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**INDEPENDENT STATE AUDITOR'S REPORT ON
CERTAIN ACTIVITIES OF THE
DIVISION OF UNEMPLOYMENT ASSISTANCE**

**OFFICIAL AUDIT
REPORT
MAY 11, 2010**

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INTRODUCTION

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Unemployment Insurance (UI) is a federal-state program jointly financed through federal and state employer payroll taxes and contributions. UI compensation is intended to provide temporary income protection for workers who have lost their jobs and who are looking for employment. The Division of Unemployment Assistance (DUA) is responsible for administering the state's unemployment insurance program, by providing benefits and transitional services to help Massachusetts citizens get back on the road to re-employment. The DUA is part of the Department of Workforce Development, within the Massachusetts Executive Office of Labor and Workforce Development.

Massachusetts General Law 151A governs the state's unemployment insurance program. This law addresses all aspects of unemployment compensation, including: employers who are subject to this statute; the payments of contributions to the Commonwealth's Unemployment Compensation Fund (UCF) and the rates used; the inclusion of non-profit organizations and governmental employers and their liability for payments; failure to file and collection of overdue payments; unemployment benefits claims; the payment of and eligibility for benefits, claims, and appeals; records and reports; the state advisory council and its powers and duties; the charge-off of uncollectible amounts; and the jurisdiction of action to enforce the statute. Chapter 430 of the Code of Massachusetts Regulations establishes all provisions relative to the DUA, and sets forth all responsibilities incumbent upon businesses, including reporting requirements, contribution reports, wage reports, work records, experience rating, and payment in lieu of contributions.

Federal and state Unemployment Insurance law outlines in detail the rights and responsibilities for both employers and employees. Private, for-profit employers are required to pay contributions into the UCF, which funds the benefits paid to eligible claimants. Governmental or non-profit employers who choose the 'reimbursable' financing method must remit payment to the UCF for actual benefits paid to their former employees. DUA is responsible for revenue enforcement, and has been given strong enforcement powers to prevent and reduce the amount of overdue filing, contributions, and payments. In addition, Chapter 151A, Section 69A, of the General Laws provides for the Charge-off of Debt, allowing DUA to remove debt deemed uncollectible from the accounts receivable records.

In accordance with Chapter 11, Section 12, of the General Laws, the Office of the State Auditor (OSA) had conducted a review of the DUA as of June 30, 2006 with additional information supplied to us through December 31, 2007. Our audit was conducted in accordance with applicable generally accepted government auditing standards for performance audits. The purpose of the audit was to determine whether the DUA was effectively managing its accounts receivable relating to the UCF. Our objective was: (1) to determine if DUA is complying with applicable laws, rules, and regulations in its policies and procedures relating to accounts receivable; (2) to determine whether DUA is using all available tools and methods to collect payments from employers and reduce its accounts receivable; (3) to determine whether DUA performs an aging of its accounts receivable; and (4) to review DUA's policies and procedures for write-offs, and determine how much has been written off over the past five years.

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1. IMPROVEMENTS NEEDED IN MANAGEMENT OF UNEMPLOYMENT INSURANCE (UI) ACCOUNTS RECEIVABLE	16

DUA maintains a substantial accounts receivable balance consisting of delinquent UI contributions, accumulated interest and penalties, and old balances. As of June 30, 2006, DUA's UI accounts receivable balance totaled \$93,870,395 for 37,789 employers. This amount reflected the total owed in employer contributions, surcharges, reimbursable benefits paid, penalties assessed, and interest accrued. It represents amounts owed from private contributory employers, governmental employers who use the reimbursable payment method, and non-profit organizations that choose to use the reimbursable method of payment. It is comprised of both active and suspended accounts¹, and includes balances dating back to 1984. DUA has not used all the collection tools at its disposal to reduce the amount of accounts receivable, recover old amounts that continue to age, and discourage the accumulation of further debt. Based upon the aging of receivable balances, the Private Contributory UI Balance as of June 30, 2006 totaled \$70,565,853. Of that amount, approximately 9%, or \$6,487,653, represents the accounts receivable balance under one year old and 56%, or \$39,230,637, represents the accounts receivable balance over one year and less than seven years old. The remaining \$24,847,563, or 35%, represents the accounts receivable balance between seven and 22 years old. Also, as of December 31, 2007, the accounts receivable balance was \$75,809,172. An aging review of the *Non-Profit Reimbursable UI* balance of \$23,283,154, as of June 30, 2006, and \$28,920,652, as of December 31, 2007, was not available, because aging account data is not reported, as the data system that maintains the reimbursable accounts receivable amount does not have an aging reporting capability. Therefore, DUA cannot determine the percentages of the total balance that can be attributed to the year the debt was incurred. In addition to accumulating accounts receivable debt on an ongoing basis, DUA has also reduced the accounts receivable balance on three separate occasions between 2004 and 2006 by charging off \$98,603,144 of debt deemed uncollectible. By statute, DUA may only charge off debt as uncollectible after six years if the employer has ceased operations. While Chapter 151A, Section 69A of the General Laws allows that debt charge off may occur after six years, DUA uses an eight-year aging criterion, and also requires that an employer be out of business for at least two years. Without strong accounts receivable management, the effect is extensive: thousands of businesses are operating within the Commonwealth without having paid their contribution liability into the UI fund; non-compliant businesses gain an unfair competitive advantage over compliant employers, who are in effect subsidizing the UCF; there is increased risk of abuse of the UI system when businesses do not pay their contribution into the system; businesses could possibly engage in potential violations of the law without fear of the consequences if monitoring is not strengthened; there is little incentive for egregious offenders to comply with the law, since the most stringent collection measures, such as public disclosure of delinquent employers, maximum fines, felony convictions, and suspension of liquor licenses during collection proceedings, are

¹ "Suspended accounts" are those employers who have notified DUA that the business has been closed or, in the case of a sole proprietor, partnership, or certain LLC, may now be operating without any employees. An account that files eight consecutive quarters of no payroll will be suspended by DUA, as required by Chapter 151A.

rarely, if ever, used; and the UCF could have less resources available for current and future payment of benefits and be at risk of insolvency if receivables are not aggressively collected. In response to the audit report, the DUA stated that plans for future improvement and enhancements of its accounts receivable management will take place following implementation of the Quest System which will encompass all DUA revenue, UI benefits and appeals functionality, and labor market employment data. In addition, following the scheduled implementation of the DUA Revenue portion of the system, DUA stated that the recommendations included within the audit report would be pursued. Finally, DUA responded that it would welcome a tax compliance check by Operational Services Division (OSD) prior to the issuance of state contracts.

2. MANAGEMENT OF REIMBURSABLE ACCOUNTS RECEIVABLE NEEDS IMPROVEMENT

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Employers who choose the Reimbursable method as a means of financing their employees' unemployment insurance benefits in lieu of paying quarterly contributions into the UCF are required to reimburse the fund when the actual expenses are incurred. As of June 30, 2006, DUA was owed approximately \$23,283,154 from 1,016 employers using the Reimbursable method, representing actual benefits paid to employees, which must be reimbursed by the employer within 30 days of payment. As of December 31, 2007, the Reimbursable Accounts Receivable balance increased from \$23,283,154 to \$28,920,652, an increase of \$5,637,498, or 24.2%. Of that, \$4,522,664, or 80%, was for active accounts. The total number of employers increased from 1,016 as of June 30, 2006 to 1,118 as of December 31, 2007, a 10% increase. Two annual increases in the maximum UI benefit rate also took place during that time. As the data indicates, there is an increasing trend in activity for both the balances due and the number of employer accounts, as both balances are continuing to grow over time. The data information system used for reporting these receivables is not consistent with that used for the private contributory accounts receivable, and, as a result, does not include the same reporting and monitoring features, such as aging of accounts receivable. When an aging of accounts receivable does not take place, it hampers management's ability to properly and effectively monitor debt and make sound decisions regarding collection activity, results, and current economic trends. In addition, there is no means to reduce the debt that is deemed uncollectible, and, as a result, accrued interest is increasing the accounts receivable balance at a rapid rate, in many cases surpassing the amount of the original charges. An additional analysis of reimbursable accounts over \$100,000 was conducted to determine if any of the employers were currently registered as vendors with the Commonwealth of Massachusetts who had received payments for services rendered under contract. The results were as follows:

- Of the 31 employers reviewed, 15 had state-assigned vendor codes in the Commonwealth of Massachusetts Management Accounting and Reporting System (MMARS); in some cases multiple vendor codes were assigned; their total accounts receivable balance was \$9,331,065.
- Four employers received payments from the state for services rendered under contract within fiscal year 2006; their total accounts receivable balance was \$1,154,268.

Further, although there is a statewide system in place to prohibit taxpayers indebted to the state from receiving revenue from the state (the intercept program), DUA has stated that its accounting system would not be compatible with the intercept system, since DUA uses its own employer identification numbers to account for businesses, instead of either a federal identification number or the state vendor code used for the intercept program. Reduction of this significant debt should be subject to closer monitoring and more aggressive collection measures, since it represents actual expenses incurred that have reduced the UCF and must be reimbursed. In response to the audit report, the DUA stated that it concurred that for Reimbursable employer accounts receivables, data available in monthly reports from the antiquated ARIES system was not detailed enough. DUA noted that it was addressing this shortcoming through the building of the Quest System. Furthermore, DUA acknowledged that the Reimbursable receivables were overstated as collectible. With the implementation of the new system, DUA will eventually be able to charge off debt carried on long-term, out-of-business employers.

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INTRODUCTION

Background

Unemployment Insurance (UI) is a federal-state program jointly financed through federal and state employer payroll taxes and contributions. Through the Social Security Act of 1935, the federal government of the United States (US) required individual states to adopt their own unemployment insurance program. The program had two main objectives: 1) to provide temporary and partial wage replacement to involuntarily unemployed workers who were recently unemployed, and 2) to help stabilize the economy during recessions. The U.S. Department of Labor oversees the system, and each state administers its own program. In 1937, Congress passed the Federal Unemployment Tax Act (FUTA), which authorized the United States Internal Revenue Service (IRS) to collect an annual federal employer tax used to fund state workforce agencies and cover the costs of administering the UI program in all states. The federal government sets broad guidelines for coverage and eligibility, but states vary in how they determine eligibility. Within these federal constraints, individual states are allowed to raise their own contributions and run their own programs.

UI law was enacted to lighten the burden that falls on the unemployed worker and his family. UI compensation is intended to afford benefits to persons who are out of work and unable to secure work through no fault of their own. As noted in Chapter 151A of the Massachusetts General Laws, “...unemployment compensation is not a social welfare program based on need but is specifically directed toward a class of unemployed persons who have been and continue to be attached to the labor force.”² The Division of Unemployment Assistance (DUA) administers the state’s UI program, including the Medical Security Plan, which provides health insurance to certain unemployed workers. In addition, DUA is the primary source for Massachusetts’ jobs and economic data.

Massachusetts Unemployment Insurance Law

Chapter 151A of the General Laws governs the state’s UI program. This law addresses all aspects of unemployment compensation, including: employer payments of contributions to the Commonwealth’s Unemployment Compensation Fund (UCF) and the rates used; non-profit

² Massachusetts General Law 151A, Section 1, *Note 1: Purpose of Law*.

organizations and governmental employers and their liability for payments; failure to file and collection of overdue payments; unemployment benefits claims; the payment of and eligibility for benefits, claims, and appeals; records and reports; the state advisory council and its powers and duties; the charge-off of uncollectible amounts; and the jurisdiction of action to enforce the statute. Over the years, this law has undergone many revisions and amendments to reflect changes in Massachusetts' labor and the economy, and because the law involves taxing businesses and providing economic relief to the state's unemployed, the nuances and politics of UI are very complex.

Massachusetts Regulations Regarding Unemployment Assistance

Chapter 430 of the Code of Massachusetts Regulations (CMR) establishes all provisions relative to the DUA. 430 CMR 5.00, *Employer Requirement Series*, sets forth all responsibilities incumbent upon businesses, including reporting requirements, contribution reports, wage reports, work records, experience rating, and payment in lieu of contributions. 430 CMR 5.06, *Non-profit Organizations and Governmental Employers, Payment in Lieu of Contributions*, states that “All non-profit organizations and governmental employers which have elected to make payments in *lieu* of contributions pursuant to M.G.L. c. 151a, Sec. 14A shall file in the form and manner as prescribed by the Commissioner a quarterly report on wages and employment. Payment shall be made within 30 days, timely payment is required, and past due reimbursement payments in lieu of contributions shall be subject to the same interest, penalties and collection provisions provided for in M.G.L. c.151A, Sec. 14A.”³

Division of Unemployment Assistance

The Department of Workforce Development (DWD) was established in accordance with Chapter 23H, Section 1, of the General Laws, and is the agency within the Massachusetts Executive Office of Labor and Workforce Development (EOLWD) that offers a wide range of programs and resources for both employers and job seekers. The DUA is part of the DWD, and is responsible for administering the UI program in Massachusetts by providing benefits and transitional services to help unemployed Massachusetts citizens get back on the road to re-employment. UI is a temporary income protection program for workers who have lost their jobs and who are able to work, available

³ 430 CMR: Division of Unemployment Assistance, Section 5.06: *Non-profit Organizations and Governmental Employers, Payment in Lieu of Contributions*.

to work, and looking for employment.⁴ Funding for UI benefits comes from quarterly contributions paid by the state's employers to DUA. The *Massachusetts Unemployment Insurance Law* (Chapter 151A of the General Laws of the Commonwealth) governs the UI program, which covers financing, benefits, and eligibility determinations.

Employers' Rights and Responsibilities

The Massachusetts UI law places certain obligations on all employing units – individuals, firms, organizations, and governmental units – that employ one or more persons. A private, for-profit employer is required to pay contributions into the UCF, which in turn funds temporary unemployment benefits to eligible workers filing claims against Massachusetts firms. Governmental or non-profit employers have a different financing option, also known as the “reimbursable method” (see following section on *Other Financing Methods*). In addition to financing the UI program, employers are responsible for participating in the determination of eligibility of claimants when claims are filed.

Employers pay two separate but related contributions to fund UI – one federal and one state. The federal contribution is paid to the IRS under the FUTA. The federal government then covers DUA's administrative costs for the administration of the state's UI program with the FUTA contributions. The state contribution is paid to DUA by employers using the contributory method and is deposited into the UCF. (Note: Governmental and non-profit employers are exempt from the FUTA tax, and in addition, may choose to reimburse DUA dollar-for-dollar for unemployment benefits paid to their workers instead of paying contributions.)

All new employers who have not conducted business in Massachusetts before must immediately notify DUA, and a DUA identification number will be assigned and employer account will be established.⁵ In general, if an employer has employees working one or more days in each of 13 weeks during a calendar year, or pays wages of \$1,500 or more in any calendar quarter, the employer is liable for contributions under the law. The weeks of employment need not be consecutive, nor must the employees remain the same.

⁴ 2007 Commonwealth of Massachusetts, Official Website of the Executive Office of Labor and Workforce Development (EOLWD), *Workforce Development: Overview of Unemployment Insurance*.

⁵ Massachusetts Department of Workforce Development, Division of Unemployment Assistance: *Simplifying the Unemployment Insurance Law: A Guide for Employers*.

In deciding whether an employer is liable for contributions, DUA considers the following:

- The entity for which services are performed,
- The degree of direction and control over the way an employee's services are carried out,
- Where the work is carried out (whether entirely or partially in Massachusetts), and
- The exempt nature of certain classes of employment.

Agricultural employers are subject to the law if total cash wages of \$20,000 or more were paid in any calendar year, or if 10 or more individuals were employed on any day in each of 20 weeks in a year. If domestic workers, including nurses and personal care attendants, were employed and paid \$1,000 or more in cash wages in any calendar quarter, the employer is liable. (This category includes private homeowners, clubs, college fraternities, and sororities.)

Once an employer has registered with DUA, and it has been determined that the employer is required to pay unemployment contributions, this information is maintained within the employer's individual account that has been established at DUA. The account is a record of the employer's wages subject to contribution, the contributions actually paid by the employer, the UI benefits charged to the employer, and any account balance adjustment. DUA uses the account information to determine an annual contribution rate for that employer. The state contribution is "experienced rated," meaning the amount of unemployment contributions an employer pays, based on the assigned rate, is directly related to the amount of UI benefits paid to its employees. It depends on a variety of factors:

- The size of the payroll and wages subject to contribution,
- Contributions previously paid to DUA,
- The amount of unemployment benefits charged against the employer's account,
- The amount of reserves in each employer's account,
- The amount of reserves in the UCF.

In order for the contribution rate to be calculated correctly, employers are required to provide DUA with information about total wages paid on a quarterly basis, using the Contribution Report (Form 1). If an employer does not provide this information, DUA has the right to estimate the amount of

contributions due from any information available, and may assess and collect contributions, penalties, and interest for any quarter for which reports are not received.

In addition to filing a Form 1, employers must pay their contributions on a quarterly basis as well. If an employer does not pay by the due date, a penalty is assessed and a Demand for Payment is sent to any employers underpaying their contribution. By law, interest will be charged on all contributions paid after the due date, and is either 12% per year, or the interest rate established by the Department of Revenue (DOR) as of January 1 of the calendar year, whichever is higher. DUA encourages employers to manage their UI costs like any other business cost, by budgeting and forecasting accordingly.

Employees' Rights and Responsibilities

Unemployed Massachusetts citizens may be eligible for benefits from the UCF. These benefits provide temporary income protection, and are intended to give an unemployed worker time to find a new job equivalent to the one lost, without major financial distress. Unemployment benefits in Massachusetts include the following:

- A weekly benefit of approximately 50% of their weekly wage, up to a maximum of \$600 per week (amount as of the audit period).
- The collection of full benefits for a maximum of 30 weeks.
- An additional \$25 per child per week if the claimant has children, up to a maximum of half of the weekly benefit amount.
- Health insurance coverage for the claimant and his or her family, if certain income eligibility guidelines are met.

With only a few exceptions, the UI law covers most workers in public, private, and non-profit employment. Exempt classes of employment include:

- Services performed for churches and certain religious organizations;
- Work by a child under 18 for the child's mother or father, or by an individual for his or her daughter, son, or spouse;
- Student work-training experience administered by a non-profit or public educational institution;

- Student financial-assistance employment by a school, college, or university where he or she attends classes, or similar employment for the student's spouse – as long as he or she is notified at the time of hire that unemployment insurance is not provided;
- Real estate brokers or salespeople licensed by the state and paid solely on commission;
- Insurance agents or solicitors paid solely on commission (except industrial life insurance agents);
- Sole proprietors and members of partnerships;
- Services performed by an independent contractor – an individual who is free from direction and control, who is working in an independently established business or trade, who is not working in your usual course of business or your usual place of business;
- Certain employees of state and local governments, such as elected officials; those in certain policy-making and advisory positions; members of a legislative body or of the judiciary; emergency employees hired during a disaster; inmates in custodial or penal institutions; and members of the Massachusetts National Guard or Air National Guard.

Initial eligibility for benefits is based on two general criteria: *earnings* and *reason for separation from employment*. Earnings eligibility is based on wages paid to a claimant during the last four completed calendar quarters preceding the effective date of the claim. For separation eligibility, the law requires that workers be totally or partially unemployed through no fault of their own. This means that workers who have been discharged for deliberate misconduct or who leave a job voluntarily without good cause attributable to the employer are not eligible for UI benefits. Federal regulations require that UI claimants conduct an active job search while collecting UI benefits. As a condition of eligibility, DUA requires claimants to make a minimum of three work search contacts per week, keep a written log of these work search contacts, and provide a work search log to DUA upon request. The claimant must also report any earnings received while collecting UI benefits. Once the claimant returns to full-time work status, eligibility ends.

Those claimants who defraud or attempt to defraud the UI program through the fraudulent collection of benefits will be required to repay the overpaid benefits. A variety of collection tools may be utilized, including criminal and civil prosecution, the interception of Massachusetts state income tax refunds, mail and telephone dunning, and the offset of any future unemployment benefits. Additionally, DUA levies a 12% interest charge against any outstanding overpayment balance.

Revenue Enforcement

When employers do not pay their UI contributions and reimbursements, all Massachusetts employers feel the effect, since those businesses that do not pay their fair share gain an unfair competitive advantage over compliant employers who bear an increased burden and are essentially subsidizing the UCF. Moreover, the lower taxes, wages, and other overhead costs that violators improperly benefit from defraud the government of substantial tax revenues. As a result, the UCF has less financial resources available to cover current and future payment of benefits, which can have a significant impact on the economy in general.

The DUA has been given strong enforcement powers to prevent and reduce the amount of overdue filing and contributions. These enforcement tools include:

- Late filing penalties of 10% of the contribution due, with a floor of \$35 and a ceiling of \$1,000 for each late quarter.
- Levies on both a delinquent employer's bank account and state or local government funds owed to the employer after a court judgment and formal notice.
- Liens on real estate.
- Assistance from the state DOR in locating employers not registered with the DUA.
- Civil complaints brought by DUA attorneys.
- Suspension of a delinquent employer's liquor license after a court judgment and a hearing.
- After notification to the employer, public disclosure through the publication of a list of delinquent employers owing more than \$5,000.
- Prosecution of individuals and principals in corporations by the Office of the Attorney General for not filing or paying UI contributions.
- A minimum \$2,500 fine, up to a \$10,000 maximum, for filing but not paying unemployment insurance contributions.
- A minimum \$10,000 fine, up to a \$50,000 maximum, for each quarter and/or a state prison sentence for a felony conviction on contribution evasion charges.

Use of these enforcement measures by the DUA should be a deterrent for employers who willfully avoid compliance with applicable laws and regulations, and gain an unfair competitive advantage over those employers who contribute into the fund as required.

Other Financing Methods

Non-profit organizations and governmental units may finance their UI benefits under an optional method. In lieu of paying quarterly contributions, these employers may choose the ‘reimbursable method,’ whereby UCF is reimbursed only when benefits are actually paid to former employees. Under the reimbursable method, employers are billed for the cost of any and all benefits actually paid and charged to their account. DUA issues a monthly bill for these amounts, and by law, employers must pay this bill within 30 days.

UCF and the Economy

Massachusetts General Law Chapter 151A, Section 48 established the UCF. This fund is separate and apart from all funds of the Commonwealth, and is comprised of all contributions paid by employers into the Office of the State Treasurer for UI. All monies in the fund are pooled and are available to pay benefits to eligible claimants, regardless of the source of the funds.

For payment of administrative costs associated with the administration of the UI law, a separate federal account, the Unemployment Trust Fund (UTF), has been established. UTF is funded through Massachusetts employers’ FUTA payments to the IRS for administration of the state UI program.

The DWD is required by Chapter 151A, Section 14F of the General Laws to submit to the Massachusetts Legislature an annual report that states the actual balance to be credited to the Commonwealth’s account in the UTF, along with a summary of activity to date, and projected data necessary to ensure an adequate and proper average balance based on economic forecasts.

The following information was taken from these reports:

Date	Balance	Private Contributory Account Balance	Governmental Contributory Account Balance
June 30, 2006	\$890.8 million	\$786.9 million	\$103.9 million
June 30, 2007	\$1.247 billion	\$1.136 billion	\$111 million
June 30, 2008	\$1.410 billion	\$1.294 billion	\$116 million

The UI program is sensitive to periods of economic turndown that produce job losses and increased unemployment benefit costs, and is used to help counter these economic fluctuations. When a recession or economic slowdown is expected or underway, the UCF faces higher claims levels and

longer benefits duration, which puts it at risk of possible insolvency. During the 2003 Massachusetts recession, the UCF was facing imminent insolvency, because contributions totaled \$808 million, while benefits disbursed totaled \$1.67 billion, causing an \$869 million deficit. This economic condition forced the adoption of the most recent UI reform measures, in order to create a positive fund balance and weather the economic turndown. The final approved legislation resulted in a new experience rating chart that boosted the UI contributions considerably. Since UI benefits provisions were not changed, this revision in the UI law was intended to increase contributions from employers, which were projected to exceed benefits paid for the foreseeable future. The fund's solvency must be evaluated on a regular basis, to ensure that the level of reserves is sufficient to meet the benefit requirements. Ideally, the fund should build up reserves during periods of economic growth, and then rely upon these reserves to avoid UI contribution increases and/or UI benefits restrictions during economic recessions. If the fund becomes insolvent, the state will be forced to borrow from the federal government, with interest, to pay UI benefits.

Changes in the contributory requirements that burden businesses by way of a new experience rating chart, resulting in increased UI contributions, should be balanced with changes in benefits payments reflected in amount of benefits paid, collection period allowed, and eligibility requirements, resulting in a fair and equitable balance between those in need of the system's benefits and the businesses that are supporting it.

State Advisory Council

Massachusetts General Law Chapter 151A, Section 62 outlines the duties and powers of the State Advisory Council (Council) of the Massachusetts Unemployment Compensation Commission. The Council oversees the administration of the UI law (Chapter 151A), and, according to statute, shall promote, as far as possible, the regularization of employment within the Commonwealth.⁶ It advises the Commissioner of the Massachusetts Unemployment Compensation Commission; aids in the formation of policy; and ensures a fair, impartial, and neutral administration of the UI law, free from political influences. It has full investigatory powers and access to all sources of information relating to employment. The Council is comprised of six members appointed by the Governor for six-year terms, and includes equal representation from employers, employees, and persons representative of the general public. The Council reports the status of the UCF to the Governor and the General

⁶ Massachusetts General Laws, Chapter 151A: Section 62 – *State advisory council; duties, powers and reports.*

Court at least annually, and reports recommendations for changes or additions to the statute necessary for maintaining the solvency of the UCF.

DUA Offices

The administrative offices of the DUA are located at 19 Staniford Street, Boston, MA. In addition, there are four regional hearing offices: Greater Boston, Northeastern Massachusetts, Southeastern Massachusetts, and Western/Central Massachusetts. DUA also offers 33 Walk-in Centers statewide, to assist claimants in filing or re-activating a claim, changing pertinent name and address information, and assisting with any UI questions or issues. In addition, DUA has a statewide network of 37 One-Stop Career Centers that provide job search assistance, career planning information and workshops on job search techniques, data on the current statewide and local job market, resources to find the right training opportunities, and tools to conduct an effective job search. DUA also has a Tele-Claim center, to process claims and communicate claim information via telephone, and a web-based claim center where the claimant may use the Internet to interact with the agency for the purpose of processing claims.

Other Federal Laws and Regulations

The United States Department of Labor (USDOL) establishes the rules and regulations governing UI. Requirements for state laws are included in 42 United States Code (USC) Section 503, and 26 USC Section 3301, which established FUTA. FUTA imposes a federal tax on covered employers, which is currently 6.2% of the first \$7,000 of covered employee wages. Employers are able to receive a credit based on state UI payments, as well as a credit for having a federally approved experience rated State UI tax system. These two combined credits cannot exceed 5.4% of taxable employee wages. FUTA revenues are collected by the IRS and deposited into the General Fund of the United States Department of the Treasury, which by statute are appropriated to the UTF. FUTA revenues are used primarily to finance state and federal administrative expenses, and advances to states with low or exhausted fund balances.

In addition, FUTA Section 3309 (a)(2), as enacted in 1970, states that a non-profit organization or group of governmental entities may elect the reimbursement method rather than the contributory method.

According to the federal Office of Management and Budget (OMB) Circular A-133, Unemployment Compensation (UC) programs are described as providing benefits to unemployed workers for periods of involuntary unemployment, and help stabilize the economy by maintaining spending powers of workers while they are between jobs. The OMB Circular A-133 Compliance Supplement outlines the responsibilities of the USDOL, which include: (1) allocating available administrative funds among states, (2) administering the UTF through the United States Department of the Treasury and monitoring activities of the UTF, (3) establishing program performance measures, (4) monitoring State performance, (5) ensuring conformity and substantial compliance of state law and operations with federal law, and (6) setting broad overall policy for program administration.⁷ State responsibilities include: (1) establishing specific, detailed policies and operating procedures that comply with the requirements of federal laws and regulations; (2) determining the state UI tax structure; (3) collecting state UI contributions from employers (commonly called “unemployment taxes”); (4) determining claimant eligibility and disqualification provisions; (5) making payment of UC benefits to claimants; (6) managing the program’s revenue and benefit administrative functions; (7) administering the programs in accordance with established policies and procedures; and (8) enacting state UC law that conforms with federal UC law.⁸

Although the structure of the federal-state UI program partnership is based on federal law, it is primarily implemented through state law. Except for provisions necessary to comply with federal law, the provisions of state UI laws vary greatly, including their qualifying requirements and methods used to calculate unemployment compensation amounts.

In the event that a state’s UCF becomes insolvent, the federal government can lend money to that state, requiring that all loans be repaid with interest. The need for loans can be exacerbated during times of high unemployment, and/or when a state cuts taxes and increases benefits.

SUTA Dumping Law

In August 2004, Titles III and IV of the Social Security Act (42 U.S.C.503) were amended to include the *SUTA Dumping Prevention Act of 2004 (Public Law 108-295-August 9, 2004)*, for the purpose of improving the administration of unemployment taxes and benefits. (“SUTA” refers to the State

⁷ OMB Circular A-133 Compliance Supplement: *Department of Labor: CFDA 17.225- Unemployment Insurance (UI), March 2007.*

⁸ OMB Circular A-133 Compliance Supplement: *Department of Labor: CFDA 17.225- Unemployment Insurance (UI), March 2007.*

Unemployment Tax Act.) “SUTA dumping” is a term commonly used to describe a practice used by some employers doing business in the United States to circumvent paying unemployment insurance taxes, as mandated by the Unemployment Tax Act of 1939. This practice involves the manipulation of state employer account data using the UI experience rating process. When an employer has a low UI rate, payroll from another entity with a higher UI rate is shifted to that account, and is then “dumped,” allowing it to now pay a lower rate of UI than its history of layoffs would otherwise permit.

The SUTA Dumping Law requires each state to have in effect, by 2006, anti-SUTA dumping legislation that prohibits two particular forms of SUTA dumping, which are described below. It also requires states to impose meaningful civil and criminal penalties for violating or attempting to violate these provisions of state law on employers and those who encourage employers. The USDOL will be required to study and report on state implementation.

In response to the passing of the SUTA Dumping Law, the Massachusetts General Court issued Chapter 138 of the Acts of 2005, *An Act Relative to State Unemployment Tax Avoidance*, amending Chapter 151A, Sections 14N and 14(n)(1) of the General Laws. This law took effect January 1, 2006, and bars the practice of attempting to avoid high unemployment contribution rates through mergers, acquisitions, or restructurings that involve shifting payroll and workforce from an entity with a high contribution rate to one with a lower rate. To help states with the identification of the practice, the USDOL has offered federal funds to implement a UI SUTA Dumping Detection System (SDDS) that the USDOL developed and that has been successfully used in several states. The DUA would be responsible for implementing the SDDS system in Massachusetts, in compliance with federal and state legislation, by the end of 2006. The DUA reported that the SDDS was in fact put into production on September 20, 2006.

Governor’s Joint Enforcement Task Force

On March 12, 2008, Massachusetts Governor Deval L. Patrick signed Executive Order #499, establishing the *Joint Enforcement Task Force on the Underground Economy and Employee Misclassification* (Task Force) to be chaired by the Director of the Department of Labor. This task force is charged with coordinating the efforts of several state agencies to eliminate fraudulent employment activities, which is a nation-wide trend. In addition, “...the Task Force will be working to bring those employers who skirt the laws of the Commonwealth into compliance and create a level playing field

for all businesses to compete and contribute to the economic well being of our state.”⁹ The underground economy, as it is referred to, includes individuals and businesses that willfully avoid compliance with labor, licensing, and tax laws by misclassifying employees and practicing other schemes to conceal their activities and avoid their true tax liability.

The Task Force consists of representatives of several state agencies, including: the Department of Labor, Department of Industrial Accidents, Division of Occupational Safety, DWD, Division of Apprentice Training, Division of Career Services, DUA, Division of Professional Licensure, Executive Office of Public Safety and Security, DOR, and the Attorney General’s Fair Labor Division.

The Task Force shall “coordinate joint efforts to combat the underground economy and employee misclassification, including efforts to: (a) foster compliance with the law by educating business owners and employees about applicable requirements; (b) conduct joint, targeted investigations and enforcement actions against violators; (c) protect the health, safety, and benefit rights of workers; and (d) restore competitive equality for law-abiding businesses.”¹⁰ The Task Force has outlined an action plan to accomplish its mission, and will submit an annual report to the Governor stating the results and recommendations.

The “Task Force” issued its “Joint Task Force Annual Report – 2009,” which indicates that the “Task Force” recovered more than \$1.4 million in its first year of existence.

Other Pending Legislation

In 2007, Senate Bill No. 1099 was introduced as a proposal to combat tax fraud and insurance fraud. The bill proposes to amend Chapter 151A of the General Laws by adding a section entitled “*Failure to contribute to the Unemployment Compensation Fund; stop work orders; penalties; liens; actions brought by losing bidders,*” which proposes that an employer who did not contribute to the UCF must cease all business operations and pay a civil penalty for each day the employer was not in compliance. Further, every state and local licensing agency shall withhold the issuance or renewal of a license or permit to operate a business, and the state shall not enter into any contract for the performance of public work with an employer who is not in compliance with its obligation to contribute to the UCF.

⁹ The Official Website of the EOLWD.

¹⁰ Executive Order No. 499, *Establishing a Joint Enforcement Task Force on the Underground Economy and Employee Misclassification.*

The bill was not enacted.

Chapter 151A, Section 69A of the General Laws: Charge Off of Debt

The charge-off process is the removal of debt including non-filed quarters from DUA's accounts receivable records, and is provided for by Chapter 151A, Section 69A, of the General Laws which states, in part:

...The commissioner, upon certification to the state advisory council, may charge off any delinquent contributions, payments in lieu of contributions, interest, or penalties at any time after six years from the date of delinquency, if the commissioner is satisfied that such amounts are uncollectible. The term "uncollectible", as used in this section, includes, but is not limited to, those situations where (1) the employing unit has ceased operations and (2) the owner, or if the employing unit is or was a corporation, the president, the secretary, and the treasurer, or officers exercising corresponding functions, are deceased or cannot be located.

Once charged off, the debt is not subject to further collection effort, interest calculation ceases, and the liability is suppressed from all accounts receivable reporting. Employers must meet certain pre-selection and selection criteria, such as:

- A term of eight years has expired from the quarter due date to the current date.
- All monetary transactions, excluding experience rating transactions, associated with the employer account have posted dates greater than one year old.
- The debt is greater than \$1.99.
- There are suspended non-filed quarters (but not if they are assessed).

Certain debt types are excluded from charge off, such as assessed debt, previously charged-off debt, or if the employer has activity in wage reporting per the DOR.

Audit Scope, Objectives, and Methodology

In accordance with Chapter 11, Section 12, of the General Laws, the Office of the State Auditor (OSA) conducted a review of the DUA as of June 30, 2006 with additional information supplied to us through December 31, 2007. Our audit was conducted in accordance with applicable generally accepted government auditing standards for performance audits. The purpose of the audit was to determine whether the DUA was effectively managing its accounts receivable relating to the UCF. Our objective was: (1) to determine if DUA is complying with applicable laws, rules, and regulations in its policies and procedures relating to accounts receivable; (2) to determine whether DUA is using

all available tools and methods to collect payments from employers and reduce its accounts receivable; (3) to determine whether DUA performs an aging of its accounts receivable; and (4) to review DUA's policies and procedures for write-offs, and determine how much has been written off over the past five years.

Our audit methodology included reviewing DUA's enabling legislation and applicable federal and state laws, rules, regulations, policies, and procedures. In addition, we also reviewed various management and financial records and documents, including accounts receivable summary and detail reports, accounts receivable aging reports, charge-off reports, and employer information on file with the Office of the Secretary of State and the Office of the State Comptroller. We also interviewed responsible DUA officials and personnel, and performed selected tests of operations.

As detailed in the Audit Results section of the report, improvements are needed in DUA's management of UI Accounts Receivable, as follows: a) DUA maintains a high accounts receivable balance consisting of delinquent UI contributions, accumulated interest and penalties, and old balances; b) DUA has not used all the collection tools at its disposal to the fullest extent; and c) DUA has charged off almost \$98 million between 2004 and 2006. Additionally, improvements are also needed in DUA's management of Reimbursable Accounts Receivable, as follows: a) as of December 31, 2007, DUA is owed \$28,920,651.77 from employers who have chosen to use the reimbursable method, which represents actual debt incurred in the form of benefits paid to employees, and must be reimbursed by the employer; b) there is no accounts receivable aging to properly and effectively monitor the debt; c) a reduction of this significant debt should be subject to closer monitoring and more aggressive collection measures; and d) there is currently no charge-off mechanism in place to reduce the debt that is deemed uncollectible.

AUDIT RESULTS

1. IMPROVEMENTS NEEDED IN MANAGEMENT OF UNEMPLOYMENT INSURANCE (UI) ACCOUNTS RECEIVABLE

According to regulations promulgated by the Office of the State Comptroller (OSC), state departments are required to follow certain procedures relative to the collection of outstanding debt. In this regard, the OSC's 815 Code of Massachusetts Regulations (CMR) 9.05, Department Internal Debt Collection Obligations, discusses diligent efforts for collecting past due debt, as follows:

Departments are responsible for making diligent efforts to collect legislatively authorized accounts receivable and debts due the State. Departments shall maintain detailed records for all accounts receivable; debts....

Each department of the Commonwealth is responsible for accounting for, recording, reporting, and depositing funds for all services. Departmental revenues that are not collected at the point of service are generated through the initiation of billings by departments. As part of the accounting cycle, once bills are generated, departments must maintain accurate records for all payments made to the Commonwealth as well as all unpaid bills. These unpaid bills represent an accurate receivable balance on the department's accounting system. Accounts receivable balance must be managed, monitored, and "aged," a process by which all unpaid bills are categorized by the number of days each billing has been outstanding or unpaid. All long-outstanding accounts receivable that are past due should be aggressively pursued by departments so that the accounts do not become uncollectible and have to be written off, since the older an accounts receivable gets, the less likely it will be collected.

Although DUA's accounts receivable are unique in how they are created, nonetheless, they are still accounts receivable and should be under the same guidance as any other departmental accounts receivable.

DUA maintains a substantial accounts receivable balance consisting of delinquent UI contributions, accumulated interest and penalties, and old balances. DUA has not used all the collection tools at its disposal to reduce the amount of accounts receivable, recover old amounts that continue to age, and discourage the accumulation of further debt. In addition to accumulating accounts receivable debt on an ongoing basis, DUA has reduced the accounts

receivable balance by charging off over \$98 million deemed uncollectible between 2004 and 2006.

a. Analysis of Balance

As of June 30, 2006, DUA's UI accounts receivable balance totaled \$93,870,395 for 37,789 employers. This amount reflected the total owed in employer contributions, surcharges, reimbursable benefits paid, penalties assessed, and interest accrued. It represents amounts owed from private contributory employers, governmental employers who use the reimbursable payment method, and non-profit organizations that choose to use the reimbursable method of payment. It is comprised of both active and suspended accounts¹¹, and includes balances dating back to 1984. The breakdown of the balance, including active and suspended accounts, is as follows:

**Analysis of UI Accounts Receivable Balances by Status
June 30, 2006**

Type of Unemployment Insurance	Total	Active	Suspended	Number of Employers
Private Contributory	\$70,565,853	\$32,124,455	\$38,441,398	36,714
Non-profit Reimbursable	23,283,154	14,251,705	9,031,449	1,016
Governmental Reimbursable*	<u>21,388</u>	<u>21,388</u>	<u>-</u>	<u>59</u>
Total	<u>\$93,870,395</u>	<u>\$46,397,548</u>	<u>\$47,472,847</u>	<u>37,789</u>

*System does not classify suspended accounts

Liability Range

Of the \$70.5 million owed from private contributory employers, nearly half, or \$33.8 million (48%), represented amounts from 644 employers whose individual liability exceeded \$20,000 and in one instance totaled \$910,793. Additionally, of the nearly \$23.3 million owed from non-profit and governmental reimbursable employers, 85%, or \$19.8 million, represented amounts from 128 employers whose individual liability exceeded \$20,000, and in one instance totaled \$4,100,490.

¹¹ "Suspended accounts" are those employers who have notified DUA that the business has been closed or, in the case of a sole proprietor, partnership, or certain LLC, may now be operating without any employees. An account that files eight consecutive quarters of no payroll will be suspended by DUA, as required by Chapter 151A.

**Analysis of UI Accounts Receivable Balance Range
June 30, 2006**

Liability Range	Private Contributory		Non-profit Reimbursable	
	Total Amount	Number of Employers	Total Amount	Number of Employers
\$100K or more	\$11,033,321	59	\$15,396,803	31
\$50K to \$100K	9,623,578	144	2,417,869	34
\$20K to \$50K	13,173,447	441	2,034,031	63
Under \$20K	<u>36,735,507</u>	<u>36,070</u>	<u>3,434,451</u>	<u>888</u>
Total	<u>\$70,565,853</u>	<u>36,714</u>	<u>\$23,283,154</u>	<u>1,016</u>

Penalties and Interest

If employer contribution payment has not been made within 31 days, the account becomes delinquent, and interest and late penalties may be assessed. An interest rate of either 12% per year, or the interest rate established by the Department of Revenue as of January 1 of the calendar year, whichever is higher, is assessed. The table below illustrates the amount of calculated interest and penalties that are a part of the total accounts receivable balance.

**Analysis of UI Accounts Receivable Balance by Composition
June 30, 2006**

Type of Unemployment Insurance	Total	Employer Contribution	Interest and Penalties
Private Contributory	\$70,565,853	\$46,003,816	\$24,562,037
Non-profit Reimbursable	23,283,154	15,732,324	7,551,830
Governmental Reimbursable	21,388*	-	-
Total	<u>\$93,870,395</u>	<u>\$61,736,140</u>	<u>\$32,113,867</u>

*DUA summary report does not identify by employer contribution and/or interest and penalties.

The over \$32 million in interest and penalties from the above table is 34% of the total accounts receivable balance for the 37,789 employers. This amount has reached such a high level due to the lack of a charge-off mechanism to reduce the reimbursable accounts receivable, and the large number of private contributory accounts receivable that are either old or high, and thereby continue to accrue interest and penalties.

We selected a sample of 25 employer accounts, which included 10 private contributory employers, 10 non-profit reimbursable employers, and five employers whose balances had been charged-off, to analyze the account activity. In reviewing accumulated interest and penalties, we found that this amount was significant, and many cases exceeded the contribution or the

reimbursable charge, especially for the non-profit reimbursable accounts. For example, of 10 reimbursable accounts reviewed, we found:

- For nine out of 10 (90%) accounts, accrued interest and penalties were higher than the original charge; the total amount due was \$11,761,720; of that, \$4,441,126 (38%) represented original charges, while \$7,320,594 (62%) was accrued interest and penalties.
- The highest individual balance as of June 30, 2006 was \$4,100,490, of which \$1,852,156 (45%) was the original charge (payment due from employer), and \$2,248,334 (55%) was accrued interest and penalties. The employer's status as of April 30, 2007 was designated as *bankrupt*, and this balance, which continues to increase, dates back to at least 1998, according to data provided by DUA dated May 17, 2007.
- In another instance, the accumulated interest and penalty calculation of \$1,291,447.29 was more than *three times* the amount of the original charge of \$402,618.98; the employer's current status is designated as *suspended*, and this balance, which continues to increase, dates back to 1991, as reported in the account detail.

Aging of Accounts Receivable

Aging of accounts receivable represents the presentation of balances chronologically according to the date the debt was incurred. It is a key element of effective accounts receivable management, and factors into collection activity decisions, since the likelihood of collecting current debt decreases with the age of the debt. A review of the aging of the *private contributory UI* disclosed the following:

Aging of Private Contributory UI Balance as of June 30, 2006

Age	Amount	Percentage of Total
Under 1 year	\$ 6,487,653	9%
1 year	12,050,730	17%
2 years	9,003,156	13%
3 years	4,606,609	7%
4 years	4,542,171	6%
5 years	4,365,894	6%
6 years	4,662,077	7%
7 – 22 years	<u>24,847,563</u>	<u>35%</u>
Total	<u>\$ 70,565,853</u>	<u>100%</u>

An aging review of the *Non-Profit Reimbursable UI* balance of \$23,283,154 could not be completed, because aging account data is not reported, as the data system that maintains the reimbursable accounts receivable does not have an aging reporting capability. Therefore, DUA

cannot determine the percentages of the total balance that can be attributed to the year the debt was incurred.

Current Data and Trends

During the course of the audit, we summarized and reviewed certain additional accounts receivable data dated October 31, 2006, April 30, 2007, and December 31, 2007, comparing it to the June 30, 2006 balances detailed above, noting any trends. Our review of active and suspended accounts receivable data is as follows:

Analysis of Accounts Receivable Data through December 31, 2007 Private Contributory UI

Date	Total	Active	Suspended	Number of Employers
June 30, 2006	\$70,565,853.45	\$32,124,454.80	\$38,441,398.65	36,714
October 31, 2006*	65,602,127.12	33,233,869.09	32,368,258.03	34,316
April 30, 2007	67,232,132.97	31,045,052.57	36,187,080.40	33,968
December 31, 2007	75,809,172.47	34,573,994.89	41,235,177.58	34,988

*Charge-off of \$9,418,611.21 for 9,669 employers took place on October 5, 2006.

This analysis illustrates the growth that took place between June 2006 and December 2007 for private contributory accounts receivable, even taking into account the significant charge-off activity that also took place during that time period.

For Non-Profit Reimbursable Accounts Receivable, the total balance increased from \$23,283,153.53 as of June 30, 2006, to \$28,920,651.77 as of December 31, 2007, a 19.5% increase. The number of total employers with accounts receivable balances increased from 1,016 to 1,118, or 9%. Again, these statistics indicate a growing trend amongst employers to accumulate debt and not reduce their liability by making timely payments on the balances owed.

b. Collection Activity

Enforcement Options

In accordance with Chapter 151A, Sections 15 through 16, of the General Laws, DUA has a number of powerful enforcement tools at its disposal to prevent the accumulation of unpaid taxes and to collect the contributions and reimbursement payments that are owed to them. These tools include:

- Ongoing, random audits of employer accounts to determine if all workers are properly classified and wages properly reported.
- Late filing penalties of 10% of the contribution due, with a floor of \$35 and a ceiling of \$1,000 for each late quarter.
- Assessments, whereby the amount owed gets re-calculated into an estimate using a higher rate based on past activity, resulting in a substantially greater amount, including the calculation of interest and penalties.
- Levies on both a delinquent employer's bank account and state or local government funds owed to the employer after a court judgment and formal notice.
- Liens on real estate.
- Assistance from the DOR in locating employers not registered with the DUA.
- Civil complaints brought by DUA attorneys.
- Suspension of a delinquent employer's liquor license after a court judgment and a hearing.
- After notification, public disclosure through the publication of a list of delinquent employers owing more than \$5,000.
- Prosecution of individuals and principals in corporations by the Office of the Attorney General for not filing or paying unemployment insurance contributions.
- A minimum \$2,500 fine, up to \$10,000 maximum, for filing but not paying unemployment insurance contributions.
- A minimum \$10,000 fine, up to \$50,000 maximum, for each quarter and/or a state prison sentence for a felony conviction on contribution evasion charges.

Traditional collection methods do not always bring employers into compliance. As a result, there is a significant compliance issue regarding the large number of businesses that repeatedly do not file their quarterly returns or remit their contributions, especially those offenders considered to be "egregious," i.e., those debtors who refuse to comply and accumulate dozens of quarters of debt. A review of a sample of 10 employers with private contributory balances as of June 30, 2006 disclosed:

- One employer's balance of \$775,942 was comprised of 22 delinquent quarters for the period July 1, 1998 through December 31, 2003. The business was permanently discontinued as of 2005.

- One employer's balance of \$479,377 was comprised of 17 delinquent quarters for the period October 1, 1998 through March 30, 2003. The business ceased as an employer as of 2005.
- The remaining eight employers reviewed had balances ranging from \$223,514 to \$622,031, representing an average of 12 outstanding quarters, with some balances dating back to 1991.

Without stringent collection efforts, there is the risk of businesses deliberately abusing the UI system, or, in the worst-case scenario, engaging in a potential violation of the law activity, such as SUTA dumping, which is the deliberate circumvention of paying unemployment insurance by manipulating the experience rating process.

As a first step in maintaining a collection process for accounts receivable balances, the 815 CMR 9.05(2), promulgated by the Office of the State Comptroller (OSC), states:

- (d) *Dunning Notices. If the initial bill is not paid in full by the debtor by the payment due date, and the debt has not been disputed by the debtor, a Department must demonstrate diligent efforts to collect the debt. Diligent efforts shall include at a minimum, but shall not be limited to, three written billing and dunning notices in addition to the initial billing, and a final notice as follows....*
- (f) *Final Notice. The final 90 days past due notice outlined in 815 CMR 9.05(2)(d) 4 shall contain language notifying the debtor that the debt has be referred for either intercept or to a Collection Agency for collection, or both.*

The standard dunning notice developed by OSC for outstanding debts for more than 90 days is as follows:

Please be advised that your account has been deemed delinquent for failure to pay and has been referred for assessment of late charges, intercept of state payments, including state tax refunds under MGL [Chapter] 62D, and referral to a collection agency under MGL [Chapter] 7A and 815 CMR 9.00 Multiple Notices of your right to dispute this debt....

Collection Process

DUA's collection process generally involves the following steps:

1. Notification of debt: Once a business has incurred the liability, DUA sends a series of notice letters (known as Dunning letters) to encourage compliance. This notification stage generally lasts about 14 weeks.
2. Assessment: If a business still has not paid its debt after notices have been sent, DUA charges an assessment to the balance, whereby the quarterly contribution gets re-calculated, based on past activity, resulting in a substantially higher charge. This estimate

- includes the calculation of interest and penalties, and many times provides a necessary impetus to make payment.
3. Collection Action: If a business still does not pay the UI contribution, the aggressiveness of the collection effort can increase, to include a property lien, levy, and/or seizure. The filing of a *lien* enables the property of the business to be used as security for their outstanding debt. The notice of lien is a public notice to current and potential creditors of the state's interest in the business's property. *Levies* are legal seizures of an employer's assets to satisfy a tax delinquency. The difference between a lien and a levy is that property is used as security under a lien, while a levy allows for actual taking of the property to satisfy the debt. Assets that are *seized* may be sold (assuming there are no loans associated with the property), and the proceeds are applied to the outstanding debt.
 4. Legal remedies, fines, public disclosure: If previous collection actions have been exhausted or it becomes futile to continue, a civil complaint can be brought before the court by DUA's attorneys, resulting in the prosecution of individuals and principals in corporations by the Office of the Attorney General for not filing or paying unemployment insurance contributions. In addition, DUA has established significant fines that may be placed on delinquent employers for non-payment of their unemployment contributions, ranging from a minimum \$2,500 fine up to a \$10,000 maximum, or for filing but not paying unemployment insurance contributions. If contribution evasion charges are brought forth against an employer for deliberate non-payment of UI, and a felony conviction is received, a minimum \$10,000 fine, up to a \$50,000 maximum, for each quarter and/or a state prison sentence may be received by an employer. Further, if fraudulent activity can be determined, a criminal investigation can be pursued. A delinquent employer who owns a liquor license may have that license suspended, after a court judgment and a hearing. Finally, a list of delinquent employers owing more than \$5,000 can be publicly disclosed, after notification.

Analysis of Collection Activity

Although the DUA has these powerful collection tools at their disposal, there are still a significant number of businesses that continue to accumulate UI debt for dozens of payroll quarters. Our review of the collection activity for 10 accounts of private contributory employers whose balances dated back to 1991 noted the following:

- Dunning and Demand letters were sent to six of the 10 accounts reviewed; in several instances, more than one letter of each was sent to an employer. These accounts had balances ranging from \$223,514 to \$705,951, and dated back to 1996. Collection history provided by DUA did not indicate that dunning notices had been sent to the other four accounts.
- An increase in the employer's experience rating took place in four of the 10 cases reviewed; in two cases the rate changed more than once. An experience rating increase results in a higher unemployment contribution payment by the employer.

- A Field Service visit took place in two of the 10 cases reviewed, where employer accounts were audited for workers properly classified and wages properly reported.
- Assessments were sent in five of the 10 cases reviewed, which included a re-calculation of the amount owed using a higher rate based on past activity and resulting in a substantially greater amount.
- Liens were generated in seven of the 10 cases reviewed, usually more than once. In one case a lien was generated on nine separate occasions.
- There were three cases in levy of the 10 cases reviewed.
- There were no civil complaints filed for any of the 10 cases reviewed, although DUA provided us with documentation for some other cases that a civil complaint had been brought against.
- Our sample did not include any cases that had been referred to the Office of the Attorney General for prosecution, although DUA provided us with documentation for some other cases that had been forwarded to the office for our review.
- Our sample did not include any cases indicating a suspension of liquor license, public disclosure, imposition of a fine of \$2,500 - \$10,000, or imposition of a fine and/or prison sentence for felony conviction on contribution evasion charges. DUA noted that they had never used the public disclosure action.

DUA did not provide any criteria or internal policies or procedures governing how, if, or when any of these activities are to take place.

When DUA does not take prompt, aggressive collection actions against businesses that repeatedly do not remit UI contributions, an employer further accumulates debt, which over time may compound beyond the employer's ability to pay, ultimately placing the employer in financial jeopardy. More importantly, the opportunity to ultimately collect what is owed to the UI Fund is reduced significantly. The broader impact to the economy is that these businesses gain an unfair competitive advantage over the compliant employer, who is bearing an increased burden and is essentially subsidizing the UI Fund, which has less financial resources available to cover current and future payment of benefits. In addition, there is a general perception by employers regarding the fairness of a system where there is non-compliance, which then has the effect of increasing the cases of non-compliance. In times of fiscal and economic crisis, the government cannot afford to allow businesses to operate with this accumulating debt, with little or no consequences.

Timely collection action can help deter future non-payment and result in increased opportunity to collect the debt. By having a reticence to take aggressive collection action, DUA runs the risk of eventually diminishing contributions over time. When a business repeatedly does not comply after attempts to collect, they are acting as an egregious offender, and taking legal action or taking action against the owner's personal assets may be the most effective means of getting the business to be compliant. Certainly public disclosure of debt, or the threat to do so, can be a deterrent and encourage greater tax compliance.

Another means of improving collection effectiveness is the institution of performance measuring and monitoring of the results of collection actions. This would be accomplished by monitoring the level of activity, the number of actions taken, and the result of these actions. Specific performance goals that evaluate the accumulation of unpaid UI contributions, especially for the egregious offender, and the result of collection action taken should be developed. This would be useful in measuring the success/failure of various collection measures, and would help formulate more effective approaches in dealing with this compliance issue.

DUA's primary goal in its collection effort should be to prevent businesses from accumulating additional tax debt without regard for the existing tax laws. It is vital that the full range of its collection tools be used against businesses with significant debt, especially those businesses that have demonstrated a history of non-compliance, who have a legal and fiduciary obligation to pay.

While further analyzing the UI accounts receivable balances for private contributory employers, we identified those employers whose balances were \$100,000 and above, in order to determine the area where aggressive collection efforts may be most beneficial.

**Private Contributory UI
Employers with Balances of \$100K +**

Accounts Receivable Date	Number Of Employers	Total Receivable Balance	Active	Suspended	Percentage of Total Accounts Receivable
June 30, 2006	59	\$11,033,320.63	\$4,860,393.42	\$6,172,927.21	15.6%
October 31, 2006	61	11,199,957.57	5,851,353.36	5,348,604.21	17.1%
April 30, 2007	61	10,483,706.49	4,006,647.26	6,477,059.23	15.6%
December 31, 2007	70	12,706,541.27	5,363,442.68	7,343,098.59	16.7%

In addition, based on the data we received for the reimbursable accounts receivable, there were 31 employers with balances over \$100K as of June 30, 2006, for a total of \$15,396,802.66, and 39 employers with balances over \$100K as of December 31, 2007, for a total of \$18,402,213.14.

As the above data indicates, a concentrated and timely collection effort could reduce the accounts receivable balance significantly, since those employers with balances over \$100,000 consistently account for between 15 - 17% of the total balance.

c. Charge-off Authority

The charge-off process, in accordance with Chapter 151A, Section 69A, of the General Laws, results in the removal of the debt from DUA's accounts receivable records but does not forgive the debt.¹² Chapter 151A, Section 69A states, in part, as follows:

The commissioner, upon certification to the state advisory council, may charge off any delinquent contributions, payments in lieu of contributions, interest, or any penalties at any time after six years from the date of delinquency, if the commissioner is satisfied that such amounts are uncollectible. The term "uncollectible", as used in this section, includes, but is not limited to those situations where (1) the employing unit has ceased operations and (2) the owner, or if the employing unit is or was a corporation, the president, the secretary, and the treasurer, or officers exercising corresponding functions, are deceased or cannot be located.

DUA indicated that they use an eight-year aging criterion, and also require that an employer be out of business for at least two years.

As part of the analysis of the June 30, 2006 accounts receivable balance, we reviewed all charge-off activity that took place prior to that date, since it represented debt that was removed from the accounts receivable balance. We also reviewed the October 2006 charge off, which subsequently had taken place. There were three separate aggregate charge offs totaling \$98,603,143.81 that took place:

- November 2004: \$82,631,762.38
- September 2005: \$6,552,770.22
- October 2006: \$9,418,611.21

¹² Division of Unemployment Assistance Memorandum, Legal Department; To: Advisory Council, From: John P. O'Leary, Commissioner, Re: Charging Off Uncollectible Accounts, Date: November 10, 2004.

Charge-off activity is only applied to private contributory accounts receivable. Governmental and non-profit reimbursable accounts receivable did not take advantage of any charge-off measures, since the data system that maintains the reimbursable accounts receivable is different from the system used to maintain contributory account activity, and because it does not have an aging reporting capability, it is unable to determine applicable charge-off amounts and accommodate the removal of debt for these accounts. As a result, these accounts remain on the accounts receivable file indefinitely.

On November 10, 2004, in a memorandum to the Council of the Massachusetts Unemployment Compensation Commission by the Commissioner, a list of employers whose debt was deemed “uncollectible” and therefore qualified under statute to be charged off and removed from DUA’s accounts receivable record was presented for charge-off approval. The amount of this debt was \$82,631,762, which represented debt owed by 43,280 employers. Of that total, \$29,066,595 (35%) represented principle, and \$53,565,166 (65%) represented accumulated interest and penalties. Prior to this charge off, DUA officials could not recall any past charge-off activity.

On September 16, 2005, the Council authorized another charge off, in the amount of \$6,552,770. This included \$2,412,488 (37%) in principal, and \$4,140,282 (63%) in interest on that principal, and represented 4,807 employers with debt. These individual charge offs were posted to employers’ accounts on September 23, 2005.

When taking into account the above charge-off activity totaling approximately \$89 million for private contributory employers, and adding it to the June 30, 2006 accounts receivable balance of approximately \$70.5 million, it would make the total accounts receivable balance on June 30, 2006, if amounts had not been charged off, approximately \$160 million in private contributory debt, penalties, and interest owed to DUA.

Finally, a third charge-off recommendation was brought before the Council on September 15, 2006, for the removal of \$9,418,611 of debt. This was comprised of \$4,249,647 (45%) in principal, and \$5,168,964 (55%) in interest on that principal. There were 9,669 employers who were granted charge offs of their UI accounts receivable balances.

We reviewed the individual charge-off activity for October 2006 for those businesses whose charge-off amount was \$50,000 and above. There were 18 employers in that category. Although DUA used legal enforcement tools within its authority to pursue delinquency after the employers listed below had ceased operation and several years before the debts were subject to charge off, we found the following:

- The highest individual employer charge off was for \$522,437.17, and represented 15 quarters, for the time period from April 1, 1994 to June 30, 1998; the original contribution was \$251,657.38, and accrued interest amounted to \$270,779.79.
- One employer had 23 quarters charged off, for a total of \$163,890.49; this represented a six-year time period, between April 1, 1992 and March 30, 1998.
- In eight cases, employers receiving a charge off in 2006 had already received a prior charge off, either from 2005 (three cases) or in 2004 (five cases). One employer, who received a charge off of \$70,086.86 in 2006, had received a prior charge off in 2004 of \$399,209.54.
- Two employers who received a charge off in October 2006 did not have an accounts receivable balance as of June 30, 2006. (DUA informed us that these balances had been removed from the accounts receivable listing via an administrative write-off, which applies to balances under \$10 that may be approved by the Director of DUA. These balances were \$165,732.69 and \$85,057.60. When the employers subsequently qualified for a Section 69A charge off, their balances were reinstated, then simultaneously charged off.

DUA had a total accounts receivable balance of almost \$94 million as of June 30, 2006, which represented 37,789 employers within the Commonwealth, of which 50% included individual employer balances ranging from between \$20,000 to \$910,000 each. Use of traditional and non-aggressive collection measures have done little to stem the tide of ever-increasing debt, and the more aggressive and invasive collection tools available to DUA, such as lien, levies, fines, and criminal complaints, are not being utilized to their fullest extent. Meanwhile, businesses continue to accumulate debt. Charge-off activity does little to hold employers accountable for payment of their debt, regardless of the age of the debt or the business's current financial condition. Analysis of accounts receivable balances between June 30, 2006 and December 31, 2007 has shown that the balance is steadily increasing, a trend that will only be exacerbated by a challenging economic landscape.

The effect of the above condition is extensive: without strong enforcement policies and practices, thousands of businesses are operating within the Commonwealth without having paid their contribution liability into the UI fund; non-compliant businesses gain an unfair competitive advantage over compliant employers, who are in effect subsidizing the UCF; there is increased risk of abuse of the UI system when businesses do not pay their contribution into the system; businesses could possibly engage in potential violation of the law without fear of the consequences if monitoring is not strengthened; there is little incentive for egregious offenders to comply with the law, since the most stringent collection measures, such as public disclosure of delinquent employers, maximum fines, felony convictions, and suspension of liquor licenses are rarely, if ever, used; and the UCF could have less resources available for current and future payment of benefits and be at risk of insolvency if receivables are not aggressively collected.

Recommendation

It is recommended that the DUA improve its system for the management of UI accounts receivable as follows:

- Implement a uniform accounts receivable data information system, which includes all three types of accounts receivable: private contributory, reimbursable, and government. This system will be capable of producing a standard aging report, which should be monitored diligently and acted on accordingly, as it is a key element of effective accounts receivable management and effects collection activity decisions.
- Utilize more stringent collection measures to include the most aggressive and invasive action available. This includes increasing the use of levies, liens, court actions, prosecution, suspension of liquor licenses, fines, and public disclosure, which in many cases will provide the incentive for businesses to take resolution of their accumulating debt more seriously.
- Enhance its collection effectiveness by instituting performance measuring and monitoring the results of collection actions. In this way, DUA can quantify and review the level of activity, the number of actions taken, and the results of these actions. Specific performance goals that evaluate the reduction of unpaid unemployment insurance contributions, especially for the egregious offender, and the effectiveness of the various collection actions taken should be developed. This would be useful in measuring the success of its collection efforts, and to help formulate more effective approaches to dealing with this compliance issue.
- Evaluate and revise the charge-off protocol, in order to determine the benefit of removing this debt deemed uncollectible in the overall management of accounts receivable. Since approximately \$98 million had been charged off in 2004, 2005, and

2006, the strengthening and improvement of collection efforts could result in a reduction in the occasion and amounts of charge-off debt. Since the use of charge-off action has historically been a reflection of the philosophy of the administration, DUA should establish and adhere to specific policies and procedures.

- Monitor employers' post-charge-off activity, to prevent instances of an additional charge off, or of a charge off taking place for an employer who does not have a balance on the accounts receivable listing, both of which occurred during our review.

Implementation of the above measures would ensure that DUA is managing its Accounts Receivable more efficiently and effectively, while safeguarding the integrity of the UCF.

Auditee's Response

DUA stated that the \$93 million figure includes all active receivables since 1984, including contributions, reimbursement payments, and interest combined. This figure represents only one half of one percent (.5%) of the \$17.3 billion total quarterly contribution payments alone since 1991.

DUA plans for future improvement and enhancements of its accounts receivable management following the December 2009 implementation of the Quest System, a \$42+ million mainframe legacy replacement system that will encompass all DUA revenue, UI benefits and appeals functionality, and labor market employment data. Following the scheduled implementation of the DUA Revenue portion of this system, the following activities recommended in the SAO report will be pursued:

- 1. More detailed reporting on age of reimbursable employer receivables.*
- 2. Implement charge off of old reimbursable receivables from entities no longer in operation.*
- 3. Participation in the OSC intercept program.*

For about three years, DUA has had a moratorium on significant enhancements to its current UI legacy system, and IT and DUA Revenue enhancement efforts have been concentrated on the massive undertaking of designing and implementing the QUEST system. Following a transition period, DUA may begin discussions with the OSC to determine the feasibility of expanding our participation in Intercept to include UI receivables.

Regarding statewide procurement practices, DUA would welcome a tax compliance check by OSD prior to the issuance of state contracts, and concurs with the SAO on the need for such a check.

DUA also wishes to note that it has a very active and ongoing relationship with the Alcoholic Beverages Control Commission (ABCC) as well as other state licensing agencies to leverage their powers toward collection of debt owed to DUA. Further, in national comparisons published by the US DOL, MA DUA has consistently ranked high in the timely payment of UI contributions by its employers. In 2006, MA ranked 12th (top 25%) of states and territories. During US DOL Tax Performance reviews for the three years from April 2005 through March 2008, MA DUA passed every quality measure and

exceeded new employer determination timeliness standards (raised annually to higher level).

Additionally, DUA provided the following information regarding its collections and enforcement techniques and results in calendar year 2006:

<u>Administrative Collection Tools:</u>	<u>Collections</u>
<i>Dunning notices and Pre-lien notices</i>	<i>\$13.3 million</i>
<u>Legal Enforcement Tools:</u>	
<i>Certified assessment notices and seeking and obtaining court judgments</i>	<i>\$12.1 million</i>
<i>Levy of employer bank accounts</i>	<i>\$ 2.9 million</i>
<i>Post-enforcement collections (payment plans, bankruptcy dispositions)</i>	<i>\$ 4.7 million</i>
<u>Other Tools:</u>	
<i>Issuance of estimated tax bills to non-filers, field audits and post-audit collection activity, delinquency cases assigned to auditors</i>	<i>\$17.1 million</i>
<i>Collection of Past Due Reimbursable Payments</i>	<i><u>\$12.5 million</u></i>
<i>Total 2006 Recovery of Past Due Amounts</i>	<i><u>\$62.6 million</u></i>

2. MANAGEMENT OF REIMBURSABLE ACCOUNTS RECEIVABLE NEEDS IMPROVEMENT

A non-profit organization¹³ or a government employer has the option of deciding how to finance the payment of unemployment benefits to its workers. Governmental entities and non-profit employers may choose the “reimbursable” method, in lieu of paying quarterly contributions into the UCF. Instead, employers only incur a cost when a former employee files a claim for benefits and is deemed eligible. DUA then “borrows” against the UCF, created by the contributor employers, in order to immediately pay benefits. The employer is billed for these costs, which include dependency allowances, extended benefits, benefits paid when an employee quits a job and subsequently re-qualifies for benefits, and benefits paid that may be subsequently disallowed because of the claimant’s disqualification, which, under the contributory method, would be charged to the appropriate solvency account, and must be paid within 30 days. Massachusetts UI law requires employers choosing the reimbursable method to reimburse DUA for benefits paid, including, in some circumstances, benefits for which contributory

¹³ As described in Section 501(c)(3) of the United States Internal Revenue Code, which is exempt from income tax under Section 501(a) of such code.

employers are not charged (e.g., dependency allowances, state-financed extended benefits, approved voluntary separations, state-approved training programs, etc.).

Selection of the reimbursement method over the contributory method involves a degree of risk for an employer, who must fully understand its potential unemployment liability, as well as its financial obligations and responsibility to pay claims filed against the organization. Although new non-profit or government employers are asked to select a method when the organization becomes subject to the UI law, if no method is selected, then, by law, the contributory method is assigned. An employer may change from one method to another; however, that method will be in effect for at least two calendar years.

a. Analysis of Reimbursable Accounts Balance

As of June 30, 2006, the total balance of DUA's Reimbursable Accounts Receivable was \$23,283,153.53. This included benefits paid, penalties assessed, and interest accrued for 1,016 employers. A breakdown of this balance by dollar range for active and suspended accounts is included below:

Dollar Range of Account Balance Owed	Reimbursable Accounts Receivable June 30, 2006					
	Total	Total Employers	Active	Active Employers	Suspended	Suspended Employers
\$100K +	\$15,396,802.66	31	\$ 7,426,524.94	15	\$7,970,277.72	16
\$50K-\$100K	2,417,868.80	34	1,810,558.11	25	607,310.69	9
\$20K-\$50K	2,034,031.33	63	1,761,933.37	55	272,097.96	8
\$10K-\$20K	1,291,386.03	90	1,166,176.76	82	125,209.27	8
Under \$10K	<u>2,143,064.71</u>	<u>798</u>	<u>2,086,510.95</u>	<u>779</u>	<u>56,553.76</u>	<u>19</u>
	<u>\$23,283,153.53</u>	<u>1,016</u>	<u>\$14,251,704.13</u>	<u>956</u>	<u>\$9,031,449.40</u>	<u>60</u>

Suspended accounts belong to those employers who have filed eight consecutive quarters with no payroll, or who have notified DUA that the business has closed or is operating without any employees. Of the total \$23.3 million June 30, 2006 Reimbursable Accounts Receivable balance, \$19.8 million, or 85%, represented individual accounts with balances in excess of \$20,000. Of the \$19.8 million total, some \$11 million represented active accounts of 95 employers.

As more current accounts receivable data became available, we summarized, reviewed, and compared it to the June 30, 2006 balances detailed above, noting any activity trends. Our review of the December 31, 2007 Reimbursable Accounts Receivable balance is shown below:

Reimbursable Accounts Receivable
December 31, 2007

Dollar Range of Account Balance Owed	Total	Total Employers	Active	Active Employers	Suspended	Suspended Employers
\$100K +	\$18,402,213.14	39	\$ 9,332,476.71	21	\$ 9,069,736.43	18
\$50K-\$100K	2,994,661.63	44	2,452,791.92	36	541,869.71	8
\$20K-\$50K	2,811,946.08	89	2,515,038.21	80	296,907.87	9
\$10K-\$20K	2,140,147.81	154	1,980,745.58	144	159,402.23	10
Under \$10K	<u>2,571,683.11</u>	<u>792</u>	<u>2,493,315.71</u>	<u>768</u>	<u>78,367.40</u>	<u>24</u>
	<u>\$28,920,651.77</u>	<u>1,118</u>	<u>\$18,774,368.13</u>	<u>1,049</u>	<u>\$10,146,283.64</u>	<u>69</u>

Of the total \$28.9 million December 31, 2007 Reimbursable Accounts Receivable balance, \$24.2 million, or 83.7%, represented individual accounts with balances in excess of \$20,000. Of the \$24.2 million total, some \$14.3 million represented active accounts of 137 employers.

As the June 30, 2006 and December 31, 2007 tables illustrate, the Reimbursable Accounts Receivable balance is continuing to grow over time. The total amount increased from \$23,283,154 to \$28,920,652, an increase of \$5,637,498, or 24.2%. Of that, \$4,522,664, or 80%, was for active accounts. The total number of employees increased from 1,016 as of June 30, 2006 to 1,118 as of December 31, 2007, a 10% increase. As the data indicates, there is an increasing trend in activity for both the balances due and the number of employee accounts.

b. Data Information Reporting System

Effectively maintaining an accounts receivable reporting system and monitoring the system's activity over time is critical to proper accounts receivable management. If a system has limitations, it hampers management's ability to adequately perform standard accounts receivable management functions, such as monitoring delinquent accounts, prioritizing collection activity, and performing charge offs of uncollectible debt when applicable. The data reporting system in use at DUA for Reimbursable Accounts Receivable is a different system than that being used for the Private Contributory Accounts Receivable, and does not include the same reporting and monitoring features as that system, such as aging of accounts receivable, activity reporting, transaction reporting, etc. As a result, there is an inconsistent reporting of accounts receivable. This inconsistency makes it difficult to effectively monitor and manage accounts receivable,

especially when, as is in this particular case, the system being used is not as comprehensive as that used for the Private Contributory Accounts Receivable.

c. Aging of Accounts Receivable

As stated previously, aging of accounts receivable represents the presentation of balances chronologically by the date the debt was incurred. It is a key element of effective accounts receivable management, and factors into collection activity decisions, since the likelihood of collecting current debt decreases with the age of the debt. The current data information system being used to report the Reimbursable Accounts Receivable is not capable of producing an aging report of the balance. Therefore, DUA could not provide any type of standard aging information, such as how old individual balances were, how far back the total accounts receivable went, and the breakdown of the totals by year. Without a standard monthly aging report, it is not possible to effectively manage these receivables on a regular basis, including making management decisions regarding trends, collection activity and results, the status of current data, and addressing other issues specific to the nature of reimbursable accounts.

d. Collection Activity

When charges are incurred by an employer based on actual unemployment benefits paid to their former employees, DUA will issue a “Statement of Reimbursable Benefits” (Form 1089-1), which employers are required to pay within 30 days of its mailing date. If the employer is questioning the charges, a request for review of questionable charges must be filed within the same time period. Timely payment is required on all items that are not the subject of protest, and past-due reimbursement payments in lieu of contributions shall be subject to the same interest, penalties, and collection provisions as past-due contributory payments.¹⁴

Because of the limitations of the data information system being used for the reimbursable accounts receivable, DUA could not provide what collection activity, if any, had taken place to recover the significant amount of debt incurred. Also, DUA could not provide the degree of delinquency of the balances, since the system is not capable of producing aging reports. Since it is critical that these businesses in particular be held accountable for repaying this debt, an aggressive collection effort is vital in recouping that which is owed to the fund. Timely

¹⁴ 430 CMR: Division of Unemployment Assistance, 5.06: Non-profit Organizations and Governmental Employers, Payment in *Lieu* of Contributions

collection action can slow down the accumulation of additional debt and assist in keeping the accounts receivables at a manageable level.

e. Charge-off Activity

Section 69A, Chapter 151A, of the General Laws (Charge-off of Debt) provides for the removal of those accounts receivable balances deemed uncollectible. Non-profit Reimbursable Accounts Receivables have not been a part of this charge-off provision, while the Private Contributory Accounts Receivable have. As a result, the balances continue to accumulate interest over time, in many cases for employers who are no longer in business or are bankrupt and have been for several years, with little or no chance of being collected. DUA has been unable to reduce the debt that is deemed uncollectible, due to the lack of an aging function, and as a result accrued interest is increasing the accounts receivable balance at a rapid rate, in many cases surpassing the amount of the original charges.

We selected a sample of 10 accounts from the December 31, 2007 Reimbursable Accounts Receivable list, and reviewed the account detail and transaction history. We noted the status of each account, date of original charge, amount of original charge, accumulated interest, and the May 8, 2007 balance (for comparison purposes). We also made note of the nature of any current activity. The status of the employers in the sample included two active accounts, three suspended accounts, and five bankrupt employers. The summary of our results is as follows:

- The oldest original activity for one employer dated back to January 1991 (18 years old); original charge was \$758,612.12; accumulated interest is \$1,105,915.58; interest is accumulating at \$7,000 - \$8,700 each month; employer is currently bankrupt.
- The highest account balance was \$4,284,464.40; the original charge was \$1,852,155.68, dating back to March 1998 (10 years old); accumulated interest was \$2,432,308.72; account activity noted a credit entry of \$325,751 on May 19, 2004 and another for \$355,364 on November 3, 2005; interest is accumulating at \$17,000 - \$21,000 each month; employer is currently bankrupt.
- One active account totaling \$444,706.43 (half of which was interest) is accumulating interest at \$1,900 - \$2,400 each month; there is no payment activity.
- All accounts are accumulating monthly interest; in all but the most recent case (September 2003), the accumulated interest is higher than the original charge.

In a separate analysis of the June 30, 2006 Reimbursable Accounts Receivable, we selected the 31 employers owing over \$100,000 to determine if any of the accounts represented employers that were currently active or affiliated with a currently active company. We found the following:

- One educational facility is currently active, with an accounts receivable balance of \$243,938.
- A medical facility has gone through a series of changes and mergers, but is still listed as a going concern; its accounts receivable balance is \$688,045.
- One non-profit, although defunct and with a balance of \$402,630, had its property auctioned off in February 2005, for \$725,000.
- Another non-profit, also defunct, has a principal affiliated with several other non-profits, with similar names and types of services offered; its accounts receivable balance is \$305,899.
- Two cities of the Commonwealth have accounts receivable balances totaling \$584,771.

An additional analysis of reimbursable accounts over \$100,000 was conducted to determine if any of the employers were currently registered as vendors with the Commonwealth of Massachusetts, who had received payments for services rendered under contract with other state agencies. Currently, the state procurement process does not include a tax compliance check inquiry of DUA. The results were as follows:

- Of the 31 employers reviewed, 15 had state-assigned vendor codes in the Commonwealth of Massachusetts Management Accounting and Reporting System (MMARS); in some cases multiple vendor codes were assigned; their total accounts receivable balance was \$9,331,065.
- Four employers received payments from the state for services rendered under contract within fiscal year 2006; their total accounts receivable balance was \$1,154,268.

Further, although there is a statewide system in place to prohibit taxpayers indebted to the state from receiving revenue from the state (the intercept program), DUA's current accounting system would not be compatible with the intercept system, since DUA manages its accounts receivables according to employer number rather than federal identification number or the state vendor code used for the intercept program. Compatibility with the intercept program, as well as utilization of other available information technology statewide, would assist DUA in its

collection effort for the reimbursable accounts receivable, as well as prohibit those employers with a DUA liability from receiving state funds as a vendor.

Employers who choose the Reimbursable method as a means of financing their employees' unemployment insurance benefits in lieu of paying quarterly contributions into the UCF are required to reimburse the fund when the actual expenses are incurred. As of December 31, 2007, DUA was owed \$28,920,651.77 from 1118 employers using the Reimbursable method, representing actual benefits paid to employees, which must be reimbursed by the employer within 30 days. There is currently no means to reduce the debt that is deemed uncollectible, and as a result accrued interest is increasing the accounts receivable balance at a rapid rate, in many cases surpassing the amount of the original charges. Reduction of this significant debt should be subject to closer monitoring and more aggressive collection measures, since it represents actual expenses incurred that have reduced the UCF and must be reimbursed.

Recommendation

It is recommended that the DUA immediately revise its system for the management of Reimbursable accounts receivable, to include the following improvements:

- Collection of Reimbursable accounts receivable should be made a priority, as it represents a more serious debt than private contributory debt and is an actual expense that has been incurred, for which employers are obligated to pay within 30 days.
- Development and implementation of a new data information system for Reimbursable accounts receivable consistent with that being utilized by the Private Contributory accounts receivable. This would allow DUA to adequately perform standard accounts receivable management functions, such as monitoring delinquent accounts, prioritizing collection activity, and performing charge offs of uncollectible debt when applicable, and would result in a uniform presentation of the total accounts receivable balance for DUA. An improved system would enhance the effectiveness of overall accounts receivable management.
- Performance of an accounts receivable aging for reimbursable balances, as a means of properly and effectively monitoring this debt, by determining current and delinquent balances that would effect management decisions regarding collection activity, results, and trends.
- Consideration of instituting a means of reducing uncollectible accounts receivable through the approved charge-off mechanism, Section 69A, the statute that is utilized by the private contributory accounts receivable. DUA should consider amending its policy, procedures, and/or enabling legislation to reflect this decision.

- Pursuing a means of interfacing with the state intercept program, as well as considering the feasibility of utilizing other state information technology to collaborate with other state agencies having contact with employers who are delinquent with DUA. In this way, an employer having a liability with DUA would be unable to receive funds from the Commonwealth via an approved contract.

Implementation of the above measures would ensure that DUA is managing its Reimbursable Accounts Receivable efficiently and effectively, and would result in more compliant employers and a healthier UCF balance.

Auditee's Response

DUA readily concurs that for Reimbursable employer accounts receivables (reimbursable employers represent about 1.5% of all MA employers), data available in regular monthly reports from the antiquated ARIES system is not detailed enough. DUA is addressing that shortcoming through the building of the QUEST system. The fact that reimbursable debt represents about 24% of the past due amount as of June 30, 2006 is in large part related to the fact that this antiquated ARIES system has no protocols in place to charge off old debt from out-of-business entities, as provided for in Chapter 151A, Section 69A. Thus, such receivables are overstated as "collectible." The introduction of the QUEST system will eventually allow DUA to implement the charge off of debt carried on long-term, out of business employers.

DUA also stated that following a transition period, it would begin discussions with the OSC to determine the feasibility of expanding its participation in Intercept to include UI receivables.

APPENDIX

Chapter 647, Acts of 1989, An Act Relative to Improving the
Internal Controls within State Agencies

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Chapter 647

THE COMMONWEALTH OF MASSACHUSETTS

In the Year One Thousand Nine Hundred and Eighty-nine

AN ACT RELATIVE TO IMPROVING THE INTERNAL CONTROLS WITHIN STATE AGENCIES.

Be it enacted by the Senate and House of Representatives in General Court assembled, and by the authority of the same, as follows:

Notwithstanding any general or special law to the contrary, the following internal control standards shall define the minimum level of quality acceptable for internal control systems in operation throughout the various state agencies and departments and shall constitute the criteria against which such internal control systems will be evaluated. Internal control systems for the various state agencies and departments of the commonwealth shall be developed in accordance with internal control guidelines established by the office of the comptroller.

(A) Internal control systems of the agency are to be clearly documented and readily available for examination. Objectives for each of these standards are to be identified or developed for each agency activity and are to be logical, applicable and complete. Documentation of the agency's internal control systems should include (1) internal control procedures, (2) internal control accountability systems and (3), identification of the operating cycles. Documentation of the agency's internal control systems should appear in management directives, administrative policy, and accounting policies, procedures and manuals.

(B) All transactions and other significant events are to be promptly recorded, clearly documented and properly classified. Documentation of a transaction or event should include the entire process or life cycle of the transaction or event, including (1) the initiation or authorization of the transaction or event, (2) all aspects of the transaction while in process and (3), the final classification in summary records.

(C) Transactions and other significant events are to be authorized and executed only by persons acting within the scope of their authority. Authorizations should be clearly communicated to managers and employees and should

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include the specific conditions and terms under which authorizations are to be made.

(D) Key duties and responsibilities including (1) authorizing, approving, and recording transactions, (2) issuing and receiving assets, (3) making payments and (4), reviewing or auditing transactions, should be assigned systematically to a number of individuals to ensure that effective checks and balances exist.

(E) Qualified and continuous supervision is to be provided to ensure that internal control objectives are achieved. The duties of the supervisor in carrying out this responsibility shall include (1) clearly communicating the duties, responsibilities and accountabilities assigned to each staff member, (2) systematically reviewing each member's work to the extent necessary and (3), approving work at critical points to ensure that work flows as intended.

(F) Access to resources and records is to be limited to authorized individuals as determined by the agency head. Restrictions on access to resources will depend upon the vulnerability of the resource and the perceived risk of loss, both of which shall be periodically assessed. The agency head shall be responsible for maintaining accountability for the custody and use of resources and shall assign qualified individuals for that purpose. Periodic comparison shall be made between the resources and the recorded accountability of the resources to reduce the risk of unauthorized use or loss and protect against waste and wrongful acts. The vulnerability and value of the agency resources shall determine the frequency of this comparison.

Within each agency there shall be an official, equivalent in title or rank to an assistant or deputy to the department head, whose responsibility, in addition to his regularly assigned duties, shall be to ensure that the agency has written documentation of its internal accounting and administrative control system on file. Said official shall, annually, or more often as conditions warrant, evaluate the effectiveness of the agency's internal control system and establish and implement changes necessary to ensure the continued integrity of the system. Said official shall in the performance of his duties ensure that: (1) the documentation of all internal control systems is readily available for examination by the comptroller, the secretary of administration and finance and the state auditor, (2) the results of audits and recommendations to improve departmental internal controls are promptly evaluated by the agency management, (3) timely and appropriate corrective actions are effected

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by the agency management in response to an audit and (4), all actions determined by the agency management as necessary to correct or otherwise resolve matters will be addressed by the agency in their budgetary request to the general court.

All unaccounted for variances, losses, shortages or thefts of funds or property shall be immediately reported to the state auditor's office, who shall review the matter to determine the amount involved which shall be reported to appropriate management and law enforcement officials. Said auditor shall also determine the internal control weaknesses that contributed to or caused the condition. Said auditor shall then make recommendations to the agency official overseeing the internal control system and other appropriate management officials. The recommendations of said auditor shall address the correction of the conditions found and the necessary internal control policies and procedures that must be modified. The agency oversight official and the appropriate management officials shall immediately implement policies and procedures necessary to prevent a recurrence of the problems identified.

House of Representatives, December 21, 1989.

Passed to be enacted, *George Turman*, Speaker.

In Senate, December 22, 1989.

Passed to be enacted, *William W. Budge*, President.

January 3, 1990.

Approved, *Richard H. Kohn* Governor.