

A Review of
**Projections for the Smart Jobs Fund,
the Unemployment Compensation Trust Fund,
and the Smart Jobs Holding Fund**

September 20, 2001

SAO Report No. 02-001

Members of the Legislative Audit Committee:

The State Auditor's Office estimates that the ending balance in the Smart Jobs Fund at the Texas Department of Economic Development (Department) will be \$101.6 million when the Smart Jobs program is concluded. Of this amount, \$83.4 million is not obligated and is currently available. We estimate an additional \$18.2 million will become available as existing contracts are closed. Our estimate is significantly higher than the Department's estimated fund balance of \$71.6 million primarily because:

- The Department's estimate is based on actual encumbrances of \$28.7 million for existing contracts. However, based on historical payout trends, we estimate that \$18.2 million will become available as these contracts are closed.
- The Department reserves \$7.6 million for grants that it has not yet awarded. However, the Department has not been authorized to award any new contracts and the Smart Jobs program expires on December 31, 2001.
- The Department's estimate reserves \$4 million to award contracts based on House Bill 1333 (77th Legislature) related to the creation of qualified defense related jobs. However, the Department has not executed any contracts for these funds.

In reviewing the costs necessary to conclude the Smart Jobs program, we determined that the Department's estimate of \$923,000 for fiscal year 2002 administrative expenditures for terminating the Smart Jobs program is reasonable. However, the information provided by the Department did not justify the need for its estimated fiscal year 2003 Smart Jobs program administrative expenditures of \$177,000. This amount is included in our estimate of the remaining balance in the Smart Job Fund.

The Texas Workforce Commission's (Commission) two-month projections of fund balances for the Unemployment Compensation Trust Fund have generally been within five percent of the actual fund balance for each month. The Commission's projection process uses specific factors and reliable historical data to estimate balances in the Unemployment Compensation Trust Fund and the Smart Jobs Holding Fund.

In addition to reviewing the projection process, we reviewed projections the Commission made in May and June 2001. Our analysis confirmed that the Commission followed its process and that its projected increase from \$109.7 million below the statutory floor in May 2001 to \$132.4 million below the floor in June 2001, before Smart Jobs Holding Fund transfers, was due primarily to a \$21.3 million increase in estimated unemployment compensation benefits.

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The attachment to this letter contains additional detail on the results of our work, which we performed at the request of Senator Rodney Ellis and Representative Robert Junell. Please contact Cindy Reed, Audit Manager, at (512) 936-9500 if you have any questions.

Sincerely,

Lawrence F. Alwin, CPA
State Auditor

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Attachment

cc: Texas Department of Economic Development
Mr. Jeff Moseley, Executive Director
Chair and Board members
Texas Workforce Commission
Ms. Cassie Carlson Reed, Executive Director
Chair and Commissioners

Background

The Texas Labor Code, Section 204.123, requires that balances in the Smart Jobs Holding Fund be transferred to the Unemployment Compensation Trust Fund, the Smart Jobs Fund, or both, depending on the October 1 balance in the Unemployment Compensation Trust Fund. The Unemployment Compensation Trust Fund is administered by the Texas Workforce Commission (Commission).

If the October 1 balance in the Unemployment Compensation Trust Fund is below its statutory floor, Smart Jobs Holding Fund balances will be transferred to the Unemployment Compensation Trust Fund to bring the balance to the floor amount. Any remaining Smart Jobs Holding Fund balances will be transferred to the Smart Jobs Fund. If the October 1 balance is above the statutory floor, then balances in the Smart Jobs Holding Fund will be transferred only to the Smart Jobs Fund.

The Commission is projecting that the Unemployment Compensation Trust Fund balance will be below the statutory floor on October 1, 2001. The Commission is also projecting that after transferring the full amount of the Smart Jobs Holding Fund to the Unemployment Compensation Trust Fund, the Unemployment Compensation Trust Fund balance will still be significantly below the floor. If the actual Unemployment Compensation Trust Fund balance is below the floor on October 1, 2001, an automatic deficit tax will be included in the 2002 tax rates as provided by statute.

The Texas Department of Economic Development (Department) has not accepted any new Smart Jobs applications since March 2000, when serious problems in program management were identified. The Department had 286 active contracts as of June 30, 2001. The Smart Jobs program will terminate on December 31, 2001.

What is the projected ending balance in the Smart Jobs Fund?

The State Auditor's Office (Office) estimates that \$101.6 million will be available in the Smart Jobs Fund when the program is concluded. Of this amount, \$83.4 million is not obligated and is currently available. We estimate that an additional \$18.2 million will become available as existing contracts are closed. Our estimate is significantly higher than the Department's estimated fund balance of \$71.6 million.

How We Estimated the Amount of Smart Jobs Funds That Will Become Available From Existing Contracts

We estimate that \$18.2 million will be available from amounts already obligated on existing Smart Jobs contracts because:

- The total contracted amount on the existing Smart Jobs contracts is \$33.1 million.
- During the last year, Smart Jobs contractors earned an average of 45 percent of their contracted amounts. Therefore, we estimate that the Department will spend a total of \$14.9 million ($\$33.1 \text{ million} \times 0.45$) on existing contracts.
- The Department has already paid contractors \$4.4 million on existing contracts. Therefore, we estimate that it will spend \$10.5 million more ($\$14.9 \text{ million} - \4.4 million) on outstanding contracts.
- As of June 30, 2001, the Department encumbered \$28.7 million for existing contracts. Therefore, we estimate that \$18.2 million of this amount ($\$28.7 \text{ million} - \10.5 million) will be available from these contracts once these contracts are closed.

Our estimate and the Department's estimate differ primarily because:

- The Department's estimate is based on actual encumbrances of \$28.7 million for existing contracts. However, contractors have historically earned significantly less than their contracted amounts. Based on historical payout trends, we estimate that \$18.2 million of the \$28.7 million obligated on these contracts will become available as these contracts are closed (see text box on previous page).
- The Department's estimate reserves \$7.6 million for grants that it has not yet awarded. Approximately \$6.8 million of this amount is for corporate expansion and recruitment verbal commitments, dating back to September 1998, that the Department made to ten businesses that planned to expand or relocate their operations in Texas. However, no contracts have been executed, the Department has not been authorized to award any new contracts, and the Smart Jobs program expires on December 31, 2001. The Department also reserves \$0.8 million for Smart Jobs applications that were, according to the Department, processed and approved by the program before it stopped accepting applications in March 2000. No contracts have been executed for these applications.
- The Department's estimate reserves \$4 million to award contracts based on House Bill 1333 (77th Legislature) related to the creation of qualified defense related jobs. However, the Department has not executed any contracts for these funds.

Is the Department's estimate of administrative expenditures needed to close the Smart Jobs Program reasonable?

The Department's estimate of \$923,000 for fiscal year 2002 administrative expenditures for terminating the Smart Jobs program is reasonable. However, the information provided by the Department did not justify the need for its estimated fiscal year 2003 Smart Jobs program administrative expenditures of \$177,000.

As of June 30, 2001, the Department had 286 remaining Smart Jobs contracts. The majority of these contracts will terminate by December 31, 2001, and all contracts will be closed by the end of fiscal year 2002. As a result, the Department estimates that it will spend \$306,000 of its fiscal year 2002 administrative expense estimate after December 31, 2001.

The Department's estimate for fiscal year 2003 Smart Jobs program administrative expenses assumes that the Department will continue certain activities that we cannot validate will be necessary eight months after the Smart Jobs program expires.

How does the commission project balances for the Unemployment Compensation Trust Fund and the Smart Jobs Holding Fund?

The Commission follows a defined process to produce projections for the balances in the Unemployment Compensation Trust Fund and the Smart Jobs Holding Fund. The Commission's projection process uses specific factors and reliable historical data to predict fund balances.

The projections of fund balances are based on estimates of future tax remittances, benefit payments, transfers and adjustments, and interest earnings. The Commission estimates tax remittances based on expected annual taxable wages multiplied by the anticipated tax yield. The Commission projects benefit payments based on the estimated values for the following:

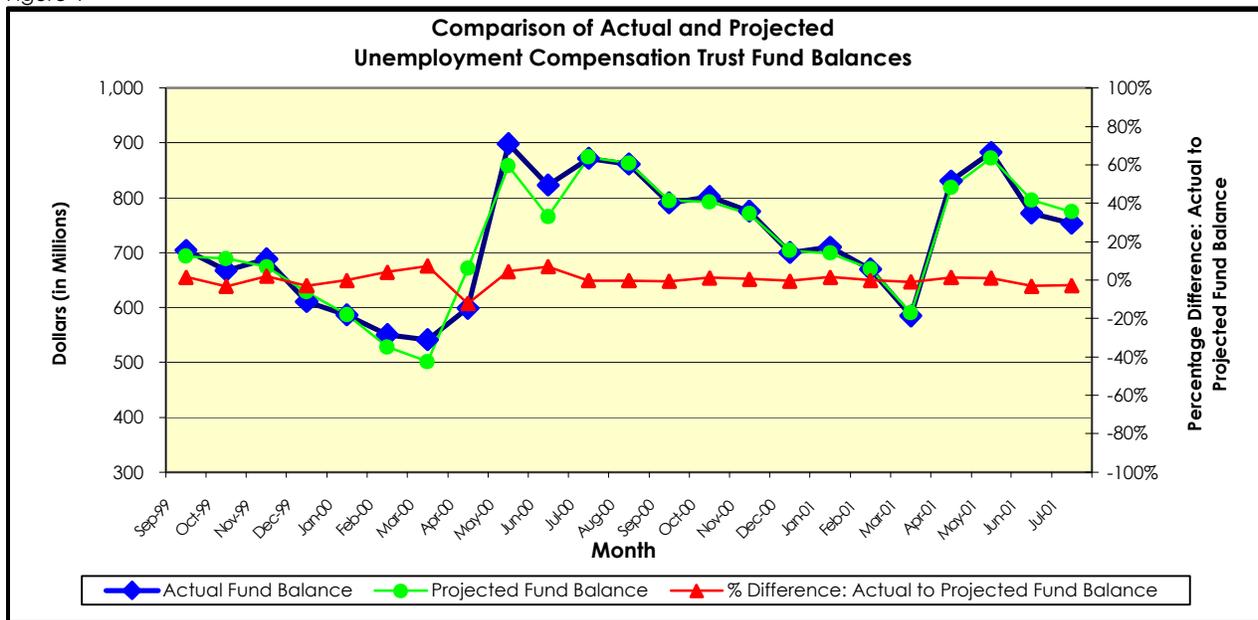
- Percentage of eligible claimants who receive benefits
- Amount of the average benefit check
- Average number of weeks benefits are paid

The Commission monitors daily tax receipts and daily benefit payments and incorporates that information, along with other historical data, into the projection process.

How do projected Unemployment Compensation Trust Fund balances compare with actual fund balances?

The Commission's projected Unemployment Compensation Trust Fund balances are generally within five percent of the actual fund balance for each month end. Figure 1 shows the differences between projected balances prepared two months in advance and actual fund balances for each month from September 1999 through July 2001.

Figure 1



Source: Texas Workforce Commission Unemployment Compensation Fund Projection Data

Why did the Commission's projections change significantly between May and June 2001?

The Commission's projection for the amount by which the Unemployment Compensation Trust Fund will be below the statutory floor, before Smart Jobs Holding Fund transfers, increased from \$109.7 million in May 2001 to \$132.4 million in June 2001 because:

- There was a \$21.3 million increase in estimated benefit payments. This increase reflects an increase in the estimated number of claimants and a higher average benefit amount.
- There was a \$6.7 million decrease in estimated tax remittances.
- There was a \$500,000 decrease in estimated interest income.
- There was a \$5.1 million decrease in the estimated floor amount.
- There was a \$700,000 increase in transfers from the Smart Jobs Fund.

Summary of Objectives, Scope, and Methodology

The project objectives were to:

- Determine the projected balance of the Smart Jobs fund at the conclusion of the Smart Jobs program and the remaining obligations and costs necessary to terminate the program.
- Determine whether the Commission follows an established process and uses reliable data in preparing monthly projected balances in the Unemployment Compensation Trust Fund and the Smart Jobs Holding Fund and identify factors used in the projections.
- Identify the reasons for the increase in the projected amount below the Unemployment Compensation Trust Fund floor between the May and June 2001 projections.

The scope of the project included the Department's estimate of the remaining balance in the Smart Jobs Fund. We also reviewed the Commission's process and data used in projecting balances in the Unemployment Compensation Trust Fund and Smart Jobs Holding Fund reported in May, June, and July 2001, and fund balance data for September 1999 through July 2001.

The project methodology consisted of gaining an understanding of the statutory requirements and procedures related to the projections of the Smart Jobs Fund, the Unemployment Compensation Trust Fund, and the Smart Jobs Holding Fund. The methodology also included conducting tests to accomplish the project objectives.

This review was performed as an "Other Activity of an Audit Organization" as described in the General Accounting Office's Government Auditing Standards, 1994 Revisions, paragraph 2.10.

Management Responses



STATE OF TEXAS
DEPARTMENT OF ECONOMIC DEVELOPMENT

September 17, 2001

Lawrence F. Alwin, CPA
State Auditor
1501 N. Congress, Suite 4.224
Robert E. Johnson Building
Austin, Texas 78701

Dear Mr. Alwin:

The Department substantially agrees with most of the review of the *Projections for the Smart Jobs Fund, the Unemployment Compensation Trust Fund, and the Smart Jobs Holding Fund*.

- We agree that as existing contracts are closed there will be additional funds available. The estimate of a 45 percent payout rate seems reasonable based on historical trends.
- The Department will not award any additional contracts for either the corporate expansion and recruitment commitments or the applications which were accepted before the program was closed in March 2000, unless specifically instructed to do so by leadership.

The commitments referred to were issued to ten major corporations to consider in their decisions to locate or expand businesses in Texas. In announcing their selections in Texas, they also announced the potential creation of approximately 6,000 jobs in the state. Texas has a nation-wide reputation for its 'business friendly climate' which should be considered in any decisions regarding these commitments.

The applications received prior to closing the program are similar to another larger group of applications for which the Department received written approval to execute contracts. These involve companies who had already started their training programs prior to closing the program. These applications may subject the State to litigation which could result in additional liabilities to the Smart Jobs Fund.

- The Department will not operate any programs in connection with the provisions of House Bill 1333 (77th Legislature) unless specific written instructions are received from leadership.

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The Department anticipates that during fiscal year 2003 there will be interim legislative committees charged with studying the issue of business incentives for the State, the Comptroller's office and the Texas Council on Workforce and Economic Competitiveness will also begin studies of the efficiency and effectiveness of customized training programs, and several of the committees of the 78th Legislature may request information or testimony from the Department regarding the Smart Jobs program when considering and drafting new legislation. If we are not permitted to budget the direct expenses necessary to respond to these requests, the transfer of program knowledge and information may not be available as a resource to these agencies or committees.

I commend your staff for their diligence in performing the review of the Department and the Texas Workforce Commission. I look forward to receiving instructions from leadership regarding the policy issues raised by the report and to successfully closing the Smart Jobs program. I also hope that the experience gained in the re-engineering processes of the program can be beneficial to the State in the future. Please contact me if I may be of any assistance.

Sincerely,



Jeff Moseley
Executive Director

Texas Workforce Commission

Member of the Texas Workforce Network

Diane D. Rath, Chair
Commissioner Representing
the Public

T. P. O'Mahoney
Commissioner Representing
Labor

Ron Lehman
Commissioner Representing
Employers

Cassie Carlson Reed
Executive Director

September 11, 2001

Mr. Lawrence F. Alwin, CPA
State Auditor
State Auditor's Office
Robert E. Johnson Building
1501 North Congress Avenue, Suite 4.224
Austin, Texas 78701

Dear Mr. Alwin:

The Texas Workforce Commission (TWC) appreciates the work performed to determine the reliability of the projections of the balances of the Unemployment Compensation Trust Fund. TWC continuously strives to improve processes and incorporate all available information to assure the reliability of the UI Trust Fund estimates. The auditor's work has provided assurance that TWC is successfully estimating the Trust Fund balances within an immaterial variance.

As always, TWC appreciates the professionalism of the staff of the State Auditor's Office and the positive relationship that TWC shares with the State Auditor's Office.

Sincerely,



Cassie Carlson Reed
Executive Director

cc: Diane D. Rath, Chair and Commissioner Representing the Public
T.P. O'Mahoney, Commissioner Representing Labor
Ron Lehman, Commissioner Representing Employers