

## EMPLOYMENT SECURITY MANUAL

### (ETA Audit Policy)

#### THE FIELD AUDIT FUNCTION

**3670** Objectives of a Field Audit Program. A comprehensive field audit program is vital to administration of a State unemployment compensation system. A well-planned and cost effective field audit program, executed in coordination with central office activities and other unemployment insurance field undertakings, is an efficient means of ensuring compliance with State Unemployment Compensation law and timely collection of taxes on an equitable basis.

**3671** Definitions.

- Field Audit. A field audit, as the term is used herein, is a systematic examination of a subject employer's books and records, using generally accepted auditing standards and procedures, covering a specified period of time during which the employer is liable for reporting under the law. An effective audit will accomplish the following:
- A. Determine the taxable amounts of payments made by an employer for personal services and the contributions paid or payable on such amounts;
  - B. Reconcile audit findings with amounts the employer has reported to the State agency, if any;
  - C. Determine any interest, and/or penalties due under the State employment security law;
  - D. Determine, if necessary, the employer's financial ability to meet UC tax obligations; and
  - E. Provide a cost effective method of promoting employers understanding of employer rights and responsibilities under State unemployment law.
  - F. In addition, an audit as defined must meet the following minimum requirements:
    - 1. Cover a minimum four calendar quarters (except as noted in 3675 A).
    - 2. Verify the business entity as a sole proprietor, partnership, corporation, joint venture, or other.
    - 3. Document records examined and evidence obtained in tests used to verify payroll procedure, accuracy, and completeness.
    - 4. Document records examined and the evidence obtained in the search for misclassified workers and payments.
    - 5. Closeout conference with the employer or a designated representative. If closeout not possible, explain in report.
    - 6. Include a written report stating all facts contributing to or supporting final determination.

**Change Audit.** An audit resulting in the discovery of wages or taxes not previously reported or reported incorrectly by the employer.

**Conclusion.** An expression in the audit report of the auditor's opinion regarding the employer's compliance with State UI laws.

**Employer/Designated representative.** The owner, general partner, corporation officer/any employee or other individual with written authorization to access and make available all employment records.

**Evidence.** The data and information an auditor obtains during an audit that has a bearing on findings and supports conclusions and determinations.

**Findings.** A logical pulling together of information to arrive at conclusions about matters which were analyzed or evaluated (e.g., a response to a test of transactions). Findings will be the basis for the auditor's conclusion(s).

**Reconciliation.** Comparing two or more items and identifying and resolving any differences.

**Source Document.** A record of initial activity or transaction. Examples of source documents include time cards, cancelled checks/stubs, cash vouchers, purchase/sales records.

**Test of Transaction.** A procedure used by an auditor to test the reliability of evidence supporting findings and conclusions affecting employer compliance with State UC laws, regulations and policy. Included are tests to authenticate payroll systems from source documents to accounting records, and through to employer contribution reports.

**Tolerance.** A schedule of monetary deviation from a standard established by the State for auditor guidance in determining the need and scope of an extension. Tolerance definitions may be based on a percentage of taxable payroll or contributions. Variances may be allowed for size of payroll and/or tax rate. If the auditor elects to disregard the tolerance, the decision should be explained in the audit report.

**Work Paper.** Document prepared or obtained by the auditor on the performance of an audit. Included in work papers are analyses, transcriptions, letters, memos, and confirmation results related to compliance with UI laws. Work papers serve as the basis of the work performed, and support the auditor's conclusion. Upon review of work paper(s), a reviewer can determine the quality of work performed.

**3675** **Scope of Audits.** The scope of an audit is the number of quarters examined.

**A.** **Audit Period.** Audits should cover a minimum of four (4) consecutive quarters for which reports have been submitted by the employer, except registered (active) or out of business (inactive) employers who at the time of the audit have operated less than four quarters. It is acceptable to audit quarters for which estimates, assessments, final assessments or jeopardy assessments have been made.

It is not necessary for each audit to cover the entire period of liability, the entire period since the last audit, or the statute of limitations.

**B.** **Extending the Audit.** If a sample of quarters audited produces amounts over the tolerances

established by the States, the audit scope should be extended as necessary to account for all payments for personal services. In any case, the audit should not be extended beyond the statute of limitations, or the period covered by a prior audit unless State law provides otherwise.

- C. Finality. If a money deficiency is established during an audit, the auditor should initiate collection procedures. Collection at time of audit is desirable.

**3677** Subject Employer Audit Penetration. The number of audits to be conducted each fiscal year (FY) should represent a percentage of subject contributory employers at the end of the immediately preceding fiscal year. Example: The audit count for FY 1988 will be based on the number of contributory subject employers as of September 30, 1987.

Refer to the "desired level of achievement" (DLA) in the UI Quality Appraisal System for the percentage (penetration rate) of employers to be audited during a fiscal year. Exclude reimbursable and governmental entities from the universe of employers to be audited.

**3679** Selection of Employers for Audit. States are encouraged to maintain audit selection criteria that include indices that potentially reflect noncompliance such as high employee turnover, sudden growth or decrease in employment, type of industry, location (geography) of employers, prior reporting history, results of prior audit and adjudicated determinations.

To ensure that all employers are included in the audit selection process, at least 10% of audit assignments must be randomly selected from the total universe of contributory employers.

To assure inclusion of large employers in the audit program, 1% of total audits required to meet the audit DLA must be large employers. All States must include at least one large employer in their annual audit program. Large employer is defined as an employing unit reporting wages paid to 100 or more individuals during the current or preceding calendar year or an employing unit reporting at least one million dollar (\$1,000,000) in taxable payroll for the calendar year preceding the first quarter being audited. Either term of definition may be used in selecting large employers as long as each large employer audit can be identified and verified by number of employees or size of payroll.

Assignments issued to resolve report and money delinquency, blocked claims, and status assignments should not be routinely converted or expanded to audits. If circumstances indicate problems or conditions not apparent when the assignment was made, then expansion of the assignment to include an audit may be warranted.

Field collections incident to delinquent employer contacts or collections made at the time of initial employer registration (status assignments) in the field are not audit performance measurements. Such collections are not to be counted as audit yield.

**3683** Field Audit Manual. To effectively administer its field audit program, each State must maintain a current Manual of Field Audit Procedures. The manual should cover the following procedures:

1. Assignment preparation
2. Setting up audit appointments
3. Pre-audit discussion with employer or a designated representative
4. Steps in conducting the audit

5. Closeout discussion with employer or an employer's authorized representative.
6. Instructions for preparing the Field Audit Report

**3687** Contents of an Audit Report. A completed change and no-change audit will be documented by a written record which contains work papers presenting evidence and supporting findings and conclusions. The audit findings will be explained and be in accordance with the specific requirements of State law, administrative rules and procedures. All audit reports should contain sufficient information to show:

- How existence of the business was verified
- How ownership, was verified
- Name, title, and telephone number of the individual with whom the purpose of the audit was discussed prior to the audit; when employer designates a representative record name, title and telephone number of the employer and the designee
- Name, title, and telephone number of the individual with whom a closeout meeting was held; when employer designates a representative record name, title and telephone number of employer and the designee
- What payroll record tests were performed and what evidence was gathered to verify the accuracy and completeness of payroll, including, but not limited to:
  - A. Verification of payroll posting system
  - B. Reconciliation of total payroll to total wages
  - C. Computation of total taxable payroll
  - D. Reconciliation of verified total taxable payroll to total taxable wages
- What other employer records were examined and what evidence was gathered to search for misclassified workers and hidden wages, including, but not limited to:
  - A. Examination of contract labor records
  - B. Examination of cash disbursements
  - C. Examination of detailed general ledger/chart of accounts
  - D. Examination of miscellaneous account reports and records
- What reason was given for the number of quarters audited (if more or less than four quarters)
- That necessary adjustment forms were completed with the audit
- That all monies due were collected, and if not an explanation provided

**3689** Control of Field Audit Assignments.

The central or district office should maintain a numeric control file of field audit assignments. The control file should be automated to the extent possible, show the date issued, the tax office or individual to whom assigned and the date completed. The control file should be monitored to insure audit assignments are completed timely.

If an auditor conducting a status assignment, delinquency control, benefit wage verification or other non-audit assignment, determines an audit is essential to resolve an issue or to complete an investigation, the four quarter minimum scope requirement should be complied with. Justification for the decision to audit must be included in both the audit report and report of the assignment.

Selection of audit assignments should:

1. not be left to the discretion of the individual auditor;
2. be made from either the district tax office or central office;
3. be automated and capable of selecting accounts for audit on a periodic basis, assigning to local
  - A. If the employer was sent a pre-audit letter which requested specific documents, the letter may document what records are requested.
  - B. If the cash disbursement records are requested, but not available or are available but not examined, an explanation is necessary.
  - C. If 1099's are available but not examined, an explanation is necessary.
4. Name and telephone number of the employer and/or a designated representative with whom the purpose of the audit was discussed prior to the audit.

Audit report should record one of the following:

- A. If the employer is involved in discussion, record name and title.
  - B. If the employer designated a representative, record the name and title of the employer who designated the representative and also record the name and title of the designated representative.
5. Name and telephone number of the employer and/or designated representative with whom a closeout meeting was held.

Audit Report should record the following:

- A. If the same information is included in the previous question, the work paper(s) could refer to that specific question as "same as question # X".
- B. If another partner or corporate officer other than identified in the pre-audit meeting is involved in the closeout meeting, record name and title.
- C. If another partner or corporate officer other than identified in the pre-audit meeting has selected a designated representative to attend the closeout meeting, the auditor should record the name and title of the employer who designated the representative and also record the name and title of the designated representative.

6. What employer records other than payroll were examined for hidden wages.
- A. The documentation to show the search for hidden wages is shown in section IV of this document.

7. What reason was given for the number of quarters audited (if more or less than four quarters.)

Audit report should record the following:

- A. If less than four quarters a reason needs to be given.

8. That necessary adjustment forms were completed with the audit.

Audit Report should record the following:

- A. If prepared manually, a copy of the adjustment forms should be included in the completed audit file.

- B. If computer assisted, a printout of the adjustments should be included in the completed audit file.

9. That all monies due were collected, and if not an explanation provided.

Audit Report should record the following:

- A. If the auditor collected the balance due and the transaction is recorded in the audit, no additional documentation is necessary.

- B. If the auditor does not collect the balance due, an explanation as to why not should be documented.