THE FAST LANE AND UNEMPLOYMENT DRAIN

> In this world nothing can be said to be certain, except death and taxes.
>
> \- Benjamin Franklin

BY SHELDON ALTSHULER, ARM

BEN FRANKLIN WAS MAN OF MANY TALENTS – a scientist, legislator, diplomat, swimming hall of fame member (believe it or not) and, of course, one of the Founding Fathers and as such, an originator of public entity leadership.

It is a convincing argument as well that he was America's original risk manager, employing risk management, mitigation and financing techniques before it was a crucial component of any entity or enterprise.

While we can all agree that death is a sad certainty, taxes do not have to necessarily be an unavoidable fate. As it relates to public entities, certain statutory taxes can indeed can be avoided allowing for favorable financial outcomes that lend support to public entity budgetary mandates and demands in a time of ever-increasing service demands and scope of mission.

In fairness to Ben Franklin, a clear legal allowance for the circumvention of tax may not have existed during his lifetime and this cost reduction option, available only to 501(c)3 entities, including public entities, is linked directly to the statutory State Unemployment Insurance system (established 150 years after Franklin's own inevitable death). Success in realizing the hard financial savings of this option are entirely dependent on employing successful risk management techniques.

RISK MANAGEMENT'S IMPACT ON UNEMPLOYMENT COST

Within the customary structure of the State Unemployment Insurance system—entities pay unemployment taxes prior to any claims, at a potentially inflated rate, that are generally based on payroll and prior year unemployment activity. The funds go to the state's unemployment compensation pool to pay benefits on all statewide employees. Rates are based on a combination of the overall risk of the unemployment pool and an individual employer's experience—with factors outside of an entities control leading to increased program costs (state borrowing, subsidizing other employers, surcharges etc.). Any balance remaining in an entity's account is happily assumed by the state as their surplus and to pay for any non-related poor performers in the unemployment pool. On top of this, many states have borrowed from the feds to fund any negative stress to the pool—essentially a punitive tax on all tax paying entities regardless of their individual outcomes.

However, the weighted punitive nature of the state Unemployment Insurance Tax can be avoided by public entities who elect to become a "reimbursing employer." A reimbursing employer (or opt-out) is

a public entity that pays the state only for its own unemployment claims, dollar-for-dollar, thereby potentially reducing their unemployment costs if their claims experience is lower than what they are paying into the state system. Recent studies have shown that entities pay $2 for every $1 in benefits payable. Opting out of the tax system cuts that inflated burden in half.

So the reward is there for an entity who wishes to opt out and file as a reimbursable employer—a likely 50 percent reduction in cost as it relates to this budget line-item. But where there is reward, there is ultimately risk.

Reimbursing entities face potential financial risk should benefits paid to separated (terminated, laid-off, seasonal or reduction in force) personnel exceed what their tax rate would have been. Loss of funding for services, outsourcing of job functions, or poor hiring practices all impact outcomes. But these triggers that ultimately impact cost can be well managed through some of the key risk management practices: identification, assessment, and control.

IDENTIFY THE RISK: What is your cost? The hard numbers come from the state agency responsible for unemployment insurance and may be provided with various form headings (Experience Tax Rate or Contribution Rate Notice being the most common). All these forms, no matter the issuing state, will provide you with a tax rate percent that when applied to your state specific wage base will give you the hard dollar cost for your unemployment tax burden.

For example, an employee making $35,000 in New Jersey will "only" be taxed on the state specific wage base of ($33,700—again state specific as states have varying wage bases)—if the tax rate is assigned at 3 percent, the ultimate cost burden for this employee would be $1,011. If your entity has 500 employees with income near or at the wage base, the total tax burden would be around $500,000 annually.

ASSESS AND ANALYZE: What are the actual outcomes? How many claims does your entity assume a year for unemployment benefits? What is the hard cost of those claims? Remember that your tax rate does not necessarily reflect your specific outcomes as additional tax burdens and rate formulas are applied to maintain the solvency of any given state systems.

Looking at our New Jersey entity, it is entirely plausible that their total benefits paid would have been half of the total tax bill of $500,000. Determining the exact number of claims paid over a historical basis and aligning their direct benefit charges is essential in calculating the opportunity (or exposure) that opting out of the state tax system offers. The tax rate notices should provide some basis for this review including prior year benefit charges but ultimately state supplied data can be lacking (and erroneous). A depository for this information should be any given entity's human resource department (or sometimes finance) who should have detail on claims filed and outcome detail.

The end-goal of the analysis should focus on the following—does my tax burden exceed my claims payment? Is there a strong degree of certainty that past results have consistently been maintained under the tax burden? And, is there a basis for the assumption that future claim counts and benefits will mirror historical outcomes?

Digging deeper into the outcomes is essential—what is causing claims? Is the public entity doing what they need to avoid claims or achieve a better win ratio for filed claims? Is the public entity aware of any changes in budgetary funding that can lead to increased claims? The numbers tell volumes, but understanding what drives those numbers past, present and future is critical.

CONTROL: Whether or not an entity chooses to pursue an opt-out/reimbursing employer status, a prudent entity's risk management team should assure that the unemployment process is managed and outcomes reviewed in order to maximize the reduction of these cost burdens.

It is necessary for the HR department to align with risk management to achieve these goals and is a partnership that both groups play integral functions. The more significant control strategies include:

Clearly defining employee expectations

Does your entity have detailed job descriptions? An updated employee handbook with clearly defined policies? Do employees sign off job descriptions, policies and handbook? While these endeavors typically fall under the domain of the human resource department, risk management would be well served to conduct audits in partnership with HR to assure that best practices are implemented and that all personnel related documents are in place, utilized and meet statutory expectations.

Facts, Facts and more facts

Every entity will have an unemployment claim (or many more!). The reduction of that financial exposure will rely on providing the documentation to support an argument that benefits should be denied. This includes written proof of the employee's acknowledgement of policies, reports of unsatisfactory work or misconduct, and documentation of all warnings or discipline that occurred, whether verbal or written. The more facts, the better and any documentation directed toward employee performance should allow for an acknowledgement of receipt, review and understanding by that employee.

Review Human Resource Practices

The intent of the State Unemployment Insurance system is inherently noble - to help workers who are out of a job. Those clearly protected under the various state specific statutes are employees who suffer layoffs, workforce reduction, and seasonal lulls. And rightly so.

In conjunction with a public entity's human resource department, risk management should review outcomes for trends—with an eye on causation—is there unwarranted hiring based on budget realities? How are pending reductions in grants or the loss of funding sources communicated in advance of hiring or firing? Is there adequate representation at hearings to assure that claims that should be denied are denied? Who is responsible for responding to claims? Is that response timely? Each of these queries needs to be clearly vetted.

Returning to Ben Franklin's words of wisdom, we may find that his assertion of death and taxes is partially correct, but we can agree that a "Penny saved is a penny earned." Employing risk management techniques to the ownership—financially and procedurally—of the public entity unemployment tax burden can indeed lead to a positive financial outcomes. ■

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