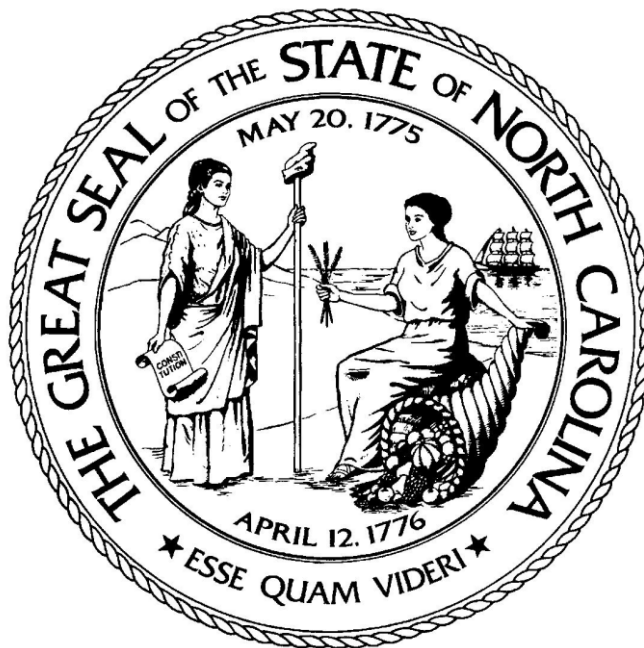


**2011-2012
HOUSE UNEMPLOYMENT FRAUD
TASK FORCE**



**REPORT TO THE 2011-2012
GENERAL ASSEMBLY OF NORTH CAROLINA
2012 SESSION**

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TABLE OF CONTENTS

<u>Letter of Transmittal</u>	i
<u>Unemployment Fraud Task Force Committee Membership</u>	ii
<u>Preface</u>	1
<u>Committee Proceedings</u>	
<u>Committee Recommendations and Legislative Proposals</u>	
1. <u>AN ACT TO MAKE VARIOUS CHANGES TO THE UNEMPLOYMENT INSURANCE LAWS TO BETTER ENABLE THE STATE TO PREVENT UNEMPLOYMENT COMPENSATION OVERPAYMENTS AND TO DETECT AND RECOVER UNEMPLOYMENT COMPENSATION OVERPAYMENTS</u>	

Appendices*

- A. . [Authorization](#)
- B. [Meeting Agendas](#)

*All of the meeting handouts, including Power Point presentations, may be accessed online in PDF format at the Unemployment Fraud Task Force Committee website: <http://www.ncleg.net/committees/>



HOUSE UNEMPLOYMENT FRAUD TASK FORCE
State Legislative Building
Raleigh, North Carolina 27603

Representative Marilyn Avila, Co-Chair

Representative G. L. Pridgen, Co-Chair

May 9, 2012

TO THE HONORABLE MEMBERS OF THE NORTH CAROLINA HOUSE OF REPRESENTATIVES:

The House Unemployment Fraud Task Force submits to you for your consideration its report pursuant to G.S. 120-19.6(a1) and Rule 26 of the Rules of the House of Representatives of the 2011 General Assembly.

Respectfully Submitted,

Rep. Marilyn Avila, Co-Chair

Rep. G. L. Pridgen Co-Chair

2011-2012

HOUSE
UNEMPLOYMENT FRAUD TASK FORCE COMMITTEE

MEMBERSHIP

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Rep. G. L. Pridgen, Co-Chair

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Representative Julia Howard
Representative Harry Warren
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PREFACE

The Speaker of the House of Representatives established the House Unemployment Fraud Task Force pursuant to G.S. 120-19.6(a1) and Rule 26 of the Rules of the House of Representatives of the 2011 General Assembly on March 15, 2012. The Committee is charged to study issues relating to unemployment and unemployment fraud in North Carolina and to recommend legislative action if needed to address unemployment fraud prevention and recovery. The Committee consists of nine members appointed by the Speaker of the House of Representatives. The co-chairs for 2011-2012 are Representative Marilyn Avila and Representative G. L. Pridgen.

A copy of the authorization for the House Unemployment Fraud Task Force is included in Appendix A. A committee notebook containing the Committee minutes and all information presented to the Committee is filed in the Legislative Library and may also be accessed online at the Committee's website: <http://www.ncleg.net/committees/>. As part of its work, the Committee compiled a vast array of resources that may be accessed online at its website. Those resources include unemployment insurance claims manual, adjudicator's determination forms, appeals decision forms, Commission decision forms, precedent decisions manual, ESC interpretation manual, and a glossary of unemployment insurance terms.

COMMITTEE PROCEEDINGS

The House Unemployment Fraud Task Force, established by the Speaker of the House of Representatives on March 15, 2012, met three times prior to the convening of the 2012 Regular Session of the 2011 General Assembly. Appendix B contains a copy of the Committee's agenda for each meeting. All of the materials distributed at the meetings may be viewed on the Committee's website.

Congress established the Unemployment Insurance Program (UI Program) in 1935 as Title III of the Social Security Act. The UI Program provides temporary cash benefits to workers who lose their jobs through no fault of their own and also serves to stabilize the economy in times of economic recession. It is a complex program jointly administered by the U.S. Department of Labor (USDOL) and the states. States have wide latitude to administer their UI Programs so long as their programs stay within the guidelines established by federal law.

The UI Program is funded through federal and state taxes levied on employers. The federal unemployment tax (FUTA) rate is 6% and is imposed on wages up to \$7,000 a year. The FUTA funds the administrative costs of the UI Programs and other related federal costs of the UI Program. North Carolina's state unemployment tax (SUTA) rate² varies from 0% to 6.84% based upon the employer's experience rating and is imposed on wages up to \$20,400³ for the 2012

² North Carolina also imposes a tax on contributions at the rate of 20% of the contributions due in any calendar year when the Employment Security Reserve Fund does not equal or exceed \$163,349,000. The Reserve Fund has fallen below this amount since the 2005 calendar year. The revenue from this tax is credited to the Reserve Fund and its use is not restricted. The State made the interest payment on the federal loan of \$78.8 million in September 2011 from monies available in the Reserve Fund.

³ This amount is indexed annually.

taxable year. The contributions paid by employers are credited to the State Unemployment Trust Fund (Trust Fund) and may be used only to pay claimant benefits. When states lack the funds to pay unemployment insurance benefits, they may obtain a loan, or an "advance," from the federal government. North Carolina received its first advance from the federal treasury to finance the benefits payable from the Trust Fund in February 2009. As of March 29, 2012, North Carolina had an outstanding loan balance of \$2.8 billion.⁴

The health of a state's unemployment trust fund depends, in part, on the current economic conditions, the amount of taxes collected from employers, and the ability of the state to control its benefit payments by accurately determining individuals' eligibility for UI benefits in a timely manner.⁵ The General Assembly has little control over the current economic conditions. With regard to tax revenues, the 2012 General Assembly directed the Department of Commerce to contract with an independent consulting firm specializing in unemployment insurance and employment security reform to obtain recommendations on what tax structure changes would be fair to employers and how these revenues and other financial options might be used in servicing and liquidating the State debt incurred to pay unemployment insurance.⁶ The charge of the House Unemployment Fraud Task Force is, in part, to determine if legislative action is needed to address the accuracy of benefit payments.⁷

⁴ Thirty states have an outstanding loan from the federal government. Only three states have a larger loan balance than North Carolina: California, New York, and Pennsylvania.

⁵ GAO-02-697 Report on "Unemployment Insurance, Increased Focus on Program Integrity Could Reduce Billions in Overpayments." July 2002.

⁶ Senate Bill 99, S.L. 2011-10.

⁷ The Committee acknowledges that fraud is also an issue for employers. The Committee understands the issue of "SUTA dumping," a tax evasion scheme where shell companies are formed to obtain a lower UI tax rate, received increased federal and state scrutiny in the mid-2000s and that the Division of Employment Security has a program to address SUTA dumping.

The Committee began its work by learning the mechanics of how unemployment benefits are claimed and administered. It invited the professionals from the Division of Employment Security (DES), Department of Commerce, who have worked in their respective areas for years, to explain how the claims adjudication process works at both the local offices and the central office, how the Integrity Unit seeks to ensure benefit payment control, how appeals are administered at both the appeals hearing level and the Commission level, and how employment tax contributions are enforced. The Committee learned DES paid \$1.4 billion in regular UI benefits in 2011 and \$8.5 billion in federally funded benefits. DES paid UI benefits to 549,199 individuals, adjudicated more than 136,000 claims, and held more than 54,000 appeals in 2011. The average duration of benefits in 2011 was 16.3 weeks compared to 13.9 weeks in 2008. The average UI benefit amount in 2011 was \$280.19 compared to \$277.00 in 2008. The unemployment rate in 2011 was 10% compared to 8.5% in 2008.

The Committee learned the State is not alone as it looks at the accuracy of benefit payments. In 2002, the United States General Accounting Office issued a report on the unemployment insurance program and the need for an increased focus on program integrity.⁸ The key component to program integrity is the accuracy of benefit payments. Improper payments occur when funds go to the wrong recipient; when the right recipient receives the wrong amount; and when documentation is not available to support a UI claim. Not all improper payments are fraudulent, but all improper payments weaken the integrity of the UI Program and the viability of the State's Trust Fund.

⁸ See footnote #5.

Since 2008, there has been increased federal emphasis on preventing, detecting, and recovering improper payments. The focus of President Obama's Executive Order 13520, issued November 23, 2009, was the reduction of improper payments in major programs administered by the federal government, including the UI Program. In response to the level of improper payments in the UI Program, USDOL developed a strategic plan to address the root causes of improper payments. The plan involves new performance measures for the states, increased funding of new tools and technology, and a focus on the root causes leading to improper payments. Gay Gilbert, Administrator, Office of Unemployment Insurance, USDOL, and Dale Ziegler, Deputy Administrator, Office of Workforce Services, USDOL, identified three root causes leading to improper payments at the April 3, 2012, meeting:

- Claimants continuing to claim benefits after returning to work.
- Untimely and insufficient separation information from employers and third party administrators.
- A gap in employment service registration.

They offered several suggestions to address these root causes:⁹

- Increased use of the National Directory of New Hires.
- Enhanced cross-matching procedures.
- Improved claimant and employer messaging campaigns.
- State and business implementation of the State Information Data Exchange System (SIDES) and State marketing of SIDES to employers and third-party administrators.
- State implementation of the Unemployment Insurance Compensation Debt of the Treasury Offset Program (TOP-UIC).

⁹ [Presentation made by Gay Gilbert and Dale Ziegler on April 3, 2012.](#)

- Automated SUTA detection systems to detect employers engaged in UI tax rate manipulation.
- Detection and enforcement activities to address workers mistakenly classified by an employer as a non-employee.
- Implementation of the three provisions of the Integrity Act, included as part of the Trade Adjustment Assistance Extension Act of 2011:
 - Mandatory penalty assessment of 15% on UI fraud claims.
 - Prohibition on non-charging of an employer's account if an overpayment is made due to the employer's failure to respond timely and adequately to the agency.
 - Requirement for employers to report rehired employees to the National Directory of New Hires within 60 days.

The Committee also heard a presentation from Doug Holmes, President of the UWC-Strategic Services on Unemployment & Workers' Compensation, regarding best state practices for improper payment prevention, detection, and recovery. His observations included the following list of suggestions for North Carolina:¹⁰

- Increased system integration between the State and USDOL.
- Increased use of withholding of benefits to collect overpayments. In North Carolina, an overpayment may be withheld from future UI benefits.
- Extension of the period in which overpayments may be collected and in which fraud may be identified and prosecuted.
- Increased criminal penalties for overpayments.

¹⁰ [Presentation made by Doug Holmes on April 3, 2012.](#)

- Improved use of cross-matches that identify individuals working while receiving UI benefits.
- Dedicated staffing and system resources to overpayment prevention, detection, and recovery.
- Increased outreach to employers to exchange information electronically to identify issues.

At its April 18, 2012, meeting, the Committee reviewed both federal and State legislation enacted in 2011 that influenced unemployment law. Congress enacted the Trade Adjustment Assistance Extension Act of 2011 in October 2011. That Act included legislative language suggested by USDOL in June of 2011 to improve program integrity within the UI Program. The General Assembly enacted Senate Bill 532, which made several changes to North Carolina's UI Program.

The Trade Adjustment Assistance Extension Act of 2011 contained three key integrity provisions recommended by USDOL that will require action by the states:

- New Hire Directory. - To address the gap in employment service registration, the federal law requires states to expand the definition of a 'newly hired employee' to include a rehired employee who was separated for at least 60 days. It also requires employers to enter the start date of employment when the employer submits the information to the New Hire Directory. The New Hire Directory was created years ago to assist states with the collection of child support payments. The Directory is administered by the Department of Health and Human Services. The directory is also a valuable tool for unemployment insurance programs because it allows the agency to cross-check claimants with new hires. This information assists the agency with the

detection of overpayments being made to individuals who have returned to work. States are required to make the necessary statutory changes to its New Hire Directory within two months after the latest legislative session ends.

- Prohibition on Non-Charging of Employer Accounts. – To address the untimely and insufficient separation information provided by employers and third party administrators to the agencies, the federal law requires states to enact a provision prohibiting the non-charging of an employer's unemployment insurance account when an improper payment is made because of the employer's failure to respond timely or adequately to a written request for separation information. In most states, an employer's state unemployment tax rate is based upon an experience rating whereby employers that have more claims or charges against their unemployment insurance account have a higher tax rate. Under current law, benefits paid to a claimant erroneously may not be charged to the employer's account. Under this provision, the benefits would be charged to the employer's account if the erroneous payment is made because the employer failed to respond timely and adequately to the agency. This provision points to a trend whereby employers are expected to improve the quality of information provided to state employment agencies at the front end of the UI claim process, rather than waiting until a hearing to provide details. Although a state may impose a stricter standard, it must impose the minimal federal standard by October 21, 2013.
- Monetary Penalty Assessment. – To address claimants who fraudulently continue to accept unemployment benefits after returning to work, the federal law requires states to impose a penalty on the claimant equal to

15% of the amount of erroneous overpayment if the agency determines that the overpayment is due to fraud. Under G.S. 96-18(a), a fraudulent overpayment is one that results from a person's false statement or representation knowing it to be false or from a person knowingly failing to disclose a material fact to obtain or increase a benefit received. The money collected from the penalty is payable to the State Unemployment Trust Fund and its use is limited to the payment of unemployment compensation benefits. States may enact a larger penalty amount and may use the additional amount for whatever purpose it desires. The 15% federal mandatory penalty must be in place by October 21, 2013.

The General Assembly enacted Senate Bill 532 on July 26, 2012.¹¹ Senate Bill 532 had four operative parts:

- It created the Division of Employment Security within the Department of Commerce and transferred the functions of the Employment Security Commission to that Division.
- It made the Division subject to rulemaking under Article 2A of chapter 150B of the General Statutes.
- It made substantive changes to the employment security laws.
- It made conforming changes to the employment security laws.

On June 30, 2011, the Governor vetoed the bill. In the Governor's Objections and Veto Message, she stated USDOL informed the administration that a lack of conformity between the bill and federal law could result in a loss of money for the State's unemployment insurance program and a reduction in the

A state's law must conform to the provisions of the federal unemployment compensation laws in order for employers in a state to be eligible for a credit against the FUTA tax and for the state to be eligible to receive an administrative grant to operate its unemployment compensation programs. ¹¹ S.L. 2011-401.

FUTA tax credit.¹² A state's law must conform to the provisions of the federal unemployment compensation laws in order for employers in a state to be eligible for a credit against the FUTA tax and for the state to be eligible to receive an administrative grant to operate its unemployment compensation programs.

The General Assembly overrode the Governor's veto on July 26, 2011. After passage of the bill, the Employment Security Commission informed the General Assembly by a letter dated October 12, 2011, of its intention to suspend the provisions of the bill determined by USDOL to be noncompliant with federal law. G.S. 96-19(b) gives DES the authority to suspend enforcement of a provision upon receiving notification from USDOL that the provision is noncompliant with the requirements of federal law. The suspension may be in effect until the Legislature next has an opportunity to reconsider the provisions purported to be noncompliant with federal law. USDOL noted the following concerns:

- The legislation expanded the time for an employer to provide information required to protest a claim from 10 days to 30 days. The extension of time would make it virtually impossible for the agency to make timely determinations under the standards set by federal regulations.¹³
- An individual is totally disqualified from receiving benefits if DES determines the individual was discharged for misconduct connected with the work. The legislation expanded the definition of "misconduct connected with the work" to include both of the following:

¹² Federal law provides a credit against the FUTA tax rate of up to 5.4% for states that have an approved UI Program. The credit may be reduced by 0.3% a year if a state has an outstanding loan. Currently, the FUTA tax credit for NC employers is 5.1% because of NC's outstanding loan balance to the federal government.

¹³ For most intrastate claims, federal regulations require that a state pay at least 87% of its claims within 14 days of the end of the first compensable week, or 21 days for states that do not have a waiting week requirement, and 93% of such claims within 35 days.

- Arrest for or conviction of certain offenses. The new definition did not require that the criminal conduct be connected with the individual's work.
- Failure to adequately perform employment duties after being warned. In order to be the basis for a disqualification to receive unemployment benefits, unsatisfactory job performance must be the result of intentional behavior or gross negligence, and must be egregious.
- The legislation allowed the parties to tender stipulation of the ultimate issues in cases pending on appeal to the agency. While a stipulation of facts might be acceptable, a stipulation of the issues vitiates the agency's federally-mandated responsibility to apply the unemployment law to specific facts. USDOL also recommended that any procedure or process by which an appeals referee or hearing officer accepts a stipulation of fact should be recorded.

Senate Bill 532 created a Board of Review¹⁴ to determine appeals policies and procedures and to hear appeals arising from the decisions and determinations of the Employment Security Section and the Employment Insurance Section. The annual salaries of the three-person board are to be set by the General Assembly in the current Operations Appropriations Act. The Current Operations and Capital Improvements Appropriations Act of 2011 did not set the salaries for the members of the Board of Review.

The Committee considered the differences between overpayments and fraudulent overpayments. G.S. 96-18(a) makes it a Class 1 misdemeanor for a person to make a false statement or representation *knowing* it to be false or to

¹⁴ G.S. 96-4(b).

knowingly fail to disclose a material fact to obtain or increase any UI compensation benefit. One of the leading causes of overpayments is a person continuing to claim benefits after returning to work. The Committee learned that proving a person *knowingly* made a false statement is sometimes difficult when the overlap of benefits and earnings is for a limited period of time. Claimants who return to work, but don't receive a paycheck for a period of two to four weeks after starting employment, sometimes fail to correctly answer the question asked regarding weekly earnings. The Committee spent considerable time discussing how to better educate claimants to answer the weekly questions correctly.

The difference between whether an overpayment is fraudulent or not makes the following differences in how the overpayment may be recovered:

- A person who has been found to have obtained a benefit fraudulently is not entitled to receive benefits for a period of 52 weeks.¹⁵
- DES has 10 years to recover a fraudulent overpayment; it has only three years to recover an overpayment.¹⁶
- DES may recover a fraudulent overpayment by deducting 100% of the overpayment from future benefits payable to the person; it may deduct only 50% from future benefits for a non-fraudulent overpayment.¹⁷

The Committee learned more about the Unemployment Insurance Compensation Debt of the Treasury Offset Program (TOP-UIC) from Thomas Kobiulus, with the US Treasury Department, and Becky Park, Co-Project Manager for TOP-UIC, US Treasury Department.¹⁸ The TOP compares payee names and taxpayer identification numbers on federal payment certification

¹⁵ G.S. 96-18(e).

¹⁶ G.S. 96-18(g)(1) and (2).

¹⁷ G.S. 96-18(g)(3)c. and (3)d.

¹⁸ [..\\April 18\\TOP UI Presentation NC- revised 4-17 2012.pdf](#)

vouchers to names and taxpayer identification numbers in TOP's debtor database. When a match occurs, TOP intercepts, or "offsets," all or part of a payee's eligible Federal or state payments. Congress first permitted UI compensation debts and uncollected contributions to be recovered under TOP in 2008.¹⁹ The initial legislation limited the types of UI debts that could be recovered through TOP. However, in December 2010, Congress removed many of the limitations.²⁰ Today, the definition of "covered unemployment compensation debt" is no longer limited to overpayments due to fraud and any associated penalties or interest may be recovered through TOP if the UI compensation debt is due to a person's failure to report earnings or delinquent contributions. In addition, the term is no longer limited to debts that remain uncollected for 10 years.

To participate in the TOP-UIC, a state must have a Safeguards Procedure Report approved by the IRS, must send debtors 60 days-notice of the State's intent to send the debt to TOP-UIC, and must complete several forms required by the Financial Management Service of the US Treasury Department. As of April 16, 2012, 14 states are participating in the TOP-UIC. Those states have recovered more than \$140.6 million in tax refund payment offsets since February 2011.

Lastly, the Committee learned how DES uses cross-matching to discover and recover UI benefit overpayments.²¹ It is the policy of DES to cross-match new hires weekly against the National New Hire Directory database and to cross-match wages quarterly against the Directory's database. It is the Committee's understanding that DES is pursuing the cross-matching of jail

¹⁹ Pub. L. 110-328.

²⁰ Pub. L. 111-291.

²¹ [Presentation made by Chanita Arceneaux on April 18, 2012.](#)

system records. The Committee may continue to pursue the cross-matching policies of DES since it is a key tool in overpayment prevention, detection, and recovery. In the USDOL presentation at the April 3, 2012, meeting, Gilbert and Ziegler spoke to the importance of SIDES: the State Information Data Exchange System. Holmes also emphasized the importance of participating in SIDES. Eighteen states have implemented SIDES and 25 more states are in different stages of programming and testing. In Holmes' presentation on "Best Practices", he mentioned the use of an array of cross-matches and the need to dedicate both staff and system resources to the cross-matching effort in order to use the tool effectively.

Based on the information the Committee obtained at its first two meetings, it proposes that the 2012 Regular Session of the 2011 General Assembly enact the following Legislative Recommendation to better enable the State to prevent, detect, and recover unemployment compensation overpayments:

- Remove the statute of limitations on the recovery of overpayments.
- Increase the criminal penalty for fraudulent overpayments that exceed \$400.
- Impose the federally-mandated 15% penalty on fraudulent overpayments, effective October 1, 2013.
- Impose the federally-mandated prohibition on the non-charging of employer accounts if an overpayment is made due to the failure of the employer to respond timely and adequately to DES with information that could have prevented the overpayment, effective October 1, 2013.
- Amend the Directory of New Hires to require employers to report new hires within the last 60 days.
- Direct DES to report to the Committee on September 1, November 1, and January 1 on its efforts to comply with the TOP-UIC program.

