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| **SENATE MEMBERS****Robert Stivers**President, LRC Co-Chair**David Givens**President Pro Tempore **Damon Thayer**Majority Floor Leader**Morgan McGarvey**Minority Floor Leader**Julie Raque Adams**Majority Caucus Chair**Reginald Thomas**Minority Caucus Chair**Mike Wilson**Majority Whip**Dennis Parrett**Minority Whip |  |  |  | **HOUSE MEMBERS****David W. Osborne**Speaker, LRC Co-Chair**David Meade**Speaker Pro Tempore**Steven Rudy**Majority Floor Leader**Joni L. Jenkins**Minority Floor Leader**Suzanne Miles**Majority Caucus Chair**Derrick Graham**Minority Caucus Chair**Chad McCoy**Majority Whip**Angie Hatton**Minority Whip |
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| **LEGISLATIVE RESEARCH COMMISSION** |
| **State Capitol 700 Capital Avenue Frankfort KY 40601** |
|  | **502-564-8100**Capitol Fax 502-564-2922Annex Fax 502-564-6543legislature.ky.gov**Jay D. Hartz**Director |  |
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**MEMORANDUM**

**TO: Robert Stivers, President of the Senate**

 **David W. Osborne, Speaker of the House**

 **Members of the Legislative Research Commission**

**FROM: Senator Mike Nemes, Co-Chair, Unemployment Insurance Reform Task Force**

 **Representative Russell Webber, Co-Chair, Unemployment Insurance Reform Task Force**

**SUBJECT: Report of the Unemployment Insurance Reform Task Force**

**DATE:** **December 1, 2021**

**OVERVIEW**

In May, 2021, the Legislative Research Commission created and authorized the Unemployment Insurance Reform Task Force. The duties of the task force include, without limitation, the following issues:

1. Review the current unemployment insurance system;
2. Evaluate and discuss possible long term changes to the unemployment insurance system that address the system’s fiscal well-being and stability;
3. Solicit recommendations from stakeholders and interested parties; and
4. Develop a list of recommendations for the General Assembly to consider related to reform of the unemployment insurance system.

The task force met monthly during the 2021 Interim of the General Assembly. The task force shall submit findings and recommendations to the Legislative Research Commission for referral to the appropriate committee or committees by December 1, 2021.

Membership of the task force was established and the initial meeting was held on June 22, 2021. The membership is as follows:

Legislative Members:

Sen. Mike Nemes - Co-Chair

Rep. Russell Webber - Co-Chair

Sen. Ralph Alvarado

Sen. Brandon Storm

Sen. Mike Wilson

Sen. David Yates

Rep. Josh Branscum

Rep. McKenzie Cantrell

Rep. Phillip Pratt

Rep. Scott Sharp

Meetings were held on June 22, 2021, July 27, 2021, August 30, 2021, September 28, 2021, October 28, 2021, and November 30, 2021.

During the June 22, 2021 meeting, members were informed of unemployment insurance issues relating to small businesses, private providers, and fraud.

During the July 27, 2021 meeting, the Labor Cabinet updated the members on the unemployment insurance system and processes.

During the August 30, 2021 meeting, the Auditor of Public Accounts presented the results of an audit of the unemployment insurance system. The members also heard from a constituent regarding issues receiving benefits and in-person appointments. The members also received a presentation from a non-partisan group that studied unemployment insurance systems nationwide.

During the September 28, 2021 meeting, the Labor Cabinet provided another update and proposed unemployment insurance system changes.

During the October 28, 2021 meeting, the Labor Cabinet, the Kentucky Chamber of Commerce, and the Foundation for Government Accountability provided reform recommendations.

During the November 30, 2021 meeting,

**ISSUES DISCUSSED**

**Benefits**

According to the Foundation for Government Accountability (FGA), three steps need to be taken to reform the UI system: institute smart benefit design, prioritize reemployment, and protect the system from fraud. Unemployment insurance is intended to be: assistance for laid off workers, intentionally temporary and limited, modeled after insurance, and paid for by payroll taxes on employers. Unemployment insurance is not designed to be: a long term full wage replacement, workforce development, a form of disability, or paid for by employees. FGA testified that its three-step approach will realign Kentucky’s unemployment insurance system so it can operate as intended.

First, FGA recommended that Kentucky institute a smart benefit design. FGA compared Kentucky’s unemployment insurance system to Florida, North Carolina, and Georgia to demonstrate the changes it believes are necessary. Those states recreated their unemployment insurance systems to increase competitiveness after the 2008 recession. FGA discussed several successful policies these states adopted including indexing of benefits. An indexing policy ties the maximum number of unemployment insurance benefit weeks to the state’s unemployment rate. Florida passed legislation in 2012 implementing an indexing policy which cut the maximum number of benefit weeks to 9.2, decreased program costs from $333 million to $80 million, reduced employer unemployment insurance taxes to $1.50 per $1000, and increased the state’s trust fund solvency from -$1.7 billion to $3.9 billion. According to FGA’s projections, Kentucky could increase its unemployment insurance trust fund by $567 million over three years and decrease the average unemployment insurance tax by 17.3 percent over five years if indexing legislation is adopted. Second, FGA recommended that Kentucky adopt policies that prioritize reemployment and offered policy-models already enacted in other states. These include: more rigorous work search requirements, mandatory job training, an improved system to allow employers to report work refusals, and a job referral program linking the unemployed with employers with positions to fill. Third, and lastly, FGA recommended that Kentucky improve its system security, which is necessary to protect the unemployment insurance trust fund. While Kentucky has been a leader in this area, there are still steps the state should take, such as locking proven fraudsters out of the system and heightened flagging of suspicious cases.

The Labor Cabinet recommended implementation of a short time compensation program that would allow for work sharing between employees in order to avoid layoffs. Individuals would receive a prorated portion of unemployment insurance benefits, in other words, it would ensure less money than full unemployment insurance benefits are paid. Employers would be able to keep qualified employees on the payroll. This change would require statutory amendments and additional staff would likely be required to implement the policy. The Cabinet also recommended making changes to the temporary and limited statutory provisions which allow for a waiver of overpayment of benefits through no fault of the employee. Kentucky is one of a handful of states that does not provide this mechanism.

The Kentucky Chamber recommended several changes originally suggested during the 2019 Regular Session in House Bill 317, including changes to benefit levels and duration of benefits.

**Burdens on Employers**

The Kentucky Chamber noted that it is working on suggestions for reforming the unemployment insurance tax framework in Kentucky in efforts to lessen the burden on employers. The Chamber also noted that the unemployment insurance trust fund must be replenished. It proposed that federal funds could be used for this purpose in order to relieve the burden on employers.

**Administration of the UI program**

The Labor Cabinet restored unemployment insurance in-person services at 13 Kentucky Career Centers and opened a call center to assist unemployment insurance claimants in April 2021. Between April 15, 2021 and September 24, 2021, Kentucky Career Center staff attended more than 56,811 in-person appointments. The Office of Unemployment Insurance (OUI) staff took more than 94,586 calls through the unemployment insurance helpline.

Staffing for the OUI is regulated by the federal government and guidelines are outlined in unemployment insurance program letters. Flexible staffing was approved for the OUI in April 2021, which allowed employees from other state agencies and cabinets to assist with unemployment insurance claims, but the approval expired on September 6, 2021 and was not extended by the federal government. On March 4, 2021, the Labor Cabinet issued a written budget request to legislative leadership which included $1.1 million of general fund dollars for fiscal year 2021 and $8.4 million in fiscal year 2022 to provide funding to restore 90 OUI staff positions. The General Assembly allocated one-time federal funds for these positions.

According to the Labor Cabinet, a one-time allocation of federal funds makes it difficult to attract skilled employees since it creates short-term employment opportunity without guaranteeing future permanent employment. It explained that because the General Assembly allocated federal funds for the 90 positions currently needed, these positions are considered time-limited and will be eliminated after one year when the federal funding expires. Current state employees are reluctant to fill these positions because they are unstable in comparison to state-merit positions.

Additionally, the Labor Cabinet testified that Kentucky could be assigned a Tiger Team by the U.S. Department of Labor. The team is comprised of experts across many disciplines including fraud specialists, equity and customer service specialists, unemployment insurance program specialists, business intelligence analysts, computer systems engineers, and project managers. The Tiger Team will conduct extensive discovery assessments, provide resources for identification verification, and propose solutions to address fraud and equitable access. They will provide the Labor Cabinet with expert advice based on assessments of what was and was not successful in other states. Federal funds and grants for modernization will also be identified by the Tiger Team. The eight-week Tiger Team session began on October 5, 2021.

Recently, Kentucky Career Centers refocused on employment services and began holding regular job fairs. A $1.3 million Reemployment Services and Eligibility Assessment (RESEA) grant from the U.S. Department of Labor was recently awarded; it is geared towards individuals who have likely exhausted unemployment insurance benefits. RESEA requires unemployment insurance claimants to go through an orientation, create an individualized employment plan, and enroll in a case management system.

When COVID-19 infections were surging, Kentucky Career Centers implemented safety protocols to protect staff and claimants. The protocols include: a mask mandate for staff, work stations that are spaced six feet apart, and a requirement that staff contact appointment attendees in advance to verify their current health status.

COVID-19 exposure impacted staffing at multiple Kentucky Career Centers. In these cases, in-person appointments were moved to phone appointments. There are currently 135 Kentucky Career Center staff members with 25 openings across the state.

From March 2020 to September 19, 2021, a total of 2,426,605 unemployment insurance claims were received and a total of $6,640,473,258 paid through all unemployment insurance benefit programs. During the 2021 Regular Session, legislation was passed creating a waiver for overpayment of unemployment insurance benefits. Unemployment insurance claimants began receiving letters in June 2021 regarding overpayments of unemployment insurance benefits. There have been 5,780 overpayment claims processed and $8,333,203.78 in benefits waived thus far. There is currently a back log of about 80,000 unemployment insurance claims, this includes traditional unemployment insurance claims and all other extended pandemic related unemployment insurance claims.

The Labor Cabinet explained that of the 400,000 unanswered emails sent to the OUI that were previously discussed by the Auditor of Public Accounts, only 127,000 of those emails were unique. Of those 127,000 emails, 67,000 were from individuals that are receiving unemployment insurance benefit payments. 24,000 emails still need to be addressed. All OUI email accounts have been reevaluated to ensure that unemployment insurance claimants are able to send communications through the proper channels.

**Unemployment insurance fraud**

Representatives of the Kentucky Chamber of Commerce noted the challenges faced by businesses in combating fraudulently filed unemployment insurance claims. The US. Department of Labor estimated that over $63 billion was paid out across the country in improper or fraudulent unemployment insurance claims in the first 12 months of the COVID-19 pandemic. The Chamber stated concerned that employers ultimately bear the cost of these paid fraudulent claims since employers pay into the unemployment insurance trust fund. A business that assists employers in handling unemployment claims noted that phishing emails, debit card scams, job seeker scams, and phone scams are plaguing an outdated system that is not equipped to handle the large volume of claims. Discussions were held regarding the time period in which an employer can respond to a claim for benefits.

The Labor Cabinet pointed out that due to HB 413, claims were not paid out of the employers’ unemployment insurance account. Therefore, there was no negative impact on employers due to payment of fraudulent claims. Any data breaches that occurred were limited and originated within the OUI. The Cabinet further explained that adjustments were made to prevent future breaches. This included installing a new front door interface and changing the PIN code system. The results of four separate audits that the OUI is undergoing will be made public.

**Workforce concerns**

The Kentucky Association of Private Providers noted that the workforce shortage is a tremendous issue for providers, it has increased overtime costs. Expanded federal pandemic unemployment assistance payments make it difficult for providers to find and hire staff. Medicaid reimbursements allow most providers to pay employees about $10 an hour when the federal pandemic unemployment assistance payments amount to about $15 an hour. In addition, there have been issues with employees being approved for unemployment insurance benefits that had been terminated based on allegations of abuse.

The National Federation of Independent Business/Kentucky conducted a statewide survey of its members and found that about 90 percent of its members had job openings. Some small businesses struggle with unemployment insurance because they do not have a dedicated human resources staff that are knowledgeable on this topic. Small business owners are competing with the expanded federal pandemic unemployment assistance payments. A halt to the expanded federal pandemic unemployment assistance payments was urged.

The Kentucky Chamber emphasized workforce concerns. It noted that workforce participation in Kentucky must improve. Kentucky is one of the highest states in duration of paid unemployment insurance benefits. The Chamber recommended changing the definition of “suitable work” and making it more flexible depending upon the duration of unemployment. Job contacts should be renamed “work search activities” with a definition that explains what does and does not constitute suitable work search activities to allow for a continuation of benefits. The Chamber recommended a robust job referral program and a more efficient way for employers to report workers who refuse interviews or job offers. In addition, work must be done to strengthen the work search audit process within the Labor Cabinet. Also, the skills gap must be addressed.

**Technology concerns**

The taskforce meetings prompted discussions about technology and Kentucky’s unemployment insurance system including: the launch timeline for the upgraded unemployment insurance system, the data breaches of the current system, the efficacy of the existing digital unemployment insurance platform, and the technology-based fraud protection mechanisms.

The Request for Proposals (RFP) for upgrades to the unemployment insurance system is currently in its late stages. The General Assembly passed legislation during the 2018 Regular Session that allows the Service Capacity Upgrade Fund (SCUF) to be used for the RFP. The new system is estimated to cost around $60 million dollars. The current amount in the SCUF account is $40 million.

The second round of RFP for a new unemployment system was released on August 27, 2021 and proposals submitted. Additional language addresses the extensive need for additional system security and requires that the prime vendor previously implemented a similar updated system in another state or jurisdiction. The project is estimated to cost about $47.5 million with $30 million being allocated from restricted funds, $10 million allocated from bond funds, and $7.5 million from the general fund. After a vendor is selected and the contract finalized, it will take 18 to 24 months to implement the modernized unemployment insurance system.

Several members of the task force stated concerns that the cost of the new system will exceed projected costs. The Labor Cabinet indicated they share those concerns and are closely monitoring the process.

Data breaches were frequently mentioned during the task force meetings. The Labor Cabinet explained that adjustments were made to prevent future breaches including installing a new front door interface and changing the PIN code system. Any person that filed an unemployment insurance claim in the last 20 years was required to reset their PIN number and verify their identity.

Auditor Harmon indicated he was aware of two data breaches that were not reported in a timely manner. Sara Beth Gregory added that the Office of Unemployment Insurance was under the Education and Workforce Development Cabinet in FY 2020, when data breaches occurred.

The Labor Cabinet, Office of Unemployment Insurance (OUI), and Commonwealth Office of Technology (COT) leadership met for a three day strategic planning session to identify problems and create solutions in order to improve the unemployment insurance system experience and efficiency. Action items from the session included the virtual appointment process, claimant website improvements, fraud prevention and detection, and a weekly data dashboard. Virtual unemployment insurance appointments will be available to claimants with unresolved issues. OUI will reach out to these claimants starting with the oldest claims first. The online appointment schedule was rolled out September 27, 2021 with an option to have a phone appointment. The claimant website will be improved by adding benchmarks to let the claimant know where they are in the claims process, automated communication for missing information, and a real-time chat function. OUI is also reviewing language on the claimant website to replace industry specific terminology with easier to understand language.

The Labor Cabinet is launching ID.me, a federally certified technology partner used by the Internal Revenue Service and Department of the Treasury for secure digital identity verification, in an effort to increase fraud prevention and detection. A weekly dashboard has been launched to provide weekly updates on the number of: new initial unemployment insurance claims, continuing unemployment insurance claims, and issues with claims. Additionally, it will monitor the total number of claims awaiting claimant action and the total number of claims paid. These issues will continue to be discussed and improved upon through quarterly strategic planning sessions with the Labor Cabinet, OUI, and COT leadership.

**Audit**

The Auditor of Public Accounts does an annual audit of the Commonwealth of Kentucky’s Annual Comprehensive Financial Report in accordance with generally accepted accounting principles. In December 2020, the APA issued a Qualified Audit Opinion on the Unemployment Insurance Fund. Volume I, which was released in February 2021, reports the financial and internal control findings from the audit. Out of the 25 findings for FY 2020, more than half involved the Office of Unemployment Insurance and the Unemployment Insurance Fund. Volume II, which was released in April 2021, reports on compliance with federal requirements for federal awards. Out of 21 findings for FY 2020, eight of those involved the Office of Unemployment Insurance and the Unemployment Insurance Fund and identified $670.7 million in questioned costs, including the $655 million in unemployment insurance benefits paid during FY 2020.

The COVID-19 pandemic presented major challenges for unemployment insurance systems across the country. As a result, three federal unemployment insurance programs were created by the CARES Act: Pandemic Unemployment Assistance (PUA), Pandemic Emergency Unemployment Compensation (PEUC), and Federal Pandemic Unemployment Compensation (FPUC). PUA funded unemployment benefits for claimants who historically have not been eligible for traditional unemployment insurance. In order to pay claims as quickly as possible, the Office of Unemployment Insurance determined that anyone who applied for PUA benefits and was deemed eligible would receive the minimum PUA benefit. In addition, PUA claims were automatically backdated by the Office of Unemployment Insurance to March 1, 2020, which resulted in claimants being paid benefits for weeks when they were potentially still employed. PEUC provided 13 weeks of additional unemployment benefits to eligible individuals whose traditional unemployment benefits had been exhausted. FPUC provided an additional $600 of benefits per week to all eligible claimants receiving at least $1 of traditional unemployment compensation, PUA, or PEUC.

The Office of Unemployment Insurance implemented an auto pay policy in an attempt to distribute benefit payments to unemployed individuals more quickly. According to Auditor Mike Harmon, this decision may have led to federal violations. The implementation of the auto pay feature eliminated the control which required claimants to report the weekly wage information needed to determine whether they were actually eligible for benefits. Long time employees of the Office of Unemployment Insurance and Commonwealth Office of Technology staff expressed concerns about the policy. Auto pay was in effect two weeks for traditional unemployment insurance and eight weeks for PUA. During this time, $17.8 million was paid in traditional unemployment 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 an environment conducive to improper or fraudulent payments which may have led to some full-time state employees receiving unemployment insurance payments.

Auditors selected a sample of 37 full-time state employees who filed for and received unemployment insurance benefits. Of the 37 state employees, 16 were found to have been paid traditional unemployment insurance and FPUC for loss of part-time jobs despite still being employed full time by the state. There was a total net overpayment of $116,978 in the sample.

Auditors also found that 10 employees within the Office of Unemployment Insurance, accessed their own unemployment insurance claims within the system, which violated Office of Unemployment Insurance policies. It could not be determined whether the employees had lifted stops on their own accounts, but, given the potential for wrongdoing, this finding was referred to the office of the Attorney General and the Executive Branch Ethics Commission. Employees accessed their own accounts even though staff are trained not to do so. If stops were removed from those accounts, there was no way for the APA to determine who lifted those stops.

The auditors also reviewed a random sample of 99 claim weeks and found that incorrect amounts were posted to employer accounts and benefits were not calculated correctly during 31 of the sampled claim weeks. These errors cumulatively amounted to $17,830 in overpayments and $1,926 in underpayments. In addition, $18,867 was overpaid because the Office of Unemployment Insurance backdated PUA and FPUC claims to March 1, 2020.

Both federal and state mandated monthly system security checks were not performed, and the unemployment insurance mainframe performed various tasks that went undocumented. System updates and software changes were pushed through with improper and missing documentation, without testing, and without proper implementation in contravention of the Office of Unemployment Insurance’s policies. The agency also failed to report data breaches as required by the Kentucky Revised Statutes. Treasury Offset Program (TOP) collections were also improperly suspended on April 6, 2020, and were not resumed as of February 17, 2021. States are required to use TOP to collect unemployment compensation debts that remain uncollected one year after becoming due. In May 2020 and February 2021, the U.S. Department of Labor notified the Office of Unemployment Insurance that TOP collections could not be suspended. The Office of Unemployment Insurance also failed to provide ACFR estimates for accounts payable in a timely manner. Ultimately, those estimates ranged from $88.9 million to $2.08 billion. Auditors also noted issues with the Office of Unemployment Insurance’s backlog of unemployment insurance claims and an excessive amount of unread emails from claimants.

The Auditor issued an adverse opinion on Kentucky’s compliance with federal unemployment insurance program requirements based on the findings detailed in Volume II. An adverse opinion is the worst opinion that can be issued following an audit. The Office of Unemployment Insurance findings were significant enough to indicate the Commonwealth did not materially comply with the federal requirements for the unemployment insurance program.

The Auditor made several recommendations for the UI system. Those are attached as Appendix I.

A summary of the recommendation of the Kentucky Chamber are attached as Appendix II.

**RECOMMENDATIONS**

The following topics should be explored by the General Assembly:

* Indexing of number of weeks benefits are payable to the state unemployment insurance rate
* Increasing the number of job contacts a claimant must make in a week
* Capping the amount of benefits that can be received if a worker’s regular weekly benefit rate is temporarily increased or supplemented by federal, state, or local funds during a state of emergency
* Change the charging method for employers to a “proportion to base-period wages” method
* Reforming the UI Tax system
* Implementing a comprehensive job referral program into the unemployment insurance system
* Decrease from three years to one year the period of time for an employer to qualify for an experience rating
* Develop ways to improve workforce participation
* Switch the emphasis of the system from unemployment to reemployment.
* Strengthen internal policies of the Labor Cabinet to insure that employees of the Cabinet cannot access their own UI claim information
* Improve transparency and access to information at the Labor Cabinet
* Combat UI fraud by locking known fraudsters out of the system
* Implementation of the recommendations made by the Auditor in his report
* Increased funding of the UI system to implement reforms
* Continued monitoring of the production of a new UI system technology upgrade
* Consider the reforms recommended in House Bill 317 from the 2019 Regular Session

**APPENDIX I**

**KENTUCKY STATE AUDITOR’S RECOMMENDATIONS FOR OFFICE OF UNEMPLOYMENT INSURANCE (FY 2020)**

**Section One:**

**FINDING 2020-001:** We recommend FAC strengthen policies, procedures, and internal controls over the tracking and recording of capital assets to ensure they are recognized and properly reported in accordance with accounting requirements and established policy. Prepared journal entries should be reviewed and verified to ensure the accuracy and completeness of the financial statements.

**FINDING 2020-002:**

* Changes to the closing package process to accurately account for the employer tax overpayment liability should be discussed between FAC and OUI.
* As federal money continues to be received for unemployment compensation, FAC should review the closing package process, specifically for OUI, for possible changes or adjustments to properly classify financial statement line items.
* FAC should review its compilation process to accurately account for the financial activity of the Unemployment Compensation fund.

**FINDING 2020-003:** The COVID-19 pandemic continues to pose challenges to the country’s economy, public health, and governments at all levels. Although the needs of the Commonwealth are great, internal controls exist to ensure that, regardless of the situation, government programs can be executed in the most efficient and effective manner that maintains program integrity, protects taxpayers, and ensures those eligible, and only those eligible, receive all of the benefits to which they are entitled. We recommend, if internal controls must be adjusted based on extraordinary circumstances, program integrity should remain a key objective of the entity.

**FINDING 2020-004:** We recommend OUI develop formal system documentation explaining all processing performed by KEWES and UI-related mainframe batch jobs and interfaces, including critical security functionality enabled. We also recommend OUI ensure the proposed flow documentation is completed. Also, all error warnings generated as well as edits and audits established within KEWES should be thoroughly documented to support the processing being performed by KEWES.

**FINDING 2020-005:** First, we would like to acknowledge how difficult the COVID-19 pandemic was and continues to be. We also realize there was a sense of urgency at the onset of the pandemic to assist the public. However, if management had applied the change controls established, some if not all of the weaknesses commented on within this finding could have been prevented. As such, we recommend OUI update and consistently apply the policies and procedures outlined in the Standard Procedures for Unemployment Insurance System Modification and Enhancement Process document, such as specifically retaining documentation to support the program modification process, including approvals necessary. At a minimum, each change request should include:

* date submitted
* name of the person submitting the request
* name of the person assigned to complete the request
* SOW or detailed steps to resolving the request
* testing procedures performed
* results of testing
* date of testing
* name of tester
* time and date the request is considered resolved
* name of the person approving the proposed resolution.

The policy should also address emergency situations or non-standard requests where a departure from the normal approval process is appropriate and authorized by the agency. The policy should provide examples of what constitutes an emergency situation or a nonstandard request. All policies and procedures related to the program modification process should be distributed to the appropriate personnel and OUI should ensure the policies are consistently applied.

These policies and procedures are crucial to enabling OUI to ensure that individuals only receive benefits in accordance with statutory provisions. OUI plays a fundamental role in ensuring the integrity of their UI program. OUI should continue to operate its programs, both new and existing, in conformity and compliance with federal laws and guidance and promote program integrity.

**FINDING 2020-006:** We recommend OUI restore and strengthen its internal controls to ensure benefits are only granted to eligible claimants. We also recommend OUI implement a process to identify and recapture benefit overpayments caused by the exceptions identified above to the extent required by state and federal law.

**FINDING 2020-007:** We recommend OUI modify its operating manual to require appropriate steps to quantify and verify accurate receivable amounts associated with funds owed to Kentucky from other states and the federal government. This is especially pertinent for the federal receivable due to continued financial support from the federal government for the unemployment insurance program.

**FINDING 2020-008:** The Office of Unemployment Insurance should review claims paid to fully-employed claimants to identify possible improper payments. If improper payments are identified, overpayment amounts should be established and, when required by law, recoveries of the funds should be made.

Key system controls are in place to reduce the risk of improper or fraudulent payments. Those controls should not be removed in the interest of expediency. If management wishes to issue legitimate benefits more expediently, those benefits should be paid without compromising program integrity.

**FINDING 2020-009:** We recommend the OUI Integrity Branch review their operations manual and ensure that procedures are adequate to verify the appropriateness of the accounts payable date range, the completeness of the accounts payable database, and the appropriateness of the query used to determine accounts payable amounts.

In light of ongoing federal financial support for unemployment insurance during the COVID-19 pandemic, we also recommend that OUI consider changing their closing package compilation process to account for these new funding sources.

**FINDING 2020-010:** We recommend the OUI- Integrity Branch review their operations manual and ensure that procedures are adequate to develop reasonable and verifiable estimates for any material benefit payable amounts that cannot be captured by their normal process. OUI should develop procedures that establish internal controls over the determination of the need for estimates and the formulation of those estimates

**FINDING 2020-011:** We recommend COT create written logical security procedures related to the Linux servers to ensure only authorized access is granted. Once finalized, the procedures should be distributed to applicable COT and agency staff to ensure all staff is aware of the requirements for gaining and removing access to servers administered by COT. Within these procedures, COT should ensure agency staff are aware that EIM does not automatically remove a user’s access to the Linux production servers upon exiting the agency.

In addition, we recommend COT develop listings of users with access to Linux servers administered by COT on a periodic basis and provide these to the agency owners for review. COT should request that they review the access rights within the listing and provide confirmation of necessity for all accounts. Any accounts that are no longer needed should be reported to COT with a request for the access to be removed. This type of communication to applicable agencies will help ensure the procedures in place are followed consistently, only necessary and approved accounts remain active, and user accounts are revoked timely, as necessary.

Furthermore, we recommend COT review all password settings established on the four eMARS Linux/Unix servers to ensure they comply with enterprise policies.

Finally, we recommend COT provide a list of all services running on the four eMARS Linux/Unix servers to the Finance Cabinet for review and approval. This process should be performed anytime a new service is installed on the servers. Approvals provided by the Finance Cabinet should be maintained for audit purposes.

**FINDING 2020-012:** We recommend COT comply with CIO-093 by developing SSPs for the core infrastructure systems maintained by COT – Windows, Unix/Linux, Network, Directory Services, and Databases. All SSPs developed should be updated in a timely manner. Finally, all documentation developed to comply with CIO-093 should be distributed to the appropriate personnel to ensure risk is appropriately mitigated throughout the Commonwealth.

**FINDING 2020-013:** We recommend COT ensure ServiceNow is fully implemented and used to track all machines they manage on behalf of the Commonwealth. COT should work with the all state agencies to determine which machines house critical or sensitive information and ensure these are properly secured. We also recommend COT designate which agencies are consolidated on their contact listing.

**FINDING 2020-014:** We recommend Revenue ensure compliance with enterprise policies CIO-093 and CIO106. To comply with these policies, Revenue should assess the privacy impact associated with CARS, EEPS, and ARP by completing the PIA documentation developed by COT. Revenue should also develop an SSP that assigns a Security Categorization for CARS, EEPS, and ARP and conduct and document a risk assessment for these applications. The risk assessment should be repeated at least annually and be updated in a timely manner. Once the documentation has been developed, it should be distributed to the appropriate personnel to ensure risk is appropriately mitigated throughout the Commonwealth. We recommend Revenue apply the same recommendations to DORIS once in production.

**FINDING 2020-015:** We recommend Finance ensure compliance with all enterprise policies by:

* Developing an SSP that assigns a Security Categorization for eMARS that complies with CIO-093.
* Conducting and documenting a risk assessment for eMARS to comply with CIO106. For compliance with CIO-106, the risk assessment should be repeated at least annually and be updated in a timely manner. In addition, once developed, the SSP should be distributed to the appropriate personnel to ensure risk is appropriately mitigated throughout the Commonwealth.
* Fully assess the privacy impact associated with eMARS by completing the PIA documentation developed by COT.

**FINDING 2020-016:** We recommend Finance:

* Sufficiently protect data classified as confidential or internal in compliance with COT enterprise policies and standards by completing current work plans to enhance security over certain confidential and internal data.
* Develop a process to periodically review access granted to Finance employees to ensure the shared directory is properly secured.

**FINDING 2020-017:** We recommend FAC review the internal controls related to the calculation of the compensated absences liability and ensure amounts initially reported are accurate.

**FINDING 2020-018:** We recommend KDA implement adequate internal controls to confirm and validate information provided for the preparation of the SEFA prior to submission. KDA should consult with the Office of the Controller as deemed necessary to ensure compliance with reporting requirements

**FINDING 2020-019:** We recommend KDE:

* Evaluate cash balances for closed grants which are unobligated.
* Consult with its federal grantor to determine if any repayment is necessary.
* Work with the FAC to ensure proper recording of any changes.

**FINDING 2020-020:** We recommend KYTC integrate the monitoring of the central salt repository into its existing asset count process and document the results.

**FINDING 2020-021:** We recommend KYTC revisit and revise its AFR compilation procedures to ensure that receipts are recorded in the proper period so that deferred inflows of resources and revenues are accurately presented in the transportation fund in the Commonwealth’s CAFR.

**FINDING 2020-022:** We recommend OUI ensure compliance with enterprise policies CIO-093 and CIO-106. To comply with these policies, OUI should assess the privacy impact associated with KEWES by completing the PIA documentation developed by COT. OUI should also develop a SSP that assigns a Security Categorization for KEWES and conduct and document a risk assessment for KEWES. The risk assessment should be repeated at least annually and be updated in a timely manner. Once the documentation has been developed, it should be distributed to the appropriate personnel to ensure risk is appropriately mitigated throughout the Commonwealth.

We also recommend OUI assist the DOL and COT with performing monthly, detailed vulnerability assessments against KEWES production servers. OUI should work with DOL and COT to analyze vulnerability scan reports and remediate any weaknesses identified. All vulnerability scan reports, including remediation taken, should be documented and maintained for audit purposes.

**FINDING 2020-023:** We recommend OUI management ensure all steps within the security breach process are consistently completed. Specifically, if a potential breach is identified, designated OUI staff should be contacted immediately. COT should then be notified, as well as the Kentucky State Police, APA, Attorney General, and Finance Secretary within 72 hours. After the incident has been investigated, OUI should inform these same agencies whether the misuse of personal information has occurred. If a breach has occurred, OUI should then follow the procedures regarding notifying individuals impacted.

All OUI staff should be made aware of the agency’s internal procedures related to the requirements of the EDU-00, CIO-090, and associated statutes. OUI staff should be knowledgeable concerning the appropriate actions involved with the identification, reporting, and notification of potential security incidents.

 Finally, OUI should work to ensure the system upgrade is completed to permanently fix the document upload functionality as soon as possible.

**FINDING 2020-024:** We recommend OUI continuously follow the procedures documented in the Computer Access Request Procedures. Also, we recommend OUI update the Computer Access Request Procedures to address the granting of access during emergencies that will allow OUI better control over access to KEWES, along with other systems. In addition, we recommend OUI perform a periodic review of accounts with access to KEWES to ensure they are required. The results of this review, including actions taken, should be documented and retained for audit purposes.

We also recommend access to the SADMIN User account be limited. Additionally, we recommend OUI ensure system changes are made to require periodic password changes within KEWES.

**FINDING 2020-025:** We recommend that OUI review the SEFA submission to ensure all CARES Act expenditures are reported separately from the non-CARES Act expenditures.

**Section Two:**

**FINDING 2020-026**: We recommend DMA ensure compliance with 2 CFR 200.405 and 2 CFR 200.430 by implementing a methodology that accurately accounts for and allocates payroll costs to federal grants based on the work performed. In instances where federal funding is not available for a particular grant’s management costs, other allowable non-federal funding sources should be utilized as to prevent unallowable costs and activities. DMA should consult with FEMA for additional guidance as needed.

**FINDING 2020-030:** We recommend OUI implement formal audit and review procedures to ensure staff with the ability to access, remove, or clear stops on accounts do not perform such actions on their own accounts. Procedures should be in place to monitor whether or not employees have accessed their own account. The Labor Cabinet should adopt and continue the practice of producing the reports detailed in the Kentucky Department of Education Workforce Development Cabinet’s Internal Security Handbook.

**FINDING 2020-031:** We recommend the Commonwealth resume TOP collections in accordance with guidance from the U.S. Department of Labor.

**FINDING 202-034:** We recommend CHFS:

* Establish and implement internal control procedures for monitoring the targeted case management requirements for members covered by the Managed Care Organizations to ensure compliance with the CFR and KARs.
* Ensure files are maintained for the Title V program to ensure the Medicaid members are receiving the assessments and care needed, and to ensure these are for allowable recipients.

**FINDING 2020-035:** We recommend the CHFS implement internal controls by documenting policies and procedures to ensure the MCO SOC reports are evaluated and corrective action is taken if necessary

**FINDING 2020-036:** We recommend CHFS review the internal controls related to earmarking and ensure future compliance with the 10% administrative limit. CHFS should also communicate with the federal government regarding this issue and take appropriate action as needed.

**FINDING 2020-037:** We recommend CHFS review internal controls and consider identifying the program period in the contracts to ensure 90% of the LIHEAP funds are obligated in the first federal fiscal year.

**FINDING 2020-038:** We recommend CHFS maintain supporting documentation used for the preparation of the report to ensure the accuracy of the report data.

**FINDING 2020-039:** We recommend CHFS maintain supporting documentation used for the preparation of the MCH report. For example, for form 6, screenshots of the data could be made when the report is completed. We also recommend CHFS review internal control procedures to ensure the accuracy of the report data.

**FINDING 2020-040:** We recommend CHFS review the ACF 204 reporting procedures to ensure the accuracy of the report data.

**FINDING 2020-041:** We recommend DMA ensure compliance with 2 CFR 200.405 and 2 CFR 200.430 by implementing a methodology that accurately accounts for and allocates payroll costs to federal grants based on the work performed. In instances where federal funding is not available for a particular grant’s management costs, other allowable non-federal funding sources should be utilized as to prevent unallowable costs and activities. DMA should consult with FEMA for additional guidance as needed.

**FINDING 2020-042:** We recommend DWI implement adequate internal controls to ensure the ETA 2112, ETA 2208a, and ETA 9130 reports are reviewed before submission to the U.S. DOL. The ETA 9130 should be certified by an authorized official who is not the report preparer. These internal control procedures should also be shared with the Kentucky Labor Cabinet so that internal controls remain in place if the responsibility for these reports is transitioned.

**FINDING 2020-043:** We recommend KDE implement adequate internal controls and properly manage grant activities to ensure compliance with cash management in accordance with Federal regulations.

**FINDING 2020-044:** We recommend KYTC strengthen its review of expenditures within federal program CFDA 97.036 when compiling the SEFA.

**FINDING 2020-045:** We recommend OSBD continue to work with U.S. Department of the Treasury on a final determination on the application and interpretation of the effective date of distributed guidance, including if guidance issued is to be retroactively applied. For any costs ultimately determined to be unallowable, and outside the period of performance, OSBD should coordinate with KSP to move those expenditures to allowable funding sources and recoup those funds within the State’s CRF. Any returned CRF funds would then be available to be used on other allowable expenses in accordance with established guidelines.

**FINDING 2020-046:** We recommend the following:

* OUI charge only allowable costs incurred during the established period of performance.
* OUI implement internal controls to ensure grant accounting templates are prepared with accurate information and updated when necessary.
* OUI implement internal controls to identify and correct the grant-related accounting errors in a timely manner

**APPENDIX II**

Kentucky Chamber Recommendations to the Unemployment Insurance Task Force
October, 28, 2021

* Provide additional funds to the Unemployment Insurance Trust Fund to return the balance to the pre-pandemic level (approximately $600 million).
* Continue to explore changes proposed in House Bill 317 in the 2019 regular session.
* Make improvements to the unemployment insurance (UI) tax structure. Kentucky’s UI tax structure is generally viewed as one of the worst in the nation due to higher rates than usual and some distortionary features as well. The Kentucky Chamber recently announced a new partnership with the Tax Foundation to conduct a comprehensive review of Kentucky’s tax code and recommend reforms. This review will include analysis of Kentucky’s UI tax structure and suggestions for improvement and will be complete later this year.
* Strengthen Kentucky’s work search requirement. In 2019, the national average for how long an unemployed individual received unemployment benefits was 14.8 weeks. For the states that surround Kentucky, the average was 13.3. Kentucky’s average was 18.2 weeks. **In 2019, this was the longest average benefit duration in the country.**
	+ Redefine “job contact” as “work search activities” and define in statute what constitutes a “work search activity.” Other states’ work search requirements include a broad range of activities that reflect what a modern job search actually looks like and acknowledge that job-seeking skills vary from person-to-person. Kentucky might include work search activities such as:
		- Formally submitting a job application either in person or online
		- Being interviewed for a job virtually, in-person, or in a group interview setting
		- Job shadowing
		- Attending a job fair or networking event hosted by a local chamber of commerce or business organization
		- Participating in a job search skills workshop or seminar
		- Participating in official Kentucky Career Center or partner programs related to job searching or employment

* All work search activities must be fully verifiable. The General Assembly should work with the Cabinet to determine criteria for verifying completion of eligible work search activities.
* Using a broad definition of work search activities as proposed, claimants should conduct at least five work search activities per week to continue receiving benefits. This number is in line with states like Florida, Wisconsin, Utah, Arizona, and Nebraska. There are multiple ways we might structure this requirement, such as specifying that a certain number must be formal job applications or limiting the number of work search activities that can be recorded for a single day. The other 49 states provide a wide range of options and ideas, but **the Chamber believes one job contact per week is a weak goal for a modern-day job search.**
* Update the statutory requirement that claimants find suitable work. Under state law, the Cabinet must consider various criteria in determining what is or is not suitable work for a claimant. This includes factors such as the claimant’s previous wages, their employment history, and their background and skills. In other states, the definition of suitable work can change the longer a claimant remains on unemployment benefits. In New York, for example, the definition of suitable work changes after 10 weeks to include any work that a claimant is able to perform regardless of whether or not they have related experience or training.
* Kentucky should develop a robust job referral program similar to South Carolina’s, in which employers submit job opportunities to their UI administrative agency and then staff at that agency connect claimants directly with those opportunities based on their suitability. Participation in a referral program like this should be tied to benefit eligibility.
* The Cabinet should update its online portal for employers to report candidates who refuse a job offer with an option to also report applicants who fail to show up for interviews without notice. Many Chamber members have reported an uptick in job applicants not showing up for interviews in recent months. This should be reportable and be considered by the Cabinet when evaluating a claimant’s request for benefits. Such a reporting option would not create an automatic termination of benefits but could be a part of the cabinet’s existing auditing of work search requirements.
* Kentucky should look at ways to strengthen and increase the frequency of the auditing processes to ensure claimants are fulfilling work search requirements. The Chamber would like to see some requirements outlined in statute as well as expectations for routine reporting from the Cabinet on the results of audits and data on Kentucky’s work search program. Equally as important, claimants should have a clear understanding of how the Cabinet will hold them accountable to state work search requirements.