PERFORMANCE AUDIT REPORT

Pennsylvania Department of Labor and Industry Service and Infrastructure Improvement Fund (SIIF)

April 2017

Commonwealth of Pennsylvania
Department of the Auditor General

Eugene A. DePasquale • Auditor General

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EUGENE A. DEPASQUALE
AUDITOR GENERAL

April 24, 2017

The Honorable Tom Wolf
Governor
Commonwealth of Pennsylvania
Harrisburg, PA 17120

Dear Governor Wolf:

This report contains the results of the Department of the Auditor General's performance audit of the Pennsylvania Department of Labor and Industry (L&I). Specifically, we evaluated L&I's duties and responsibilities related to fulfilling the intent of Act 34 of 2013 (Act 34). This audit was conducted under the authority of Section 402 of The Fiscal Code, 72 P.S. § 402, and in accordance with applicable generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Our performance audit had four objectives: (1) determining whether L&I expended Unemployment Compensation (UC) Service and Infrastructure Improvement Fund (SIIF) dollars in accordance with Act 34; (2) validating the improvements and efficiencies, including cost savings, L&I achieved as a result of SIIF-funded activities; (3) evaluating the reasonableness of L&I's economic forecasts of the potential impact to the UC system with and without additional SIIF funding; and (4) reviewing L&I's economic forecasts/projections for the amount of SIIF funding needed for calendar years 2017 through 2020, and how/when L&I can eliminate the need for the SIIF after implementing new technologies for the UC system. Our audit period was January 1, 2013 through December 31, 2016, for the first objective, and January 1, 2013 through March 1, 2017, for the remaining objectives, with updates through the report's release.

Act 34 established SIIF to improve the quality, efficiency, and timeliness of services provided by the UC service center system to individuals claiming unemployment compensation, including claim filing, claim administration, adjudication services, and staffing and training of system employees. It also permitted the use of SIIF dollars for significant and lasting improvements to the UC system's information management technology, communications technology, and other infrastructure components. Lastly, SIIF funds could be used to pay the costs of collecting the UC contributions deposited into the SIIF.

Our auditors found that L&I did not use proper accounting methods to record SIIF expenditures that totaled more than $178.4 million. This prevented us from directly matching SIIF expenditures with the purposes stated in Act 34. Failure to separately track and record SIIF expenditures also resulted in L&I preparing generalized reports to the Governor and General Assembly. We found errors in L&I's compilation of these reports, and therefore, the reports were not considered reliable. While improvements and efficiencies were achieved by L&I during the four-year funding period of SIIF from 2013 through 2016 to services provided to UC claimants and to UC system infrastructure, we could not directly correlate the SIIF expenditures to these outcomes.

When SIIF funding was not reauthorized, L&I was forced to cut $57.5 million from its UC administrative budget for 2017, causing the immediate closure of three of eight UC service centers and the elimination of 521 positons, which resulted in 488 employees ultimately being furloughed, including 333 UC service center employees. With the abrupt closing of three UC service centers on December 20, 2016, customer service declined significantly with claimants not being able to get through on the phone lines. Busy signals skyrocketed, and calls that made it into the waiting queue experienced long hold times. The remaining UC program staff had to work extra hard to compensate for the extra work load and backlogs that began to accumulate.

Looking ahead, L&I projected UC administrative revenues and expenditures, including a projection for implementing a new UC benefit modernization system, over the next four calendar years 2017 through 2020 to determine the annual cash flow shortfall. If no additional funds are received from the state, L&I's budgetary forecast requires further UC operating cost reductions and UC service center closures. Based on our analysis, L&I's projection appears reasonable.

We offer a total of ten recommendations in this report. Seven involve improving in the areas of L&I's accountability over the SIIF, producing detailed reports of SIIF activity that will enable the General Assembly to properly evaluate the impact of its decisions, and generating additional revenue. We also offer three recommendations that encourage L&I to work with the General Assembly to ensure Pennsylvanians receive adequate UC services.

In closing, we would like to thank L&I for its cooperation and assistance during the audit. L&I agreed with all findings and recommendations presented in this report. We will follow up at the appropriate time to determine whether and to what extent all recommendations have been implemented.

Sincerely,

Eugene A. DePasquale
Auditor General

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Executive Summary

The Pennsylvania Department of Labor and Industry (L&I) is responsible for the administration and operation of Pennsylvania's Unemployment Compensation (UC) program, which provides temporary income to replace lost wages for qualified workers. UC claims are filed online, mailed to a UC service center, or submitted via telephone call to a UC service center. Prior to December 19, 2016, L&I operated eight UC service centers across the state. However, three were closed and nearly 500 employees furloughed after the Service and Infrastructure Improvement Fund[1] (SIIF) was not reauthorized by the legislature and the supplemental funding ended as of December 31, 2016. Act 34 of 2013 (Act 34) created SIIF as a temporary supplemental funding source to improve UC services for claimants and to make lasting infrastructure improvements to the UC system during a time when federal funding for UC administration was declining. A total of $178.4 million was authorized and spent during calendar years 2013 through 2016.

Our performance audit had four objectives: (1) determining if L&I expended SIIF funds in accordance with Act 34; (2) validating the improvements and efficiencies, including cost savings, L&I achieved as a result of SIIF-funded activities; (3) evaluating the reasonableness of L&I's economic forecasts of the potential impact to the UC system with and without additional SIIF funding; and (4) reviewing L&I's economic forecasts/projections for the amount of SIIF funding needed for calendar years 2017 through 2020, and how/when L&I can eliminate the need for the SIIF after implementing new technologies for the UC system. Our audit period was January 1, 2013 through December 31, 2016, for the first objective, and January 1, 2013 through March 1, 2017, for the remaining objectives, with updates through the report's release.

Our audit contains three findings and ten recommendations. L&I is in agreement with all of the findings and recommendations and is committed to working with the General Assembly to create a long-term funding solution and to make lasting improvements to its UC system.

Finding 1 – Labor and Industry's failure to use proper accounting methods to record SIIF dollars prevented us from directly matching SIIF dollars with the purposes stated in Act 34 of 2013.

L&I management considered UC administrative funds from all sources, including not only SIIF monies, but also federal UC administrative funds and interest and penalties on UC tax money owed and collected, as one pot of funds used to administer the UC program. Therefore, management did not account for specific SIIF expenditures as they were incurred, but instead, administrative expenditures from all sources were comingled and recorded in the Administrative

[1] 43 P.S. § 781.9.

Fund and periodically L&I transferred large lump sums to shift expenditure dollars to the SIIF. Overall, there were 14 lump sum transfers over the four-year period totaling $178.4 million. Because L&I did not separately account for nor track specific SIIF expenditures, we could not determine whether or not all SIIF funds were used in accordance with Act 34.

Failure to separately track and record SIIF expenditures also resulted in L&I preparing generalized reports for the Governor and General Assembly. We found that L&I was not preparing and providing annual reports to the Governor and General Assembly as required by Act 34. L&I did not submit the first annual report until January 7, 2016, or over a year and a half after the calendar year 2014 report was due. In that report L&I indicated that all of the SIIF monies were used to pay for personnel costs of staff engaged in improving the quality, efficiency, and timeliness of UC services; however, L&I's accounting methodology prevents the direct link for SIIF dollars to personnel cost of specific L&I staff.

L&I subsequently attempted to justify that SIIF monies were not entirely expended on personnel costs as previously stated in the January 7, 2016 report by compiling an after-the-fact report showing SIIF dollars expended for other areas of operations and infrastructure. This report (provided to the General Assembly on May 26, 2016) showed expenditures of SIIF dollars for state fiscal years ending June 30, 2014, 2015, and 2016 (through April 2016). Based on our test work, we found errors in L&I's compilation of these reports, and therefore, L&I's accounting of SIIF expenditures is not considered reliable.

Finding 2 – While improvements and efficiencies have been made to the Unemployment Compensation Program between 2013 and 2016, the SIIF expenditures could not be directly matched with outcomes meeting the intent of Act 34.

Although L&I's inadequate accounting and failure to segregate the expenditures related to the SIIF funding prevented us from making direct correlation between actual SIIF expenditures and the improvements/efficiencies realized, based on our audit procedures, we determined that certain UC program improvements and efficiencies, as presented by L&I, corresponded with the purposes of Act 34. Over the four year period 2013 through 2016, L&I made certain improvements to the quality, efficiency, and timeliness of UC services provided to claimants and employers, including improving performance in key USDOL core measures, phone virtualization and telecommunications modifications, Unemployment Compensation Board of Review enhancements, collections of monies due from claimants and employers through the UC Amnesty and Treasury Offset programs, and cost savings on interpreter services. Additionally, L&I made or is in the process of making certain infrastructure improvements to the UC system, including the Unemployment Compensation Management System which improved UC tax operational processes, the ongoing Unemployment Compensation Benefits Modernization project to improve the benefits delivery system, automation of the National directory of New

Hires and Justice Network systems, and implementation of the State Information Data Exchange System.

Finding 3 – L&I's forecasts that without a long-term funding solution, additional service centers will need to be closed and may result in online-only claims filing are reasonable.

When SIIF funding was not reauthorized, L&I was forced to cut $57.5 million from its UC administrative budget for 2017, causing the immediate closure of three of eight UC service centers and eliminating 521 positons, which resulted in 488 employees ultimately being furloughed, including 333 UC service center employees. With the abrupt closing of three UC service centers on December 20, 2016, customer service declined significantly with claimants not being able to get through on the phone lines. Busy signals skyrocketed and calls that made it into the waiting queue experienced long hold times.

Looking ahead, L&I projected revenues and expenditures, including a projection for UC modernization costs, of UC administrative funds over the next four calendar years 2017 through 2020 to determine the annual cash flow shortfall. According to L&I, if no additional funds are received from the state, L&I's budgetary forecast requires further UC operating cost reductions and UC service center closures in 2017 and 2018. Based on our analysis, L&I's projection appears reasonable.

L&I's projection of expenditures does not include the cost of recalling the employees furloughed in December 2016, which is estimated by L&I to be $38.5 million based on state fiscal year 2015-2016 actual costs. To avoid any additional service center closings in 2017 or 2018, or other reductions in operating costs, L&I projects that at least an additional $12.1 million state supplement is needed in calendar year 2017 to break even and a $20.2 million supplement in calendar year 2018 to keep the UC program running in its current state while long-term decisions are made. These cash flow shortfalls also do not include the costs associated with implementing a new, much needed benefit modernization system, which L&I estimates will cost $63.8 million from calendar years 2017 through 2020.

A collaboration between L&I and the General Assembly is crucial to providing the best solution possible for the type of UC program service that is needed for Pennsylvania to ensure that the intent of the UC law is met, including meeting USDOL core performance measures, by providing the support needed to those who lose their jobs through no fault of their own or are forced to work less than their full-time hours. With its current situation, L&I will immediately need a short-term funding solution while working through long-term funding decisions. It is imperative, however, that the short-term funding solution continues until long-term funding is in place to avoid the costs of furloughing personnel and potential closing of additional UC service centers. Additionally, the revenue and expenditure projections indicate that it is critical that L&I continue to achieve further cost savings for the UC program beyond implementing a new benefit modernization system.

Introduction and Background

In November and December 2016, several state legislators requested that Auditor General Eugene A. DePasquale commence an audit to determine how $178 million of funds authorized by Act 34 of 2013 (Act 34) were spent by the Pennsylvania Department of Labor and Industry (L&I). Act 34 established a restricted account, known as the Service and Infrastructure Improvement Fund (SIIF), within the State Treasury,[2] consisting of employees' contributions deposited into the Unemployment Compensation (UC) Fund[3] by which a portion of the employees' contributions (based on wages paid for employment) are placed into the SIIF to be used for specific purposes as established in the act[4] (see additional information below).

As a result, in January 2017, the Department of the Auditor General (DAG) commenced a performance audit to evaluate L&I's duties and responsibilities related to fulfilling the intent of Act 34. Our audit focused on the following four audit objectives, which are further explained in Appendix A – *Objectives, Scope, and Methodology*:

- Review L&I's accounting of expenditures made from the UC SIIF for each calendar year 2013, 2014, 2015 and 2016 and determine whether L&I spent SIIF funds in accordance with Act 34.

- Validate improvements and efficiencies, including any cost savings, achieved by L&I from receipt of additional funding in the UC SIIF for the UC system.

- Evaluate the reasonableness of L&I's economic forecast of the potential impact to the UC system if additional funding for the UC SIIF:

    a. Is not authorized for calendar year 2017, or thereafter.
    b. Is authorized for calendar year 2017, but not thereafter.

- Review L&I's economic forecast/projection on how and when L&I can eliminate the need for additional SIIF funding, including the amount of SIIF funding needed for calendar years 2017, 2018, 2019 and 2020, and ensure the implementation of new technologies for the UC system, and therefore not require further legislative supplemental appropriations.

Our audit covered the period of January 1, 2013 through December 31, 2016 for the first objective, and January 1, 2013 through March 1, 2017 for the remaining objectives.

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[2] 43 P.S. § 781.9(a).
[3] 43 P.S. § 781.4(e)(2).
[4] 43 P.S. § 781.9(c).

The following provides background information to help the reader understand the findings and the significance of the issues discussed.

Background on the Department of Labor and Industry

L&I was established in 1913 and originally inspected the working conditions in factories around the state.[5] Currently, L&I employs over 5,000 people and has approximately 200 offices statewide. L&I is now charged with administering benefits to unemployed individuals, overseeing the administration of workers' compensation benefits to individuals with job related injuries, and provides vocational rehabilitation to people with disabilities. L&I also provides employment and job training services for adults, youth, older workers, and workers who were dislocated. In addition to helping the unemployed in Pennsylvania, L&I is charged with enforcing safety standards and administers the commonwealth's programs for community service by young Pennsylvanians. While L&I has various responsibilities that have grown from its simple start, the responsibility at the heart of this audit is L&I's administration of unemployment benefits.

Background of the Unemployment Compensation Program

The UC program is a unique federal-state partnership. It is based on federal law, but administered by state employees under state law. The UC program as it is known today started in Wisconsin in 1932 in the midst of the Great Depression. By 1935, when the Social Security Act was signed into law by President Franklin Roosevelt, six other states had enacted unemployment insurance laws. The Social Security Act included provisions for old age insurance, welfare, and unemployment insurance. The passage and enactment of the Social Security Act was the first step towards establishing unemployment insurance programs throughout the country. Less than a year after the first unemployment check was issued, in the amount of $15, the Supreme Court upheld the Social Security Act, and within four months the 48 states, Alaska, Hawaii, and the District of Columbia had enacted their own unemployment insurance laws.[6]

The UC program is intended to provide temporary cash benefits to individuals who are unemployed through no fault of their own so that they can meet their basic financial needs while searching for new employment.

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[5] http://www.dli.pa.gov/Pages/Heritage.aspx; subsequent to1913, L&I's powers and duties were continued under Section 2201 of the Administrative Code of 1929 (*see* 71 P.S. § 561).
[6] https://www.dol.gov/ocia/pdf/75th-anniversary-summary-FINAL.pdf.

Each state administers its program and establishes its own eligibility requirements within the guidelines established by Federal law. Eligibility for unemployment benefits and the amount and length of time benefits are available are determined by state law. In all but three states, benefit funding is based solely on a tax imposed on employers. The other three states, including Pennsylvania, also require minimal employee contributions.[7] In addition to the tax imposed on employers and employees, each state receives federal funding based, in part, on the number of UC claims. Therefore, as a state's number of UC claims increases or decreases, its federal funding is either positively or negatively affected.

The UC program has underwent many changes since its inception, but the one most applicable to this audit is the method of applying for benefits. Remote application via telephone became available in the 1990s, which was followed by application via the internet. The majority of applications for benefits are now filed remotely.[8]

Pennsylvania UC Information[9]

From December 2007 through June 2009,[10] the United States economy was in a recession and unemployment rates skyrocketed. This resulted in Pennsylvania (and the other states) experiencing an extraordinarily high volume of unemployed citizens seeking to apply for UC benefits. Based on this volume and the urgency of the situation, the U.S. Department of Labor (USDOL) issued a directive requiring states to focus primarily on processing initial claims to allow claimants to begin receiving payments. This, in turn, resulted in backlogs of work within other areas of the UC program such as: processing overpayments, identifying the time that lapsed between application and first payment, assessing the quality of determinations, and the timeliness in which appeals are addressed and decided.

Once the economy began to recover, L&I began to see a reduction in the number of UC claims as well as a reduction in the unemployment rates as noted in the below table; however, the significant backlog of work remained.

[7] https://workforcesecurity.doleta.gov/unemploy/uifactsheet.asp.
[8] https://www.dol.gov/ocia/pdf/75th-anniversary-summary-FINAL.pdf.
[9] The information in this section, except for the dates of the recession, was provided by L&I and is provided for background purposes only. We did not consider this information to be significant to the audit findings and conclusions within the context of the audit objectives and did not validate the information.
[10] http://www.nber.org/cycles.html, accessed 3/28/2017.

Calendar Year	Initial Claims	Continued Claims	Lower Authority Appeals Filed	Pennsylvania Seasonally-Adjusted Unemployment Rate
2012	1,803,368	18,934,045	88,873	Not provided
2013	1,432,251	14,560,855	84,494	6.5%
2014	1,156,630	8,528,800	83,157	5.3%
2015	1,082,601	7,514,166	73,133	4.7%
2016	988,822	7,147,862	66,679	5.4%

Table developed by DAG using information provided by L&I. This information is presented for background purposes only.

With the decrease in claims came a corresponding decrease in federal funding for Pennsylvania to administer the UC program as follows:

Federal Fiscal Year (FFY)	Total Federal Funding to administer the UC Program
FFY 2012	$175,506,283
FFY 2013	$155,899,993
FFY 2014	$140,094,958
FFY 2015	$136,669,929
FFY 2016	$133,887,019

Table developed by DAG using information provided by L&I. This information is presented for background purposes only.

Between FFY 2012 and FFY 2016, total federal funding to administer the UC was reduced by 24 percent.

Background of the UC SIIF

As a result of declining federal funds available for Pennsylvania to administer the UC program and to improve the level of customer service to UC system users, the Pennsylvania legislature passed Act 34 in 2013 to temporarily supplement the decrease in total funding. Act 34 set up the SIIF and established annual funding for four calendar years—2013 through 2016. The annual funding was intended to bridge the gap between the cost to effectively run the program and the amount of federal funding available for Pennsylvania. The act established guidelines rather than a set amount of annual funding as outlined below:[11]

[11] 43 P.S. § 781.4(e)(2).

For each calendar year 2013 through 2016, an amount determined by the Secretary of L&I and approved by the Governor are to be deposited into the SIIF as follows:

- Calendar year 2013 – an amount not to exceed $40 million.
- Calendar year 2014 – an amount not to exceed $30 million.
- Calendar years 2015 and 2016 – an amount for each calendar year may not exceed $190 million adjusted by the increase in the Bureau of Labor Statistics Consumer Price Index for the period from May 2013 through January of the calendar year less the amount of Federal administrative funding for the preceding Federal fiscal year. (See Finding #1 for a breakout by year of the SIIF funding actually received.)

Overall, L&I spent $178,406,892 in SIIF monies during the period January 1, 2013 through December 31, 2016.

According to Act 34, monies in the SIIF are appropriated on a continuing basis, upon approval of the Governor,[12] to L&I to be prioritized for the following purposes:

1. To improve the quality, efficiency and timeliness of services provided by the service center system to individuals claiming compensation under this act, including claim filing, claim administration, adjudication services, and staffing and training of system employees.

2. Expenditures for information management technology, communications technology, and other infrastructure components that the secretary determines are likely to result in significant and lasting improvements to the unemployment compensation system.

3. To pay the costs of collecting the contributions deposited into the SIIF.

Background on the Request for this Audit

In the spring of 2016, L&I began discussions with the chairs of the Senate and House L&I Committees about the need to extend SIIF funding past the date, December 31, 2016, on which funds would no longer be deposited in the SIIF.[13] L&I initially requested funding for an additional four years in anticipation of a continued reduction in federal funding to administer the UC Program.

[12] 43 P.S. § 781.9(c).
[13] 43 P.S. § 781.4(e)(2).

During the negotiations between members of the legislature, a one year extension at $57.5 million was drafted, which would have allowed L&I to continue service to the public at the level they were operating at and to secure a vendor for the modernization of their benefit delivery computer system,[14] which is used to process benefit applications as well as issue unemployment benefits.[15] This draft legislation also called for an audit to be conducted by the DAG of the UC SIIF containing six specific objectives. However, this legislation failed to be voted on by the Senate in November 2016.

According to L&I, as a result of the legislature not passing this legislation to extend the SIIF funding, L&I was forced to cut operating expenses and in December 2016 L&I closed three UC service centers (Allentown, Altoona, and Lancaster) and furloughed a portion of the staff at the Harrisburg UC service center. In addition to the furloughs that occurred with the closure of the service centers, L&I furloughed employees in the areas of tax, policy, UC Board of Review, information technology, legal, and administrative services. A total of 521 positions were eliminated within the UC system, of which 22 employees were provided positions in other non-UC areas of L&I, and another 11 employees found positions in other Commonwealth agencies. The remaining 488 employees were furloughed. See Finding #3 for further details regarding the UC service center closures and furloughed employees.

Although the draft legislation requiring this office to conduct an audit of the UC SIIF revenues and spending was not voted on by the Senate, several legislators formally requested the DAG to conduct an audit of the SIIF funds to answer their questions as to how the monies had been spent between calendar years 2013 and 2016 (the duration of Act 34), which then could help provide a pathway to bridge the divide between the General Assembly and L&I to reach a funding resolution for future SIIF funding.

[14] Discussed in Finding #3 of this report.
[15] House Bill 2375, P.N. 4065 (latest Printer's Number), 2015-2016 Legislative Session.

Finding 1 – Labor and Industry's failure to use proper accounting methods to record SIIF dollars prevented us from directly matching SIIF dollars with the purposes stated in Act 34 of 2013.

Act 34 of 2013 (Act 34) established a restricted account known as the Service and Infrastructure Improvement Fund[16] (SIIF) within the Unemployment Compensation (UC) Fund.[17] During calendar years 2013 through 2016, a total of $178.4 million of UC collections received from the UC taxes paid by employees based on their wages was deposited into the SIIF. Monies deposited into the SIIF were to be prioritized by the Pennsylvania Department of Labor and Industry (L&I) for the following purposes:

1. To improve the quality, efficiency and timeliness of services provided by the service center system to individuals claiming compensation under this act, including claim filing, claim administration, adjudication services and staffing and training of system employees.

2. Expenditures for information management technology, communications technology and other infrastructure components that the secretary determines are likely to result in significant and lasting improvements to the unemployment compensation system.

3. To pay the costs of collecting the contributions deposited into the Service and Infrastructure Improvement Fund.[18]

Failure by L&I to provide a proper accounting of all expenditures paid with SIIF monies resulted in management providing the Governor and General Assembly reports lacking the necessary level of specificity to determine whether SIIF dollars were spent in accordance with Act 34. Additional details are discussed in the following sections.

SIIF expenditures not separately accounted for or tracked.

L&I management considered UC administrative funds from all sources, including not only SIIF monies, but also federal UC administrative funds and interest and penalties on UC tax money owed and collected, as one pot of funds used to administer the UC program. Therefore, management did not account for specific SIIF expenditures as they were incurred, but instead, administrative expenditures from all sources were comingled and recorded in the Administrative

[16] 43 P.S. § 781.9(a).
[17] 43 P.S. § 841(a).
[18] 43 P.S. § 781.9(c).

Fund, and periodically L&I transferred large lump sums to shift expenditure dollars to the SIIF.[19] L&I received the following federal and state "UC administrative funds" for the years 2013 through 2016:

UC Administrative Funding Sources							
	Federal Funds		**State Funds**				
Calendar Year a/	**Federal Administrative**	**Federal Special Projects b/**	**Special Admin c/**	**General Appropriation d/**	**Misc e/**	**SIIF**	**Total**
2013	$150,990,585	$2,900,000	$5,750,000	$1,840,000	-	$ 27,000,000	$188,480,585
2014	$132,740,059	-	$14,653,743	$1,636,846	$168,600	$ 43,000,000	$192,199,248
2015	$128,923,929	$5,307,092	$13,400,000	-	$ 72,613	$ 51,837,902	$199,541,536
2016	$129,925,395 f/	$1,774,961	- g/	-	-	$ 56,568,990	$188,269,346
Total	$542,579,968	$9,982,053	$33,803,743	$3,476,846	$241,213	$178,406,892	$768,490,715

a/ This table is based on the calendar year of when funds were actually received. Federal funds are awarded based on federal fiscal years which run from October 1 through September 30 and received throughout the year.
b/ Federal supplemental grants for a specific UC projects.
c/ Includes penalties and interest on UC tax money owed and collected from employers and interest collected from employees.
d/ General appropriations allocated for legacy mainframe costs.
e/ Includes state portion of proceeds from the sale of Coatesville center and other miscellaneous reimbursements.
f/ 2016 Federal Administrative Revenue does not include $49,498,124 which was received the last week of December 2016 because this amount is included in the 2017 projections in Finding #3.
g/ As of December 31, 2016, SAP Special Admin. funds to be allocated for UC Admin. for state fiscal year ending June 30, 2017, had not been determined.
Source: Table developed by Department of the Auditor General (DAG) using information provided by L&I. This information was agreed to L&I's spreadsheet of cash flows, Notice of Obligations, and/or Expenditure Symbol Notifications for reasonableness.

A separate restricted account had been established to record SIIF transactions within the Commonwealth's SAP accounting system. However, instead of directly recording specific expenditures in the SIIF account, L&I initially lumped together and recorded all "UC administrative expenditures" in the SAP accounting system to the Administrative Fund and then subsequently recorded large lump sum transfers to move expenditures from the Administrative Fund to the SIIF.[20] None of the transfers, however, identified which specific expenditures were being transferred, nor that they were directly associated with SIIF. Most of the transfers were simply labeled as Personnel Service Transfer (as shown in the table below). L&I management stated that this was done for ease of accounting since L&I viewed all administrative funds, including SIIF, as one pot of money to be used for UC program administration.

[19] UC taxes paid by employers and employees are deposited into the UC Fund. The SIIF is a restricted account created within the UC Fund. Administrative expenditures from all funding sources are comingled and recorded in the Administration Fund.
[20] From inception of SIIF in 2013 through the first half of 2016, L&I transferred the expenditures from the Administrative Fund to the SIIF under the line item Other Personnel Cost Transfers. In the second half of 2016, L&I changed the line item being utilized to Other Operating Costs since it considered this line item to be more accurate since SIIF monies were being utilized for more than just personnel costs.

The following table identifies the transfer dates and amount of each transfer transaction L&I recorded to transfer the expenditures into SIIF from 2013 through 2016:

SIIF Transfers			
Transfer Date	**Transfer G/L Account**	**Transfer Amount**	**Calendar Year Total**
August 8, 2013	Personnel Services Transfer	$7,000,000	
August 22, 2013	Personnel Services Transfer	$7,000,000	
September 19, 2013	Personnel Services Transfer	$6,000,000	
October 3, 2013	Personnel Services Transfer	$7,000,000	
Total 2013			$27,000,000
January 30, 2014	Personnel Services Transfer	$13,000,000	
September 17, 2014	Personnel Services Transfer	$15,000,000	
November 17, 2014	Personnel Services Transfer	$15,000,000	
Total 2014			$43,000,000
May 27, 2015	Personnel Services Transfer	$20,000,000	
August 25, 2015	Personnel Services Transfer	$20,000,000	
October 19, 2015	Personnel Services Transfer	$11,000,000	
December 15, 2015	Personnel Services Transfer	$837,902	
Total 2015			$51,837,902
May 20, 2016	Personnel Services Transfer	$20,000,000	
September 6, 2016	Other Operation Exp. Transfer	$20,000,000	
November 3, 2016	Other Operation Exp. Transfer	$16,568,990	
Total 2016			$56,568,990
Total SIIF			**$178,406,892**

Source: Table prepared by DAG from information in the Commonwealth's SAP accounting system.

In regard to not directly recording and accounting for SIIF expenditures, L&I management further stated:

> SIIF funding was used in conjunction with Federal Administrative Funding to administer the Unemployment Compensation program and related systems generally to improve the quality, efficiency and timeliness of services and to pay for technology and infrastructure components. SIIF funding was used in accordance with the enacted legislation for the permitted purposes stated therein. The statute does not specify the manner in which the SIIF funding is to be applied to the permitted expenditures, therefore, leaving the method of applying the funds up to the discretion of the department.

Although this statement is true, it is a prudent business and accounting practice that expenditures for specific purposes should be separately tracked and accounted for to ensure compliance with those intended purposes; particularly since the Legislature did require an annual accounting of the expenditures. Further, even though Act 34 does not specify the manner in which L&I should account for SIIF expenditures, Act 34 did establish a restricted account in order to segregate and separately record the expenditures related to the specific purposes. The bottom line is that, because L&I did not separately account for nor track specific SIIF expenditures, we could not determine whether or not all SIIF funds were used in accordance with Act 34. In addition, as discussed in the next section, failure to separately track and record SIIF expenditures resulted in generalized reports for the Governor and General Assembly.

Generalized reporting of SIIF expenditures

In addition to not separately accounting for SIIF expenditures, L&I was not preparing and providing annual reports to the Governor and General Assembly, as required by Statute. Act 34 requires that:

> No later than June 30 of each calendar year from 2014 through 2019, the department [L&I] shall provide a report to the Governor and the General Assembly, through the Secretary-Parliamentarian of the Senate and the Chief Clerk of the House of Representatives, regarding the Service and Infrastructure Improvement Fund, which report shall include an accounting for the contributions deposited into the fund, the expenditures and transfers from the fund during the prior year and a description of the purposes for which expenditures from the fund were made in the prior year.[21]

Without separately accounting for SIIF expenditures and the purposes of the expenditures, L&I cannot accurately compile and report how SIIF funds were expended. L&I did submit the first SIIF annual report to the General Assembly on January 7, 2016, over a year and a half after the calendar year 2014 report was due. This report covered the state fiscal years ending June 30, 2014, and June 30, 2015. Since SIIF expenditures during this time period were recorded as large lump sum transfers of personnel services costs, the report indicated that all SIIF monies for the two years, totaling $90 million, were used to pay for the personnel costs of staff engaged in improving the quality, efficiency, and timeliness of UC services; however, L&I's accounting methodology prevents the direct link from SIIF dollars to personnel costs of specific staff. Therefore, we could not validate L&I's claim. The report further noted that this allowed for federal funding to be utilized for infrastructure development and information technology projects.

L&I subsequently attempted to justify that SIIF monies were not entirely expended on personnel costs, as previously stated in the January 7, 2016 report, by compiling an after-the-fact report showing SIIF dollars expended for other areas of operations and infrastructure. L&I provided this after-the-fact report to the General Assembly on May 26, 2016, which showed expenditures

[21] 43 P.S. § 781.9(g).

of SIIF dollars for state fiscal years ending June 30, 2014, 2015, and 2016 (through April 2016). The report identified major areas that SIIF funds were utilized for the UC program. These general categories included EUC Program, UC Tax System, Internal IT services, Telecom Services, Interpreter Services, Legacy Mainframe, Amnesty Program, Software/Hardware, Equipment Upgrades, Carnegie Mellon, Career Link Support, and UC Benefits Modernization. L&I compiled expenditure amounts by these categories. Further, according to L&I, in order for the report to equal the total amount of SIIF dollars available that year, L&I plugged any difference into a miscellaneous category called "All Other" which generally comprised of personnel costs. As a result, we requested that L&I provide a detailed listing from the Commonwealth's SAP accounting system showing how L&I compiled the dollars for each general category.

Based upon our review of the information provided, we found certain expenditures that appeared to be normal operating expenditures, which may not be in accordance with Act 34, such as postage, real estate utilities, office cleaning supplies, audit billings, and maintaining the legacy IT system. We questioned as to how these expenditures related to Act 34, and management responded that when compiling the after-the-fact report, the intent of Act 34 was not considered when it identified which specific SAP account coding and detailed expenditures made up the total amounts in each reported SIIF expenditure category.

L&I management indicated that if we found any expenditures included in its accounting that were not in accordance with Act 34, L&I could replace these costs with other personnel costs. UC program personnel costs far exceeded available SIIF dollars for each of the four years 2013 through 2016. In other words, management believed all UC program personnel costs were in accordance with the first purpose of Act 34, which was to improve the quality, efficiency and timeliness of services provided by the service center system to individuals claiming compensation under this act, including claim filing, claim administration, adjudication services and staffing and training of system employees. However, there is no way to confirm that the personnel costs paid with SIIF dollars actually fulfilled this Act 34 requirement.

Additionally, as L&I prepared this documentation of its accounting of SIIF expenditures for us, L&I identified errors in the amounts reported to the General Assembly in the May 26, 2016 report, such as duplication of the same expenditures in more than one category. As we further evaluated the details of L&I's accounting, we noted additional expenditure items that may be in error or duplicated between two categories beyond the initial errors identified by L&I.

Due to the errors in compiling the report, combined with the fact that expenditures of SIIF dollars were not separately tracked, but were comingled with expenditures of other "UC administrative funds," L&I's after-the-fact and random accounting of SIIF expenditures is not considered reliable. Therefore, we could not determine whether SIIF funds were spent in accordance with Act 34.

We did, however, attempt to verify that some of the monies in the "UC administration funds" were used for purposes in accordance with Act 34 by requesting L&I to provide examples of non-personnel expenditure documents, including detailed invoices, that directly related to the intent of Act 34 that were paid with the UC pot of money. The expenditure documentation provided included costs related to the UC tax system, UC benefit modernization, telecommunication services, interpreter services, and sign language services, all of which appear related to the intent of Act 34 by improving services or infrastructure of the UC system.

While it is apparent that L&I has made various improvements to the quality, efficiency and timeliness of services provided by the service center system to individuals seeking UC benefit payments and to infrastructure improvements to the UC system over the four year funding period (2013 through 2016), we cannot determine with specificity what SIIF dollars were used to pay for which specific improvements, nor that the expenditures were all in accordance with Act 34. See Finding #2 for discussion of L&I's improvements and efficiencies to the UC system.

Recommendations for Finding 1

We recommend that if additional SIIF dollars are provided, L&I should:

1. Use specific account coding in the SAP accounting system to directly record SIIF expenditure transactions that relate only to the purposes stated in the new SIIF legislation, which would allow for the accurate and reliable reporting of SIIF activities.

2. Submit accurate and timely annual reports to the Governor and General Assembly that provide a clear picture of SIIF transactional activity, including the accounting of deposits and expenditures of the fund, so they are able to make informed decisions that impact the UC program.

3. Implement a process that includes sufficient oversight of the preparation and submission of the annual reports to ensure accuracy of the information.

4. Measure and track the impact that SIIF dollars have on the quality, efficiency and timeliness of UC services in accordance with the USDOL performance standards.

Finding 2 – While improvements and efficiencies have been made to the Unemployment Compensation Program between 2013 and 2016, the SIIF expenditures could not be directly matched with outcomes meeting the intent of Act 34.

During the four-year period from 2013 through 2016, the General Assembly authorized the Department of Labor and Industry (L&I) through Act 34 of 2013 (Act 34) to spend more than $178 million from the Service and Infrastructure Improvement Fund (SIIF) to, among others, improve the quality, efficiency, and timeliness of services provided to claimants and to make significant and lasting improvements to the infrastructure of the Unemployment Compensation (UC) system. [22] Per our request, L&I senior-level management provided us numerous examples of improvements and efficiencies to UC services and infrastructure that it claimed resulted from spending SIIF dollars. However, because L&I management failed to segregate and directly record SIIF-related expenditures but instead recorded all the UC administrative expenses in the Administration Fund, we could not directly attribute which improvements and efficiencies were realized due to the specific expenditure of SIIF dollars (see Finding #1).

Although we could not directly correlate UC program improvements and efficiencies to specific SIIF expenditures, based on our audit procedures we determined that certain improvements, as presented by L&I, corresponded with the purposes of Act 34.[23] L&I segregated its improvements and efficiencies by the purposes of Act 34 as follows:

- Improve the quality, efficiency, and timeliness of UC services provided to claimants and employers (Act 34 Section 301.9(c)(1)):
    - **Background on Performance Measures**
        - U.S. Department of Labor's Core Performance Measures
    - **Specific enhancements made by L&I to UC Services**
        - Phone Virtualization and Telecommunications Modifications
        - Unemployment Compensation Board of Review
        - Former UC Amnesty Program
        - Treasury Offset Program
        - Interpreter Services

[22] 43 P.S. § 781.9(c).
[23] We did not evaluate the impact of furloughing nearly 500 UC program employees in December 2016 to the improvements and efficiencies presented by L&I which are included in this finding.

- Make significant and lasting improvements to the information management technology, communications technology, and other infrastructure components of the UC system (Act 34 Section 301.9(c)(2):
  - **Specific Enhancements Made by L&I to UC Infrastructure**
    - Unemployment Compensation Tax Services
    - UC Benefits Modernization System
    - Other UC Technological Upgrades

The following sections discuss each of the above improvements and efficiencies that L&I has asserted was a result, at least in part, from spending SIIF dollars.

Improve the Quality, Efficiency and Timeliness of UC Services Provided to Claimants and Employers.

Background on Performance Measures:

U.S. Department of Labor's Core Performance Measures: The U.S. Department of Labor (USDOL) administers the Unemployment Insurance (UI) program for the federal government, which provides temporary financial assistance to unemployed workers that qualify under State law. The states administer separate UI programs, known as UC in Pennsylvania, within the Federal guidelines. As such, the states establish benefit amounts and eligibility requirements. In most states, benefit funding is generated solely from a tax imposed on employers; however, PA is one of three states that requires employee contributions as well.[24]

To ensure the UI program operates effectively to protect vulnerable individuals who have become unemployed through no fault of their own, USDOL monitors state performance of key UI processes (Core Measures) that signify the health of the UI system. State program data is collected and compared to established benchmarks, known as Acceptable Levels of Performance (ALPs). L&I provided a summary of Pennsylvania's performance statistics for the federal fiscal years (FFY) ended September 30, 2013 through 2016 to illustrate the impact of SIIF funding on L&I's service levels. We used USDOL's website to validate PA's performance scores that L&I provided and obtained the scores for the quarter ended December 31, 2016, as presented in the table below.

[24] https://oui.doleta.gov/unemploy/uifactsheet.asp and Pennsylvania Unemployment Compensation Law booklet (www.uc.pa.gov).

USDOL UI Standards & Acceptable Levels of Performance
PA UC Performance Statistics

UI Performance Standard	USDOL Acceptable Level of Performance (ALP)	FFY Ended 9/30/2013	FFY Ended 9/30/2016	Quarter Ended 12/31/2016
All 1st Payment Promptness	% of all 1st payments within 14/21 days after the compensable week **ALP – 87%**	81.6%	92.6%	93.4%
Non-Mon Determination Timeliness	% issued within 21 days of detection date. **ALP – 80%**	61.0%	73.6%	83.4%
Non-Mon Separation Determination Quality	% of separation determinations with scores greater than 95 points **ALP – 75%**	51.8%	54.9%	58.0%
Non-Mon Non-separation Determination Quality	% of non-separation determinations with scores greater than 95 points **ALP – 75%**	66.0%	73.9%	81.3%
Lower Authority Appeals	% of Lower Authority Appeals with Quality Scores equal to or greater than 85% of potential points **ALP – >80%**	96.7%	97.5%	97.5%
Ave. Age of Pending Lower Auth. Appeals	The sum of the ages, in days from filing, of all pending Lower Authority Appeals divided by the number of Lower Authority Appeals **ALP – <30 days**	31.6 days	18.7 days	25.3 days
Ave. Age of Pending Higher Auth. Appeals	The sum of the ages, in days from filing, of all pending Higher Authority Appeals divided by the number of Higher Authority Appeals **ALP – <40 days**	67.5 days	29.4 days	35.8 days
New Employer Status Dets (90-day) Timeliness	% of New Employer Status Determinations made within 90 days of the last day in the quarter in which the business became liable. **ALP – >70%**	95.7%	87.7%	88.6%
Detection of Overpayments	≥50% and <95% of detectable / recoverable overpayments are established for recovery	37.33%	40.22%	39.67%
Tax Quality	Pass = No more than 3 tax function fails in the calendar year and no single tax function failed for three consecutive years	Fail	Pass	Pass

Legend: [green] - ALP met; [red] - ALP not met

Source: USDOL website https://ows.doleta.gov/unemploy/performance1.asp. See assessment of data reliability in Appendix A.

As shown in the table, L&I only met the ALP for two of the ten performance standards listed, at the end of FFY 2013. However, at December 31, 2016, after four years of the SIIF dollars being spent, L&I exceeded eight of the ten performance standards listed, including a significant increase in first payment promptness. According to L&I management, the USDOL considers this core measure one of the most important because it wants eligible claimants to receive their benefits timely. Although PA's performance scores show a marked improvement during the four-year period of SIIF funding, a direct link between the two could not definitively be determined because L&I did not properly record direct expenditures of SIIF funds in the Commonwealth's SAP accounting system (as explained in Finding #1).

As the economy improved from 2013 through 2016 and federal funding for UC administration declined, to better match total funding with operational expenses, L&I did not fill vacant UC program positions in order to reduce staffing levels and the associated costs. As L&I's agency complement decreased 11.8 percent over the four-year period, according to the PA State Government Workforce Statistics Report, UC program staff decreased by 28 percent, including a decrease of 26 percent at the UC service centers.[25] Despite this sizeable reduction in staffing, L&I implemented numerous UC policies and initiatives to address PA's sub-standard performance. For example, an Initial Claims monitoring tool was implemented, which helped to improve first payment promptness by providing daily information about first pay cases at each service center. L&I also identified late first payments in order to address deficiencies. As confirmed with USDOL reports, L&I exceeded the ALP standard for First Payment Promptness every quarter since the quarter ended December 31, 2013.

Management also created a Quality Assurance Unit to improve the UC program's Non-Monetary (Non-Mon) Determination Quality. Members of this unit reviewed weekly cases and work with UC service center supervisors to ensure the quality of the determinations. Training to improve PA's benefit timeliness and quality was also conducted with service center staff. In its 2014 UI State Quality Service Plan (SQSP), L&I reported to the USDOL that service improvements were achieved, in part, due to management's instruction for field staff to focus on reducing the pending non-mon determination working inventory, which had grown to 30,800 cases in January 2013. By September 2013, the inventory was less than 18,500 cases. These efforts were partly successful as PA improved its Non-Mon Determination Timeliness and Non-Mon Non-separation Determination Quality percentages. However, PA continued to score well below the ALP for Non-Mon Separation Determination Quality.

Between August 2013 and December 2016, L&I implemented numerous operational changes at its UC service center to increase efficiencies and improve services provided to claimants

[25] The percentage decrease in UC program and service center staff was calculated by comparing the decrease in staff complement at December 31, 2012, of 1,782 and 1,089, respectively, to the staff complement at December 18, 2016, of 1,289 and 809, respectively, just before furloughs of nearly 500 UC program staff on December 20, 2016.

and employers. Some of these changes included: adding a second shift at the Erie service center to catch up on the claims support work needed at all service centers; converting the Duquesne service center to a Work Processing Center to resolve potential issues found during audits of claims that could result in overpayments; utilizing an appeals tracking tool at all service centers to improve the efficiency of the appeals process; and dedicating Wednesdays and Fridays as "No Call" days, which allowed UC service center staff to focus on various claims-related duties, including manual reviews of internet claims, fact finding for existing claims, and preparation for pending weeks' claim activities. UC service center hours of operation are Monday, Tuesday, and Thursday, 8:00am to 4:00pm.[26] In its 2014 and 2015 SQSPs, L&I reported that these operational changes were implemented to address performance deficiencies in the areas where PA failed to meet the USDOL ALPs.

Specific enhancements made by L&I to UC Services:

Phone Virtualization and Telecommunications Modifications: Prior to closing three UC service centers in December 2016, L&I operated eight regional service centers across the state. Each UC service center had local phone numbers and its own phone queues set up to sort incoming calls according to different UC topics, such as Initial Claims or Continued Claims. Based on a caller's selected topic, the caller was placed on hold in a queue and waited to speak with a UC service representative located at the specific service center called. Thus, at times, one service center could have had many callers waiting on hold, while another center may have had none in its queues.

The implementation of the Phone Virtualization Project eliminated this scenario by utilizing a toll-free number and statewide phone queues, rather than queues for individual service centers. L&I stated that after implementation, calls were placed into the statewide topical phone queues and answered by the next available UC service representative in the state, regardless of the service center in which the representative is located. Most UC questions from callers can be answered by any trained UC service representative; however, callers are transferred to the appropriate regional service center if needed. This virtualization of the phone queues increased service efficiency by maximizing the UC staff's time handling calls and providing better service to the public. The telephone call reports we reviewed provided evidence corroborating that the switch to the virtualized queueing system occurred in March 2016.

Unemployment Compensation Board of Review (UCBR): UC claimants have the right to appeal the UC service center's determination of benefits related to a claim. A hearing is held by a UC Referee, which reviews the facts of the appeal and hears testimony from the claimant before rendering a decision. Claimants may also appeal the referee's decision. These appeals are sent to the UC Board of Review (UCBR), which consists of three members

[26] http://www.uc.pa.gov/pages/contact-us-uc-benefits-info.aspx.

appointed by the Governor. The UCBR makes its decisions based on the facts presented at the UC hearings. The UCBR decisions may be appealed to Commonwealth Court.

During the period of SIIF funding, L&I carried out several projects to improve the efficiency of the UC appeals process. The UCBR implemented the Central Print Project (BORG CP), purchased a talk to text software application, and implemented the Board Electronic Files (BEF) project.

The BORG CP was rolled out to all UC Referee Offices between February 2015 and April 2016. The project centralized the printing and mailing of UC Referee appeals decisions made at the field offices, saving time and money.

The talk to text software allows UC Referees to dictate appeals decisions into a MS Word document, saving the time and cost of a clerk transcribing the decisions from an audio recording.

The BEF project provided UCBR members with immediate electronic access to appeals documents and the ability to transmit documents to UCBR members. This reduced the costs of shipping files and improved the timeliness of processing appeals. Although we did not validate its figure, L&I provided a chart showing approximately $20,500 in savings on postage. In addition, the UCBR also began the development of a Further Appeals Database (FAD) application prior to the expiration of SIIF funding. The new application was necessary due to compatibility issues between MS Access, which is currently used, and MS Office 2016, which is scheduled to be rolled out after the FAD application is complete in early 2017. It will use stored data to automatically populate forms, send e-mails, and create appeals-related documents.

The UCBR initiatives described above improved the efficiency of the UC appeals process. L&I has subsequently reduced its inventory of appeals and exceeded the Federal performance metrics for appeals processing. The talk-to-text software and related hardware, which L&I indicated had cost approximately $12,000, which we did not validate, was the only cost associated with these initiatives that was specifically identified in L&I's summary of the UCBR improvements provided for the audit. It noted that other costs related to staff involved with the development of the projects from L&I's Office of Information Technology and UCBR, independent contractor charges, the cost of other software and hardware, and other personnel costs, such as travel expenses, but did not provide specific amounts. Although the costs cannot be traced directly to SIIF funds, we believe the efficiencies and improvements in services related to the UC appeals process does meet the intent of Act 34.

<u>Former UC Amnesty Program</u>: According to L&I, between June 1, 2013 and August 31, 2013, eligible claimants who had previously received an overpayment of UC benefits and employers with delinquent UC taxes could receive discounts on the penalties and interest

incurred, and possibly a discount on the principal amount, if they paid off what they owed or the amount owed less any discount on the principal amount. The former UC Amnesty Program was conducted to collect monies that were owed to the UC Trust Fund and to avoid possible legal action against claimants and employers.

L&I staff from more than a dozen bureaus were part of a project management team needed to plan, coordinate, and oversee this program. Two toll-free phone numbers were established solely for claimant and employer inquiries and to facilitate the Amnesty Program repayment process, and 55 call agents were trained to answer calls regarding the program. L&I sent amnesty notices to more than 130,000 claimants and 40,000 employers at the beginning and midway through the program period.

As reported in L&I's Amnesty Program Final Report (April 2014), approximately $15.6 million was recovered from nearly 13,000 claimants and employers that participated in the program. L&I indicated that the cost for the three-month program totaled $1,034,000 and that it used $670,000 of SIIF funds and supplemental funding through a federal grant for the remaining $364,000. L&I calculated its cost to be $.04 out of every dollar collected ($670,000/$15.6 million). Although the SIIF funds cannot be directly linked to Amnesty Program expenditures, L&I designed and implemented improved/efficient services specific to the program for claimants and employers.

<u>Treasury Offset Program</u>: L&I began the Treasury Offset Program (TOP) for the 2011 tax year, coordinating with the U.S. Treasury to seize claimants' federal income tax refunds and deposit them into the UC Trust Fund to collect fraudulent UC overpayments from claimants. The TOP was expanded to also recoup unpaid UC taxes by offsetting income tax refunds to employers beginning with the 2014 tax year. According to L&I's report, total collections from claimants and employers from the inception of the program through February 2017 were $79.1 million and $3.1 million, respectively. We did not validate these amounts. Similar to the Amnesty Program, the TOP required UC service center staff to be knowledgeable of the program and procedures in order to address questions from claimants and employers. However, because it was in place and operating prior to Act 34, we consider only the expansion of the program to collect delinquent UC taxes from employers to be an improvement in UC services, as required by the act.

<u>Interpreter Services</u>: According to the Civil Rights Act of 1964, Title VI, Section 601, no person shall be excluded from participation in or be denied benefits under any program or activity receiving Federal financial assistance based on race, color, or national origin. Based on this act and case law, the USDOL provided guidance to states in order to prevent discrimination against individuals who cannot fluently speak English. In UI Program Letter 30-11, USDOL reminded states of their obligation to take reasonable steps to ensure such individuals are provided language assistance, free of charge, which permits meaningful access to program services and information.

L&I hired a vendor to provide interpreter services to non-English speaking claimants. The interpreter joins the claimant and UC service center interviewer on the telephone to assist in information gathering and explaining program parameters. During the period of SIIF funding, L&I switched interpreter services vendors, saving $.42 per minute for Spanish services and $.46 per minute for other languages. In July 2016, the savings increased to $.46 and $.51 per minute, respectively, after the per-minute rates declined. L&I provided the following calls/cost information below to show the cost reduction.

INTERPRETER SERVICES COST			
Calendar Year	**Calls**	**Interpreter Services Vendor**	**Cost**
2013	34,229	A	$ 529,933
2014	37,414	A (9 months) / B (3 months)	$ 813,169
2015	28,763	B	$ 259,702
2016	17,917	B	$ 128,757
Total	**118,323**	-	**$ 1,731,561**

Source: Interpreter services calls and cost information provided by L&I management. This is included for informational purposes, and we did not perform any procedures to validate. Therefore, this information is of undetermined reliability, as noted in Appendix A.

To save additional costs, L&I internally created a team of 16 Spanish speaking UC interviewers, examiners, and supervisors in November 2015. Team members volunteered to handle claimants' calls from a Spanish Phone Queue set up for the team, which worked out of the Allentown, Lancaster, and Erie UC service centers. According to L&I, nearly $140,000 was saved during 2015 and 2016, because approximately 35,000 calls did not require use of the interpreter services' vendor. However, due to the closings of the Allentown and Lancaster UC service centers in December 2016, the team was reduced to three members, which may inhibit future cost savings. We agreed with L&I's calculations of the call/savings data, but did not validate underlying data to support figures on the worksheets provided.

Make Significant and Lasting Improvements to the Information Management Technology, Communications Technology, and Other Infrastructure Components of the UC System.

Specific Enhancements Made by L&I to UC Infrastructure:

Unemployment Compensation Tax Services: The performance of L&I's UC tax operations have improved over the audit period, according to the USDOL performance standards reporting noted in the earlier table. The enhanced functionality of L&I's Unemployment Compensation Management System (UCMS) is credited for improving many of the UC tax operational processes. According to L&I management, considerable resources and time were spent on stabilizing and refining UCMS after it terminated the IBM contract for UCMS in 2013 (see Finding #3 for more information). The functional areas of registering new employers, establishing accounts, electronic filing of quarterly tax reports, electronic payments, and improved collection of taxes, interest and penalties were significantly improved. Although we did not validate its figures, L&I provided a breakdown of the more than $12.7 million of estimated savings realized on the reduction of printing reports and processing payments as a result of the electronic filing and payments functionality of UCMS over the 2013-2016 four-year period. Per L&I, the overall result of these improvements is the more timely and accurate collection of taxes. Annually, more than $2.5 billion is deposited into the UC Trust Fund.

Although the entire amounts may not be directly related to UC tax operations, more than $41.8 million were expended for UCMS during the audit period, as indicated on the SAP accounting system. While we could not identify the specific amounts, any SIIF funding spent on UCMS improvements would be considered within the intent of Act 34.

Unemployment Compensation Benefits Modernization: L&I is in process of replacing its 40-year old mainframe legacy benefit delivery system with a new, modernized system. See detailed discussion regarding this benefit modernization project in Finding #3. During calendar years 2015 and 2016, L&I spent nearly $4.5 million on the UC benefit modernization project, as noted in SAP. These costs are associated with early stages of the project, including developing a Request for Proposal and soliciting vendor proposals. The $4.5 million included costs for a project management vendor and a consultant, along with L&I personnel. All costs associated with the development of the new UC benefits delivery system are in accordance with the purposes of Act 34.

Other UC Technological Upgrades: According to L&I, it completed several other technological upgrades between 2013 and 2016. These upgrades improved customer service, increased UC operational efficiency and performance, and reduced costs. For example, automation of the National Directory of New Hires (NDNH) was completed in 2014, which identifies potential new employment for claimants through a weekly cross-match against a national database of new hires information. Automation of the Justice Network system (JNET) in September 2015 improved the process of conducting cross-matches of claimants with county prison records to identify and prevent incarcerated individuals from receiving UC benefit payments. The technological upgrades of these processes were made to improve L&I's detection of UC benefit overpayments. However, L&I could not provide the cost of the upgrades because L&I did not separately track the costs. Generically, personnel costs for L&I's Office of UC Benefits Policy staff who worked on the projects as part of their ordinary work tasks and the mainframe IT vendor costs included in the fixed monthly billings supported the NDNH and JNET process upgrades.

L&I implemented another technological improvement during 2014, participating in the national UI Separation Information Data Exchange System (UI SIDES), a web-based system designed for the efficient and secure transmission of UI related information between state agencies, employers, and third-party administrators. PA's portion, known as the State Information Data Exchange System (SIDES), permits these entities to timely provide UC wage and separation information electronically using a nationally-standardized format. This process potentially reduces the need for follow-up phone calls, eliminates unnecessary appeals, decreases overpayments, and reduces paper usage and postage costs. L&I provided a table showing an estimated savings of more than $673,000 since implementation in March 2014 from the printing and postage costs of UC forms that is no longer needed. We were not provided nor did we test the underlying data to support these estimated cost savings provided by L&I. As with the other technological upgrades, costs were not specifically tracked; thus, the total cost to implement SIDES could not be determined.

CONCLUSION

While it is evident that L&I improved UC services through the management of its human resources, application of UC policies, modifications to existing processes and systems, and implementation of technological upgrades and enhancements that made PA's UC program more efficient over the four-year period of SIIF funding, L&I's lack of proper accounting and lack of segregating the expenditures related to the SIIF funding prevented us from making direct correlation between actual SIIF expenditures and the improvements/efficiencies realized. Finally, because of the method used to account for the SIIF funds, we could not determine the costs, individually or in total, associated with any of the reported improvements.

Recommendations for Finding 2

We recommend that L&I:

1. Adopt and implement a new methodology to specifically segregate and account for the following:

    a. UC services enhancements and related SIIF expenditures to improve the quality, efficiency and timeliness of service to the UC system in accordance with the USDOL performance standards.

    b. UC infrastructure enhancements and related SIIF expenditures to make lasting improvements to the UC system infrastructure, including information technology, communications, and other infrastructure components.

2. Revisit the concept of L&I's former UC Amnesty Program that ended in April 2014, which recovered approximately $15.6 million from nearly 13,000 claimants and employers, as a way to generate revenue.

Finding 3 – L&I's forecasts that without a long-term funding solution, additional service centers will need to be closed and may result in online-only claims filing are reasonable.

In accordance with Act 34 of 2013 (Act 34), deposits were to be made into the Unemployment Compensation (UC) Service and Infrastructure Improvement Fund (SIIF) during calendar years 2013 through 2016,[27] with no provision for any additional deposits to the SIIF after 2016. In the spring of 2016, discussions began between the Pennsylvania Department of Labor and Industry (L&I), the Governor's Office, and the General Assembly to potentially extend funding for an additional year through 2017 in the amount of $57.5 million. The House passed bill HB 2375[28] to provide this additional funding; however, the Senate adjourned its 2016 session without voting on the bill.

WHAT OCCURRED IN DECEMBER 2016.

Based on the discussions at the various hearings which occurred during February and March 2017,[29] it is apparent that there were communication breakdowns as to the intent of Act 34, particularly its purpose and any future funding needs. While Act 34 only provided SIIF dollars for the four-year period ending December 31, 2016, L&I's Secretary indicated that management believed that the "sun setting" provision was to allow the General Assembly to reassess the position of the UC program in 2016 to determine further funding needs and options for the SIIF. On the other hand, the General Assembly apparently believed that this was a once and done infusion of additional dollars because several legislators questioned why L&I did not have a plan to eliminate its need for additional SIIF funding after 2016. The inability to find a mutual resolution to getting HB 2375 passed, and therefore additional funding provided for another year, led to the Secretary of L&I to make hard decisions on how to operate the UC program without funding supplementation from the state. As a result, L&I had to immediately cut its operating costs and perform operational restructuring using only its federal funding. Thus, hard decisions were made, including the sudden closures of three service centers in December 2016 and the layoff of staff.

[27] 43 P.S. § 781.4(e)(2).
[28] House Bill 2375, P.N. 4065 (latest Printer's Number), 2015-2016 Legislative Session.
[29] L&I House Appropriations Hearing on February 22, 2017, L&I Senate Appropriations Hearing on February 28, 2017, and House Labor Committee Hearing on March 1, 2017.

L&I closes three UC Service Centers and furloughs nearly 500 employees.

When HB 2375 could not be agreed upon, L&I was forced to cut $57.5 million from its UC administrative budget for 2017, causing L&I to immediately close three of eight UC service centers[30] and eliminate 521 positons, which resulted in 488 employees ultimately being furloughed, including 333 UC service center employees. With the abrupt closing of three UC service centers on December 20, 2016, customer service declined significantly with claimants not being able to get through on the phone lines. Busy signals skyrocketed, and calls that made it into the waiting queue experienced long hold times as shown in the tables below.

Large Increase in Busy Signals with Service Center Closures and Furloughs

Month / Year	Call Attempts	Number Unique Callers	Busy Signals	Percent of Attempts Busy
October 2016	313,799	128,343	138,595	44.2%
November 2016	981,540	149,990	787,966	80.3%
December 2016	8,772,738	242,090	8,643,277	98.5%
January 2017	17,064,654	311,941	16,953,321	99.3%
February 2017	4,004,976	162,602	3,786,185	94.5%

Source: UC call data compiled from call reports provided by L&I management. L&I's call reports are of undetermined reliability as noted in Appendix A. However, this data is the best data available and we performed certain tests of the reasonableness of this data. Although this determination may affect the precision of the numbers we present, there is sufficient evidence in total to support our finding, conclusions, and recommendations.

[30] L&I's eight UC service centers include Scranton, Allentown, Erie, Altoona, Lancaster, Indiana, Pittsburgh, and Harrisburg. Note that the Allentown, Lancaster, and Altoona UC service centers were closed on December 20, 2016.

Large Increase in Call Wait Times with Service Center Closures and Furloughs

Month / Year	Received Calls [b/]	Average Wait Time [c/]	Longest Wait Time [c/]
October 2016	133,946	13:14	55:04
November 2016	150,713	27:26	4:28:28
December 1-19, 2016	91,102	38:46	6:51:39
December 20-31, 2016 [a/]	28,089	58:22	4:19:47

[a/] Three UC service centers were closed and 488 UC employees furloughed on December 20, 2016.
[b/] Received calls – calls entering the call waiting queue.
[c/] Wait times – length of time from the call entering the queue until the call is answered or the caller terminates the call. Length of time is in hours:minutes:seconds.

Source: UC call data compiled from call reports provided by L&I management. L&I's call reports are of undetermined reliability as noted in Appendix A. However, this data is the best data available and we performed certain tests of the reasonableness of this data. Although this determination may affect the precision of the numbers we present, there is sufficient evidence in total to support our finding, conclusions, and recommendations.

In deciding on which three service centers to close, L&I considered the following:

- Fixed costs, and building leases
- Regional location
- Economics of the location, including unemployment rate
- Number of employees at the location
- Downsize all locations versus closing a few
- Leased buildings versus state owned
- Performance metrics

In the end, L&I's decision was to close the Lancaster, Allentown, and Altoona service centers as explained below:

- The Lancaster service center had a higher lease payment with a closer lease expiration date. The parking costs were high and it was within close proximity to the Harrisburg service center.

- The Allentown service center had a higher lease payment with a closer lease expiration date. L&I also planned to close the Allentown tax office which was housed in the same building allowing more savings to terminate the lease. Allentown was also in close proximity to the Scranton service center.

- The Altoona service center was state owned, and therefore, would be easier to reopen quickly if additional SIIF dollars are eventually received. The only two state owned service centers are in Altoona and Erie. Erie was not considered due to the fact that it is the only center that has an evening shift for taking calls.

Additionally, staff at the Harrisburg service center was significantly reduced as well as employees throughout the UC system were furloughed. In total, L&I eliminated 521 positions from the UC program complement. Twenty-two of these employees found positions in other non-UC areas of L&I. An additional 11 employees found positions in other Commonwealth agencies prior to furloughs. The remaining 488 employees were furloughed. The following table shows the breakdown by UC program area of these furloughed employees.

Furloughs	
UC Program Area	Number of Employees
UC Service Centers-Altoona (closed)	107
UC Service Centers-Lancaster (closed)	79
UC Service Centers-Allentown (closed)	86
UC Service Centers-Harrisburg	59
UC Service Centers-Erie	2
Total of UC Service Centers [a/]	333
UC Policy-(Various locations)	18
UC Tax-(Various locations)	39
UC Board of Review-(Various locations)	39
Office of Information Tech.-(Various locations)	32
Admin. Services-(Dauphin)	12
Office of Chief Counsel/UC Deputate-(Various locations)	11
Workforce Development-(Dauphin)	4
Total Furloughs	**488**
[a/] Includes UC: Claims Examiners, Claims Intake Interviewers, Claims Intermittent Intake Interviewers, and Claim Supervisors.	

Source: This information was developed by the staff of the Department of the Auditor General based on personnel information provided by L&I management. We evaluated the reasonableness of this information by comparing to L&I's budget hearings, media reports, and the Commonwealth's PennWatch website.

WHAT COULD OCCUR OVER THE NEXT FOUR YEARS.

SIIF Funding Actual/Projected.

Looking ahead, L&I projected revenues and expenditures, including a projection for UC modernization costs, of UC administrative funds over the next four calendar years (CY) 2017 through 2020 to determine the annual cash flow shortfall. This excludes the personnel costs related to the UC employees furloughed on December 20, 2016; however, operating costs related to the closed service centers are still included within L&I's projections. See our analysis of L&I's projections and economic forecasts based on these projections in the sections that follow.

Projected UC Revenues and Expenditures Based on Calendar Year (CY) 2016 Actual Revenues and Expenditures (Amounts in Thousands)						
	CY 2016 (Actual)	CY 2017 (Projected)	CY 2018 (Projected)	CY 2019 (Projected)	CY 2020 (Projected)	Total
Revenues:						
Federal Funds	$ 132,114	$ 127,367	$ 129,625	$ 133,282	$ 137,049	$ 659,437
State Funds - Special Admin. a/	-	$ 9,900	$ 9,500	$ 9,500	$ 9,500	$ 38,400
State Funds - SIIF b/	$ 56,569	-	-	-	-	$ 56,569
Total Revenues	$ 188,683	$ 137,267	$ 139,125	$ 142,782	$ 146,549	$ 754,406
Expenditures:						
Personnel	$ 133,705	$ 98,767	$ 107,680	$ 117,398	$ 127,993	$ 585,543
Operations	$ 49,070	$ 50,597	$ 51,659	$ 52,951	$ 54,380	$ 258,657
Total Expenditures	$ 182,775	$ 149,364	$ 159,339	$ 170,349	$ 182,373	$ 844,200
Surplus/(Deficit) Subtotal	**$5,908**	**$ (12,097)**	**$ (20,214)**	**$ (27,567)**	**$ (35,824)**	**$ (89,794)**
Est. Benefit Modernization Costs	$ (3,114)	$ (17,626)	$ (18,752)	$ (20,865)	$ (6,581)	$ (66,938)
Surplus/(Deficit) after Benefit Modernization Costs	**$ 2,794**	**$ (29,723)**	**$ (38,966)**	**$ (48,432)**	**$ (42,405)**	**$ (156,732)**
Estimated Savings from implementing Benefit Modernization System	**$ -**	**$ -**	**$ -**	**$ 4,259**	**$ 9,119**	**$ 13,378**
Total Surplus/(Deficit)	**$ 2,794**	**$ (29,723)**	**$ (38,966)**	**$ (44,173)**	**$ (33,286)**	**$ (143,354)**

a/ Special Admin. funds are penalties and interest on UC tax money owed and collected from employees and employers.

b/ Funding for SIIF expired in 2016.

Source: This Table was summarized from the detailed projection spreadsheets prepared by L&I which can be found in Appendix B. CY 2016 actual amounts were compiled by L&I using the Commonwealth's SAP accounting system. We independently traced this information to SAP Business Warehouse reports. However, we did not test the underlying transactions recorded in SAP. Therefore, while we consider the CY 2016 information to be reliable, it is with this limitation. Further, as with any projections, there were several judgements made by L&I in developing the projections. While we agree with the reasonableness of certain judgements made by L&I in developing these projections, our concerns with certain assumptions have been detailed in this finding.

The following assumptions were used by L&I in projecting UC revenues and expenditures for calendar years 2017 through 2020. Through our auditing procedures, we determined that the assumptions L&I used in making its projections appear to be reasonable, except as noted and emphasized in **bold** in each section below.

Revenue Assumptions:

Federal Funds

- The estimated federal revenues are based in large part on expected UC claim levels. The UC claims activity has been falling in recent years and is projected to continue during 2017 before slowly climbing through 2020. Therefore, federal revenues are projected to decrease in CY 2017 and then rise over the next three years, 2018 through 2020.

- As a result of a review conducted by a consultant hired by the Governor's Budget Office, L&I's federal reporting, which is utilized to determine the amount of federal funds to be allocated to each state for UC administration, came into question. L&I was not including the state-funded SIIF expenditures within the federal report. According to management, L&I believes that it reported UC administrative expenditures correctly in the manner prescribed by USDOL. Management provided correspondence from USDOL to support that SIIF expenditures should not be reported. Management stated that in order to receive more federal funding, USDOL would need to change its policy on state supplemental funding.[31] However, according to the consultant, reporting all administrative expenditures incurred to administer the UC program, including expenditures of both state and federal funds, provides the best chance for a larger allocation of funds, but admits the federal formula to determine allocations to states is not known and it is impossible to know whether Pennsylvania could actually receive more federal funds by reporting all state expenditures, including SIIF.

  Based on the consultant's recommendation, L&I did resubmit federal reports for the federal fiscal years 2015, 2016, and 2017, to include state SIIF expenditures. As of March 22, 2017, L&I has only received acknowledgement of receipt of the revised reports from USDOL, but no other information. The National Association of State Workforce Agencies (NASWA) confirmed to us that reporting SIIF expenditures has no impact to the determination of the federal fund allocation based on the current formula utilized by USDOL. NASWA stated this was also confirmed with USDOL. Therefore, based on NASWA, we do not foresee that Pennsylvania will receive any additional UC funds from resubmitting these federal reports and believe that L&I appropriately did not

[31] NASWA stated that even if the USDOL policy and formula were to change to consider state supplemental expenditures, there is no guarantee that Pennsylvania would receive additional federal funds because there are a total of 41 states, including Pennsylvania, who reported for 2015 that state funds were used to supplement federal funds administer their UC programs.

include any additional federal funds in its revenue projections for calendar years 2017 through 2020.

State Funds

- Calendar Year (CY) 2016 includes actual SIIF dollars received. Projections for 2017 through 2020 assumes no additional SIIF monies.

- State funding for the projected years is based solely on penalties and interest (P&I) from the unemployment insurance (UI) fund. According to L&I's Center for Workforce Information & Analysis (CWIA) the P&I funding is $9.9 million for CY 2017 and $9.5 million for CY 2018, 2019, and 2020 based on historic data over the last 15 years. We obtained this historical data from CWIA and calculated the average annual P&I receipts for the previous three state fiscal years, and L&I's projections appear reasonable.[32] The Secretary of L&I has the option to use P&I funds for UC and/or Workforce Development administration. L&I projections assume all P&I funds will be allocated for UC administration.

- The CY 2016 state funding does not include P&I funds. Actual dollars are based on when funds were actually received. The 2015-16 state P&I funding was received July – August of 2015 and the 2016-2017 was not yet received through the end of the calendar year, December 31, 2016; therefore, no P&I dollars were received during CY 2016.

<u>Expenditure Assumptions</u>:

Personnel Costs

- CY 2016 personnel expenditures are actual costs that include the nearly 500 employees who were from the UC program and furloughed in December 2016.

- In order to project personnel costs for 2017 through 2020, L&I removed $38.5 million in costs associated with the nearly 500 furloughed employees.

- For 2017-2020, L&I applied pay increases in accordance with the current union contract through June 30, 2019, as follows:
  - 2017 - 2% general pay increase (GPI).
  - 2018 - A salary longevity step of 2.2% and GPI of 2.5%.

[32] Our evaluation of the historical P&I receipts only included a cursory review of the information and recalculation of the average yearly receipts for the most recent three state fiscal years for reasonableness (July 1, 2012 to June 30, 2015 for the 2017 projection and July 1, 2013 to June 30, 2016 for the 2018 through 2020 projections). We did not test transactions to validate receipt of the actual P&I presented in L&I's data.

  - 2019 – Salary longevity step of 2.2%. Also, L&I assumed a GPI of 2.5% consistent with the prior years under the union contract.
  - 2020 – L&I assumed a salary longevity step of 2.2% and GPI of 2.5% consistent with the prior years under the union contract.
  - L&I assumed similar salary increases as noted above for management employees.

- An estimated benefit rate of 0.859 is calculated for 2017 based on actual positions filled, salaries, and benefits. This flat rate is applied for each year 2017 through 2020. **We believe this rate could increase over the four years as costs for pension and medical benefits increase. This could potentially increase the personnel costs above the amounts projected by L&I.**

- **Additional personnel costs for having to pay a higher UC tax rate because of furloughing employees was <u>not</u> included in the projections.**

<u>Operational Costs</u>

- Operational cost projections for CY 2017-2020 were calculated by multiplying the previous year's actual or estimated costs by the increases in estimated Consumer Price Index (CPI) as provided by L&I's CWIA office.[33] The estimated percent increases (inflation rate) to CPI over the next four years are:
  - 2017 - 2.5%
  - 2018 - 2.1%
  - 2019 - 2.5%
  - 2020 - 2.7%

- L&I management stated that it did <u>not</u> reduce projections by the operational costs related to the closures of three UC service centers in December 2016 due to the uncertainty of the savings from the closed service centers. Management stated in regard to the Lancaster UC service center lease that the landlord's attorneys are still reviewing the lease as to whether the lease can be broken early without further costs. Therefore, L&I is continuing to pay for the lease for at least another month or more as of our inquiry on March 23, 2017. In regard to the Allentown UC service center, no costs are being charged for terminating the lease early on February 28, 2017. The monthly lease cost at the two centers are $40,453 and $26,673, respectively. **While some operational costs could be uncertain with the shifting of costs to other centers, the savings from the lease costs can be reasonably determined but were not removed from the projections by L&I. These leases, which collectively total over $800,000 annually, should have been removed by L&I and future years should have been reduced when preparing these projections.**

[33] Based on historic Urban percentages - CPI forecast from IHS Global Insight (January 2017).

- Projected operational costs were <u>not</u> reduced by cuts that were made in other offices within L&I at the same time as the UC furloughs in December 2016, including the Office of Information Technology, Administrative Services, and Office of Chief Counsel. A portion of costs from these other offices are allocated to the UC program. L&I management stated the projected costs were not reduced due to the uncertainty of any cost saving from these offices into future years. **While the amount of the future savings in these areas are uncertain, we believe there could be additional savings which further would reduce the projected costs of the UC program.**

- **Projected operational costs were <u>not</u> reduced by the costs associated with maintaining the old legacy mainframe benefit system when it is decommissioned once the new benefit modernization system is implemented. Implementation of the new system is estimated to occur between January 2019 and July 2019 (see further details discussed in the Benefit Modernization Section below). L&I management provided costs to maintain the old legacy system of $7.5 million in calendar year 2016. These costs are projected over all four years through 2020. However, the projections should not include these costs once the new system is implemented. Note that costs for maintenance, operations, and support of the new benefit modernization system after implementation are included within the total estimated costs of benefit modernization.**

<u>Benefit Modernization</u>

In June 2006, IBM was awarded a contract for the modernization of the UC system, known as the Unemployment Compensation Modernization System (UCMS), to replace L&I's aging mainframe system for wage records, employer tax, and claims processing, payments, and appeals. The implementation of UCMS was to occur in three phases:

Phase 1 – Wage records
Phase 2 – Employer tax
Phase 3 – Claims processing/payment and appeals

The initial contract with IBM to complete these three phases totaled $109.9 million and was to be completed by February 2010; however, this project experienced significant delays and cost overruns, ultimately costing nearly $170 million, with much of the system never completed when the contract expired in September 2013. **Phase 1 of UCMS was implemented in May 2008**. **Phase 2**, which includes the employer tax portion of the system, **went live in March 2011**; however, this phase immediately encountered major issues that required additional work, which took years to fix. **Phase 3** for benefit claims processing, payment, and appeals **continued to lag behind with problems and ultimately never went live**. In August 2012, L&I engaged Carnegie Mellon University's Software Engineering Institute (SEI) to review the project and determine how best to proceed. SEI's analysis and report were released in July 2013 and recommended to continue to work through the issues on Phase 2, related to the tax portions of the project, but recommended that work on Phase 3 related to the benefit claims be discontinued. L&I proceeded with SEI's recommendations.[34]

With the original modernization project terminated, L&I was still in need of a new benefits delivery system to replace the current, antiquated legacy mainframe computer system that is more than 40 years old and very expensive to maintain, very difficult to modify, and inefficient. L&I stated that modernizing the benefits delivery system is a top priority and believes that a new benefits system will enhance customer service, increase functionality through self-service, expand hours of system availability, automate many manual processes, improve system performance and adaptability, improve accuracy, and provide compatibility with mobile applications.

After procuring a project management firm, a Request for Proposal (RFP) was developed and published in July 2016 to procure a system design, development, and implementation (DDI) vendor.[35] L&I is currently evaluating proposals in order to select a DDI vendor. L&I expects to have a final contract executed by June 2017. L&I estimates that once the DDI vendor contract is fully executed the new benefits delivery system should be implemented within 18 to 24 months, or between January 2019 and July 2019. After implementation, there is a period of time expected for system fixes and standard ongoing maintenance, operations, and support. L&I assumes the DDI contract will be for five years with three one-year options. Our audit only focuses on projections through 2020 and does not include all potential costs that are expected beyond 2020 related to this contract.

Since L&I does not have a contract for the UC benefits system in place, L&I conducted industry research and had discussions with other states to provide the following estimation of the costs of the project.

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[34] In March 2017, the Commonwealth filed a lawsuit Dauphin County Court of Common Pleas against IBM for fraud and failures related to the Unemployment Compensation Modernization System project. The lawsuit filed on behalf of L&I by the Pennsylvania Governor asserts breach of contract, fraudulent misrepresentation, negligent misrepresentation, constructive fraud, and fraudulent concealment.
See https://www.governor.pa.gov/wolf-administration-sues-ibm-over-delayed-costly-unemployment-compensation-system-upgrade/.

[35] The Governor's Office of Administration Office of Information Technology (OAOIT) has a key role in the procurement of information technology, including the setting of schedule timelines, Request for Proposal (RFP) development, RFP solicitation process, and RFP evaluation process, and negotiating and executing a final contract.

Estimated Benefits Modernization Costs for CY 2017-2020

	2017	2018	2019	2020	**TOTAL**
System Design, Development, & Implementation (DDI) Vendor	$15,000,000	$15,000,000	$17,500,000	$5,000,000	**$52,500,000**
CSG Government Solutions Inc. - Project Management	$1,050,000	$1,050,000	$1,050,000	$262,500	**$3,412,500**
CSG Government Solutions Inc. - Independent Verification & Validation	$476,000	$801,900	$415,480	$18,020	**$1,711,400**
Carnegie Mellon Software Engineering Institute Advisory Services	$300,000	$300,000	$300,000	$300,000	**$1,200,000**
L&I Personnel	$800,000	$1,600,000	$1,600,000	$1,000,000	**$5,000,000**
TOTAL	**$17,626,000**	**$18,751,900**	**$20,865,480**	**$6,580,520**	**$63,823,900**

Note: Implementation of the benefit modernization system is estimated to occur between January 2019 and July 2019. After implementation, L&I estimates costs for ongoing maintenance, operations, and support.

Source: The projections included in this table were prepared by L&I management from the sources described in the bullets following the table.

- The DDI vendor is the largest portion of the costs of this benefit modernization project, estimated at $52,500,000 through 2020. These estimates assume a fully executed contract with the DDI vendor by June 2017, based on the Office of Administration schedule updated as of February 21, 2017. Additionally, these estimates assume a DDI contract totaling $75 million over eight years, which includes $45 million for design, development, and implementation, and the remaining $30 million for maintenance, operations, and support from July 2019 through 2025 at $5 million per year.

- L&I has contracted with CSG Government Solutions Inc. (CSG) to manage the completion of this project. In addition, CSG will perform independent verification and validation (IVV) of the DDI vendor's work. Purchase Order (PO) 4300450013 stipulates L&I pay quarterly installments of $262,500 through 2018. L&I estimates that these quarterly payments will be extended through March 2020 once the system has been implemented and subsequent performance issues have been addressed. Additionally, PO 4300450013 provides IVV services beginning June 2017 and continuing through early 2020 at a total cost of $1.7 million as shown in the four-year projection table above.

- L&I, through a Commonwealth Master Agreement, has contracted with Carnegie Mellon SEI to provide software acquisition and technical program expertise. In accordance with

Statement of Work (SOW) 16-00857-SA-002, L&I will pay approximately $300,000 per year for these advisory services.

- L&I expects that internal personnel assisting with the project will cost approximately $5 million by 2020. The figures in Table 2 are based upon actual personnel costs that occurred during CY 2016 which totaled $767,663. L&I expects personnel costs for 2018 and 2019 will double and will remain higher in 2020 to account for an anticipated temporary increase in staff assigned to the project to perform system testing and training.

Cost Savings from Benefit Modernization

- L&I management estimates possible cost savings from the benefit modernization will be in the range of 5 to 10 percent of total UC administrative costs. To be conservative, potential cost savings is calculated at 5 percent. These cost savings will begin to be realized after full implementation of the new system. With implementation estimated between January and July 2019, only a half year of savings is conservatively included for 2019.

Potential Future Funding Scenarios for SIIF

As part of our third audit objective, we reviewed two different state funding scenarios and the approximate impact to the UC operations under each scenario. For this purpose, **neither scenario includes any funding projection for UC benefits modernization.**

L&I's UC program projections of revenues and expenditures has a baseline which excludes personnel costs for the three UC service center closures in December 2016; however, L&I did not exclude operational costs related these closures. Therefore, since L&I could not provide the detail of the operational costs for us to remove them, these costs remain in the projections over all four years.[36] One final note — while L&I's forecasts discussed below do not include benefit modernization costs which must also be considered in making funding decisions, L&I management stated that replacing its old legacy system is a priority as discussed in the previous section.

[36] We calculated the operating costs of the closed UC service centers to be at least $800,000 based only the monthly lease payments for two centers because the third closed service center was state-owned. There would also be additional operating cost savings such as utilities.

Scenario 1 - No additional SIIF dollars are received

According to L&I, if no additional funds are received from the state, L&I's budgetary forecast requires further UC operating cost reductions and UC service center closures in 2017 and 2018 as follows:

- One service center will be closed in CY 2017, with all service center staff furloughed.
- Two service centers will be closed in CY 2018, with all service center staff furloughed.

L&I management provided its actual personnel and operating costs of each UC service center during CY 2016, from which we calculated an average costs per UC service center of approximately $8 million. We then evaluated L&I's economic forecast of closing one service center in 2017 and two service centers in 2018 against L&I's projections of revenues and expenditures for CY 2017 and CY 2018, excluding the costs for benefit modernization. See our evaluation in the following table.

L&I's Projected Revenues, Expenditures, and Deficits for CY 2017 and CY 2018 (in thousands)			
	CY 2016	CY 2017	CY 2018
	(Actual)	(Projected)	(Projected)
Revenues:			
Federal Funds	$132,114	$127,367	$129,625
State Funds - Special Admin.	-	$9,900	$9,500
State Funds - SIIF	$56,569	-	-
Total Revenues	$188,683	$137,267	$139,125
Expenditures:			
Personnel	$133,705	$98,767	$107,680
Operations	$49,070	$50,597	$51,659
Total Expenditures	$182,775	$149,364	$159,339
Surplus/(Deficit) Subtotal before additional operational cuts	$5,908	($12,097)	($20,214)
Reduction of costs from closing one service center in 2017		-	$8,000
One service center closure in 2017, two closures in 2018 [a/]		$8,000	$16,000
Remaining surplus/(deficit) needing further costs reductions		($4,097)	$3,786

[a/] The average cost per UC service center of $8 million was calculated based on actual personnel and operating costs for CY 2016 provided by L&I for each UC service center.

Source: This Table was summarized from the detailed projection spreadsheets prepared by L&I which can be found in Appendix B. CY 2016 actual amounts were compiled by L&I using the Commonwealth's SAP accounting system. We independently traced this information to SAP Business Warehouse reports. However, we did not test the underlying transactions recorded in SAP. Therefore, while we consider the CY 2016 information to be reliable, it is with this limitation. See Appendix A.

Based on our analysis, L&I's forecast of the necessity to close one service center in CY 2017 and two in CY 2018 appears valid. In CY 2017, in addition to closing a UC service center, L&I would also need to cut over $4 million of additional operating costs in other areas of the UC program to reach breakeven. Alternatively, a second service center could be closed in 2017 to relieve cutting additional operating costs. Then in 2018, L&I would need to close two additional UC service centers, for a total of three service center closures, which could create a potential surplus at the end of 2018.

However, with three additional service center closures over the next two years, in addition to the three service centers closed in December 2016, L&I would have only one UC service center remaining in addition to Harrisburg.[37] According to L&I, in this situation, they would not be able to provide telephone assistance to any UC claimants. All remaining UC staff would be focused on processing and paying claims. In addition, L&I anticipates that there would be long delays in the processing of claims with insufficient staff levels to handle the volume of claims. In this scenario, the claims must be filed entirely online with only online interaction with claimants.

Therefore, to avoid any additional service center closings in 2017 or 2018, or reduction in operating costs, **L&I would need at least an additional $12.1 million state supplement in 2017 to break even and a $20.2 million supplement in 2018 to maintain current status quo (3 closed centers)**.

Scenario 2 – Short-term UC SIIF funding bridge to develop long-term solution

Scenario 2 incorporates the data in scenario 1 by providing short-term bridge funding to enable a long-term solution to be developed and implemented over twelve months. L&I management has indicated that if only a one-time infusion of SIIF funding is received without a coordinated long-term strategy, this situation will only postpone by one year the closing of the service centers as described under Scenario 1 of receiving no additional funds. Any short-term funding must be sufficient to allow a long-term solution to be developed and implemented.

L&I's forecast is supported by the deficits forecasted over each of the next four calendar years through 2020. We evaluated L&I's revenue and expenditure projections for CY 2017 and CY 2018 above. Based on L&I's estimates, short-term funding of $12.1 million would be needed in CY 2017 and $20.2 million would be needed in CY 2018 to keep the UC program running in its current state while long-term decisions are made.

This does not include the cost of recalling the employees furloughed in December 2016. These costs are approximated by L&I to be $38.5 million based on state fiscal year 2015-2016 actual costs. If additional funding would be received to recall furloughed staff, L&I management stated the following actions would likely occur:

- Reopen the Altoona UC service center and recall as many staff as possible.
- Recall as many staff as possible to the Harrisburg service center.
- Lancaster UC service center staff would be offered employment in the Harrisburg service center.

[37] L&I management stated the Erie UC Service Center would remain open since this is the only other center in which the building is state owned besides Altoona which already closed in December 2016.

- Allentown UC service center staff would be offered employment in the Scranton UC service center.
- Funding will be used in the following priority:
  1. Place additional staff on the phones to better manage claimant inquiries and provide better customer service.
  2. Processing the pending payments more timely.
  3. Address the backlog that is accumulating in various work functions.

Management anticipates that it would take up to six weeks to recall furloughed staff and re-establish the infrastructure so that the staff are able to begin work again. Due to significant backlogs in adjudication that has developed since the furloughs on December 20, 2016, management stated it could be seven months or longer to achieve pre-furlough service levels, depending on the number of staff that can be recalled.

L&I believes that in this situation, the furloughed service center staff will be reluctant to return to their old jobs knowing that they will likely be furloughed again once the one-time funding runs out. If L&I cannot bring back the experienced furloughed staff, then new staff will need to be trained which takes time and may not be a prudent use of funds if L&I in less than a year has to furlough these newly trained employees.

L&I estimates that in total, it needs approximately $1 million per week to return to the performance and service levels being achieved prior to the furloughs.

Therefore, a total of $50.6 million ($12.1 million plus $38.5 million) would be needed in 2017 as the first annual supplement to allow the reopening of the three centers closed in December 2016 and to not have to close another center in 2017 nor reduce additional operating expenses. As stated before, this does not include any funding for the UC Modernization program, which is necessary. This supplement would then provide a year to prepare and implement a long-term strategy and solution for the continued UC operations.

L&I must continue to evaluate and determine ways to provide further efficiencies and cost saving measures to reduce long-term funding needs.

<u>Long-term solution for UC program</u>

With adequate multiple year funding for the UC program, L&I could return performance and service to the pre-furlough levels and implement a new UC benefit modernization system to replace the old legacy mainframe system, which is intended to improve efficiency, stability, and sustainability of the system, along with enhancing customer service.

A collaboration between L&I and the General Assembly is crucial to providing the best solution possible for the type of UC program service that is needed for Pennsylvania. It is apparent that with the abrupt closing of the three service centers in December 2016 that the present diminished service levels are not acceptable and that it is vital to ensure that the intent of the UC Law is met by providing the support needed by those who lose their jobs through no fault of their own or are forced to work less than their full-time hours. With its current situation, L&I will immediately need a short-term funding solution while working through long-term funding decisions. It is imperative, however, that the short-term funding solution continues until long-term funding is in place to avoid the costs of furloughing personnel and potential closing of additional UC service centers. Based on L&I's economic projections, while cost savings are expected when the new benefit modernization system is implemented and the old legacy system is decommissioned, it is clear that L&I will need to make further cost savings for the UC program and will still be in need of some amount of supplemental state funding to achieve and maintain adequate performance and service levels agreed upon by the General Assembly.

Recommendations for Finding 3

We recommend that L&I work with the General Assembly to:

1. Decide what type of UC program service works best for Pennsylvania taxpayers, whether the program includes UC service centers to help claimants process claims, or an entirely internet based system.

2. Provide a short-term funding extension of the SIIF which is sufficient to allow a long-term funding solution to be enacted.

3. Determine if any changes to the laws can be made to achieve lower program operating costs.

We also recommend that L&I:

4. Evaluate its UC system for additional efficiencies and cost savings measures that can be made to operations in order to provide acceptable performance levels while further reducing costs in line with a long-term funding solution enacted.

Audit Response from the Pennsylvania Department of Labor and Industry

We provided draft copies of our audit findings and related recommendations to the Pennsylvania Department of Labor and Industry (L&I) for its review. On the pages that follow, we have included L&I's response in its entirety. L&I agrees with all of our findings and related recommendations.

COMMONWEALTH OF PENNSYLVANIA
DEPARTMENT OF LABOR AND INDUSTRY
HARRISBURG, PENNSYLVANIA 17120

THE SECRETARY

April 14, 2017

The Honorable Eugene DePasquale
Auditor General
229 Finance Building
Harrisburg, PA 17120

Dear Auditor General DePasquale:

Thank you for responding to the request from members of the General Assembly for an audit of the Act 34 funds, known as the Service and Infrastructure Fund (SIIF). Your audit team was thorough and professional throughout, and the Department of Labor and Industry appreciates your involvement in conducting this important step toward finding a long-term solution to bridge the gap in federal funding to enable delivery of effective and efficient unemployment compensation (UC) services to our citizens.

The department agrees with the findings of this report. While the department spent the funds on expenses permitted in the SIIF legislation, we acknowledge the shortcomings of our accounting processes which did not sufficiently delineate between SIIF dollars and federally-provided administration dollars. We appreciate the recommendations contained herein, and will follow the accounting processes suggested with all new SIIF dollars.

The department wants to thank you for recognizing the progress and improvements made to the delivery of UC benefits and services to claimants and businesses during the time period of 2013-2016. These improvements would not have been possible without the additional administrative dollars SIIF provided.

Moving forward, the UC benefits modernization project will be critical to continue these improvements. I would note that the cost projection for benefit modernization contained on page 32*of the report was based on other states' experiences and may be higher than our successful bid. The department will provide the General Assembly with the actual contracted cost for benefit modernization once the procurement has been finalized.

We look forward to working with the General Assembly and crafting a long-term, sustainable solution to our current crisis that will enable claimants to get prompt access to their UC benefits when they need them, serve the needs of our employer community, and continue with our system improvements while striving to be as efficient and lean as possible.

Very truly yours,

Kathy M. Manderino
Secretary

cc: Robert V. O'Brien, Executive Deputy Secretary

Secretary of Labor and Industry
651 Boas Street | Harrisburg, PA 17121 | 717.705.2630 | F 717.787.8826 | www.dli.pa.gov

*The page referenced in this letter is in regard to the draft report of findings and recommendations provided to the Department of Labor and Industry for response. The corresponding reference in our final audit report is page 38.

PERFORMANCE AUDIT REPORT

Pennsylvania Department of Labor & Industry
Service and Infrastructure Fund

April 2017

Department of Labor & Industry Response

Recommendations for Finding 1

1. Agree.

2. Agree.

3. Agree.

4. Agree.

Recommendations for Finding 2

1. Agree.
   a. Agree.
   b. Agree.

2. Agree.

Recommendations for Finding 3

1. Agree.

2. Agree.

3. Agree.

4. Agree.

Appendix A Objectives, Scope, and Methodology

The Department of the Auditor General conducted this performance audit in order to provide an independent assessment of the Department of Labor and Industry's (L&I) use of the Unemployment Compensation (UC) Service and Infrastructure Improvement Fund (SIIF) monies and the improvements and efficiencies realized, as well as an evaluation of L&I's scenarios for the future of the UC program based on projected operating costs and different funding levels.

We conducted this audit in accordance with applicable *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Objectives

Our audit objectives were as follows:

- Review L&I's accounting of expenditures made from the UC SIIF for each calendar year 2013, 2014, 2015 and 2016, and determine whether L&I spent SIIF funds in accordance with Act 34 of 2013.

- Validate improvements and efficiencies, including any cost savings, achieved by L&I from receipt of additional funding in the UC SIIF for the UC system.

- Evaluate the reasonableness of L&I's economic forecast of the potential impact to the UC system if additional funding for the UC SIIF:

  a. Is not authorized for calendar year 2017, or thereafter; and
  b. Is authorized for calendar year 2017, but not thereafter.

- Review L&I's economic forecast/projection on how and when L&I can eliminate the need for additional SIIF funding including the amount of SIIF funding needed for calendar years 2017, 2018, 2019 and 2020, and ensure the implementation of new technologies for the UC system, and therefore not require further legislative supplemental appropriations.

Scope

Our audit covered the period January 1, 2013 through December 31, 2016, for the first objective and January 1, 2013 through March 1, 2017, for the remaining objectives, with updates through the report date.

L&I management is responsible for establishing and maintaining effective internal controls to provide reasonable assurance that SIIF expenditures are in compliance with applicable laws, regulations, contracts, grant agreements, and administrative policies and procedures.

In conducting our audit, we obtained an understanding of relevant internal controls, including any information systems controls, if applicable, that we considered to be significant within the context of our audit objectives.

For those internal controls that we determined to be significant within the context of our audit objectives, we also assessed the effectiveness of the design and implementation of those controls as discussed in the Methodology section that follows. Any deficiencies in internal controls that were identified during the conduct of our audit—and determined to be significant within the context of our audit objectives—are included in this audit report.

Methodology

To address our audit objectives, we performed the following:

- Reviewed applicable provisions of Act 34 of 2013 (Act 34), the Service and Infrastructure Improvement Act, as well as the PA UC Law and L&I UC program regulations.

- Reviewed policies and procedures relating to various L&I UC program initiatives.

- Observed L&I's House Appropriations Hearing on February 22, 2017, Senate Appropriations Hearing on February 28, 2017, and House Labor Committee Hearing on March 1, 2017.

- Reviewed various media reports regarding the closure of three UC service centers and UC program employees furloughed in December 2016.

- Obtained L&I organizational and functional/operational information for the UC Program.

- Conducted interviews with L&I's management responsible for the administration of Pennsylvania's UC program and related services.

- Reviewed the reports submitted to the Governor and General Assembly between January 7, 2016 and October 21, 2016, to gain an understanding of the UC activity and L&I's use of SIIF monies during calendar years 2013 through 2016.

- Reviewed the Expenditure Symbol Notifications that authorized L&I to use SIIF monies to supplement federal funding for administering UC.

- Analyzed reports produced from the Commonwealth's SAP accounting system.

- Obtained L&I's Notice of Obligation (of Federal Funds) account tracking sheet and cash flows spreadsheet to agree to the federal fiscal year funding amounts reported by L&I for calendar years 2013-2016. We also utilized the cash flows spreadsheet to identify other funding available for UC administrative costs.

- Obtained the transfer documents L&I used to transfer lump sums of UC expenditures to SIIF and traced each transfer to the Commonwealth's accounting system.

- Obtained and evaluated L&I spreadsheets created to support the SIIF expenditures included as pie charts in the May 26, 2016 report to the Governor and General Assembly for the state fiscal years ended June 30, 2014, 2015, and 2016 (through April 2016). L&I also provided similar spreadsheets for the period July 1 through December 31, 2016.

- Interviewed L&I fiscal management to determine the methodology used to compile the SIIF expenditures presented in the reports to the Governor and General Assembly.

- Reviewed 11 expenditure transactions and related supporting documents, which L&I represented as SIIF-related, to verify mathematical accuracy and the propriety of the account coding in the Commonwealth's accounting system, as well as determine if expenditures were in accordance with Act 34.

- Reviewed Pennsylvania's Performance Statistics published on the U.S. Department of Labor's (USDOL) website to confirm the performance statistics for the federal fiscal years 2013 through 2016 as provided by L&I. Additionally, we obtained PA's statistics for the quarter ended December 31, 2016, to cover the entire audit period.

- Reviewed supporting documentation for improvements and efficiencies to the UC system claimed by L&I management, including support for any cost savings, if available, in order to determine if L&I's representation of the improvements and efficiencies are reasonable and in accordance with the purposes of Act 34.

- Obtained and reviewed L&I's Unemployment Insurance (UI) State Quality Service Plans (SQSP) submitted to USDOL for the federal fiscal years 2013 through 2016.

- Reviewed the PA State Government Workforce Statistics Reports covering the audit period to identify fluctuations in L&I's agency complement.

- Obtained information from the UC pages published on L&I's website (www.uc.pa.gov).

- Obtained and evaluated L&I reports of telephone call activity showing total call attempts, number of unique callers, and busy signals by month for the period January 2013 through February 2017. Other call reports showed calls received and on-hold wait times' information for the months January 2013 through December 2016.

- Reviewed the 2013 PA UC Amnesty Program Final Report, published in April 2014. This report described the program, provided detailed results, and a breakdown of program costs.

- Reviewed USDOL UI Program Letters, which provide guidance to states for operating their UC programs.

- Recalculated L&I's cost savings calculations to agree with its determinations.

- Obtained and reviewed PA House Bill – HB2375; which proposed to extend additional UC/SIIF funding. The PA Senate adjourned the 2016 session without voting on this bill.

- Reviewed consultant report regarding L&I's federal reporting of UC program expenditures which is utilized to determine the amount of federal funds to be allocated for UC administration and discussed the report with the consultant.

- Confirmed with the National Association of State Workforce Agencies (NASWA) that reporting of SIIF expenditures has no impact to the determination of federal fund allocations for UC administration.

- Interviewed L&I management to gain an understanding of the methodology used to furlough employees and close three UC service centers in December 2016.

- Obtained L&I projections of UC revenues, including both federal and state funds, and UC expenditures, including personnel and operational costs, for the four calendar years 2017 through 2020.

- Reviewed the reasonableness of assumptions used by L&I in its revenue and expenditure projections above, including validating assumptions to independent sources.

- Evaluated L&I's revenue and expenditure projections above for completeness and mathematical accuracy.

- Interviewed L&I management to gain an understanding of the UC Benefits Modernization Project and how management estimated the cost and timeframe for design, development, implementation, and ongoing maintenance.

- Obtained L&I cost estimates/projections for the UC Benefits Modernization Project for the calendar years 2017 through 2020, including costs for the system design, development and implementation vendor; the project management and independent verification and validation vendor; a software acquisition and technical program consultant; and L&I internal personnel.

- Agreed L&I UC Benefits Modernization Project cost estimates/projections to supporting documentation for reasonableness.

- Interviewed L&I management to gain an understanding of UC administrative funding and what could be if:

  - No additional SIIF dollars are received.
  - Short-term SIIF funding is received as a bridge to develop a long-term solution.

- Evaluated the reasonableness of L&I's economic forecasts using the SIIF funding scenarios above based on L&I's UC administrative revenue and expenditure projections.

- Interviewed L&I management to gain an understanding of how furloughed employees would be recalled and UC service centers reopened or remain closed based on potential SIIF funding scenarios.

Data Reliability

In performing this audit, we obtained computer-processed information from L&I regarding: (1) SIIF revenues and expenditures for calendar years 2013 through 2016; (2) furloughed personnel in December 2016; (3) phone call statistics from January 2013 through February 2017; (4) USDOL performance measures for federal fiscal years ended September 30, 2013 and September 30, 2016, and the quarter ended December 31, 2016; (5) other information regarding efficiencies and improvements to the UC system that we note in Finding #2; and (6) projected SIIF revenues and expenditures for calendar years 2017 through 2020. *Government Auditing Standards* requires us to assess the sufficiency and appropriateness of computer-processed information that we use to support our findings, conclusions, or recommendations. The assessment of the sufficiency and appropriateness of computer-processed information includes considerations regarding the completeness and accuracy of the data for the intended purposes.

(1) - (2) In regard to computer-processed data for SIIF revenues, expenditures, and furloughed personnel, L&I provided various information compiled from the Commonwealth's SAP accounting system. Data from the SAP accounting system is subjected to financial audit standard-related tests of sufficiency and appropriateness of evidence as part of the audits of the Commonwealth's Comprehensive Annual Financial Reports (CAFRs) and the Single Audits of the Commonwealth for state fiscal years ending June 30, 2013, 2014, 2015, and 2016. Additionally, to assess the completeness and accuracy of the data provided by L&I, we conducted additional audit procedures as follows:

- We agreed UC administrative funding sources to L&I's spreadsheet of cash flows, Notice of Obligations, and/or Expenditure Symbol Notifications for reasonableness.

- We independently prepared SAP reports showing transfers of SIIF expenditure dollars through the SAP Business Warehouse and compared these reports to the source transfer transaction documentation provided by L&I.

- We agreed the total number of furloughed personnel from the list provided by L&I to the numbers reported by the L&I Secretary during House and Senate budget hearings, and the House Labor Committee hearing. We also agreed the numbers to media reports and reviewed the reduction in the number of L&I's employees as shown on the Commonwealth's Penn Watch website from December 15, 2016 to January 15, 2017, for reasonableness.

Based on the above, we found no limitations with using the data for our intended purposes. In accordance with *Government Auditing Standards*, we concluded that L&I's computer-processed data was <u>sufficiently reliable</u> for the purposes of this engagement.

(3) In regard to computer-processed data for call statistics presented in this report, L&I provided statistics compiled from monthly call reports from Verizon's phone system, OpenScape Contact Center. We traced the call statistics provided by L&I to these reports; however, we did not perform procedures to validate the statistical/informational data from Verizon. As such, we deemed this call data to be of undetermined reliability. However, the data is the best data

available, and we performed certain tests of the reasonableness of the data. Although this determination may affect the precision of the numbers we present, there is sufficient evidence in total to support our findings, conclusions, and recommendations.

(4) In regard to computer-processed data relating to USDOL performance statistics included in Finding #2, L&I provided information regarding its performance in key USDOL core measures. To validate the information provided by L&I, we independently obtained Pennsylvania's performance scores directly from USDOL's website, noting agreement. We also reviewed L&I's UI SQSPs submitted to USDOL for federal fiscal years 2013 to 2016 for reasonableness of L&I's performance in USDOL's core measures. We did not, however, test any underlying data that L&I provided to USDOL to compile these statistics. Based on the above, in accordance with *Government Auditing Standards*, we concluded that L&I's computer-processed data was sufficiently reliable for the purposes of this engagement, with the limitation that we did not test the underlying data used to compile the USDOL performance statistics.

(5) L&I provided other information regarding efficiencies and improvements to the UC system that we note in Finding #2. We did not test the underlying data in order to validate the information provided. Therefore, this information is of undetermined reliability. This information includes:

- Cost savings for postage due to the Board Electric Files project within the Unemployment Compensation Board of Review.

- Collections from overpayments to claimants and unpaid UC taxes from employers due to the Treasury Offset Program.

- Interpreter services calls, costs, and savings.

- Unemployment Compensation Tax Services cost savings from reduced of printing due to electric report filing and payment processing.

- Cost savings from reduced printing and postage due to implementation of the State Information Data Exchange System.

While the dollar amounts reported in Finding #2 were of undetermined reliability, these data were the best data available, and we performed certain reasonableness tests on the data. Although this determination of undetermined liability may affect the precision of the numbers we present, there is sufficient evidence in total to support our findings, conclusions, and recommendations.

(6) In regard to computer-processed data relating to L&I's projections of UC revenues and expenditures reported in Finding #3, management provided Excel spreadsheets which included

actual revenues and expenditures for calendar year (CY) 2016 and projected revenues and expenditures for CY 2017 to CY 2020. To determine the reliability of this data we performed the following:

- We interviewed L&I management responsible for preparing the projection spreadsheets to determine the methodology and assumptions used.

- We traced CY 2016 actual revenues and expenditures used as base amounts to SAP reports for agreement. We did not perform any detailed test of underlying transactions that make up the CY 2016.

- Assumptions used by L&I were agreed to supporting documentation from other sources.

- L&I's projection spreadsheet was reviewed for mathematical accuracy.

Based on the above, in accordance with *Government Auditing Standards*, we concluded that L&I's computer-processed data used as the basis for their projections was sufficiently reliable for the purposes of this engagement, with the limitation that we did not test any detailed transactions supporting these amounts. Further, as with any projections, there were several judgements made by L&I in developing the projections. While we agreed with the reasonableness of certain judgements made by L&I in developing these projections, our concerns with certain assumptions have been detailed in Finding #3.

Appendix B L&I's Projected UC Revenues and Expenditures Based on Calendar Year 2016 Actual Revenues and Expenditures

Calendar Year 2016 UC Actuals

Revenue					$188,683,009
	Federal Funds			$132,114,019	
		Base	$122,518,165		
		Above Base	$7,650,548		
		Restoration/Add'l Base	$1,945,306		
	State Funds			$56,568,990	
		Special Admin	$0		
		Service & Infrastructure	$56,568,990		
Expenditures					$182,775,884
	Personnel			$133,705,489	
		UC Service Centers	$64,005,582		
		UC Policy	$7,351,774		
		UC Tax	$21,858,695		
		UC Board of Review	$15,112,564		
		UC Deputate	$2,043,146		
		Off of Info Tech	$8,818,498		
		Admin Services	$6,531,009		
		Off of Chief Counsel	$4,753,536		
		Workforce Dev	$3,230,685		
	Operational			$49,070,395	
		Information Technology	$23,742,181		
		Specialized Services	$6,242,222		
		Real Estate/Utilities	$5,316,149		
		Telecomm	$5,169,807		
		Postage/Printing	$3,137,114		
		Office supplies	$1,164,185		
		Equipment	$1,084,169		
		All Other Operational	($292,158)		
		Training	$642,161		
		Payment Processing	$2,864,565		
Surplus Subtotal					$5,907,125
Benefit Modernization Costs					$3,113,588
Total Surplus					$2,793,537

Calendar Year 2017 UC Projections

Revenue					$137,267,000
	Federal Funds			$127,367,000	
		Base	$119,652,991		
		Above Base	$7,714,009		
	State Funds			$9,900,000	
		Special Admin	$9,900,000		
		Service & Infrastructure	$0		
Expenditures					$149,363,600
	Personnel			$98,766,983	
		UC Service Centers	$38,344,394		
		UC Policy	$5,723,682		
		UC Tax	$16,378,931		
		UC Board of Review	$11,999,590		
		UC Deputate	$2,119,110		
		Off of Info Tech	$9,146,370		
		Admin Services	$6,773,832		
		Off of Chief Counsel	$4,930,272		
		Workforce Dev	$3,350,802		
	Operational			$50,596,617	
		Information Technology	$24,335,736		
		Specialized Services	$6,398,277		
		Real Estate/Utilities	$5,449,053		
		Telecomm	$5,299,052		
		Postage/Printing	$3,215,542		
		Office supplies	$1,193,290		
		Equipment	$1,111,273		
		Training	$658,215		
		Payment Processing	$2,936,179		
Deficit Subtotal					($12,096,600)
Benefit Modernization Costs					$17,626,000
Total Deficit					($29,722,600)

Calendar Year 2018 UC Projections

Revenue					$139,125,000
	Federal Funds			$129,625,000	
		Base	$121,911,163		
		Above Base	$7,713,837		
	State Funds			$9,500,000	
		Special Admin	$9,500,000		
		Service & Infrastructure	$0		
Expenditures					$159,339,497
	Personnel			$107,680,351	
		UC Service Centers	$41,804,838		
		UC Policy	$6,240,224		
		UC Tax	$17,857,072		
		UC Board of Review	$13,082,510		
		UC Deputate	$2,310,352		
		Off of Info Tech	$9,971,797		
		Admin Services	$7,385,146		
		Off of Chief Counsel	$5,375,212		
		Workforce Dev	$3,653,200		
	Operational			$51,659,146	
		Information Technology	$24,846,786		
		Specialized Services	$6,532,641		
		Real Estate/Utilities	$5,563,483		
		Telecomm	$5,410,332		
		Postage/Printing	$3,283,068		
		Office supplies	$1,218,349		
		Equipment	$1,134,610		
		Training	$672,038		
		Payment Processing	$2,997,839		
Deficit Subtotal					($20,214,497)
Benefit Modernization Costs					$18,751,900
Total Deficit					($38,966,397)

Calendar Year 2019 UC Projections

Revenue					$142,782,000
	Federal Funds			$133,282,000	
		Base	$125,568,163		
		Above Base	$7,713,837		
	State Funds			$9,500,000	
		Special Admin	$9,500,000		
		Service & Infrastructure	$0		
Expenditures					$170,348,745
	Personnel			$117,398,120	
		UC Service Centers	$45,577,576		
		UC Policy	$6,803,382		
		UC Tax	$19,468,609		
		UC Board of Review	$14,263,160		
		UC Deputate	$2,518,854		
		Off of Info Tech	$10,871,717		
		Admin Services	$8,051,629		
		Off of Chief Counsel	$5,860,305		
		Workforce Dev	$3,982,888		
	Operational			$52,950,625	
		Information Technology	$25,467,956		
		Specialized Services	$6,695,957		
		Real Estate/Utilities	$5,702,570		
		Telecomm	$5,545,590		
		Postage/Printing	$3,365,145		
		Office supplies	$1,248,808		
		Equipment	$1,162,975		
		Training	$688,839		
		Payment Processing	$3,072,785		
Deficit Subtotal					($27,566,745)
Benefit Modernization Costs					$20,865,480
Total Deficit					($48,432,225)

Calendar Year 2020 UC Projections

Revenue					$146,549,000
	Federal Funds			$137,049,000	
		Base	$129,335,163		
		Above Base	$7,713,837		
	State Funds			$9,500,000	
		Special Admin	$9,500,000		
		Service & Infrastructure	$0		
Expenditures					$182,373,171
	Personnel			$127,992,879	
		UC Service Centers	$49,690,790		
		UC Policy	$7,417,363		
		UC Tax	$21,225,581		
		UC Board of Review	$15,550,359		
		UC Deputate	$2,746,171		
		Off of Info Tech	$11,852,850		
		Admin Services	$8,778,259		
		Off of Chief Counsel	$6,389,177		
		Workforce Dev	$4,342,329		
	Operational			$54,380,292	
		Information Technology	$26,155,591		
		Specialized Services	$6,876,748		
		Real Estate/Utilities	$5,856,540		
		Telecomm	$5,695,321		
		Postage/Printing	$3,456,004		
		Office supplies	$1,282,526		
		Equipment	$1,194,375		
		Training	$707,437		
		Payment Processing	$3,155,750		
Deficit Subtotal					($35,824,171)
Benefit Modernization Costs					$6,580,520
Total Deficit					($42,404,691)

Source: Information provided by L&I. Note that the projected Benefit Modernization Costs are summarized from the table included in Finding #3 prepared by L&I.

Appendix C Distribution List

This report was distributed to the following Commonwealth officials:

The Honorable Tom Wolf
Governor

The Honorable Kathy Manderino
Secretary
Pennsylvania Department of Labor and Industry

Mr. Robert V. O'Brien
Executive Deputy Secretary
Pennsylvania Department of Labor and Industry

The Honorable Randy Albright
Secretary of the Budget
Office of the Budget

The Honorable Joseph M. Torsella
State Treasurer
Pennsylvania Treasury Department

The Honorable Josh Shapiro
Attorney General
Office of the Attorney General

The Honorable Sharon P. Minnich
Secretary of Administration
Office of Administration

The Honorable Rob Kauffman
Majority Chair
House Labor and Industry Committee

The Honorable John Galloway
Democratic Chair
House Labor and Industry Committee

The Honorable Kim Ward
Majority Chair
Senate Labor and Industry Committee

The Honorable Christine Tartaglione
Democratic Chair
Senate Labor and Industry Committee

Mr. Brian Lyman, CPA
Director
Bureau of Audits
Office of Comptroller Operations

Ms. Mary Spila
Collections/Cataloging
State Library of Pennsylvania

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