An Audit Report on

Unemployment Insurance Tax at the Texas Workforce Commission

July 2011
Report No. 11-042
Overall Conclusion

The Texas Workforce Commission (Commission) has effective processes and controls in place to verify that employers that are subject to unemployment insurance tax make proper tax payments to the State of Texas. The Commission collected $2.1 billion in unemployment taxes from 450,966 employers in fiscal year 2010. However, the Commission should strengthen its collection process by:

- Retaining support for payments that service agents make.
- Consistently following its internal policies and procedures related to delinquent employers.

The Commission has multiple tools in place to monitor employers for unemployment insurance tax liability. These tools include tax audits, receiving and processing complaint referrals, and generating and reviewing reports that can identify unregistered employers and wage-reporting errors. The Commission should improve its tax audit process by incorporating a supervisory review of the tax audit data entered into its unemployment tax system and consistently adhering to its policies and procedures.

In addition, the Commission should review its tax audit rejection procedures. The Commission’s account examiners rejected 5,791 tax audit assignments in calendar year 2010. Of the 30 tax audit rejections tested, 18 (60 percent) did not have adequate documentation entered in the Commission’s tax system. As a result, state auditors could not determine whether the reasons provided for the rejections were appropriate.

The Commission has effective controls over its tax system, and these controls were operating as intended. An external review of the tax system did not identify any significant weaknesses in information system controls. However, auditors determined that data in the Commission’s complaint referral database was not sufficiently reliable for the purposes of this report. Auditors identified several weaknesses within the database, including a lack of supervisory review of complaint referral data and incomplete investigation results.

This audit was conducted in accordance with Texas Government Code, Section 321.0132.

For more information regarding this report, please contact Angelica Ramirez, Audit Manager, or John Keel, State Auditor, at (512) 936-9500.
Summary of Management’s Response

The Commission generally agrees with the findings and recommendations in this report. The Commission’s detailed management responses are presented immediately following each set of recommendations in the Detailed Results section of this report.

Summary of Information Technology Review

The Commission has effective general and application controls over its tax system, and the data in the system was sufficiently reliable for purposes of this report. However, the Commission should strengthen its controls over the entry of employer wage information related to tax audits into the tax system to help ensure continued accuracy.

In addition, the Commission should address weaknesses in the controls over its complaint referral database. Auditors determined that the database was not sufficiently reliable for the purposes of this report because of a lack of supervisory reviews of complaint referral data and the entry of incomplete investigation results.

Summary of Objective, Scope, and Methodology

The objective of this audit was to determine whether the Commission has effective processes and related controls to verify whether entities that are subject to unemployment insurance tax make proper tax payments.

The scope of this audit included unemployment insurance tax payments made in the fourth quarter (October through December) of calendar year 2010 and the Commission’s unemployment insurance tax monitoring functions from September 2008 through March 2011. The scope also included automated systems and processes in those areas.

The audit methodology included collecting information and documentation from the Commission; reviewing policies and procedures, statutes, and rules related to unemployment insurance tax; and analyzing and evaluating data and the results of tests. Specifically, auditors reviewed unemployment insurance tax payments, tax audits, abatements, complaint referral assignments, delinquent accounts, blocked claim assignments, and wage-reporting exception reports. Auditors also visited four regional/field tax offices in Austin, Houston, Dallas/Fort Worth, and Wichita Falls to test selected tax audit reports and supporting documentation.

Auditors also communicated less significant issues to Commission management separately in writing.
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Detailed Results

Chapter 1

The Texas Workforce Commission (Commission) has effective processes and controls in place to verify that employers that are subject to unemployment insurance tax make the proper tax payments. However, auditors identified opportunities for the Commission to strengthen controls in areas including updating its records retention policy, maintaining supporting documentation, and enforcing Texas Administrative Code payment requirements. In addition, the Commission did not consistently comply with its delinquency collection policies and procedures. The Commission should strengthen its collection processes by:

- Retaining supporting documentation for certain service agent tax payment allocations.
- Monitoring account examiners’ work lists to ensure that account examiners contacted delinquent employers in a timely manner.

The Commission collected more than $285 million in unemployment taxes from 258,112 employers in the fourth quarter of calendar year 2010. During calendar year 2010, the Commission also collected more than 98 percent of the tax payments from delinquent employers.

In addition, the Commission properly reviewed and processed employers’ requests to abate penalties and interest incurred as a result of the late filing of quarterly wage reports.
Chapter 1-A

The Commission Properly Collected and Recorded Tax Payments for Employers That Were Subject to Unemployment Insurance Tax

The Commission has effective processes and controls in place to verify that employers that are subject to unemployment insurance tax make the proper tax payments. However, the Commission should improve some areas of its tax payment collection process. The Commission receives manual and electronic unemployment tax insurance payments from employers. Manual payments include cash, checks, money orders, and vouchers. Electronic payments can be made by credit card, automated clearinghouse, and electronic funds transfer (see text box for information on the processing of tax payments).

In the fourth quarter of calendar year 2010, 407,914 employers submitted at least one quarterly wage report (see text box for the definition of this report type). Of those employers:

- 97 percent were small employers (paid wages to fewer than 100 individuals).
- 3 percent were large employers (paid wages to 100 or more individuals).

The Commission collected 268,591 payments totaling $285,198,829 in the fourth quarter of calendar year 2010. Table 1 shows the percentage of electronic and manual payments the Commission received for that same quarter.

Table 1

<table>
<thead>
<tr>
<th>Payment Type</th>
<th>Number of Payments Received</th>
<th>Percentage of Total Number of Payments Received (268,591)</th>
<th>Dollar Value of Payments Received ($285,198,829)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Electronic</td>
<td></td>
<td>58%</td>
<td>80%</td>
</tr>
<tr>
<td>Manual</td>
<td></td>
<td>42%</td>
<td>20%</td>
</tr>
</tbody>
</table>

Source: The Commission’s tax system.

Auditors tested 90 payments: 40 manual payments, 40 electronic payments, and 10 voucher payments. Overall, auditors determined that 75 (83 percent) of the 90 payments were recorded and supported to ensure that the Commission

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1 Vouchers provide deposit instructions for payments that were originally received by another state agency or another Commission fund.
correctly processed the payments. However, the Commission should improve certain controls. Specifically:

- The Commission did not record the postmark dates in the tax system for 32 (80 percent) of 40 manual payments tested. For payments that the Commission’s exceptions/batch control section (section) determined were submitted in a timely manner, the section assigned a general receipt date that was equal to the payment due date in the tax system. The section did not document the actual postmark dates in the tax system, nor did it retain sufficient documentation to substantiate the actual receipt date for those payments. Title 40, Texas Administrative Code, Section 815.102, specifies the supporting documentation that the Commission should use to assign a receipt date to a tax-related submission (such as a U.S. Postal Service postmark date, postal meter date, and other documentation). Of the 32 manual payments without supporting documentation for the receipt date, 17 (53 percent) had a scanned date in the tax system that was later than the payment due date. Because of the lack of corroborative evidence, auditors were unable to verify whether those 17 payments were submitted by the due date and whether any of those 17 payments should have also included late payment penalties and interest.

- The Commission was unable to provide adequate supporting documentation for 14 (35 percent) of 40 electronic payments tested. All 14 transactions were for service agent payments from a single, common service agent (see text box for definition of a service agent). The Commission processed the transactions for this single agent. According to Commission staff, they retained the supporting documentation for the payments from the service agent for only 60 days. The Commission’s record retention schedule does not specifically address the retention period for supporting documentation for payments from service agents. However, the Commission’s revenue and trust management section requires that supporting documentation for electronic payments be retained for a minimum of six years.

In addition, all 29 receipts tested for tax payments that employers submitted to account examiners at field offices were recorded in the account examiners’ receipt books and correctly entered into the tax system. However, having account examiners accept payments, especially cash payments, in the field poses a risk that the Commission’s state office may not receive the payment.
Recommendations

The Commission should:

- Consider evaluating the risk of not documenting the actual postmark dates of all payments in the tax system.

- Specify in its record retention schedule a retention period for supporting documentation of payments from service agents that is consistent with the retention period for other electronic payments’ supporting documentation, and retain supporting documentation for all service agent payments in compliance with the retention schedule.

Management’s Response

**Recommendation:** The Commission should consider evaluating the risk of not documenting the actual postmark dates of all payments in the tax system.

**Management Response:**

The Commission agrees to evaluate the risk of not entering the actual postmark dates for all payments in the unemployment tax system by December 31, 2011. As a part of this evaluation, we will also identify any cost-beneficial options for revising the current procedure of only entering actual postmark dates for tax payments received for processing one day after the due date. By June 30, 2012, we will implement any necessary changes to our current procedures in order to improve supporting documentation of receipt date for unemployment tax payments. The Chief Accounting Officer will be responsible for implementing these proposed actions.

**Recommendation:** The Commission should specify in its record retention schedule a retention period for supporting documentation of payments from service agents that is consistent with the retention period for other electronic payments’ supporting documentation, and retain supporting documentation for all service agent payments in compliance with the retention schedule.

**Management Response:**

The Commission agrees with this finding. Input files for service agents who submit payments and allocations via EFT should be retained on the same schedule as other service agents who submit payments and allocations in other formats. AD&M Tax intends to extend the retention schedule to 6 quarters to be consistent with the input file retention of other forms of service agent payments and allocations. The target date for implementation is October 1, 2011. The person responsible for implementation is the Labor Law Manager for Applications Development and Maintenance.
The Commission Should Enhance Its Enforcement of Texas Administrative Code Electronic Funds Transfer Requirements

Title 40, Texas Administrative Code, Section 815.109(d) (40 TAC 815.109(d)), requires that employers whose insurance tax payments in the preceding state fiscal year totaled $250,000 or more must submit insurance tax payments using electronic funds transfer (EFT). EFT allows the Commission to receive and deposit the funds on the same day that the employer submits them. Other forms of payment may require significantly more time to be posted to the Unemployment Trust Fund.

One (20 percent) of 5 non-EFT payments from large employers tested did not comply with 40 TAC 815.109(d) because it was a personal check in the amount of $270,461 from an employer that became subject to the EFT requirement the previous year. Commission staff sent a letter notifying the employer of the EFT requirement. The Commission does not assess a penalty on employers for non-compliance with the EFT requirement, even though Texas Government Code, Section 404.095 (d), permits the Commission to assess a penalty in an amount equal to 5.0 percent of the payment amount.

Recommendation

The Commission should consider implementing procedures to ensure that employers comply with 40 TAC 815.109(d) pertaining to EFT payments.

Management’s Response

The Commission considered if it should implement additional procedures to ensure that employers comply with EFT requirements. However, it is not the Commission’s policy to assess punitive penalties, especially on employers who are newly subject to a requirement. The agency achieved a 99.83% compliance rate for the 1st quarter of 2011. During the 1st quarter of 2011 only 2 out of 1,177 employers required to pay taxes by EFT did not comply. The agency identified another 21 employers who have until 2012 to register and pay their taxes by EFT before they are considered out of compliance with agency rules. The Tax Department will initiate contact with these and future employers to assist them with EFT registration but will not implement procedures to assess penalties for non-compliance with the Commission’s EFT requirements.
Texas Labor Code
(Collection Actions)

Section 213.057 (Tax Lien)
The amount due from an employing unit under this subtitle is secured by a lien on property belonging to the employing unit or to any individual indebted for the sum.

Section 213.059 (Levy/Freeze)
If a person is delinquent in the payment of any amount, including contributions, penalties, and interest due under this subtitle, the commission may notify personally or by mail any other person who:
1. possesses or controls an asset belonging to the delinquent person; or
2. owes a debt to the delinquent person.

Section 213.031 (Civil Suit or Notice of Assessment)
If after notice an employer does not pay a contribution or a penalty or interest on a contribution, the commission shall collect the amount due by:
1. bringing a civil action in the name of the state and the attorney general in a district court in Travis County; or
2. serving a notice of assessment on the defaulting employer, stating the amount of the contribution, penalty, and interest outstanding.

Chapter 1-C
The Commission Generally Complied with Its Delinquent Employer Collection Policies and Procedures

Based on delinquent employer accounts reviewed as of March 1, 2011, the Commission generally complied with applicable Commission policies and procedures for obtaining delinquent tax payments from employers. However, the Commission should ensure that it contacts delinquent employers within the required time frame established by its policies and procedures.

The Commission had 2,239 accounts in the delinquent collection process with approximately $14 million in past due unemployment insurance tax as of March 1, 2011. In calendar year 2010, the Commission collected more than 98 percent of delinquent tax payments from delinquent employers. For calendar years 2006 through 2010, the collection rate remained between 98 percent and 99 percent.

The Texas Labor Code grants the Commission the authority to impose various collection actions on employers that are delinquent in the payment of unemployment insurance tax, penalties, and interest (see text box). The Commission’s tax system identifies delinquent employer accounts that exceed a certain threshold and transmits data on the accounts into an automated collections system. The automated collections system contains a built-in time line that identifies and produces collection actions on employers’ accounts as described below:

- Day 0 – The tax system identifies the delinquent employer’s account, creates an assignment for the account examiner, and produces a “statement of account” to send to the employer.
- Day 1-20 – The account examiner properly communicates the delinquency to the employer.
- Day 21 – The tax system produces a “default notice” to send to the employer.
- Day 49 – The tax system produces a tax lien and posts a county recording fee amount on the employer’s account.
- Day 50-119 – The Commission reviews the employer’s account to determine whether to implement a freeze and/or levy and notice of assessment if the account continues to remain delinquent.
Collection Contact

An account examiner is required to communicate a tax delinquency to an employer through face-to-face or telephone contact with the person responsible for the delinquency (such as the owner, officer, or partner) and, at a minimum, ask for the amount due. The account examiner must make at least three attempts on three separate days to properly contact the employer.

Source: The Commission.

The Commission did not consistently contact employers to request payment of delinquent taxes in accordance with its procedures. Specifically, for 3 (9 percent) of 35 delinquent employer accounts tested, the account examiner responsible for the account did not adequately communicate the delinquency with the employer within the first 20 days of the collection process as required (see text box). Of those 3 accounts, 1 employer received contact 18 days late, and the other 2 did not receive contact while the account was in the collection process. Those errors were due to the account examiner not properly monitoring the delinquent collection work list as required by the Commission’s field tax manual. If adequate contact is not made initially, this could result in the delinquent tax payment not being collected or the account becoming recycled to the beginning of the collection process and delaying the collection of the delinquent unemployment insurance tax.

Furthermore, the Commission did not consistently ensure that it adequately contacted employers prior to issuing tax liens. Two (6 percent) of 322 delinquent accounts tested had an inappropriate tax lien issued because the Commission did not ensure that the employer received adequate contact. According to Commission procedures, when an employer account is reviewed on day 42 to determine whether a tax lien should be issued, the Commission should verify that adequate contact has been made. If adequate contact has not been made, the collections department should contact the account examiner and stop the tax system from producing a tax lien on day 49. Those errors resulted because the Commission did not adequately review the delinquent employer accounts when it determined whether tax liens should be issued. Issuing inappropriate tax liens on employers could have an adverse effect on the employers’ credit-worthiness.

Recommendations

The Commission should:

- Ensure that account examiners monitor their collection work lists and make adequate contact with delinquent employers as required.
- Ensure that it properly reviews delinquent employer accounts when determining whether tax liens should be issued.

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2 Three of 35 delinquent accounts tested were excluded from tax lien testing because the account either had a valid stop placed on it (and therefore, no lien was issued) or it was in the collection process for fewer than 49 days (tax liens are issued on day 49).
Management's Response

Recommendation: The Commission should ensure that account examiners monitor their collection work lists and make adequate contact with delinquent employers as required.

Management Response:

The Commission agrees that collection work lists should be monitored and that adequate contact should be made with delinquent employers. The Tax Department will conduct collection work list and employer contact refresher training for Tax personnel. Corrective action will be implemented by the Tax Director by December 31, 2011.

Recommendation: The Commission should ensure that it properly reviews delinquent employer accounts when determining whether tax liens should be issued.

Management Response:

Due to the very complex nature of the two employer accounts in question, it was not readily apparent during the audit whether proper contact was made before liens were filed for tax delinquency. However, upon further examination of the employer accounts, it was determined that appropriate contact was made and documented prior to processing them in the Automated Collection Action Program (ACAP). Therefore, additional procedures to ensure accounts are properly reviewed are not considered necessary at this time.

Our examination found that both delinquent accounts indicate extensive contact or attempted contact with the employers before liens were filed. One account was brought to the Commission’s attention through a comprehensive back pay investigation by the Department of Labor (DOL). After initial contacts by both DOL and the Commission, the employer became uncooperative, avoiding subsequent attempts to communicate. The second account, which was one of four related accounts, was established following extensive communications with the controller of the parent entity in which the tax delinquency was discussed. Communication was made even more difficult due to incorrect contact information provided by the employer. Based on the age of the debts, the prior conversions, and the prior Statements of Employer Account mailed and not returned, tax liens were filed. More importantly, in both instances, the employers received timely ‘Due Notice’ in the form of an Employers Default Notice which outlines potential legal actions for tax delinquencies.
Abatements
When employers file quarterly wage reports late, they are assessed late penalties and charged interest on the taxes associated with the late reports. Employers have the option to request the removal of penalties and interest incurred, which is called abatement. To request abatement, the employer must provide a reason for the late filing in the form of a signed letter, request that no penalty be assessed due to the reasons given, and transmit both the late report and the tax amount due.
Source: The Commission.

Chapter 1-D
The Commission Properly Reviewed and Processed Abatement Requests from Employers

The Commission properly reviewed and processed employers’ requests to abate penalties and interest incurred as a result of the late filing of quarterly wage reports. The Commission has the authority to remove all or part of the penalties and interest charged when employers file a quarterly wage report after the report’s due date. The removal or reduction of the penalties is known as abatement (see text box). Auditors tested 37 abatement requests the Commission completed during fiscal year 2010 and identified no errors.
Chapter 2

The Commission Monitored Employers to Identify Unemployment Tax Liability and Unregistered Employers; However, It Should Strengthen Controls Over Certain Monitoring Functions

The Commission has multiple tools in place to monitor employers for unemployment insurance tax liability. Those tools include tax audits, receiving and processing complaints, and generating and reviewing reports that can identify unregistered employers and wage-reporting errors.

The Commission completed 21,446 tax audits from September 1, 2008, to January 31, 2011. The Commission substantially complied with its policies and procedures for conducting tax audits in the 90 tax audits that state auditors reviewed. However, the Commission should strengthen its tax audit process in certain areas. Specifically:

- The tax audit data in the tax system did not always agree with the supporting tax audit documentation.
- The Commission did not always comply with its policy that prohibits employers from being audited more than once in a 36-month period.
- The Commission did not adequately monitor tax audit rejections or restrict the number of tax audits that each account examiner could reject.

The Commission has an effective process in place to address complaint referrals initiated within the agency and those that are initiated from external sources. Auditors tested 25 complaint referrals for which assignments were issued and in all 25 complaint referrals, the results of the investigation could be justified by the supporting documentation. However, Commission procedures did not include sufficient details related to the recording, processing, and disposition of complaint referrals.

The Commission also identifies unregistered employers and wage-reporting errors through:

- Blocked claim assignments.
- Exception reports.

Those tools assist the Commission in identifying tax liable employers and can potentially result in additional tax payments due to the Commission.
Chapter 2-A

The Commission’s Tax Audits Substantially Complied with Agency Policies and Procedures and Met Federal Guidelines

The U.S. Department of Labor established performance measures for tax audits. In calendar year 2009, states were required to audit 2 percent of their active employers. The U.S. Department of Labor also requires that 1 percent of all tax audits cover “large” employers or employers with 100 or more employees. As of the end of calendar year 2009, the U.S. Department of Labor reported that the Commission met or exceeded that performance measure by conducting 9,067 tax audits, or tax audits of 2.0 percent of the 444,935 liable active employers. Of these 9,067 tax audits, 163 (1.8 percent) were of large employers.

In addition, the Commission completed 21,446 tax audits from September 1, 2008, to January 31, 2011. These tax audits resulted in an additional $563,625 in taxes due to the Commission and the identification of 15,289 misclassified workers. Commission staff conducted those tax audits in all six tax regions (see Appendix 2 for a map of the regional offices).

State auditors reviewed 90 tax audits and determined that the Commission substantially complied with its policies and procedures for conducting tax audits. Specifically:

- For 87 (97 percent) of the 90 tax audits tested, the supporting tax audit files contained all of the documents required by the Commission’s policies and procedures. Three tax audit files did not contain all required documents.

- For 89 (99 percent) of the 90 tax audits tested, the Commission calculated the tax liability using the appropriate tax rate, taxable wages, and interest rate. The Commission did not retain the supporting documentation for one tax audit.

- Account examiners submitted adjustment reports for all 36 tax audits for which they were required to submit those reports. Adjustment reports are required when an employer is a corporation, an employer account needs to be updated, or if there has been a change in ownership.

However, the Commission should strengthen its tax audit process in certain areas. The tax audit data in the Commission’s tax system did not agree with the supporting tax audit documentation for 21 (23 percent) of the 90 tax audits tested. Data entry errors were the primary cause of the discrepancies.

In addition, the Commission did not always comply with its policy that prohibits employers from being audited more than once in a 36-month period. The Commission’s Audit Manual states that a tax audit should not include any time period covered in a previous tax audit, nor should an employer be audited...
more than once in a 36-month period. Exceptions to this policy should be approved by the regional tax manager or audit program administrator. However, the Commission lacks written procedures requiring this approval to be documented. As a result, state auditors could not determine whether the regional tax manager or audit program administrator had approved the exceptions for the 9 of the 90 tax audits tested for which the employers had been audited within the last 36-month period.

The Commission’s policy also includes a provision that allows account examiners to reject tax audit candidates that have been audited within the last 36 months and whose tax audits did not result in any change to reportable wages or tax. Four (44 percent) of the 9 tax audits discussed above were of employers audited within the last 36 months whose prior tax audits did not result in any change (see additional information on tax audit rejections below).

**Recommendations**

The Commission should:

- Require a review of tax audit results entered into the tax system to ensure accuracy and agreement with audit documentation.

- Retain documentation of tax audit reviews and include the documentation in the tax audit package.

- Develop a formal policy to clarify how approvals of exceptions to the Commission’s policy on the frequency of tax audits should be approved and documented.

**Management’s Response**

*Recommendation:* The Commission should require a review of tax audit results entered into the tax system to ensure accuracy and agreement with audit documentation.

*Management Response:* The Commission agrees with the recommendation to require a review of audit results entered into the tax system to ensure accuracy and agreement with the audit documentation. The Tax Department will update staff and present review training to Tax personnel. Corrective action will be implemented by the Tax Director by December 31, 2011.
**Recommendation:** The Commission should retain documentation of tax audit reviews and include the documentation in the tax audit package.

**Management Response:**

The Commission agrees with the recommendation to retain documentation of the audit review and include the documentation in the audit package. The Tax Department will provide refresher training to the audit supervisors that the audit report (C-51) must contain their review score and their supervisor number. Corrective action will be implemented by the Tax Director by December 31, 2011.

**Recommendation:** The Commission should develop a formal policy to clarify how approvals of exceptions to the Commission’s policy on the frequency of tax audits should be approved and documented.

**Management Response:**

The Commission agrees with the recommendation to clarify how approvals of exception to the Commission’s policy on the frequency of audits should be approved and documented. The Tax Department will, through department procedures, require supervisor approval and account documentation for any audit that is conducted less than 36 months after a prior audit. Procedure and documentation training will be given to regional tax managers and supervisors. Corrective action will be implemented by the Tax Director by December 31, 2011.
The Commission’s Audit Manual – Tax Audit Rejections

An account examiner will reject a tax audit candidate if (1) the candidate’s account was audited within the last 36 months and the tax audit was a “no change” audit or (2) the tax audit showed the employer overreported total wages, taxable wages, or tax to the Commission.

Appropriate codes for rejecting a tax audit include:

1 - Employer not in tax area.
2 - Audited within last 36 months.
3 - Records in another tax area, or employer had 100 or more employees.
4 - Employer has no records for audit.
5 - Legal action requested or pending.
6 - Regional tax manager.

Account examiners may refresh their audit candidate list annually. They may refresh all or only part of their list, but only one refresh of the list is allowed. The time period set aside for this annual refresh is the last two weeks of December and the first two weeks of January. The exact beginning and ending dates are set annually by the Commission’s field tax operations section. No tax system comments are required.

Source: The Commission.

The Commission staff rejected 5,791 tax audit assignments during calendar year 2010. The majority (90 percent) of tax audit rejections occurred during the four-week period in which an annual refresh of a tax audit candidate list is permitted (see text box for additional information). The Commission’s policy allows only one refresh of the list annually; however, seventeen examiners rejected at least 60 tax audit candidates during the annual refresh period for calendar year 2010. The list allows a maximum of 30 tax audit candidates.

In addition, during calendar year 2010:

- On average, each account examiner rejected 30 tax audit assignments.
- Five account examiners rejected more than 100 tax audit assignments, including one examiner who rejected 489 tax audit assignments.
- Twenty-eight employers were rejected more than once.
- A total of 190 (97 percent) of the Commission’s 196 account examiners rejected at least two tax audit candidates.

The Commission does not adequately monitor tax audit rejections or restrict the number of tax audits that an account examiner can reject. As a result, some employers may never be audited due to inappropriate tax audit rejections.

In addition, 18 (60 percent) of 30 tax audit rejections tested did not have adequate documentation to support the rejection code selected. Inappropriate tax audit rejections can impair the Commission’s ability to identify employers that are incorrectly reporting wages and tax information. The Commission does not have a policy that requires account examiners to create and retain detailed documentation supporting the decision to reject a tax audit candidate.

Recommendations

The Commission should:

- Implement controls to monitor all tax audit rejections to ensure compliance with agency policy.
- Restrict the number of tax audits that an account examiner may reject during the yearly refresh.
Expand current policies and procedures to require (1) documentation of a tax audit rejection reason be created and retained for audit rejections that are not part of the annual refresh period and (2) a review of all tax audit rejections that are not part of the annual refresh period to ensure the tax audit rejections are appropriately coded and supported.

Management’s Response

The Commission agrees with implementing controls to monitor audit rejections and to review all tax audit rejections that are not part of the annual refresh period. The Commission will request programming that will automatically refresh all audit work lists once each year during the last two weeks of December. The Commission will require documentation, justification and supervisor approval for any additional audit rejects outside of established parameters. Corrective action will be implemented by The Tax Director by December 15, 2011.

Chapter 2-C
The Commission Effectively Monitored Tax Liability Through Its Complaint Referral Process

The Commission has a process in place to address complaint referrals initiated within the agency and those initiated by external complainants. From September 1, 2009, to August 31, 2010, the Commission investigated 678 complaint referrals. Twenty-five of 30 complaint referrals tested resulted in an investigation assignment to an account examiner. The other five complaint referrals did not result in an assignment issued. Specifically:

- For all 25 complaint referrals for which investigation assignments were issued, the supporting documentation justified the results of the investigation.
- For all 25 complaint referrals for which investigation assignments were issued, the state office sent investigation instructions to the account examiner.
- For 28 (93 percent) of 30 complaint referrals tested, comments on the investigation were included in the tax system to support the disposition of the investigation. For 2 (7 percent) complaint referrals, auditors could not verify that comments existed.
- For 27 (90 percent) of 30 complaint referrals tested, the investigation results in the tax system were consistent with the investigation results in the complaint referral database. For 2 (7 percent) complaint referrals, there was not any information in the tax system. For one complaint
referral, there was not enough information to determine whether the results were consistent.

- For 3 (10 percent) of 30 complaint referrals tested, the complaint referral database did not contain a resolution date, even though a resolution was documented.

The Commission has very limited procedures for addressing complaint referrals. Those procedures did not include sufficient details related to the recording, processing, and disposition of complaint referrals. The lack of detailed procedures can cause inconsistencies in the way Commission staff work and dispose of complaint referrals. According to the Commission, it is in the process of developing a comprehensive set of procedures.

**Recommendation**

The Commission should develop detailed procedures that fully address the recording, processing, and disposition of complaint referrals.

**Management’s Response**

*The Commission agrees with developing detailed procedures that fully address the recording, processing and disposition of complaint referrals. The Tax Department is currently drafting those procedures. Corrective action will be implemented by the Tax Director by December 31, 2011.*
Chapter 2-D

The Commission Identifies Unregistered Employers That Are Tax Liable and Employers That Incorrectly Report Wages

Blocked claim assignments and exception reports are effective in identifying employers that are subject to unemployment insurance tax that are not registered with the Commission (see text box for additional information). The Commission completed all 30 blocked claim assignments tested in a timely manner. The Commission’s tax system contained the required documentation, including the outcome of the investigation if applicable, for all 30 blocked claim assignments tested.

The Commission took appropriate action to ensure that employers were responsible for the accurate amount of unemployment insurance taxes. Specifically, of the 30 blocked claim assignments tested:

- Three (10 percent) resulted in a new account registration.
- Seventeen had adjustments identified during the investigation. The Commission’s tax system appropriately reflected the updated wage reports, adjustment reports, interest, and/or new registration for all 17 employer accounts.

In addition, the Commission completed 13,359 (99 percent) of 13,463 blocked claim assignments within the required time limits during fiscal year 2010 (see text box). The Houston and Dallas/Fort Worth regions had the largest number of assignments that were not completed in a timely manner. Specifically, Houston did not complete 25 claim assignments and Dallas/Fort Worth did not complete 44 claim assignments in a timely manner during fiscal year 2010. The Lubbock and East Central regions took the highest average number of days to complete a blocked claim assignments, with 13 calendar days and 7 calendar days, respectively.

The Commission may also identify unregistered employers during its quarterly and monthly comparisons of Commission data with data from the U.S. Internal Revenue Service, the Texas Office of the Secretary of State, and the Texas Office of the Comptroller of Public Accounts. However, the Commission does not have a methodology to track the newly registered employers that resulted from the data comparisons; the Commission does not retain a list of the courtesy letters it sends to inform employers of potential liability (see Appendix 3 for examples of the courtesy letters).
To monitor wage-reporting errors, the Commission asserted that it reviews 10 exception reports; three of which it identified as being key reports (see text box). The Commission resolved in a timely manner all 30 exceptions tested from those key reports.

**Recommendation**

The Commission should consider tracking the total number of unregistered employers identified by all internal monitoring processes.

**Management’s Response**

*The Commission considered the recommendation to track the number of all unregistered employers identified by all internal monitoring processes. The Commission has determined that it is not cost effective to track letters sent to entities that may not be liable for state unemployment tax. The Tax Department’s Mission Statement requires that staff “assist employers in complying with the Texas Unemployment Compensation Act (TUCA).” Sending letters to unregistered entities is one method to implement that mission. The Commission only establishes accounts for those organizations who meet the liability requirements under the TUCA. The Commission will continue to coordinate our outreach efforts with the Texas Secretary of State, the Comptroller of Public Accounts, the Internal Revenue Service and other similar organizations. Links to the TWC home page can be found on the Secretary of State, Comptroller of Public Accounts, the Department of Labor, and the IRS’ web sites as well as other web sites including Texas.gov.*
Chapter 3

The Data in the Commission’s Tax System Is Sufficiently Reliable; However, the Commission Should Strengthen Its Data Entry Controls and Its Complaint Referral Database

The Commission has effective general and application controls over its tax system, and the data in the tax system is sufficiently reliable for purposes of this report. However, the Commission should strengthen its controls over the entry of employer wage information related to tax audits into the tax system to help ensure continued accuracy.

In addition, the Commission should address weaknesses in the controls over its complaint referral database. Auditors determined that the database was not sufficiently reliable for the purposes of this report. Auditors used the complaint referral data to perform analytical and testing procedures using supporting documentation that the Commission provided.

Chapter 3-A

While the Commission’s Controls Are Operating as Intended, the Commission Should Ensure That Its Tax System Does Not Accept Amounts for Total Taxable Wages That Are Higher Than Total Wages Reported

Information technology (IT) controls over the Commission’s tax system and interfaced systems are operating as intended. An external auditor did not identify any significant weaknesses during a review of general controls and some application controls performed for the State of Texas Federal Portion of the Statewide Single Audit Report for the Fiscal Year Ended August 31, 2010 (State Auditor’s Office Report No. 11-318, February 2011). In addition, the Commission asserted that its staff reviewed the data entered into the tax system for completeness using information from independent sources, such as the U.S. Internal Revenue Service, the Texas Office of the Secretary of State, and the Texas Office of the Comptroller of Public Accounts.

The Commission’s input and process controls were adequate and effective to ensure that tax system data related to tax payments, wages, tax audit results, and delinquent employers was sufficiently reliable for the purposes of this report. In addition, the tax system generates a list of tax audit candidates that contains an equal number of stratified and random candidates.

However, the tax system allows the Commission’s account examiners to enter a total taxable wage amount that is higher than the total wages entered for tax audit purposes. The total taxable wage amount should be equal to or less than the total wage amount. The Commission uses the total taxable wage amount data to prepare its reports on quarterly tax audit activity statistics for the U.S. Department of Labor. If the tax system contains inaccurate wage information, this could result in the Commission reporting incorrect tax audit wage data to
the U.S. Department of Labor. Commission management stated that they rely on manual supervisory reviews of tax audit data entered into the tax system to identify this type of data entry error.

**Recommendation**

The Commission should implement input controls over its tax system to prevent account examiners from entering a total taxable wage amount that is higher than the total wages entered for tax audits.

**Management’s Response**

*The Commission agrees with this finding. AD&M Tax will add edits to the system that will prevent Account Examiners from entering any taxable wage amount that is greater than the total wage amount to the audit results screen. The target date for implementation is January 1, 2012. The person responsible for implementation is the Labor Law Manager for Applications Development and Maintenance.*

Chapter 3-B

**The Commission Should Strengthen Controls Over Its Complaint Referral Database**

The Commission uses a complaint referral database to monitor the complaints received from external and internal sources about employers that are subject to unemployment insurance taxes. Access controls sufficiently restrict access to the database to only those Commission employees whose job duties require access. However, auditors identified potentially significant weaknesses in the Commission’s application controls over the database, which was not sufficiently reliable for the purposes of this report. The database lacked (1) edit checks that would prevent the database from accepting impractical dates and (2) data in key fields. Auditors analyzed 678 complaint referrals entered into the complaint referral database from September 1, 2009, to August 31, 2010, and identified the following:

- Twenty- two complaint referrals contained a justification for resolution but not a resolution date.
- Twenty- four complaint referrals assigned for investigation did not contain any information about the investigation results.
- Two complaint referrals had resolution dates that were before the complaint receipt dates.
• Four complaint referrals did not contain any information in the assignment source field.

• Three complaint referrals did not contain any information in the complainant field.

The Commission did not perform supervisory reviews of the information entered into the complaint referral database and lacked detailed policies and procedures for the entry of complaint referral data. Commission management stated that the tax system is the Commission’s official record of complaint referrals, rather than the complaint referral database. However, Commission employees use the complaint referral database to produce reports for Commission management. If Commission management is provided inaccurate and/or incomplete complaint referral data, there is an increased risk that management will make decisions based on misleading information.

Auditors used the complaint referral database to perform analytical and testing procedures by using supporting documentation that the Commission provided for the complaint referral assignments tested (see Chapter 2 for more information).

Recommendations

The Commission should:

• Implement edit checks in its complaint referral database to prevent the database from accepting resolution dates that are prior to receipt dates and accepting no data in key fields.

• Perform periodic reviews of the data entered into the complaint referral database to identify and correct errors to ensure completeness and accuracy of data.

Management’s Response

The Commission has reviewed and analyzed how the complaint database is used. The Tax Department has decided to discontinue entering assignment results in the database. Effective January 1, 2012 the database will only be used to record receipt of complaints and documentation of assignments issued or not issued. All assignment results will be recorded and maintained on the TWC mainframe via the FTA screen. All management reports will be generated based on information entered into the mainframe. This change will give the agency a more comprehensive file of investigation results and flexibility in management reports. Corrective action will be implemented by the Tax Director by December 31, 2011.
Appendices

Appendix 1

Objective, Scope, and Methodology

Objective

The objective of this audit was to determine whether the Texas Workforce Commission (Commission) has effective processes and related controls to verify whether entities that are subject to unemployment insurance tax make proper tax payments.

Scope

The scope of this audit included unemployment insurance tax payments made in the fourth quarter (October through December) of calendar year 2010 and the Commission’s unemployment insurance tax monitoring functions from September 2008 through March 2011. Our work also included automated systems and processes in those areas.

Methodology

The audit methodology included collecting information and documentation from the Commission; reviewing policies and procedures, statutes, and rules related to unemployment insurance tax; and analyzing and evaluating data and the results of tests. Specifically, auditors reviewed unemployment insurance tax payments, tax audits, abatements, complaint referral assignments, delinquent accounts, blocked claim assignments, and wage-reporting exception reports. Auditors also visited four regional/field tax offices in Austin, Houston, Dallas/Fort Worth, and Wichita Falls to test selected tax audit reports and supporting documentation.

Auditors assessed the reliability of the Commission’s unemployment insurance tax data in its automated tax system by interviewing Commission management knowledgeable of the data, performing electronic testing of key data elements, and reviewing work that the external auditor completed for the State of Texas Federal Portion of the Statewide Single Audit Report for the Fiscal Year Ended August 31, 2010 (State Auditor’s Office Report No. 11-318, February 2011). State auditors relied on the work completed by the external auditor. In addition, auditors gained data reliability assurance by reviewing certain application controls related to the input and processing of unemployment insurance tax payment, tax audit, and delinquency collection data in the tax system and interfaced systems. Auditors determined that the Commission’s unemployment insurance tax data from the tax system was sufficiently reliable for the purposes of this report.
Auditors also assessed the reliability of the complaint referral database and determined that the complaint referral data was not sufficiently reliable for the purposes of this report due to potentially significant weaknesses related to data entry controls. Specifically, the Commission lacked adequate edit checks preventing the database from accepting impractical dates and accepting no data in key fields. As a result, the database was incomplete and/or may contain inaccurate data. However, auditors were able to use the data to perform analytical and testing procedures by also using supporting documentation that the Commission provided for the complaint referral assignments tested.

**Information collected and reviewed** included the following:

- Policies and procedures for unemployment insurance tax payments, tax audits, and the collection of delinquent payments.

- Unemployment insurance tax payments, tax audits, abatements, complaint referral assignments, delinquent accounts, blocked claim assignments, and wage-reporting exception reports.

- Documentation maintained in the Commission’s automated tax system and interfaced systems.

- Commission tax audit reports and supporting documentation.

- Field tax payments receipts, State of Texas Financial Network (TEXNET) deposit reports, warrant reports, voluntary offset reports, journal request vouchers, and service agent documentation (magnetic media allocation lists) that supported tax payments tested.

- Tax department directory.

- Total number of employers in Texas.

- Refunds and credits the Commission made to employer accounts.

**Procedures and tests conducted** included the following:

- Interviewed management and key personnel at the Commission.

- Analyzed and tested unemployment insurance tax payments, completed tax audits, rejected tax audits, approved tax abatements, referral assignments, delinquent accounts, blocked claim assignments, and wage-reporting exception reports.

- Reviewed and tested compliance with Commission policies and procedures, the Texas Administrative Code, and the Texas Labor Code.

- Reviewed calendar year 2010 regional evaluation summaries.
- Verified the Commission’s calculation of its delinquent tax payment collection rate.

- Reviewed input controls and access rights for the complaint referral database (access database).

- Reviewed application controls (input and processing) over the Commission’s automated tax system and interfaced systems to assess the reliability of the data tested.

- Reviewed external auditors’ work papers on general and limited application controls over the tax system.

Criteria used included the following:

- Texas Labor Code, Chapter 201 (Texas Unemployment Compensation Act).

- Title 40, Texas Administrative Code, Chapter 815 (Unemployment Insurance).

- Commission policies and procedures including:
  - *Collections Manual.*
  - *Audit System Manual.*
  - *Status Procedures Manual.*
  - State office operations collections section procedures.
  - Exceptions procedures.
  - Depository data entry procedures.

- The Commission’s records retention schedule.

**Project Information**

Audit fieldwork was conducted from January 2011 through May 2011. We conducted this performance audit in accordance with 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 objective.
The following members of the State Auditor’s staff performed the audit:

- Michael Simon, MBA, CGAP (Project Manager)
- Kelley Ngaide, CFE (Assistant Project Manager)
- David Dowden
- Carl Ela, CGAP
- Kendra Shelton, MAC, CPA
- Lisa M. Thompson
- Charles P. Dunlap, Jr., CPA (Quality Control Reviewer)
- Angelica M. Ramirez, CPA (Audit Manager)
The Texas Workforce Commission (Commission) has six regions that include 31 field tax offices to monitor entities subject to unemployment insurance tax payments (see Figure 1). Additionally, the Commission’s state office is in Austin. Each region has a regional tax manager who oversees the operations of the field tax offices.

Source: The Commission created the map, and the State Auditor’s Office updated the map to show the field office locations as of May 2011.
Appendix 3

Examples of Courtesy Letters the Commission Sends to Entities That May Be Liable for Unemployment Taxes

The Texas Workforce Commission (Commission) may identify unregistered employers using data from the U.S. Internal Revenue Service, the Texas Office of the Secretary of State, and the Texas Office of the Comptroller of Public Accounts. Below are examples of the three types of courtesy letters that the Commission sends to inform employers of potential liability.

To Employers Identified Using U.S. Internal Revenue Service Data

Based on authorization granted by federal law in Section 6103(d) of the Internal Revenue Code, this agency has been informed that you recently filed for a federal identification number with the Internal Revenue Service. If you employ workers in Texas, you may be liable for the payment of state unemployment taxes. This letter is to advise you of your potential liability and if possible, help you avoid penalties and interest for the late payment of taxes. Registration for a federal identification number is a primary indicator an organization has or will have employees. The Texas unemployment Compensation Act requires Texas employers to register with this Agency for unemployment insurance purposes.

You must register within 10 days if you:

a. Pay wages to one or more workers in Texas (this includes corporate officers and contract labor)

b. Pay wages to domestic or agricultural workers in Texas (including migrant or seasonal workers)

c. Acquire a previously owned business

d. Operate in more than one state and have employees in Texas

e. Change your organizational structure (e.g. Sole Owner to a Corporation)

DO NOT register if:

a. You are registered with the Commission. (Enter your account number and correct federal identification number in the spaces provided above.)

b. You have not paid any wages in Texas. (If you intend to pay wages in the future, please register after your first payment.)

c. Your organization is a Church

You may register online and obtain your account number immediately at http://tchosts.tw.state.tx.us/TAXB (). You may also download a registration form, Status Report (E-1), at this site. If you need assistance in registering, please contact the nearest Texas Workforce Commission Tax Office listed on the back of this letter.

Status Report
Tax Department
To Employers Identified Using Texas Office of the Secretary of State Data

TAX DEPARTMENT
STATUS SECTION
TEXAS WORKFORCE COMMISSION
101 East 15th Street
AUSTIN, TX 78778

TEXAS WORKFORCE COMMISSION
Austin, Texas 78778

If you employ workers in Texas, you may be liable for the payment of state unemployment taxes. In our continuing efforts to keep Texas employers informed, we are contacting anyone who recently registered with the Secretary of State.

This letter is to advise you of your potential liability and if possible, help you avoid penalties and interest for the late payment of taxes. Registration with the Secretary of State indicates an organization may have employees. The Texas Unemployment Compensation Act requires Texas employers to register with this Agency for unemployment insurance purposes.

You must register within 10 days if you:

a. Pay wages to one or more workers in Texas (this includes corporate officers and contract labor)
b. Pay wages to domestic or agricultural workers in Texas (including migrant or seasonal workers)
c. Acquire a previously owned business
d. Operate in more than one state and have employees in Texas
e. Change your organizational structure (e.g. Sole Owner to a Corporation)

DO NOT register if:

a. You have not paid any wages in Texas. (If you intend to pay wages in the future, please register after your first payment.)
b. Your organization is a Church

You may register online and obtain your account number immediately at http://m06hostp.twc.state.tx.us/TAXREG/. You may also download a registration form, Status Report (C-1), at this site. If you need assistance in registering, please contact the nearest Texas Workforce Commission Tax Office listed on the back of this letter.

Status Section
Tax Department
Enclosure

Equal Employment Opportunity Employer
To Employers Identified Using Texas Office of the Comptroller of Public Accounts Data

If you employ workers in Texas, you may be liable for the payment of state unemployment taxes. In our continuing efforts to keep Texas employers informed, we are contacting anyone who recently registered with the Comptroller of Public Accounts.

This letter is to advise you of your potential liability and if possible, help you avoid penalties and interest for the late payment of taxes. Registration with the Comptroller indicates an organization may have employees. The Texas Unemployment Compensation Act requires Texas employers to register with this Agency for unemployment insurance purposes.

You must register within 10 days if you:

a. Pay wages to one or more workers in Texas (this includes corporate officers and contract labor)
b. Pay wages to domestic or agricultural workers in Texas (including migrant or seasonal workers)
c. Acquire a previously owned business
d. Operate in more than one state and have employees in Texas
e. Change your organizational structure (e.g. Sole Owner to a Corporation)

DO NOT register if:

a. You are already registered with the Commission. (Enter your account number and correct federal identification number in the in the spaces provided above and return this letter in the envelope provided.)
b. You have not paid any wages in Texas. (If you intend to pay wages in the future, please register after your first payment.)
c. Your organization is a Church

You may register online and obtain your account number immediately at http://m6hostp.twc.state.tx.us/TAXREG/. You may also download a registration form, Status Report (S-1), at this site. If you need assistance in registering, please contact the nearest Texas Workforce Commission Tax Office listed on the back of this letter.

Status Section
Tax Department
Enclosure

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The Honorable Harvey Hilderbran, House Ways and Means Committee

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The Honorable Rick Perry, Governor

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