualified audit opinion for the unemployment compensation fund for the Commonwealth's FY 2020 ACFR.
- ▶ OUI didn't realize an estimate was needed until auditors inquired after widespread public reporting of the large backlog of FY20 claims.
- ▶ Estimates provided ranged from \$88.9 million to \$2.08 billion.
- ▶ Auditors learned OUI was still receiving, and in some cases finding, new FY20 claims even into October 2020, which made it difficult to calculate an accurate estimate.



Mike Harmon
State Auditor

The Backlog of Claims

- ▶ Although OUI officials made high-risk decisions, such as implementing the Auto-Pay policy, in an attempt to pay benefits more quickly, many claims still were not timely processed.
- ▶ As of October 29, 2020, the claims backlog of unprocessed, initial jobless claims totaled approximately 80,000.



Mike Harmon
State Auditor

Archiving of UI Assistance Emails

- ▶ Emails received through the UI assistance email link on the OUI website from between March 19 and April 19 were moved to the OUI Assistance Backlog Inbox.
 - ▶ More emails were moved between April 23 and May 10.
- ▶ **As of November 9, 2020, more than 400,000 of these emails remained unread.**
 - ▶ Auditors did not review the specific contents of the 400,000 emails, but these emails could include indications or problems for OUI to address, not to mention general questions from unemployed Kentuckians.



Mike Harmon
State Auditor

Audit Process for FY 2021

- ▶ FY 2021 ended on June 30, 2021.
- ▶ APA auditors are in the early stages of work on the audit of the Commonwealth's Annual Comprehensive Financial Report (ACFR) & Statewide Single Audit for FY 2021.
 - ▶ APA will issue audit opinion on ACFR, typically near end of calendar year.
- ▶ In early 2022, APA will release SSWAK reports for FY 2021:
 - ▶ Volume I on financial statement and internal control findings (approx. February).
 - ▶ Volume II on federal program compliance (late spring).



Mike Harmon
State Auditor

Unemployment System Findings

as reported in

Statewide Single Audit of Kentucky

Volume 1 and Volume 2
Fiscal Year 2020



Office of Auditor Mike Harmon