Attachment B

John Hickenlooper
Governor

Ellen Golombek
Executive Director

DEPARTMENT OF LABOR AND EMPLOYMENT

OFFICE OF THE EXECUTIVE DIRECTOR

633 17TH Street, Suite 1200
Denver, Colorado 80202-2117

February 7, 2011

Honorable Senator Lois Tochtrop, Chair
Legislative Audit Committee
200 East 14th Avenue
Denver, CO 80203-2211

Dear Senator Tochtrop,

Please find the attached response to the Legislative Audit Committee request for an update on implementation of the recommendations from the June 2010 audit of Colorado's Unemployment Insurance Trust Fund. The department is preparing to present this report and answer your questions at the Legislative Audit Committee meeting on February 15th.

Our staff worked diligently with the audit team from your office during the course of the audit and they continue working towards creating solutions to ensure Colorado's Trust Fund will be able to meet the needs of Colorado citizens. We are grateful for your efforts and the analysis provided by the State Auditor's Office and look forward to our opportunity to discuss with the Committee the progress that has been made as well as the many challenges that lie ahead. Please let us know if there are any other specific questions that the Committee would like to see addressed.

Sincerely,

(Sent electronically)

Ellen Golombek
Executive Director

2010 Colorado Unemployment Insurance Trust Fund Summary Report

This report summarizes the present financial status of the Colorado Unemployment Insurance trust fund, briefly addresses some issues related to the fund's financing structure raised in the recent review of the trust fund conducted by the Office of the State Auditor (OSA), and presents fund forecasts that incorporate various remedial measures designed to bolster fund solvency.

Current Fund Status. The unemployment insurance trust fund balance stood at $46.6 million as of December 31, 2009, a decline of nearly $571 million from the prior December. The fund became insolvent mid-January 2010 at which time the Department began paying unemployment insurance benefits with monies borrowed from the Federal Unemployment Account (FUA). Through June 30 advances from the FUA totaled $333.8 million with a principal repayment of $160 million made in May resulting in a June 30 fund balance of roughly $193.8 million.[1] At $129.3 million, borrowing for the third quarter fell from the second quarter's amount of $147.6 million bringing total outstanding federal advances to $303.1 million by September 30. Under low growth economic conditions and absent any changes to the fund's financing mechanisms, the Department currently forecasts that the fund will reach a maximum deficit of about $800 million by early 2012 and will not consistently regain solvency until mid-2015.[2]

During 2009, unemployment insurance contributions paid by non-reimbursable Colorado employers totaled $334.7 million. Employer contributions were higher the prior year when they were $392.8 million. At this time we expect employer contributions to rise to about $430 million for 2010. Additionally, because of the declining fund balance in 2009 interest earnings on fund reserves fell to $16.1 million last year, down almost half from the $31.0 million earned in calendar year 2008. The fund's negative balance throughout 2010 means that interest earnings will be negligible this year.

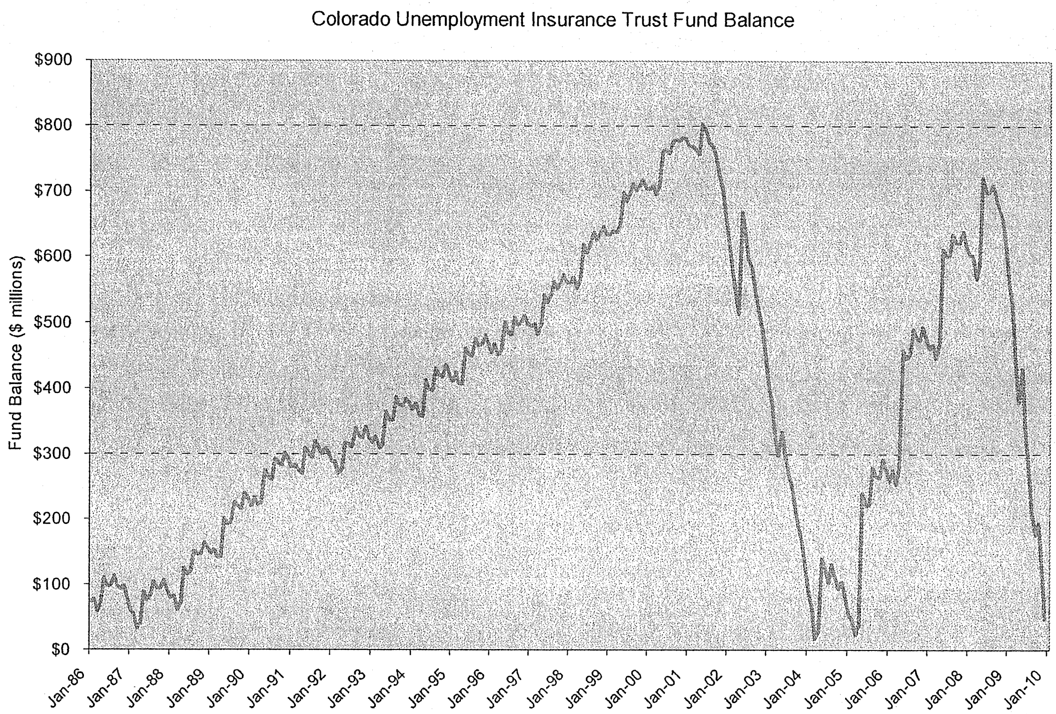
Benefits paid out under the State UI program more than doubled in 2009. After remaining relatively stable from 2005 to 2007, fund payouts to eligible claimants climbed from $407.5 million in 2008 to about $1.1 billion in 2009. The Department anticipates that benefit payments will moderate only slightly in 2010.

The trust fund balance peaked at $721.3 million in May 2008 during this economic cycle. The decline in the fund balance since mid-2008 is not surprising given the forward-financing aspect of the UI system and its counter-cyclical nature. During times of vigorous economic growth, such as that seen in Colorado from 1992-1999, more money is paid into the system than flows out in benefits thereby expanding the fund's assets. The opposite occurs in periods of economic contraction; slow or negative job growth leads to a drop in fund revenues while higher unemployment rates mean more is paid out in benefits. The fund thus accumulates reserves during periods of economic prosperity in

[1] The official fund balance reported to USDOL as of June 30 was about minus $20 million which excludes the net amount borrowed from the Federal Unemployment Account.

[2] Under more optimistic economic assumptions fund solvency would be restored as early as 2013.

order to have the means available with which to pay benefits when economic conditions deteriorate. The following chart makes clear how rapidly fund reserves can be depleted during economic slumps.[3]



The trust fund last became insolvent in 1982 as a result of the harsh back-to-back recessions that gripped the nation at that time. Solvency was not consistently regained until 1985. During this period about $222 million in principal was borrowed from the FUA and an additional $15 million was repaid in interest. It is worth noting that although the fund remained narrowly solvent in the aftermath of the 2001 recession, it did so only as a result of a special distribution to the State's trust fund of $142.7 million in federal Reed Act Funds-- without the distribution, the fund would have entered insolvency in late 2003 or early 2004.[4]

Solvency Considerations. A basic principle of unemployment insurance financing is that expected income should equal expected expenditures over the long-term.[5] This implies that the fund's tax structure should be designed in such a way that the trust fund develops neither persistently large positive nor negative balances for long periods. Because no objective insurable standard for potential benefit liability exists, however, it

[3] More than thirty states have obtained advances from the federal government in order to pay unemployment benefits thus far in this cycle. Total state borrowing currently exceeds $40 billion and USDOL projects that as many as forty states may end up borrowing a total of $90 billion by 2013.
[4] The distribution was made in April 2002. The fund reached a precariously low balance of $8 million early April 2004, an amount sufficient to pay benefits for several days at that time.
[5] This means that the average premium rate must equal the average benefit cost rate over the long-run.

is not possible to develop measures that definitively determine whether the system will have a tendency either toward under- or over-financing.[6]

The notion that premiums should be structured so as to allow assets to build up sufficiently during economic expansions in order to pay benefits during contractions without resorting to borrowing is referred to as forward-financing. The alternative is deficit-financing, in which borrowing becomes an integral part of the system's structure and is used as a means of covering liabilities. Forward-financing is generally considered preferable because of the borrowing costs associated with deficit financing. A desirable and challenging objective of any UI system is to maintain employer tax rates as low as possible while at the same time building a large enough reserve fund to cover future claimant liabilities. Low rates may lead the fund into insolvency during recession while high rates could cause the accumulation of excessive reserves.

Evaluation of the three common solvency measures described in the OSA trust fund audit illustrates the vulnerability of a preferred-forward financing UI benefit regime to deep and protracted economic slumps. Using December 2007 as the starting date for the recession in conjunction with CDLE's current low forecast suggesting a maximum deficit of around $800 million during this cycle implies that a December 2007 fund balance of around $1.4 billion would have been large enough to avert insolvency (the actual balance was about $617 million).[7] This level of $1.4 billion corresponds to a reserve ratio of around 1.7 percent. The Department's 2003 study of the fund's tax structure had demonstrated that 1.4 percent would have been adequate to prevent borrowing during the 2001 recession while research based upon the experience of the downturns of the early 1980s had recommended adoption of a 1.6 percent standard. The differences here are small and a reasonable approach might be to simply average the three results and adopt a 1.6 percent solvency standard.

Establishing a solvency standard via the average high cost multiple (AHCM) method generates much different results. The AHCM is predicated upon annual benefit cost rates-- the OSA report noted that USDOL guidelines call for an AHCM at the beginning of a downturn of 1.0. The fund's actual AHCM at year-end 2007 was 0.94 or only slightly below the recommended level of 1.0.[8] This would suggest a desired December 2007 fund balance of $656 million, an amount which would have been completely inadequate in forestalling insolvency.

Using the high-cost multiple (HCM) method produces one outcome very close to that of the reserve ratio method. As opposed to the AHCM which is predicated upon the three highest annual benefit cost rates of the past 20 years, the HCM utilizes only the single

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[6] The determination of potential liability over the long-term will stem from forecasts of the duration, frequency and severity of economic downturns.

[7] The reserve ratio or adequacy ratio is the fund balance divided by the annual total wages for private non-reimbursable employers covered by the Colorado Employment Security Act.

[8] OSA incorrectly reported the fund's AHCM for 2007 to be 0.67. The HCM and AHCM figures represent the number of years that the fund can pay benefits given a fixed burn rate—thus, an AHCM of 1.0 means the fund can pay benefits for twelve months at some constant benefit cost rate absent the inflow of any additional revenues to the fund over that period.

highest benefit cost rate in the State's history. The fund's HCM as of December 2007 stood at 0.59, well below USDOL's guidelines which call for a HCM at the beginning of a downturn of between 1.5 and 3.0. A high-cost multiple of 1.5 is consistent with a fund balance of roughly $1.6 billion as of December 2007 while the 3.0 standard implies a necessary fund balance of nearly $3.2 billion. The 1.5 HCM metric therefore yields a result quite similar to that of the 1.6 percent reserve ratio measure (i.e., $1.6 billion compared with $1.4 billion).

Each of the three solvency measures has its shortcomings. The high-cost measurements are sensitive to benefit cost rates which climb during recessions. The average high-cost multiple, which considers the state's benefit payment occurrences over the most recent twenty years, appears particularly vulnerable to understating adequate solvency levels during recessions more punishing than those outside of recent experience.

Audit Recommendations. In its evaluation of the trust fund's current financing structure, the OSA noted the same weaknesses that the Department had identified in its 2003 study—namely, a maximum wage base that has failed to keep up with average earnings in Colorado; a tax schedule that has long been outdated; and a maximum employer premium rate that is too low and which results in substantial ineffective employer benefit charging. Moreover, the OSA observed that the 20 percent employer tax credit becomes effective at a trigger level that bears little relation to actual fund solvency. We briefly consider each of these in turn.

In Colorado, employer UI premiums are assessed on the first $10,000 of a covered employee's wages—this $10,000 threshold is referred to as the maximum taxable wage base. When the wage base was last raised to its current level in 1988, average annual earnings for covered private sector workers in the State was about $21,000 so that the taxable wage base represented about 47 percent of annual wages. With today's average earnings for private covered workers at roughly $46,000, in order to achieve parity with the 1988 wage base today's taxable wage base should be $22,000. As we will see in the following section, increasing the wage base to this level may, by itself, move the fund very close to a fully solvent position by 2015 even under low-growth conditions. We also evaluate how a much more gradual increase in the wage base to $11,000 in 2012 and rising to $14,000 by 2015 would impact the fund.

The present tax table contains twelve premium rate schedules that link employer premium rates to the trust fund balance. Currently, premium rates move to their minimum levels when the trust fund balance on June 30 of a given year exceeds $450 million. This minimum rate level, which was increased from $350 million in 1991, was considered the level at which the fund would have been fully solvent at that time utilizing a 1.6 percent reserve ratio standard. We saw earlier that the Department's current low forecast suggests that fund reserves of approximately $1.4 billion as of December 2007 might be just sufficient to stave off borrowing during this economic cycle and that this amount corresponds to a reserve ratio of about 1.6 percent. This means that minimum employer premium rates should take hold only once the fund balance reaches $1.4 billion rather than the $450 million level at which minimum rates now become effective. In the subsequent section we summarize the impact to the fund that might result from modifying the premium schedules to account for such changes.[9]

Federal statutes governing UI financing require that employers with the lowest experience-rating have a base premium rate of at least 5.4 percent. The OSA audit noted that 37 states had maximum rates greater than 5.4 percent in 2009 although Colorado's maximum premium rate has never exceeded this minimum. Last year, Colorado employers subject to the maximum rate of 5.4 percent had about $96 million in benefits charged against them while paying into the trust fund just over $17 million in premiums.

The difference between the amount of benefits charged against a firm and the amount it pays in premiums is referred to as an ineffective charge. Some ineffective charging is generally unavoidable since there is no reason for benefit charges and contributions to be equal, particularly over short time periods. Because benefit claims are paid from the trust fund regardless of how much an individual firm pays into the fund in way of contributions, those employers with significant and persistent amounts of ineffective charges are essentially being subsidized by other employers with less benefit charging.

A premium rate of about 30 percent would have been necessary in order to eliminate ineffective charging for maximum rated employers in 2009. A more modest increase to 8 percent would expand fund reserves by about $26 million annually while reducing the amount of ineffective charging and cross-subsidization of firms. We incorporate an 8 percent maximum premium rate into the forecasts to get an idea of what the potential impact to fund solvency might be.

Lastly, we look at the 20 percent employer premium credit that is activated when the fund's reserve ratio equals or exceeds 1.1 percent. The credit, which became effective a decade ago, triggered on in 2001 and 2002 and reduced fund reserves by around $52 million at that time. Assuming a solvency standard of 1.6 percent, there is no reason for the credit to trigger on at a solvency level lower than this. We therefore use a 1.6 percent threshold in evaluating what such an increase might have upon fund solvency.

Forecasts. In late February each year the Department typically prepares several fund forecasts predicated upon low, moderate, and high growth economic scenarios. The forecasts, which are continually monitored and adjusted throughout the year, are intended to provide guidelines for the path of the fund as well as UI program workloads over a five-year forecast horizon. The forecasts can thus be a useful tool in shaping decisions related to UI program management and staffing as well as trust fund policy and fiscal analysis.

Unlike previous economic slumps, the recession which officially ended June 2009 appears likely to have severe and long-lasting impacts upon state and national labor

[9] For simplicity, we evaluated the impact of what might happen to fund reserves if all fund intervals contained in the rate schedules were increased by a factor of three. Minimum premium rates would then trigger on at a fund balance of $1.35 million, just less than the $1.4 million need for a 1.6 percent adequacy standard. The difference here has only a minimal effect upon the forecasts.

markets. Consequently, many economists believe that national unemployment levels will remain well above pre-recession rates through at least 2014.[10] Because Colorado's economic performance is tied so closely to the nation's, we have used the Department's low forecast for 2011-15 throughout this report.[11]

The low growth scenario is predicated upon a gradual and slow recovery in employment growth. We assume nonfarm payrolls will decline 1.5 percent this year and remain flat in 2011 before progressively climbing to 2.5 percent by 2014. Wage gains are forecast to stay subdued through 2013 before rising to 3.0 percent or greater by 2014 while unemployment is expected to remain above trend until 2014.[12] Under these conditions, and assuming no changes to the system's financing structure, the fund balance is forecast to fall to a maximum deficit of $800 million during first quarter 2012 before gradually improving and regaining solvency by mid-2015. The combination of slow job growth and relatively high unemployment is expected to cause benefit payments to continue at elevated levels through 2011 before moderating significantly beginning 2012. Average employer premium rates for the five-year period 2011-15 will be 0.88 percent while the average benefit cost rate over this period is anticipated to be 0.73 percent.[13] In this scenario, the June 2015 fund balance is projected to be $250 million and the fund's reserve ratio would be 0.27 percent, far short of the desired 1.6 percent suggested standard. The solvency surcharge remains on through 2015 in this forecast while the 20 percent premium credit for employers never triggers on.

Modifying the tax schedules that relate premium rates to the fund balance has no impact should the wage base stay at $10,000 through 2015. Increasing the maximum base premium from 5.4 percent to 8 percent increases fund reserves to about $340 million by June 2015. Thus, under a status quo financing structure, the fund appears unlikely to approach recommended solvency levels by the end of the forecast horizon.

Although the Department does not recommend such action, it is instructive to see how an increase in the taxable wage base to $22,000 beginning 2012 would affect fund solvency. Assuming no other statutory changes the impact is almost immediate—the fund becomes

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[10] Indeed, while forecasters have generally grown increasingly dubious about the likelihood of back-to-back slumps, several have noted the possibility that labor markets will not recover until 2017 or so.

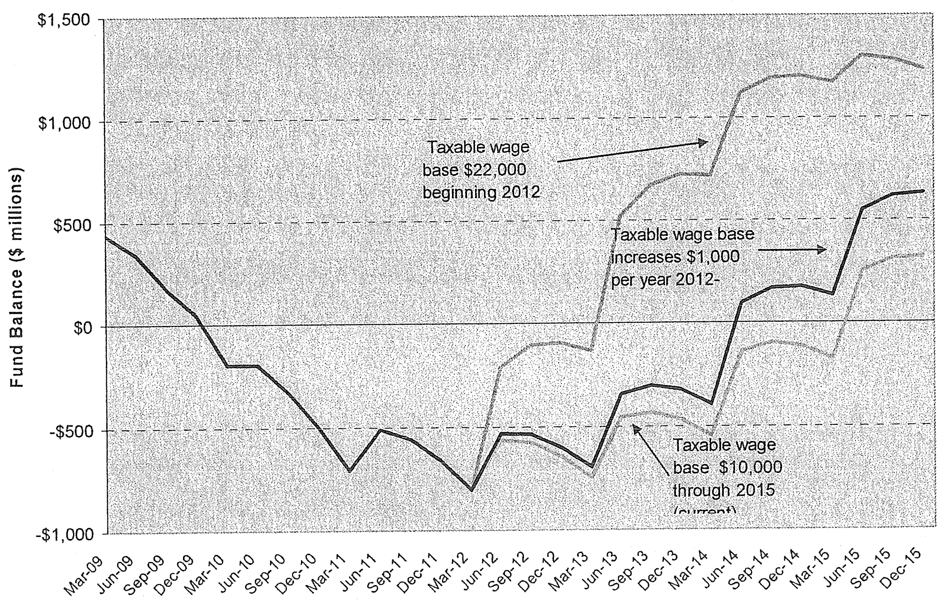
[11] Fund forecasts based upon moderate and high growth conditions are available but seem less likely to prevail over the short-term. The low growth forecast presents the most conservative outlook for the fund although this is not intended to be a worst-case scenario. We examined each of the 24 possible forecast combinations that include the various changes to the wage base, rate schedules, maximum rate, and employer tax credit but we discuss only several of these.

[12] The low growth model assumptions are generally similar to those used by Colorado Legislative Council although the Department's low growth scenario contains less optimistic expectations for job gains over the next two years.

[13] The average tax rate is expected total revenues divided by expected total private wages while the average benefit cost rate is expected benefit payments divided by expected total private wages. For comparison purposes, the average premium rate for the twenty-year period 1991-2010 was 0.44 percent and the average benefit cost rate was 0.57 percent; the average premium rate 1980-99 was 0.58 percent while the average benefit cost rate was 0.56 percent. We noted earlier that a successful forward-financing scheme requires that average premium rates equal average benefit cost rates over a long time horizon.

solvent by mid-2013 and the balance grows to $1.3 billion by June 2015 and reaches a reserve ratio of 1.4 percent, close to the recommended 1.6 percent adequacy level. The solvency surcharge triggers off in 2015 while the 20 percent premium credit triggers on resulting in a combined estimated net savings to employers of about $600 million in premiums in 2015. The average employer premium rate 2011-15 under these conditions would be 1.12 percent. If the 20 percent premium credit were raised from a 1.1 percent reserve ratio threshold to 1.6 percent, the credit would not become effective and the fund balance would rise to nearly $1.4 billion by June 2015.

UI Trust Fund Forecasts With Alternative Taxable Wage Bases



A more practical approach would seem to involve phasing in a gradual series of increases to the taxable wage base beginning 2012. For example, a 2012 wage base of $11,000 that expanded by $1,000 per year through 2015 would be less onerous for employers than a sharp increase to $22,000 while still improving the trust fund's solvency position. Modifying only the wage base in this manner is forecast to restore fund solvency by mid-2014, a full year earlier than occurs with the current wage base. By June 2015 fund reserves reach an estimated $550 million for a reserve ratio of 0.6 percent. The average premium rate 2011-15 would be 0.96 percent, only slightly higher than the average rate under the status quo outlook but well below that prevailing with a $22,000 wage base. Unlike an increase to a $22,000 wage base, however, the solvency surcharge continues to stay on for the entire forecast period and the 20 percent employer premium credit never takes effect. By including the modification to the rate schedules in conjunction with an increase in the maximum premium rate to 8 percent fund solvency is further enhanced—the fund balance grows to $660 million by June 2015 and the reserve ratio increases to

0.7 percent. The average employer premium rate under these circumstances is 1.0 percent, only slightly higher than the rate with just the gradual increase in the wage base.

Interest Fees. Federal statutes governing advances to state UI trust funds require that interest payable on FUA borrowing be repaid from funds other than employer premiums. The Colorado Employment Security Act (8-77-103) describes which firms are subject to repayment and how the interest charge shall be assessed. It is plausible that congressional action may extend federal interest-free borrowing by states into 2011; however, the Department is currently developing processes for billing, collecting, and repaying interest on the assumption that interest will be charged to states with outstanding loans beginning January 1, 2011.

Based upon information available at the end of August, the Department believes that about 87,390 businesses or roughly 58 percent of all establishments, including reimbursable or group-rated accounts such as state and local government and non-profit organizations, will be exempt from any interest repayment charges because they have had no benefit charging. The share of total wages for these firms is only about 10 percent of all wages paid by private sector Colorado employers which mean they are, for the most part, very small firms.

An additional 25,255 firms, or just fewer than 17 percent of the total, would be exempt because their percent of excess is 7 percent or greater. These are somewhat larger firms as their share of total wages is about 30 percent.

Thus, about three-quarters of all employers, the majority of them very small in terms of payroll, will likely be exempt from the interest repayment charge. Making some crude simplifying assumptions about quarterly wages for those subject to repayment along with a rough forecast of the total interest due September 2011 results in an estimated interest charge on those employers subject to repayment of about 0.00073or 0.07 percent at this time.[14] The precise assessment will be calculated in May 2011 when the amount of interest due on the first repayment as well as total wages for firms subject to interest repayment will be available.

Recommendations. The Department believes that adoption of a 1.6 percent solvency standard is reasonable. With no remedial modifications to the fund's current tax structure, the fund is forecast to remain insolvent through 2015 under conditions of a subpar economic rebound. Adjusting the rate schedules, the premium credit trigger, and the maximum premium rate have only minor positive impacts to fund solvency in the absence of changes to the taxable wage base. Regardless of whatever wage base or premium rate schedules are ultimately decided upon, it is important to understand that holding these fixed at any level means that over time both will again be insufficient to maintain fund solvency. We therefore suggest that both the wage base and rate schedule intervals be indexed in some way to the annual change in private sector earnings.

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[14] We use 4 percent as the annual interest rate charged by the U.S. Treasury in these estimates. The interest rate charged on federal borrowing is equal to the quarterly yield paid on state trust fund reserves, which was 3.9294 percent for the quarter ending 9/30/10.

A graduated increase in the wage base such as that described reduces the length of time the fund remains insolvent, lessens the amount borrowed from FUA, and eases the immediate tax burden on Colorado employers. Incorporating other changes, such bringing the rate schedules up-to-date with a 1.6 percent reserve ratio solvency standard and increasing the maximum base rate to 8 percent would further augment fund solvency. Although these changes still leave the trust fund short of fully meeting a 1.6 percent solvency standard by 2015, they are critical first steps toward restoring and maintaining the long-term solvency of the trust fund.

AUDIT RECOMMENDATION STATUS REPORT

AUDIT NAME: Evaluation of Unemployment Insurance Trust Fund
AUDIT NUMBER: 1993
DEPARTMENT/AGENCY/ENTITY: Department of Labor and Employment
DATE: June 2010

SUMMARY INFORMATION

Please complete the table below with summary information for all audit recommendations. ***For multi-part recommendations, list each part of the recommendation SEPARATELY.*** *(For example, if Recommendation 1 has three parts, list each part separately in the table.)*

Recommendation Number *(e.g., 1a, 1b, 2, etc.)*	**Agency's Response** *(i.e., agree, partially agree, disagree)*	**Original Implementation Date** *(as listed in the audit report)*	**Implementation Status** *(Implemented, Partially Implemented, or Not Implemented)* ** A recommendation that is in progress should be denoted as "partially implemented."*	**Revised Implementation Date** *(Complete only if agency is revising the original implementation date.)*
1	Agree	January 2011	Partially Implemented	April 2011
2a	Agree	January 2011	Implemented	
2b	Agree	January 2011	Partially Implemented	April 2011
3	Agree	January 2011	Partially Implemented	
4a	Agree	January 2011	Partially Implemented	April 2011
4b	Agree	January 2011	Partially Implemented	April 2011
4c	Agree	January 2011	Implemented	
5a	Agree	January 2011	Implemented	
5b	Agree	January 2011	Implemented	
5c	Agree	January 2011	Implemented	
5d	Agree	January 2011	Implemented	
6a	Agree	November 2010	Implemented	
6b	Agree	November 2010	Partially Implemented	April 2011
7	Agree	December 2010	Implemented	

DETAIL OF IMPLEMENTATION STATUS

Recommendation #1

Agency Addressed: Department of Labor and Employment

Recommendation Text in Audit Report: As part of a comprehensive assessment of the financing for the Unemployment Insurance (UI) Trust Fund, the Department of Labor and Employment should work with the General Assembly, the Governor's Office, and Colorado employers to evaluate options for raising the maximum chargeable wage base, including indexing the wage base to annual wages earned by Colorado employees and increasing the wage base in increments annually. Using the results of this evaluation, the Department should recommend to the General Assembly the option that best promotes the long-term solvency of the UI Trust Fund while minimizing, to the extent possible, financial hardships on employers.

Agency's Original Response: Agree.

Agency's Written Response in Audit Report: The Department agrees that an analysis of increasing the taxable wage base is needed as part of an overall analysis of unemployment insurance financing. As part of the Department's ongoing efforts to work with stakeholders, a formal study on the financing structure of the Unemployment Insurance Trust Fund will be initiated. This study will incorporate the recommendations contained within this audit as part of the analysis. Based on the analysis, the Department will recommend to the Governor's Office and General Assembly any needed adjustments to the wage base.

Agency's Current Comments on Implementation Status of Recommendation: Partially implemented. A department analysis has been done on the current position of the premium wage base and the effects of various alternative wage base levels. It is clear that some adjustments are required to adequately structure the revenue generating mechanisms. Work will continue with the above listed stakeholders and the incoming administration on evaluating the research and subsequently determine the official recommendations.

Recommendation #2

Agency Addressed: Department of Labor and Employment

Recommendation Text in Audit Report: As part of a comprehensive assessment of the financing for the Unemployment Insurance (UI) Trust Fund, the Department of Labor and Employment should work with the General Assembly, the Governor's Office, and Colorado employers to identify options for adjusting statutory base contribution rate schedules for the Unemployment Insurance Program to promote UI Trust Fund solvency. The Department should:

a. Assess options for raising the maximum base contribution rates set in statute, adjusting the reserve level triggers in the base contribution rate schedules, and changing the minimum trust fund reserve that qualifies eligible employers for a 20-percent credit on their base rate premium.
b. Use the results of the evaluation to recommend statutory changes to the General Assembly to increase the base contribution rates, as necessary.

Agency's Response: Agree

Agency's Written Response in Audit Report:

a. The Department agrees that an analysis of the base premium structure is needed as part of an overall analysis of unemployment insurance financing. As part of the Department's ongoing efforts to work with stakeholders, a formal study analyzing the financing structure of the Unemployment Insurance Trust Fund will be initiated. This study will use the recommendations contained within this audit as part of the analysis.
b. Based on the analysis, the Department will recommend to the Governor's Office and General Assembly any needed adjustments to the base contribution rates.

Agency's Comments on Implementation Status of Recommendation:

a. This recommendation has been implemented. The recent study by the department analyzed the triggers for base schedules and the 20-percent credit. The analysis indicates that adjustments to the current premium structure and premium credit are needed.

b. The department is currently working with the above stakeholders on potential strategies. The department will work with the incoming administration and the various stakeholders to finalize a recommendation for adjustments to the trust fund.

Recommendation #3

Agency Addressed: Department of Labor and Employment

Recommendation Text in Audit Report: As part of a comprehensive assessment of the financing for the Unemployment Insurance (UI) Trust Fund, the Department of Labor and Employment should work with the General Assembly, the Governor's Office, and Colorado employers to evaluate the best options for redesigning the solvency surcharge so that it serves as a short-term funding source for avoiding or delaying insolvency of the UI Trust Fund. Based on the evaluation, the Department should determine what adjustments to the solvency surcharge's rate structure will minimize the financial burden on employers and recommend statutory changes to the General Assembly, as necessary.

Agency's Response: Agree

Agency's Written Response in Audit Report: The Department agrees that the solvency surcharge was not intended to be a long-term financing mechanism. As such, the Department agrees that an analysis is needed on how the solvency surcharge should be restructured in conjunction with the overall funding system. As part of the Department's ongoing efforts to work with stakeholders, a formal study on the financing structure of the Unemployment Insurance Trust Fund will be initiated. This study will use the recommendations contained in this audit as part of the analysis. Based on the analysis, the Department will recommend to the Governor's Office and General Assembly any needed adjustments to the solvency surcharge.

Agency's Comments on Implementation Status of Recommendation: Partially implemented. The department has performed an analysis of the solvency surcharge as part of an analysis of the overall fund. The department will continue to work with the incoming administration, the General Assembly, and the various stakeholders to finalize potential recommendations for adjustments to the current structure.

Recommendation #4

Agency Addressed: Department of Labor and Employment

Recommendation Text in Audit Report: The Department of Labor and Employment should enhance the equity of base contribution rates assessed to employers under Colorado's Unemployment Insurance (UI) Program by:

a. Working with the General Assembly, the Governor's Office, and Colorado employers to identify options for minimizing subsidization of UI benefits. In conjunction with Recommendation No. 2, the Department should assess whether base contribution rates should be raised to minimize subsidization. The Department should also consider other alternatives, including automatically converting employers assessed the maximum base rate for three consecutive years to reimbursable employers or levying an additional surcharge on all employers with maximum base rates.

b. Recommending statutory changes, as necessary, to minimize future subsidization of UI benefits among employers.
c. Periodically assessing the level of subsidization occurring within the UI Program and the impacts that subsidization has on the equity of premiums paid by employers.

Agency's Response: Agree

Agency's Written Response in Audit Report:

a. While it is recognized that some subsidization is inherent in all insurance systems, the Department agrees that the level of subsidization needs to be analyzed and likely adjusted. As part of the Department's ongoing efforts to work with stakeholders, a formal study on the financing structure of the Unemployment Insurance Trust Fund will be initiated. This study will use the recommendations contained within this audit as part of the analysis.
b. Based on the analysis, the Department will recommend to the Governor's Office and General Assembly any needed adjustments to address subsidization.
c. The Department will include as part of the formal reporting process to be adopted in response to Recommendation No. 7, a portion devoted to analyzing employer subsidization.

Agency's Comments on Implementation Status of Recommendation:

a. Partially implemented. The department has analyzed potential scenarios for minimizing subsidization. Work with the various stakeholders is ongoing.
b. Partially implemented. While the department report discusses potential adjustments, formal recommendations on how/if subsidization of employers should be addressed will be made. The department will continue working with the incoming administration, the General Assembly, and various stakeholders to develop and finalize formal recommendations.
c. Implemented/ongoing. The department's year-end report included information about current subsidization of employers. It is the intent of the department that this report will be issued on an annual basis detailing current fund status including subsidization related details.

Recommendation #5

Agency Addressed: Department of Labor and Employment

Recommendation Text in Audit Report: The Department of Labor and Employment should improve its early detection of potential problems with the adequacy of Colorado's Unemployment Insurance (UI) Trust Fund reserves by:

a. Determining appropriate levels for each of the three main solvency measures—reserve ratio, high cost multiple, and average high cost multiple—and setting specific solvency goals. The Department could either adopt benchmarks established by UI experts (e.g., an average high cost multiple of 1.0, as recommended by the National Advisory Council on Unemployment Compensation) or set its own solvency goals.
b. Regularly assessing the three main solvency measures against the established goals.
c. Sharing material concerns identified from regular assessments of the solvency measures with the General Assembly and the Governor's Office.
d. Identifying options for meeting solvency goals set by the USDOL, if approved, and working with the General Assembly and the Governor's Office to change statutes, as necessary, to ensure that the State meets the goals.

Agency's Response: Agree

Agency's Written Response in Audit Report:

a. The Department agrees that solvency goals are important and need to be communicated to all stakeholders. The Department will determine appropriate levels for the three measures, adopt solvency goals, and work with stakeholders to ascertain how the goals may be achieved.

b. - d. Communication with the General Assembly and Governor's Office will occur as part of the formal reporting process to be developed as part of Recommendation No. 7. This communication will report calculations of the three solvency measures, material concerns about each, and potential options for meeting solvency requirements that may be established by the U.S. Department of Labor.

Agency's Comments on Implementation Status of Recommendation:

a. Implemented. The department, as part of the end of year report, analyzed the three main solvency measures. This analysis provided strengths and weaknesses of each. The department analysis recommended an official solvency goal for the fund.
b. – d. Implemented/ongoing. The department communicated within the end of year report an assessment of the three main solvency measures, material concerns about the fund, and the current status of the fund in relation to the solvency measures.

Recommendation #6

Agency Addressed: Department of Labor and Employment

Recommendation Text in Audit Report: The Department of Labor and Employment should evaluate the potential cost burdens on Colorado employers resulting from federal loans issued to the State while its UI Trust Fund remains insolvent. As part of this evaluation, the Department should:

a. Explore the State's options for qualifying for deferment of interest charges and assess the implications of such deferments.
b. Use its forecasts to estimate the potential costs associated with interest charged on the loans and reductions in federal tax credits during the period the UI Trust Fund remains insolvent and communicate this information to the General Assembly, the Governor's Office, and employers as early as possible. The Department could include this information in its newsletters issued to employers, on its website, and/or as part of communications included in its quarterly premium assessments to employers.

Agency's Response: Agree

Agency's Written Response in Audit Report:

a. The Department has begun the process of exploring the options for qualifying for deferment of interest payments. This process will be ongoing during this period of insolvency.
b. The Department will also begin the process of communicating with employers the potential need to assess employers an additional surcharge to pay the interest payments. As part of the communication with employers, the Department will identify potential interest amounts based on the most recent unemployment insurance trust fund forecasts.

Agency's Comments on Implementation Status of Recommendation:

a. Implemented. The department has explored the deferment of interest costs. One of the three mechanisms for deferment of interest is viable for Colorado at present. The Governor may request that the interest on the final five months of the federal fiscal year (May through September) be delayed until December of the following calendar year. It is likely that Colorado will use this deferment option each year interest is due because interest for the federal fiscal year is due September 30th and there needs to be sufficient time to collect the funds for payment to the federal government.
b. Partially implemented. Preliminary estimates of the initial interest payment have been concluded. Communication to employers and other stakeholders has not been finalized. Efforts to communicate these issues are underway but have yet to be completed.

Recommendation #7

Agency Addressed: Department of Labor and Employment

Recommendation Text in Audit Report: The Department of Labor and Employment should improve its monitoring of and reporting on the solvency of the UI Trust Fund to the Governor's Office and General Assembly. In particular, the Department should adopt a formal process to assess the financing structure, the Trust Fund's solvency, and unemployment benefits on an ongoing basis, including any events affecting the Trust Fund, and report concerns and recommendations regarding the solvency of the Trust Fund as needed.

Agency's Response: Agree

Agency's Written Response in Audit Report: The Department strives to communicate current issues on an ongoing basis and agrees that a formal communication process will greatly assist in disseminating information about this important issue. The Department will reinitiate a reporting process to formally communicate these issues. This process will be similar to that which was previously required in statute. This formal process will help ensure that the Governor's Office and General Assembly are informed of ongoing solvency issues. The Department plans to implement and submit an annual report on the condition of the Trust Fund. This report will include a calculation of each of the three solvency measures, possible options for achieving U.S. Department of Labor solvency recommendations, material concerns about the Trust Fund, and other relevant issues.

Agency's Comments on Implementation Status of Recommendation:

Implemented/ongoing. The department completed the annual report providing a detailed analysis of the Unemployment Insurance Trust Fund. This analysis was sent to the Governor's Office and General Assembly in January of 2011. This report was also provided to Legislative Council and the Joint Budget Committee. During the department's 2011 briefing to the Joint Budget, this report was presented and discussed. The analysis detailed an assessment of the financing structure, the solvency level of the fund and other relevant items needed to understand the current position of the fund.