The Florida Senate

Interim Project Report 2003-113 *January 2003*

Committee on Commerce and Economic Opportunities Senator James E. "Jim" King, Jr., President

ADMINISTRATION OF THE UNEMPLOYMENT COMPENSATION PROGRAM

SUMMARY

The Unemployment Compensation Law (ch. 443, F.S.) has not been revised to reflect the transfer in 2000 of the Unemployment Compensation (UC) Program from the former Department of Labor and Employment Security to the Agency for Workforce Innovation (AWI). In addition, the UC law contains erroneous, obsolete, and archaic provisions, leading to the gradual deterioration of the law's text during its 65-year history.

When the UC program was transferred to AWI, the Legislature required the Department of Revenue (DOR) to provide unemployment tax collection services under contract with AWI, but did not, however, specify which functions of the UC program were "unemployment tax collection services." The Legislature also directed a feasibility study be conducted on the privatization of those tax collection services. Due to interpretations of federal policies by the U.S. Department of Labor prohibiting the privatization of most unemployment tax collection services performed by DOR, it appears unlikely these services could be privatized. In addition, DOR has identified some fiscal and administrative challenges in collecting unemployment taxes under contract with AWI.

Committee staff recommends the UC law be revised to reflect the current organization of the state for administration of the UC program. As part of this revision, committee staff recommends the erroneous, obsolete, and archaic provisions of the law be corrected or updated. Committee staff also recommends the UC law be revised to clarify which functions of the UC program are unemployment tax collection services. Further, committee staff recommends that the Legislature determine whether the interagency contract will remain the permanent method for assigning powers and duties for those tax collection services to the Department of Revenue and, if the contract remains the permanent method, that the fiscal and administrative challenges identified by DOR be addressed to guarantee the enduring performance of the tax collection functions of the UC program.

BACKGROUND

The Workforce Innovation Act of 2000[1] transferred administration of the state's Unemployment Compensation (UC) Program from the Division of Unemployment Compensation of the former Department of Labor and Employment Security to a new state agency created by the act — the Agency for Workforce Innovation (AWI). The transfer was enacted as a one-paragraph provision,[2] which transferred the UC program effective October 1, 2000, by a type-two transfer.[3] The legislation did not, however, replace the corresponding references throughout the Florida Statutes from the Division of Unemployment Compensation to AWI.

Included within this one-paragraph provision, the 2000 legislation required AWI to enter into a contract with the Department of Revenue (DOR) by January 1, 2001, under which DOR would provide "unemployment tax collection services."[4] This provision also directed the Legislature's Office of Program Policy Analysis and Government Accountability to conduct a feasibility study beginning January 1, 2002, regarding the privatization of unemployment tax collection services and to report its conclusions to the Governor and the Legislature.[5] The legislation, however, did not specify

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[1] Chapter 2000-165, L.O.F.
[2] Section 11(4)(f), ch. 2000-165, L.O.F.
[3] Section 20.06(2), F.S., defines a type-two transfer as the:
> merging into another agency or department of an existing agency or department or a program, activity, or function thereof or, if certain identifiable units or subunits, programs, activities, or functions are removed from the existing agency or department, or are abolished, it is the merging into an agency or department of the existing agency or department with the certain identifiable units or subunits, programs, activities, or functions removed therefrom or abolished.

[4] Section 11(4)(f), ch. 2000-165, L.O.F.; s. 443.1316, F.S.
[5] *Id.*

which functions of the UC program were considered tax collection services.

Before its transfer to AWI, the Division of Unemployment Compensation was composed of three bureaus: a Bureau of Tax, a Bureau of Claims Administration, and a Bureau of Appeals. The Bureau of Tax was responsible for determining employer liability for unemployment taxes, collecting taxes and wage reports, and auditing employer wage records. The Bureau of Claims Administration oversaw the processing of claims for unemployment benefits, paid benefits to qualified claimants, issued determinations of claims involving questions of eligibility for benefits, and detected fraudulent claims. The Bureau of Appeals was responsible for conducting administrative hearings of appeals from determinations of claims for benefits and appeals from determinations of employer tax liability.

During the 2002 Regular Session, the Legislature abolished the Department of Labor and Employment Security and transferred the department's remaining divisions, functions, and responsibilities to other executive branch agencies.[6] In addition, the legislation clarified that AWI is the designated agency for administering federal grants and other funds of the UC program.[7] The legislation also specified that AWI's Office of Workforce Services is responsible for administering the UC program.[8] Despite these clarifications, obsolete references to the Division of Unemployment Compensation and the Department of Labor and Employment Security remain throughout the state's Unemployment Compensation Law (ch. 443, F.S.).

Florida's Unemployment Compensation Program and the National Unemployment Insurance System

Florida's UC program was created by the Legislature in 1937 as part of the national unemployment insurance (UI) system.[9] The national UI system was established as a direct result of the high unemployment experienced during the Great Depression of the 1930s. The UI system is a federal-state program, authorized by both the Social Security Act of 1935 and the Wagner-Peyser Act. The Federal Unemployment Tax Act of 1939 (FUTA) later amended the program and governs it today. The UI system's primary objectives are: (1) to give workers temporary and partial insurance against income loss resulting from unemployment and (2) to assist the countercyclical stabilization of the economy during recessions by maintaining workers' purchasing power. Florida's first unemployment benefits were paid to eligible workers in 1939.

To fund the national system, the Federal Government charges each liable employer a federal unemployment tax of 6.2 percent on the first $7,000 of each employee's wages. Because Florida's program meets federal requirements, the state's employers are eligible for up to a 5.4-percent tax credit, making the net federal tax rate 0.8 percent. The federal tax is used primarily to finance state and federal unemployment program administration and to provide loans to states with insolvent unemployment trust funds.

Administrative Resource Grants and the Resource Justification Model

From the funds generated by the federal unemployment tax, each year the U.S. Department of Labor (USDOL) provides Florida with administrative resource grants used to fund the operations of the state's UC program. To determine each state's share of the administrative resource grants, USDOL uses the Resource Justification Model (a budget formulation and allocation system) to annually allocate to each state a base grant for the federal fiscal year, plus a state may additionally earn contingency grants throughout the year.

Florida received administrative resource grants totaling almost $78.3 million for federal fiscal year 2000-2001, of which about $66.5 million was allocated as the base grant. For federal fiscal year 2001-2002, Florida's grants totaled approximately $73.1 million, nearly $64.8 million of which was allocated as the base grant. According to the Agency for Workforce Innovation, USDOL advised that Florida's base grant for federal fiscal year 2002-2003 is $60.4 million. These funds finance the processing of claims for benefits by AWI, state unemployment tax collections performed by DOR, appeals conducted by AWI and the Unemployment Appeals Commission, and related administrative functions.

Contract for Unemployment Tax Collection Services

The Agency for Workforce Innovation and the Department of Revenue began negotiations on the initial contract for unemployment tax collection services after the Governor approved the Workforce Innovation Act in May 2000. Although the legislation

[6] Chapter 2002-194, L.O.F.
[7] Section 20.50(3)(j), F.S.
[8] Section 20.50(2)(a), F.S.
[9] *See* ch. 18402, L.O.F. (1937).

required the agencies to enter into the initial contract by January 1, 2001, AWI and DOR accelerated the implementation and approved the first annual contract beginning October 1, 2000. Because the legislation did not specify which functions of the former Division of Unemployment Compensation were "unemployment tax collection services," the contract necessarily had to enumerate the functions to be performed by DOR. In consultation with the Governor's office, the agencies agreed that DOR's tax collection services would roughly encompass the duties previously performed by the Bureau of Tax of the former Division of Unemployment Compensation.

The initial contract specified that the unemployment tax collection services performed by DOR included: registering employers, processing and data entry of employer tax and wage reports, determining employer tax liability, annually determining and assigning employer tax rates, performing tax collection and enforcement activities, and maintaining employer accounts. Although the department makes the initial determination of employer tax liability, the contract allowed an employer to appeal a determination to AWI for final agency action. The initial contract also required DOR to conduct certain investigations, including investigation of claimant wages, and to perform audits of employer accounts. The terms of the 2000-2001 contract specifying which unemployment tax collection services were initially assigned to DOR remained substantially unchanged in the subsequent 2001-2002 and 2002-2003 contracts.

Each of the contracts provided that DOR receives monthly reimbursement for its costs incurred under the contract. The initial 2000-2001 contract limited reimbursements to approximately $20.9 million, of which DOR submitted charges for $17.7 million in costs. The 2001-2002 contract[10] reduced the reimbursement limit to approximately $19 million, of which the department submitted charges for almost $18.7 million. Although the 2001-2002 contract expired on September 30, 2002, the agencies extended the contract for 60 days in order to continue negotiation of the 2002-2003 contract. The 2002-2003 contract[11] limits DOR's reimbursements to approximately $19.1 million, of which about $3.3 million was charged for costs incurred during the 60-day extension of the 2001-2002 contract.

[10] *Interagency Agreement with the Agency for Workforce Innovation and the Florida Department of Revenue* (Oct. 1, 2001 – Sept. 30, 2002).
[11] The 2002-2003 contract is effective for the period beginning December 1, 2002, and ending September 30, 2003.

The Department of Revenue has not created a separate office within the department to collect unemployment taxes, but has integrated these services within the administrative structure of the General Tax Administration (GTA) Program. The GTA program comprises other tax functions, including responsibility for collecting the corporate income tax, the sales and use tax, the communications services tax, and the fuel tax.

METHODOLOGY

During the 2002-2003 interim, both the Senate and the House of Representatives assigned parallel interim projects concerning the UC law. The objective of this Senate interim project was to review the UC law, as well as any related statutes, in order to ensure that the statutory provisions reflect the current agency framework for administration of the UC program and to identify obsolete or erroneous provisions. Similarly, the objective of the House interim project was to update, remove anachronistic language, and generally "clean up" the UC law. To simultaneously achieve the objectives of both interim projects, committee staff worked cooperatively with the staff of the House Committee on Workforce and Technical Skills.

An informal workgroup was organized to examine each provision of the UC law, as well as other statutes affecting the UC program. Composed of staff from the Agency for Workforce Innovation, the Department of Revenue, the Unemployment Appeals Commission, and legislative staff, the workgroup conducted more than 10 meetings, comprising more than 25 hours, reviewing line-by-line each provision of the UC law.

To identify the statutory changes needed to conform the UC law to the current agency framework, and to update archaic provisions, committee staff prepared draft revisions to the UC law. Although the workgroup did not issue formal recommendations, the workgroup examined these draft revisions in order for committee staff to draw upon the combined expertise of the workgroup's membership and to provide committee staff with technical assistance in reviewing the UC law. In addition, committee staff consistently furnished recognized organizations in the business community with notices of the workgroup's meetings, together with copies of the draft revisions, to maximize public input.

In addition to participating in the workgroup, committee staff conducted interviews with staff from

the Agency for Workforce Innovation and staff from the Department of Revenue concerning the interagency contract for unemployment tax collection services, meeting independently with each agency's staff to identify any statutory changes needed to guarantee the enduring performance of the tax collection functions of the UC program.

FINDINGS

The UC law does not reflect the current organization of the state for administration of the UC program.

Despite the transfer of the UC program to the Agency for Workforce Innovation (AWI) in 2000, the present text of the UC law (ch. 443, F.S.) assigns the current powers and duties of the UC program to the Division of Unemployment Compensation, appearing throughout the UC law as the "division."[12] In March 2002, the Auditor General published a report recommending the Legislature amend the UC law to accurately reflect AWI's oversight responsibility for the UC program.[13]

In addition, although the UC law requires the Department of Revenue (DOR) to provide unemployment tax collection services under contract with AWI, the UC law does not specify which functions of the UC program are tax collection services. Each of the functions performed by DOR under the current contract with AWI is assigned to the "division" in the present text of the UC law. Because the Workforce Innovation Act transferred the division to AWI, these functions were also transferred. Accordingly, an inspection of the UC law does not provide notice to the public whether a function is performed by either the Agency for Workforce Innovation or the Department of Revenue.

The Department of Revenue has identified some fiscal and administrative challenges of the contract with the Agency for Workforce Innovation.

A review by the Legislature's Office of Program Policy Analysis and Government Accountability (OPPAGA) demonstrates that the Department of Revenue has streamlined the collection of unemployment taxes since it assumed responsibility for this function; that federal and state performance measures confirm unemployment tax collections have generally improved under the department's administration; and that, compared to the tax collection functions of the former Division of Unemployment Compensation, the integration of unemployment tax collection services into DOR's General Tax Administration Program has reduced the number of full-time equivalent positions performing these services by 30 percent and has achieved a substantial cost savings of at least $6 million per year.[14] An interview with DOR's staff, however, revealed the department has identified some fiscal and administrative challenges in providing unemployment tax collection services under contract with the Agency for Workforce Innovation. These challenges include DOR's inability to recover its indirect costs, its lack of rulemaking authority, and its lack of authority to enforce AWI's rules.

On November 26, 2002, the Governor and Cabinet, as head of the Department of Revenue, approved the department's 2003 proposed legislative concepts. These concepts include a proposal allowing DOR to recover its overhead and other indirect costs associated with performing unemployment tax collection services under contract with AWI. Under current law, in any contract between state agencies, the agency receiving contract or grant moneys may "charge no more than 5 percent of the total cost of the contract or grant for overhead or indirect costs or any other costs not required for the payment of direct costs."[15] The department reports it expended approximately $18.7 million under its 2001-2002 contract with AWI, of which DOR expended $889,000 on indirect costs.

Using an indirect cost allocation plan to spread these costs, DOR apportions its indirect costs among the department's programs, including the General Tax Administration Program, the Child Support Enforcement Program, and the Property Tax Administration Program. Because DOR may not charge more than 5 percent of its contract with AWI for overhead or indirect costs, the UC program's share of costs under the department's indirect cost allocation plan exceeding 5 percent of the contact must be redistributed to other programs throughout the department. An analysis prepared by DOR reveals the department redistributed $2.2 million of the UC program's share of indirect costs which could not be recovered from the 2001-2002 contracted funds. Accordingly, DOR explains it supported the contracted funds provided by the federal administrative resource

[12] *See* s. 443.036(15), F.S.

[13] Auditor General, *Agency for Workforce Innovation, Department of Labor and Employment Security, Unemployment Compensation System, Information Technology Audit,* Report No. 02-176, 3 (Mar. 2002), *available at* http://www.state.fl.us/audgen/pages/pdf_files/02-176.pdf.

[14] OPPAGA, *Federal Law Restricts Outsourcing of Many Unemployment Compensation Tax Collection Services,* Preliminary Report (Dec. 2002).

[15] Section 216.346, F.S.

grants with state monies from the General Revenue Fund.

The Department of Revenue proposes the Legislature amend the law to allow the department to recover its overhead and other indirect costs. To avoid DOR's expenditure of state monies to support unemployment tax collections, however, it is unclear to what extent the contracted funds provided by AWI would need to be increased to cover DOR's indirect costs, thereby reducing the amount of federal administrative grants available to fund other administrative functions of the UC program performed by AWI and the Unemployment Appeals Commission.

In order to adopt rules implementing the UC law, the Administrative Procedure Act (ch. 120, F.S.) requires both a grant of rulemaking authority and an enabling statute granting specific powers and duties.[16] The Workforce Innovation Act transferred to AWI the Division of Unemployment Compensation's authority to adopt rules implementing the UC law.[17] Although the UC law requires AWI to contract with DOR for unemployment tax collection services, the UC law assigns all of its powers and duties to AWI and does not grant rulemaking authority to DOR. Accordingly, only AWI may currently adopt rules for the UC program.

The Department of Revenue explains that its lack of rulemaking authority creates an obstacle to full integration of unemployment tax collection services with the collection of other taxes enforced by DOR's General Tax Administration Program, including the corporate income tax, the sales and use tax, the communications services tax, and the fuel tax. For example, in order to require a business entity to file a dual-use form, soliciting tax information for the corporate income tax together with unemployment wage and tax information, the department must have rulemaking authority for both aspects of the form.[18] Because DOR lacks rulemaking authority for unemployment tax forms, current law limits the department's legal authority to integrate forms.

In February 2002, the Agency for Workforce Innovation received a list of objections from the Legislature's Joint Administrative Procedures Committee (JAPC) to a series of proposed rules implementing the UC law. These objections, raised under JAPC's authority in the Administrative Procedure Act[19] to review proposed rules, questioned AWI's authority to adopt rules assigning responsibilities to the Department of Revenue. More specifically, the objections question AWI's authority to adopt rules allowing DOR to prescribe unemployment tax forms or require employers to submit wage reports or other employment information, or to adopt rules delegating AWI's authority to DOR for making any determination or decision affecting an employer's substantial interests under the UC law. Accordingly, in addition to DOR's lack of rulemaking authority, JAPC's objections raise the question of whether DOR has legal authority to enforce AWI's rules while providing unemployment tax collection services, even if authority is conveyed in the contract with AWI.

The U.S. Department of Labor's interpretations of federal policies prohibit privatization of most unemployment tax collection services.

The Workforce Innovation Act did not specify whether the Legislature intended an interagency contract to be the permanent — or only a temporary — method for assigning powers and duties to the Department of Revenue for unemployment tax collection services. However, the legislation directed the Office of Program Policy Analysis and Government Accountability (OPPAGA), beginning January 1, 2002, to conduct a feasibility study regarding the privatization of those tax collection services.

In December 2000, the U.S. Department of Labor (USDOL) issued a program letter[20] addressing inquiries by states concerning the outsourcing of the administrative functions of state UC programs. The

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[16] *See* s. 120.536(1), F.S., and the flush-left provisions of s. 120.52(8), F.S.:

> A grant of rulemaking authority is necessary but not sufficient to allow an agency to adopt a rule; a specific law to be implemented is also required. An agency may adopt only rules that implement or interpret the specific powers and duties granted by the enabling statute. No agency shall have authority to adopt a rule only because it is reasonably related to the purpose of the enabling legislation and is not arbitrary and capricious or is within the agency's class of powers and duties, nor shall an agency have the authority to implement statutory provisions setting forth general legislative intent or policy. Statutory language granting rulemaking authority or generally describing the powers and functions of an agency shall be construed to extend no further than implementing or interpreting the specific powers and duties conferred by the same statute.

[17] *See* s. 443.171(2)(a), F.S.

[18] The definition of a "rule" under the Administrative Procedure Act includes "any form which imposes any requirement or solicits any information not specifically required by statute or by an existing rule" (s. 120.52(15), F.S.).

[19] Section 120.545, F.S.

[20] U.S. Department of Labor, *Outsourcing of Unemployment Compensation Administrative Functions, Unemployment Insurance Program Letter No. 12-01* (Dec. 28, 2000), *available at* http://www.ows.doleta.gov/dmstree/uipl/uipl2k1/uipl_1201.htm.

program letter interprets various federal laws and regulations and provides states with policy guidance for administering their UC programs. The program letter specifies that a state may not outsource (i.e., privatize) a function of its UC program considered an "inherently governmental function"; rather, an inherently governmental function must be carried out by merit-staffed governmental employees (i.e., state employees).

Citing policies of the U.S. Office of Management and Budget,[21] USDOL's program letter interprets the collection of unemployment taxes, the determination of employer tax liability and tax rates, and the assessment of penalties and interest to be inherently governmental functions that may not be outsourced, but which must be carried out by merit-staffed governmental employees. The program letter specifies, however, that financial auditing and the collection of delinquent taxes determined to be uncollectible by a state agency are commercial activities that may be outsourced.

Because the bulk of the unemployment tax collection services performed by the Department of Revenue, including the determination of employer tax liability and the assignment of employer tax rates, are found on USDOL's proscribed list of functions that may not be outsourced, it appears clear these services could not be privatized under current federal policies.

Although OPPAGA's feasibility study had not been submitted to the Governor and the Legislature when this interim project report was published, an interview with OPPAGA's staff revealed its report[22] was near to being submitted and the report's conclusions would concur with the finding that USDOL's program letter prohibits privatization of most unemployment tax collection services provided by DOR.

The UC law includes erroneous, obsolete, and archaic provisions.

First enacted in 1937, the UC law has been amended numerous times during its 65-year history. For example, s. 443.036, F.S., which provides the chapter's definitions, has been amended more than 60 times. The UC law's age and the frequency of amendments have led to the gradual deterioration of the law's text, yielding a chapter replete with erroneous, obsolete, and archaic provisions.

Ongoing changes over time in grammar and usage of the English language have eroded the meaning of some provisions of the UC law, causing these provisions to become archaic. Further, as the Legislature has amended the UC law, many provisions were enacted as temporary, delayed, or phased in as permanent over time. These amendments have left obsolete historical references throughout the UC law, creating complicated provisions that are difficult to understand.

Nonspecific cross-references (e.g., "herein," "hereto," "hereof," "hereunder," and "hereinabove") are used in several provisions of the UC law in lieu of cross-references to discrete subdivisions of the Florida Statutes, thereby obscuring the law's meaning. In addition, because the UC law has been amended over time, various provisions use inconsistent terms, potentially leading to confusion. For example, the terms "employment record," "experience-rating record," and "employer's account" have the same meaning in s. 443.131, F.S.

Due to rapid advancements in information technology, the UC law no longer reflects the current procedures and practices used to administer the UC program involving computers, the Internet, electronic record keeping, and data storage. The UC law also refers to the employment offices of the former Department of Labor and Employment Security and has not been updated to recognize the state's workforce system, including the one-stop career centers operated by the regional workforce boards under direction from Workforce Florida, Inc.

RECOMMENDATIONS

Committee staff recommends the Unemployment Compensation Law (ch. 443, F.S.), as well as any related statutes, be revised to reflect the transfer in 2000 of the Unemployment Compensation (UC) Program to the Agency for Workforce Innovation (AWI). As part of this revision, committee staff recommends the erroneous, obsolete, and archaic provisions of the law also be corrected or updated.

Because the UC law does not specify which functions of the UC program are "unemployment tax collection services" to be performed by the Department of Revenue (DOR) under contract with AWI, committee

[21] U.S. Office of Management and Budget, Executive Office of the President, *OMB Circular No. A-76 (Revised),* 48 Fed. Reg. 37110 (Aug, 16, 1983), 64 Fed. Reg. 33927 (June 24, 1999), *available at* http://www.ows.doleta.gov/dmstree/uipl/uipl2k1/uipl_1201a1.htm; U.S. Office of Federal Procurement Policy, Office of Management and Budget, *OFFP Policy Letter No. 92-1,* 57 Fed. Reg. 45096 (Sept. 30, 1992), *available at* http://www.ows.doleta.gov/dmstree/uipl/uipl2k1/uipl_1201a2.htm.

[22] OPPAGA, *supra* note 14.

staff recommends the UC law be revised to clarify which functions are tax collection services.

Further, because it is unclear whether the interagency contract was intended to be the permanent — or only a temporary — method for assigning powers and duties to the department for unemployment tax collection services, and because it appears most of these services cannot be privatized under current federal policies, committee staff recommends the Legislature clarify whether the contract will remain the permanent method for assigning these powers and duties.

Finally, if the Legislature determines the interagency contract remains the permanent method, committee staff recommends the fiscal and administrative challenges identified by DOR be addressed to guarantee the enduring performance of the tax collection functions of the UC program.