



# **ANNUAL REPORT**

## **FRAUD DETERRENCE AND DETECTION ACTIVITIES**

***A REPORT TO THE  
CALIFORNIA LEGISLATURE***

**FOURTEENTH REPORT**

**JUNE 2008**

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## EXECUTIVE SUMMARY

This report documents the Employment Development Department’s (EDD) fraud deterrence and detection activities for Calendar Year (CY) 2007, as required by California Unemployment Insurance Code (CUIC) Section 2614.

The EDD's major program responsibilities include Unemployment Insurance (UI), Disability Insurance (DI), Employment Tax Collection, and Workforce Investment Act (WIA) programs. During 2007, through the administration of its programs, EDD collected more than \$42.9 billion in employment taxes from over 1.3 million employers and issued benefit payments in excess of \$9.1 billion on over 2.4 million UI and DI claims.

To protect the integrity of its programs, EDD enforces the CUIC provisions and various other California codes affecting its programs. Doing so assures the integrity of all EDD programs and protects the interests of employers, claimants, and taxpayers. Research suggests that organizations can reduce the risk of fraud through a combination of prevention, detection, and deterrence measures. A strong emphasis on fraud prevention may reduce opportunities for fraud to take place while fraud deterrence could persuade individuals that they should not commit fraud because of the likelihood of detection and punishment.<sup>1</sup>

The EDD takes a comprehensive approach to fraud prevention, detection, and deterrence. This approach involves EDD programs, EDD oversight entities, and business partners including federal, state, and local law enforcement agencies, and prosecutors. During CY 2007, EDD's comprehensive anti-fraud activities in the DI, UI and Tax programs identified fraud (in dollars), as follows:

<u>Description</u>	<u>DI Program</u>	<u>UI Program</u>	<u>Tax Program</u>
Cases Under Investigation	\$ 6,219,905 315 cases	\$ 11,906,815 121 cases	\$ 43,917,516 142 cases
Criminal Complaints Filed	\$ 608,224 18 cases	\$ 1,068,866 24 cases	\$ 14,029,748 24 cases
Completed Criminal Prosecutions	\$ 602,335 17 cases	\$ 21,269,236 19 cases	\$ 6,366,294 17 cases
Fraud Overpayments (OP)	\$ 9,420,838 946 OPs	\$ 77,503,785 82,786 OPs	N/A
Fraudulent Benefits Prevented	\$ 2,054,557	\$ 635,578	N/A

The detection and deterrence of fraud in the WIA program is accomplished through a variety of processes that EDD requires of the local administrative entities that provide employment training services. The program integrity components<sup>2</sup> include: Monitoring Reviews; an Incident Reporting System; Single Audits; Program Oversight; and Regulatory Controls.

The remainder of this report highlights fraud deterrence and detection activities by each EDD program and summarizes oversight activities across the Department. The final section of this report highlights enterprise-wide efforts in progress and under consideration to prevent, detect, and deter fraud.

<sup>1</sup> Management Antifraud Programs and Controls – Guidance to Help Prevent and Deter Fraud, American Institute of Certified Public Accountants, 2002, p. 5.

<sup>2</sup> See WIA program details on pages 21-22.

## **BACKGROUND**

The CUIA Section 2614 requires the Director of EDD to report to the Legislature by June 30 of each year on the Department's fraud deterrence and detection activities.

In CY 2007, EDD collected more than \$42.9 billion in employment taxes and issued benefit payments in excess of \$9.1 billion to UI and DI claimants. The EDD administers the UI, DI, and WIA programs. Through its Employment Tax Collection Program, EDD collects UI and Employment Training Tax, and DI and Personal Income Tax withholding for the State of California.

As with any program where large sums of money are involved, the temptation to defraud the system for personal gain is present. Employers may not fully pay their employment taxes as required by law; claimants may use multiple social security numbers or the identities of others or claim benefits while working; physicians may certify disability inappropriately; and claimants or physicians may submit forged documents. Further, threats may be made to the security of EDD's systems or employees.

## **APPROACH**

The EDD uses a multi-tiered, comprehensive approach to fraud deterrence and detection. This approach involves EDD programs, EDD independent oversight entities, and business partners including federal, state, and local law enforcement agencies, and prosecutors.

Each program area has established ongoing anti-fraud activities. In addition, independent oversight entities perform other activities including internal control reviews and audits, quality reviews to measure the accuracy and propriety of benefit payments, and information technology system reviews to detect system control deficiencies. Lastly, the Investigation Division (ID) identifies, investigates, and prosecutes fraud within EDD's various programs and internal operations.

Anti-fraud activities within EDD range from up-front fraud prevention such as customer education, reviews of internal control systems, employer audits, internal systems edits and controls, fiscal monitoring activities, and ongoing or special fraud detection activities. Fraud detection activities include but are not limited to: analyzing client, employer, and medical provider demographic data; establishing internal program checks and balances; performing electronic cross-matches; participating in joint efforts with other agencies and business partners; operating a fraud reporting hot line; and conducting criminal investigations that include surveillance, undercover operations, computer forensic analysis and data mining, search warrants, witness and suspect interviews, evidence seizure, and, in concert with other law enforcement agencies, arrest and prosecution of suspects.

## FRAUD DETERRENCE AND DETECTION ACTIVITIES

### STATE DISABILITY INSURANCE (SDI) PROGRAM

The SDI program is comprised of two benefit programs, the Disability Insurance (DI) program, and the Paid Family Leave (PFL) program. The DI program provides partial wage replacement for California workers who are unable to work due to illness, injury, or pregnancy. Workers covered under the SDI program are potentially eligible for PFL benefits when they are unable to work because of the need to care for a seriously ill child, parent, spouse, or registered domestic partner, or to bond with a new minor child within the first year of birth or placement by adoption or foster care into the family.

The EDD is continuing its comprehensive, multi-faceted approach to combating fraud and improving benefit payment accuracy in the DI program. During CY 2007, the DI program processed 742,976 claims and paid out over \$3.7 billion in benefits. The PFL program processed 183,347 claims and paid out over \$412 million in benefits.

The EDD collects and analyzes data to support cases for prosecution and administrative action against those suspected of committing fraudulent acts. The SDI Integrity Program includes a Program Integrity Manager and 10 Field Office Integrity Specialists (FOIS) located throughout the State. The manager and the FOIS oversee, coordinate, and conduct various staff education efforts and investigative activities involving suspicious claims in the DI offices. The DI Branch staff work closely with ID's criminal investigators to combat fraud in the DI program.

Primary SDI program fraud deterrence and detection tools include:

- **Claimant Notification** of the legal consequences for willfully making a false statement or knowingly concealing a material fact in order to obtain benefits is provided on the claim form declaration statement signed by the claimant when applying for benefits.
- **Independent Medical Examinations (IME)** provide EDD with a second medical opinion regarding the claimant's ability to perform his/her regular or customary work when the period of disability allowed by the treating physician exceeds the normal expected duration for that diagnosis. Photo identification is requested to ensure that the claimant, and not a substitute, appears for the examination.

Although the primary use of IMEs is the validation of the treating physician's prognosis and a means of controlling the duration of claims, IMEs are also a useful tool in curtailing the loss of benefits in those cases where fraud or abuse is suspected. In CY 2007, of the 26,728 IME results received, 2,719 (10.2 percent) of the claimants scheduled for an IME failed to appear, and 8,103 (30.3 percent) were found able to work on the date of the examination for the DI program.

- **Monthly Doctor Activity Reports** provide a list of the top 200 doctors certifying to the highest total amount of benefits, newly certifying physicians who certify more than a specific monetary amount or number of claims, and doctors whose claim-certifying activity has dramatically increased during the report period. These reports enable the FOIS to identify significant changes in claims activity and/or filing patterns, which may be indicators of fraud.
- **Automated Tolerance Indicators** (flags) that are associated with the certifying healthcare provider's license number help staff identify and track claims on which fraud or abuse is suspected or has previously been detected. They also alert staff to refer to special instructions that have been created to assist in the adjudication and payment of claims on which a Tolerance Indicator has been attached.
- **UI/DI Overlap Flags** generate an automated stop pay on UI, DI, and PFL claims when a prior UI claim period overlaps the dates that DI benefits are claimed. DI and PFL block payment pending an eligibility determination, thereby helping in the prevention of potentially improper payments.
- **Decedent Cross-Match Reports** identify benefit payments issued after the date of death to SDI claimants by checking the Social Security Numbers (SSN) of all claimants against SSNs of individuals reported as deceased by the Department of Health Services. The report enables DI Branch to identify and recover benefits paid subsequent to the date of death that may not otherwise have been discovered.
- **Address/Name Change Reports** record all changes of the claimant names or addresses by date and operator identification, as a means to identify claim manipulation, or "hijacking" by employees committing internal fraud. Analysis of these reports has been expanded to expose evidence of fraud or abuse which had previously gone undetected. Specifically, a variety of research tools, such as address lists for state and federal correctional institutions, address lists for all EDD offices, and reverse address directory, etc., have been developed as cross-match devices. Additionally, suspect addresses are tracked for a minimum of six months. If during or at the end of six months there is evidence of fraud or abuse at a particular address, it is referred to the appropriate FOIS. The address will continue to be tracked as needed. As a result of these enhancements, 47 referrals were made to FOIS for further action.
- The **Doctor Activity Tracking System** tracks the status of investigations involving potential doctor<sup>3</sup> or doctor impostor<sup>4</sup> fraud cases. The system also provides a useful management tool to ensure appropriate follow up occurs, and to document and evaluate accomplishments.
- **Doctor License Reports** identify all SDI claims that any particular doctor has certified. Analysis of the claims listed on the report can lead to discovery of fraudulent claims or program abuse.

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<sup>3</sup> Doctors who knowingly certify claims for individuals who are not disabled.

<sup>4</sup> Someone other than the doctor signs the doctor's name on DI claim forms.

- **DI Quality Control Reviews** test a random sample of up to 1,219 DI warrants annually for accuracy, completeness, and propriety. These reviews detect the nature and extent of improper payments, reveal operating weaknesses, and serve as a check on employee fraud or collusion. Claims that appear fraudulent are referred to investigators for follow up.
- **PFL Quality Control Reviews** test a random sample of 600 PFL warrants annually for accuracy, completeness, and propriety. These reviews detect the nature and extent of improper payments, reveal operating weaknesses, and serve as a check on agency employee fraud or collusion. Claims that appear fraudulent are referred to investigators for follow up.
- **Medical Hotsheet Reports** identify healthcare providers whose licenses have been revoked or suspended. This information, supplied by the Medical Board of California, helps ensure that claims are not certified by improperly licensed healthcare providers and alerts EDD to potential fraudulent situations.
- **Board of Chiropractic Reports** identify chiropractors whose licenses have been revoked or suspended. This information, supplied by the Board of Chiropractic Examiners, helps ensure that claims are not certified by improperly licensed chiropractors and alerts EDD to potential fraudulent situations.
- The **DI Personal Identification Number (PIN) System** provides telephone identification, authentication, and authorization services via EDD's Interactive Voice Response (IVR) system. The system enhances security of the IVR system and improves claimant privacy by preventing unauthorized access to confidential data.

Claimants are required to enter their SSN and PIN each time they request confidential payment information through DI Branch's IVR system. Claimants select their PIN the first time they use the IVR system to obtain payment information by matching personal identifying information. As an additional security and fraud detection measure, when a PIN is established or changed the claimant is sent a notice.

- The **In-Office Eligibility Review Process** provided for in Title 22, California Code of Regulations, permits the Department to require claimants suspected of fraud, who are currently receiving benefits, to submit to an in-person interview before a decision is made regarding their continued eligibility to receive benefits. The process provides the claimant with a fair and equitable opportunity to be heard in person and enables the Department to gather additional information before making its decision. The regulations provide precise time frames and procedures for conducting interviews to ensure that claimants' rights to due process are protected.
- An **EDD Toll-free Fraud Tip Hot Line**, (800) 229-6297, provides employers and individuals a designated telephone number to report alleged fraud directly to the ID's Criminal Intelligence Unit (CIU). The number of SDI program fraud allegations reported through the Hot Line is as follows: 695 allegations in CY 2005, 488 allegations in CY 2006, and 440 allegations in CY 2007.

- Fraud allegations were also reported via the **EDD Web site** ([www.edd.ca.gov](http://www.edd.ca.gov)). It provides the ability to report fraud and other sensitive information (SSNs, etc.) in a secure environment. An additional 328 allegations in CY 2005; 439 allegations in CY 2006; and 600 allegations in CY 2007 were received by the Hot Line operators in this manner.
- The **Truncation of Claimant SSNs** to only the last four digits on DI and PFL benefit checks helps to deter identity theft and protect the confidentiality of information assets.
- **Program Integrity Training** is provided to all new hires to heighten staff awareness and capacity to detect and deter fraud and abuse in the DI and PFL programs. New hires are initially exposed to the concepts and tools during new employee orientation shortly after being hired and once again in greater detail during formalized training. In addition, field office staff designated as Program Integrity Single Points of Contact (PI SPOC), who perform PI functions and work closely with the FOIS, receive specialized training.
- **On-Line DI Program Integrity Awareness Training** module was developed by the FOIS. In addition to classroom training, field office staff are able to take the on-line portions of the Refresher Program Integrity training at their work station.
- **Automated Detection Reports** developed collaboratively with ID's CIU permit CIU staff to detect unusual patterns of activity in the SDI benefit payment system involving addresses, issuance of multiple checks, and multiple claims filed by the same claimant within a specified period of time.
- An **Educational Outreach Campaign** to the California medical community led by the EDD Medical Director's Office is designed to enhance understanding of the purpose of the DI and PFL programs and their role in the claim filing process. This effort enhances the integrity of both programs by improving the quality of medical information received thereby ensuring that the benefits paid are consistent with the claimant's inability to perform their regular or customary work or the need to care for a seriously ill family member. It also helps to minimize the occurrence of medical certifications that extend the disability duration beyond normal expectancy.
- **Formal Identity (ID) Alert Procedures** were provided to staff for handling DI and PFL claims with an ID Alert flag. The Department places a "flag" on potentially compromised SSNs identified by employers/employer agents, and Investigation Division, or UI Branch. When a claim with an ID Alert flag is processed, DI program integrity staff conducts an in-depth review to ensure that the claimant is the true wage earner.
- **Medical Refresher Training** provided to field office staff by EDD's Medical Director is a comprehensive presentation of medical information intended to educate and update staff's knowledge of disabling medical conditions and medical terminology.



This information allows the staff to communicate more effectively with medical providers when discussing and obtaining additional medical information regarding a DI or PFL claim. The information provides staff with a better understanding of the diagnoses, assists them in determining the severity and expected length of a disability, enables them to read and understand the medical side of the claim form with more confidence, and take appropriate action to control claim duration or potential abuse of the programs.

- **Overpayment Conviction Workgroup** continues its efforts to ensure prompt and accurate establishment of conviction overpayments and collection activities. Various departmental entities are involved to ensure understanding of their individual roles in this effort and explore technology solutions and other procedural recommendations to enhance the department's ability to collect on conviction overpayments and restitution orders.

In addition to these fraud deterrence and detection tools, special claim processing safeguards and automation techniques unique to the PFL program are being developed. Some that are currently being utilized include:

- Requirement for submission of the birth certificate, adoption or foster care certification on all bonding claims.
- The PFL automated system includes a scanning process that provides an online viewable copy of all claim documents. To assist in detecting possible forgeries, claims examiners are able to compare current signatures of claimants and physicians with documents submitted previously by the same claimants and/or physicians.
- The PFL automated system also includes a powerful tool for identifying patterns on suspicious claims by allowing claims examiners to retrieve all information about a claimant including all flags, images, and care recipients for current and past claims.
- The **PFL Address/Name Change Report** records all changes of the claimant's name or address by date and operator identification, as a means to identify claim manipulation, or "hijacking" by employees committing internal fraud, thus adding protection to claimant information.

**RESULTS/ACCOMPLISHMENTS DURING CY 2005 through 2007**

The following table shows the DI’s program results for the last three years.

	<u>2005</u>	<u>2006</u>	<u>2007</u>
Cases Under Investigation	\$ 10,048,046 204 cases	\$ 9,048,113 215 cases	\$ 6,219,905 315 cases
Criminal Complaints Filed	\$ 345,726 22 cases	\$ 234,451 12 cases	\$ 608,224 18 cases
Completed Criminal Prosecutions	\$ 487,653 12 cases	\$ 2,724,513 7 cases	\$ 602,335 17 cases
Fraud Overpayments <sup>5</sup> (OPs)	\$ 3,678,479 1,135 OPs	\$ 5,428,292 1,254 OPs	\$ 9,420,838 946 OPs
Fraudulent Benefits Prevented	\$ 3,133,852	\$ 1,081,953	\$ 2,054,557

- During CY 2007, 315 cases potentially representing \$6,219,905<sup>6</sup> were investigated. These investigations focused on the following case types: impostor fraud/identity theft (71 cases representing \$2,836,346); altered or forged documents (148 cases representing \$1,749,572); medical practitioner fraud (16 cases representing \$659,838); and counterfeit checks (13 cases representing \$347,520). The remaining 67 miscellaneous cases, representing \$626,630 included working while certifying for benefits and other case types.
- In CY 2007, ID filed 18 Criminal Complaints representing potential fraudulent benefits in the amount of \$608,224. The ID has continued their emphasis on the more complex fraud cases such as impostor/identity theft that take longer to investigate. A couple of our large impostor cases have Reports of Investigation (ROI) which were forwarded to the United States Attorney’s Office months ago; however, these ROI’s have yet to be reviewed by the federal prosecutor.
- During CY 2007, ID completed 17 criminal prosecutions representing fraudulent benefits in the amount of \$602,335. These completed prosecutions primarily involved altered and forged medical, counterfeit checks, impostors, and working while certifying for benefits.
- In CY 2007, the DI and PFL programs established a cumulative total of 946 fraud overpayments in the amount of \$9,420,838.
  - The DI program established 98 fraud overpayments totaling \$5,562,933 on claims associated with claimants who were prosecuted.
  - The DI program established 830 fraud overpayments that were not attributed to prosecutions. These overpayments, totaling \$3,828,517 were the result of administrative actions applied by the DI program, such as false statement overpayments.

<sup>5</sup> “Fraud overpayments established” includes overpayments established as a result of both criminal and administrative actions.

<sup>6</sup> Total does not equal case type detail due to rounding off to whole dollars.

- The PFL program established 18 fraud overpayments that were not attributed to prosecuted claimants. These overpayments, totaling \$29,388 were the result of enforced administrative remedies available to the DI program, such as false statement overpayments.
- In CY 2007, departmental anti-fraud efforts stopped \$2,054,557 in fraudulent DI benefits from being paid. Of this total, \$1,425,530 is attributable to DI program anti-fraud efforts such as IMEs, verification of SSN ownership with deletion of improper base period wages, and all referrals to ID resulting in convictions or administrative actions which prevented payment of further benefits. Payment of approximately \$629,027 in fraudulent benefits was prevented through ID's ongoing investigations of identity theft, forgeries, and medical practitioner fraud.
- In 2007, 80 doctors certified to over \$1 million in benefits including five that already had a Tolerance Indicator established based on previous review. In 44 cases, after review by the DI Branch and/or ID, it was concluded that the doctors' high volume of activity was justified and no fraud or abuse was detected. In the remaining 36 cases, three are under investigation by ID; leaving 33 cases pending further evaluation by the FOIS.

## RECENT DI PROGRAM ENHANCEMENTS

In the DI program's ongoing effort to develop systems and processes to detect and prevent fraud and abuse, the following enhancements have been implemented or are under development:

- **Decedent Cross-Match Reports** received from the Department of Health Services, Vital Statistics Division (VSD) have required in-depth research on the data provided. When there is a material divergence between data provided by VSD on the owner of a particular SSN and that shown on EDD's Single Client Data Base for that SSN, DI researches that SSN in Social Security Administration's Death Index. During 2007, this research enabled DI to identify 72 percent of the causes of data conflict; including 86 miss-keyed SSNs by VSD.
- **Monthly Doctor Activity Report** provides a list of the top 200 doctors certifying to DI program benefits and was enhanced in 2007 by converting the hard copy report to an electronic monthly report. In the past it would take staff over 10 hours manually entering information from the hard copy to a database for review purposes. The report is now downloaded electronically and the data is transferred to the database within 30 minutes. This time savings provide staff time to review the information more timely and efficiently.

## UNEMPLOYMENT INSURANCE (UI) PROGRAM

The EDD administers the UI program, which provides benefits to individuals who have lost their jobs through no fault of their own, are actively seeking work, are able to work, and willing to accept employment. During CY 2007, the UI Program processed 1,565,795 new claims and paid a total of \$5.05 billion in benefits. The EDD is committed to maintaining the integrity of the UI Program.

The UI Program utilizes a variety of processes, tools, and techniques to deter and detect fraud, which include:

- **Claimant Notification** provides notice to the claimant, by way of a Claimant Handbook, of claim eligibility requirements and legal consequences of willful misrepresentation<sup>7</sup> or willful nondisclosure of facts.
- **30 Percent Fraud Penalty Assessment** on any overpayments resulting from claimant fraud.
- **Weekly Claim Certification** by claimants of their continued eligibility for benefits. This process requires the claimant's signature certifying to the accuracy and truthfulness of the statements made and that he/she understands that the law provides penalties for making false statements to obtain benefits.
- **UI Quality Control** is an independent review of a random sample of 1,100 claims annually to test the effectiveness of procedures for the prevention of improper UI payments. These reviews detect the nature and extent of improper payments, reveal operating weaknesses, and serve as a check on agency employee fraud or collusion. Claims that appear fraudulent are referred to investigators for follow up.
- The **Benefit Audit Process** matches wages reported quarterly by employers to UI benefits paid within the same period. Through this process, the UI benefits program is able to detect when claimants have been fraudulently collecting benefits while working. Overpayments and penalties are established and collected as a result of this process, protecting the solvency of the UI Trust Fund. These matches are performed on a quarterly and annual basis. The EDD utilizes an employer compliance database to track benefit audit forms that have been mailed and returned by employers.
- The **New Employee Registry (NER) Benefit Cross-Match**, implemented in July 2007, enables EDD to use new hire information from California employers to identify claimants who improperly continue to receive benefits after they have returned to work. This is accomplished by matching the new hire information with the Department's records of claimants currently collecting UI benefits. Through this process, EDD will be able to detect fraud and other eligibility issues up to six months earlier than through the Department's current benefit audit process, allowing EDD to protect the UI Trust Fund by reducing the amount of dollars overpaid to claimants.

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<sup>7</sup> To willfully provide false information or withhold information that affects the payment of UI benefits.

- **Verification of a Claimant's Right to Work** enables EDD to identify claimants who do not have legal authorization to work in the United States (U.S.), thus preventing payments to individuals who are not eligible for benefits. The Systematic Alien Verification for Entitlement process enables EDD to link with the database of the U.S. Citizenship and Immigration Services (formerly Immigration and Naturalization Service) to submit both initial and additional verification queries to obtain information necessary to reduce improper payments to individuals who do not have legal authorization to work in the U.S.
- A **SSN Verification** provides real time (on-line) access to Social Security Administration's (SSA) records. The claimant's SSN is verified during the claimant's identification process, to detect potential fraud prior to filing a UI claim.
- The **Department of Motor Vehicles (DMV)** allows EDD access to their databases, real time (on-line), to verify a claimant's California driver's license or identification card number, prior to filing a UI claim.
- The **last employer address information** is obtained from EDD's internal database. The ability to cross-match employer addresses with this database rather than relying upon the client to provide the Department with this information will better ensure that proper payments are made to the appropriate individual.
- Employers or individuals are offered several options to report alleged fraud activities. The ID operates a **Toll-free Fraud Tip Hot Line**, telephone number (800) 229-6297. The number of UI program fraud allegations received through the Hot Line is as follows: 2,270 allegations in CY 2005, 1,499 allegations in CY 2006 and 1,009 allegations in CY 2007.
- Fraud allegations were also reported via the **EDD Web site** ([www.edd.ca.gov](http://www.edd.ca.gov)). An additional 830 allegations in CY 2005; 825 allegations in CY 2006 and 1,011 allegations in CY 2007 were received by the Hot Line operators in this manner.
- The **UI Personal Identification Number (PIN)** is an automated system that allows claimants to select a PIN in order to obtain personal claim information through the Interactive Voice Response (IVR) system, which is available seven days a week, 24-hours a day. The UI PIN was established to protect claimants' confidential information. Without a PIN, claimants will be unable to access their personal and confidential claim information through the IVR.
- Changes to the **UI benefit check** were implemented as part of the Department's ongoing commitment to deter identity theft and to protect the confidentiality of its information assets. The heading "SSA NO." was removed from the face of the UI benefit check and the 9-digit SSN is no longer printed on the face of the check. In its place, **only** the last 4 digits of the claimant's SSN are displayed.

- The EDD has always used various measures to ensure the true identity of a claimant for UI benefits. The **UI Impostor Fraud Prevention** was enhanced with the implementation of EDD's Identity Alert Process. The process, developed to reduce the risk of identity theft fraud, was implemented when employers and/or employers' payroll agents contacted the Department to report that their records containing confidential employee information had been compromised. The Identity Alert Process was designed to protect the worker and employer from ongoing fraud and to ensure proper payments of UI benefits.

When a claim is initiated into the Identity Alert Process, no payments are issued until the Department obtains the information needed to validate the identity of the individual filing the UI claim. The UI Identity Regulations, pursuant to the California Code of Regulations, Title 22, Sections 1251-1 and 1326-2 allow the Department to require a claimant to provide identity verification documentation upon request.

The Identity Alert Process is funded by both federal and state monies. Approximately 66 percent of this process is accomplished using state funds. For every Personnel Year dedicated to this function, there is an estimated corresponding savings to the UI Trust Fund of more than \$4 million.

The tools utilized by EDD to prevent UI impostor fraud include:

- Flagging potentially compromised SSNs identified by employers/employer agents and EDD's ID. If a new claim is filed using one of the flagged SSNs, the claim is initiated into the Identity Alert Process and a request for identity information is mailed to the claim filer, the last employer, and the base period employer(s).
- Stopping benefit payments on active UI claims that are associated with compromised SSNs until the identity of the claimant is confirmed.
- Implementing enhanced screening procedures during the claim filing process to better authenticate the identity of claimants and to ensure only the true owner of the identity will receive UI benefits.
- Utilizing a variety of communication methods to provide information to all California employers on how to protect and properly destroy confidential personnel information and assist the Department in preventing UI fraud. This includes published articles in the California Employer's Guide (DE 44-Tax publication) as well as the California Employer Newsletter (Quarterly-Tax publication).
- Updating the EDD Web site ([www.edd.ca.gov](http://www.edd.ca.gov)) with information on UI impostor fraud and identity theft assists both employers and employees. The brochures "**How You Can Prevent Unemployment Insurance Impostor Fraud**" (designed for employers) and "**Protect Your Identity and Stop Unemployment Insurance Impostor Fraud**" (designed for employees) can be viewed as well as downloaded and printed from the EDD Web site.

- Partnering with other states that have also experienced increases in UI impostor fraud. The Department has worked closely with other states to identify common patterns and trends, share anti-fraud processes, and resolve fraud cases where the parties have a connection to multiple states.
- Developing a toolkit, as part of an ongoing **public education campaign**, for employers that includes information on how they can prevent and detect UI impostor fraud. Success in preventing, detecting, and deterring UI impostor fraud is greatly dependent upon a strong partnership with the employer community.
- Utilizing internal workgroups to evaluate the effectiveness of existing anti-fraud systems, identify enhancements, and develop new methods for detecting, deterring and preventing fraud. Currently, UI staff, in partnership with ID and the Audit and Evaluation Division (A&ED), are exploring data mining tools to actively identify patterns, data elements, and trends to detect and prevent potentially fraudulent UI claims earlier in the process.

**RESULTS/ACCOMPLISHMENTS DURING CY 2005 through 2007**

The following table shows the UI program’s results for the last three years.

	<b>2005</b>	<b>2006</b>	<b>2007</b>
Cases Under Investigation	\$ 17,048,818 83 cases	\$ 8,990,404 87 cases	\$ 11,906,815 121 cases
Criminal Complaints Filed	\$ 1,994,251 15 cases	\$ 565,519 8 cases	\$ 1,068,866 24 cases
Completed Criminal Prosecutions	\$ 7,287,065 17 cases	\$ 2,252,508 11 cases	\$ 21,269,236 19 cases
Fraud Overpayments (OPs) est.	\$104,081,174 145,534 OPs	\$127,460,958 169,645 OPs	\$ 77,503,785 82,786 OPs
Fraudulent Benefits Prevented By Investigation Division	\$ 11,938,565	\$ 1,325,094	\$ 635,578

- During CY 2007, ID investigated a total of 121 ongoing and new UI fraud cases representing potential fraudulent benefit payments in the amount of \$11,906,815. These investigations focused on the following case types: impostor fraud/identity theft (38 cases representing \$9,822,412); working while certifying for benefits (61 cases representing \$621,335); forgery – taking over another’s claim (4 cases representing \$115,820); and conspiracy between employer and claimant to certify for benefits (9 cases representing \$55,798). The remaining 9 miscellaneous cases, representing \$1,291,450, included counterfeit checks and the use of multiple SSNs by one person.
- In CY 2007, ID filed 24 Criminal Complaints representing potential fraudulent benefits in the amount of \$1,068,866. During 2007, the ID gave priority to investigating complex fraud cases involving the most egregious violations and the highest overpayments.

- In CY 2007, ID completed 19 criminal prosecutions representing fraudulent benefits in the amount of \$21,269,236. Although 19 cases prosecuted out of the total number of cases investigated of 121 seem small, these prosecution cases are very large and complex both in terms of volume of claims and dollar value. Consequently, these cases take numerous staff resources and years to prosecute. The number of cases under prosecution in any given year is also dependent on local and federal prosecutors' workload and ability to take these cases.
- During CY 2007, UI program staff established a total of 82,786 fraud overpayments totaling \$77,503,785. The EDD received additional funding during State Fiscal Year 2005-2006, to liquidate the Benefit Audit workload. This caused the decrease in the number of overpayments established from last year's figures.
  - A total of 64,057 fraud overpayments totaling \$56,944,718 were established as a result of the Benefit Audit cross-match system and the NER cross-match process. The benefit audit process protects the integrity of the UI Trust Fund, and detects UI fraud. Through this process, 56,842 overpayments were established, totaling \$52,822,939. The newly implemented NER cross-match, which began in July 2007, established \$4,121,779 in overpayments for 7,215 cases.
  - UI program staff established fraud overpayments on 1,138 cases of identity theft totaling \$3,049,569.
  - A total of 17,591 fraud overpayments were established that were not attributed to the Benefit Audit cross-match system or identity theft. These overpayments, totaling \$17,509,498, were established for a variety of reasons including retroactive disqualifications of miscellaneous eligibility issues and unreported earnings that were not discovered through the Benefit Audit cross-match system.
- In addition, in compliance with California regulations, UI program staff imposed disqualifications and overpayments on 599 cases totaling an additional \$1,469,796 in non-fraud overpayments when claimants failed to comply with the Department's request for identity verification information and there was insufficient information to determine the real owner's identity.
- In CY 2007, ID prevented approximately \$635,578 in benefits paid from UI claims that were filed by impostors based upon the identity and wage credits of full-time active employees. The decrease in dollar value of fraudulent benefits prevented in 2007 over previous years is because new controls and processes that EDD implemented beginning in 2004 greatly reduced the number of fraudulent claims established (imposter fraud) and paid, thus there were fewer fraudulent claims to identify and stop the payment of fraudulent benefits.
  - The ID prevented \$528,295 in benefits from being paid on UI claims associated with ongoing criminal investigations.



- The ID prevented \$125,283 in benefits from being paid on UI claims filed through the Internet e-apply process. These claims are not associated with ongoing criminal investigations.

## FUTURE UI PROGRAM ENHANCEMENTS

The EDD continues to monitor, research, and investigate systems and activities in order to detect and prevent fraud within the UI program. As EDD moves towards an electronic system, such as Web-based applications for delivering UI services to our clients, the need to maintain the security and integrity of the program is a high priority. California has taken a lead role in developing system enhancements for the detection and prevention of fraud within the UI program. The following describes fraud detection and prevention system enhancements to the UI program that are currently being developed:

- **Web-Based Claim Filing (WBCF)** project is reengineering the UI claim filing process to improve claimant authentication and the collection of claimants' eligibility information. This new claim filing system for staff, will improve issue detection and decrease fraud, while improving the quality of information collected during the claim filing process. This project is augmented with federal grants and once completed, will integrate the on-line (real-time) verification of a claimant's SSN and DMV license and identification card numbers, and create a cohesive process to detect potential fraud earlier in the claim filing process. This will allow EDD to conduct data cross-matches directly with the SSA and California's DMV as well as obtain last employer address information from EDD's internal Tax Accounting System (TAS). Cross-matching information with these entities, and the ability to cross-match employer addresses with EDD's TAS database rather than relying upon the client to provide the Department with this information, will better ensure that proper payments are made to the appropriate individual.
- The **Address Integrity Project** will ensure that only the rightful owner of the claim makes a change of address to a claim. As a security and fraud detection measure, a letter will be sent to the old address to notify the claimant that EDD has received a request for change of address.
- **Fraudulent Claim Profiles** are being established to institute ongoing system checks for identification of claims that fit fraud patterns.
- The **Continued Claims Redesign Project** provides claimants with the option to certify for UI benefits by telephone or the Internet, and will allow for the collection of additional client data and creation of a new client database for fraud detection.
- The **Call Center Network Platform and Application Upgrade Project** provides EDD with more detailed call information for trend analysis to improve fraud detection, as well as other automation enhancements. This upgrade will provide historical tracking data on prior calls from the caller's phone number, caller ID, calls associated with the supplied SSN, and a single management information system that reports all call activity in order to detect and deter fraud. The State awarded a new telephone platform contract "CalNet II"; the Department expects to have enhanced functionality and system improvements sooner than anticipated in this project.

Among the improvements is enhanced management information that will allow analysis of the program dynamics. Once the system is installed, analysis will begin.

- The **Combat Identity Theft Project** will develop and implement data mining software that will be used to improve EDD's ability to prevent and detect identity theft in the UI program. This project is funded in part by a Department of Labor grant. The software will be used to improve UI fraud detection by conducting in-depth data analyses and automatically identifying patterns and trends that will serve as probable indicators of fraudulent activity. The data mining software will be used by other entities within EDD to develop predictive models to improve decision-making and reduce fraud.

## EMPLOYMENT TAX PROGRAMS

The EDD is one of the largest tax collection agencies in the United States, collecting UI contributions, Employment Training Tax, DI withholdings and State Personal Income Tax withholdings. Only the Internal Revenue Service (IRS) collects more payroll tax dollars than EDD. During 2007, EDD collected \$42.9 billion in California payroll taxes from over 1.3 million employers.

EDD's approach to employment tax fraud deterrence and detection involves extensive investigative activities, including sophisticated lead development processes, and an audit program that focuses on enforcement. Tax Branch also works to deter tax fraud by educating employers on the risks of participating in the underground economy through seminars and employer assistance programs offered through its Taxpayer Education and Assistance program.

During 2007, the Tax Branch created the **Compliance Development Operations (CDO)** within the Field Audit and Compliance Division of Tax Branch. This new organization is a primary lead development arm for the Audit Program, concentrating on identifying employers participating in the underground economy for payroll tax purposes. CDO leverages its lead development activities in part by working with other governmental agencies to share information and by performing joint on-site inspections of employers determined most likely to be operating underground. The dedication of staff to perform lead development functions has proven to result in very positive audit results, sending a clear message to the employer community of their liability exposure when purposely failing to comply with reporting and payment requirements. These enforcement activities help create a level competitive playing field for all employers and aid in protecting employee rights to unemployment and disability insurance benefits.

The various CDO programs that concentrate on underground economy lead development are as follows:

- The **Joint Enforcement Strike Force (JESF)** combats the underground economy by pooling resources and sharing data among the State agencies that enforce licensing, labor, and tax laws. The JESF on the Underground Economy was formed by Executive Order in 1993 and codified in 1994. The members of JESF include EDD (lead agency), the Department of Consumer Affairs, the Department of Industrial Relations (DIR), the Franchise Tax Board (FTB), the Board of Equalization, the Department of Insurance (DOI), and the Department of Justice.

The JESF obtains information through a number of sources indicating a business is operating illegally. These sources include hot line referrals, complaints from legitimate businesses, and information sharing through partnering agencies' databases.

- The **Employment Enforcement Task Force (EETF)** was the first joint enforcement effort undertaken by JESF partner agencies. The EETF conducts joint field investigations to identify employers operating in the underground economy. The goal of EETF is to identify and bring into compliance those individuals and

businesses participating in the underground economy that are in violation of payroll tax, labor, and licensing laws.

- The **Tax Enforcement Group (TEG)** administers several of the JESF mandated programs, including the Construction Enforcement Project (CEP) and the Janitorial Enforcement Project (JEP). Additionally, TEG staff investigates businesses in non-mandated industries in an effort to detect employment tax fraud and noncompliance. The TEG conducts desk investigations through the use of various databases and income tax returns analysis to uncover noncompliant and fraudulent activity within the employer community.
- The **Economic and Employment Enforcement Coalition (EEEC)** was established in 2005 as a joint effort by state and federal agencies to combat the underground economy. The coalition's education and enforcement efforts are intended to enhance fair business competition by targeting employers who gain an unfair advantage through violation of state and federal labor, licensing, and employment laws. The EEEEC was created as a multi-agency enforcement program consisting of investigators from EDD, DIR (Division of Labor Standards Enforcement (DLSE) and Cal/OSHA), Contractors State Licensing Board, and the U.S. Department of Labor, each expert in its own field, collaborating to educate business owners and employees on state and federal labor, licensing, and employment laws; conduct vigorous and targeted enforcement against labor law violators; help level the playing field and restore competitive equity for law abiding businesses and their employees. The EEEEC partnering agencies conduct field compliance inspections on targeted industries within designated geographic locations in a sweep environment. The coalition is currently focusing its efforts on seven low-wage industries including agriculture, car wash, construction, garment manufacturing, horse race track, janitorial, and restaurant. These industries were selected for targeting by the EEEEC because employers in these industries have a history of employing vulnerable workers, paying low wages, and are frequently found to be out of compliance with labor and tax laws.

The **Tax Audit Program** reviews business entities' records to determine the level of compliance with employment tax laws governing the reporting of wages and payment of taxes and works with employers to gain long-term prospective compliance. Audit leads are obtained from various sources, including developed lead referrals from CDO from various sources, and worker UI and DI obstructed benefit claims. The Audit Program also identifies industries that are out of compliance with payroll tax law and coordinates efforts to bring these specific industries into compliance through focused audits within an industry.

The Audit Program levies compliance assessments for the amount of deficient taxes under-reported and makes determinations regarding the application of penalties due to negligence, intentional disregard, intent to evade, and fraud.

The Audit Program also works with the Taxpayer Education and Assistance program to deliver education and outreach to certain industries. These efforts include employer seminars, public presentations before professional groups, and articles for professional publications.

**CDO AND RELATED AUDIT RESULTS DURING CY 2005 through 2007**

Statistics for the EETF, TEG, and EEEEC programs are included in this section. Overall, the cumulative activities and results of these program areas over the past three years are as follows:

**CDO Joint Enforcement Activities – Combined Statistics From Programs Below\***

	<u>2005</u>	<u>2006</u>	<u>2007</u>
Joint Inspections	1,044	1,330	1,296
EDD Audit Referrals	566	782	918
EDD Payroll Tax Audits	608	604	950
EDD Payroll Tax Assessments	\$ 35,952,394	\$ 27,244,151	\$ 48,760,011
DIR Labor Code Citation Amounts	\$ 3,558,561	\$ 5,319,800	\$ 9,659,533
Previously Unreported Employees	10,244	10,541	15,751
Cases w/Fraud Penalty Assessed	92	86	126
Assessments on Fraud Cases	\$ 15,886,826	\$ 8,264,410	\$ 16,197,431

\* Please note there are discrepancies in some statistics for 2005 and 2006 from last year's report due to data capture errors which are shown correctly in this report.

- In 2007, EETF inspected 451 businesses for payroll tax and Labor Code violations. Any business suspected of operating in the underground economy is subject to inspection although EETF focuses on industries known to have a high degree of noncompliance such as auto repair, bars, car washes, construction, and restaurants. The inspections resulted in the issuance of 393 citations totaling \$3,621,313 for various violations of the Labor Code. In 2007, 405 EETF audits were completed, resulting in assessments of \$13,478,705 in unpaid employment taxes, penalties, and interest. In addition, 4,200 previously unreported employees were identified.

The following table shows the EETF's program results for the last three years.

	<u>2005</u>	<u>2006</u>	<u>2007</u>
Joint Inspections	342	423	451
EDD Audit Referrals	268	405	448
EDD Payroll Tax Audits	280	308	405
EDD Payroll Tax Assessments	\$ 11,238,855	\$ 10,597,994	\$ 13,478,705
DIR Labor Code Citation Amounts	\$ 2,333,261	\$ 2,390,950	\$ 3,621,313
Previously Unreported Employees	3,403	4,278	4,200
Cases w/Fraud Penalty Assessed	43	45	41
Assessments on Fraud Cases	\$ 3,697,824	\$ 3,152,528	\$ 3,540,876

- In 2007, the TEG conducted investigations and referred 179 cases to the audit program. This includes 118 CEP cases and 6 JEP cases. Completed audits resulted in assessments for \$18,008,426 in unpaid employment taxes, penalty, and interest. In addition, 5,313 unreported employees were identified.

The following table shows the TEG program results for the last three years.\*

	<u>2005</u>	<u>2006</u>	<u>2007</u>
Joint Inspections	34	N/A	N/A
EDD Audit Referrals	234	193	179
EDD Payroll Tax Audits	320	201	234
EDD Payroll Tax Assessments	\$ 23,454,705	\$ 12,984,479	\$ 18,008,426
DIR Labor Code Citation Amounts	\$ 210,050	\$ 650	\$ -0-
Previously Unreported Employees	6,508	4,537	5,313
Cases w/Fraud Penalty Assessed	46	16	17
Assessments on Fraud Cases	\$ 11,971,409	\$ 3,368,491	\$ 4,842,114

\*The Targeted Industries Partnership Program, included within the TEG statistics, was discontinued in mid 2005; there were no Joint Inspections completed within the TEG program in 2006 or 2007.

- In 2007, EEEEC<sup>8</sup> inspected 845 businesses for licensing, tax, and labor code violations and referred 291 employers for a payroll tax audit. The EEEEC has been mandated to focus its resources within seven industries including agriculture, car wash, construction, garment manufacturing, janitorial, race track, and restaurant. In 2007, 311 EEEEC audits were completed, resulting in assessments of \$17,272,880 in unpaid employment taxes, penalties, and interest. In addition, 6,238 previously unreported employees were identified.

The following table shows the EEEEC's program results for the last three years.\*

	<u>2005</u>	<u>2006</u>	<u>2007</u>
Joint Inspections	668	907	845
EDD Audit Referrals	64	184	291
EDD Payroll Tax Audits	8	95	311
EDD Payroll Tax Assessments	\$ 1,258,834	\$ 3,661,678	\$ 17,272,880
DIR Labor Code Citation Amounts	\$ 1,015,250	\$ 2,928,200	\$ 6,038,220
Previously Unreported Employees	333	1,726	6,238
Cases w/Fraud Penalty Assessed	3	25	68
Assessments on Fraud Cases	\$ 217,593	\$ 1,743,391	\$ 7,814,441

\* Please note that this report includes EEEEC statistics for Calendar Year 2007, while the EEEEC Annual Report dated September 2007 reports statistics on a Fiscal Year basis (July 2006 through June 2007). Consequently, the numbers in this report will not match with the EEEEC Annual Report numbers.

<sup>8</sup> The statistics referenced in the above table represent only those EEEEC joint inspections where EDD participated.

- The Audit Program as a whole in 2007 conducted 5,706 audits and investigations, resulting in assessments totaling \$179,542,306, and the identifying of 105,094 previously unreported employees. These enforcement efforts send a strong message to employers regarding the risks of purposely failing to report employee wages and pay contributions due.

The results of audits conducted through non-CDO lead sources (including Investigation Division leads) where employer fraud was found over the last three years are as follows:

	<u>2005</u>	<u>2006</u>	<u>2007</u>
Cases w/Fraud Penalty Assessed	70	63	81
Previously Unreported Employees	20,793	2,139	3,963
Assessments on Fraud Cases	\$ 15,922,023	\$ 12,603,038	\$ 19,928,389

In 2007, EDD’s ID conducted additional tax enforcement activities independent of JESF.

- The ID investigated a total of 142 ongoing and new payroll tax evasion fraud cases representing a potential tax liability of \$43,917,516. These investigations focused on the following case types: payroll tax fraud (121 cases representing \$40,821,176) and EEEEC (21 cases representing \$3,096,340).
- The ID filed 24 criminal complaints representing a potential tax liability of \$14,029,748.
- The ID completed 17 criminal prosecutions representing a potential tax liability of \$6,366,294.
- The ID referred 14 criminal cases with tax liabilities in the amount of \$6,366,294 to EDD Collection Division for recovery. The ID delivered restitution checks (received at sentencing hearings) in the amount of \$500,160 to the Collection Division. To date, the Collection Division has recovered \$520,463 on these cases.

## WORKFORCE SERVICES PROGRAMS

### WORKFORCE INVESTMENT ACT (WIA) PROGRAM

The EDD administers the federally funded WIA Program in California. The WIA program provides funding to local entities that provide employment training opportunities. The Department guides the sub-granting of WIA funds received from the Department of Labor (DOL), and provides general program direction to local administrative entities that deliver services to eligible clients via a statewide system of Local Workforce Investment Areas (LWIA) and other grantees.

The detection and deterrence of fraud in the expenditure of WIA funds is accomplished through a combination of processes that EDD requires of the local administrative entities. In addition, DOL may occasionally conduct specialized WIA reviews, which, even though their focus is on the adequacy of the State's management of the program, typically also include the review of a sample of local administrative entity activities. The program integrity components related to the WIA program include:

- **Monitoring Reviews** determine whether programs operate in compliance with the WIA and applicable federal, state, and local rules and regulations, and require corrective actions for any deficiencies.

Each LWIA administrative entity, as a condition of receiving WIA funds, is required to maintain and operate a monitoring system that ensures that each of their subrecipients are monitored on-site at least once during each program year in both fiscal and program areas. In addition, EDD conducts monitoring of LWIA administrative entities.

- **Incident Reporting System** provides reports of fraud, abuse, and criminal activity within the WIA program. This system is required by the DOL/Office of the Inspector General (OIG) under 20 Code of Federal Regulations 667.630. Each local administrative entity, as a condition of receiving WIA funds, participates in this system by being alert to indications and allegations of WIA-related fraud, abuse, and criminal activity, and by maintaining procedures that ensure that violations are reported promptly (within 24 hours of detection). The EDD then takes action to ensure the allegations are investigated and resolved.
- **Single Audits** are required of LWIA administrative entities and their subcontractors that expend an aggregate of \$500,000 or more in federal funds for fiscal years ending after December 31, 2003. These audits are required by the provisions of the U.S. Office of Management and Budget Circular A-133, as revised on June 24, 1997, entitled "Audits of States, Local Governments, and Non-Profit Organizations." Further, commercial subcontractors that expend \$500,000 or more in federal funds to operate a WIA program must obtain either an organization-wide audit or an independent financial and compliance audit. These audits are usually performed annually, but must be performed not less frequently than once every two years.



Audits of local subrecipients are resolved by the local administrative entity and audits of the local administrative entities and other direct grantees are resolved by EDD. The EDD may also conduct special WIA audits as warranted.

- **Workforce Services Division** program staff oversees the delivery of services by WIA funded organizations. Staff provides ongoing programmatic and fiscal technical assistance to WIA funded projects. Staff also reviews WIA grantee participant and financial records to ensure that they follow applicable State and federal requirements, and they ensure each grantee adheres to the terms and conditions of their grant with the Department.
- **Regulatory Controls** provide for additional fraud protection. The DOL provides a Hot Line telephone number (800) 347-3756 to report fraud and abuse complaints. This hot line functions as a national control point. Another control point is that the WIA program prohibits contracting or doing business with any agency that has been disbarred (e.g., license revoked, de-certified). Additionally, the WIA regulations have established controls against nepotism.

## RESULTS/ACCOMPLISHMENTS DURING CY 2007

The Compliance Resolution Unit (CRU) makes determinations on incident report allegations, findings contained in audit reports, and findings contained in monitoring reports. The resolution of these cases is based on the proper expenditure of WIA funds, Job Training Program Act (JTPA) funds, and Welfare-to-Work (WtW) funds. Although the JTPA and WtW programs ended, activity continues to resolve those fraud and abuse cases.

During CY 2007 CRU processed 185 cases, 123 of which were resolved, resulting in recovery of \$48,466 in nonfederal funds from LWIAs or sub-grantees. At the end of the year, 62 on-going cases with a total of \$3,743,020 remained open in various stages of the State resolution process.

- The \$3,743,020 applies to 23 of the 62 cases for which EDD has been able to determine the potential disallowance.
- The remaining 39 cases are in various stages of resolution and fact-finding by CRU, Workforce Services Division, LWIA or other sub-grantees. These activities may also involve investigations by local law enforcement, DOL or OIG.

## INDEPENDENT OVERSIGHT ACTIVITIES

The EDD's Program Review Branch (PRB) performs independent departmental oversight activities of EDD programs, including fraud detection and deterrence. Fraud detection and deterrence are accomplished through sound internal control structures, internal and external audits, risk assessments, detailed quality control reviews, and criminal investigations. The PRB has increasingly taken an active role to prevent, detect, and deter fraud within and across EDD's programs through partnerships with internal and external entities.

Fraud in EDD programs covers a variety of offenses, such as: fictitious employer registrations to establish future fraudulent UI and DI claims; forgery of checks and claim documents; identity theft/claims filed by impostors based on the wage credits of others; impostors taking over the claims of others who are deceased or returned to work; false certifications by medical practitioners and claimants; underground economy tax evasion such as underreporting or failure to report employee wages; and internal fraud by EDD employees.

The PRB performs audits in accordance with the Generally Accepted Government Auditing Standards, the International Standards for the Professional Practice of Internal Auditing, and the National Institute of Standards and Technology which are promulgated by the Comptroller of the United States, the Institute of Internal Auditors and the United States Department of Commerce respectively. These standards require auditors to possess the knowledge, skills and other competencies needed to perform audits, including sufficient knowledge to identify the indicators of fraud and to evaluate the adequacy and effectiveness of controls encompassing the organization's operations and information systems that are used to detect illegal activities and deter fraud. Audit independence is achieved by reporting to a level within the enterprise that allows the audit organization to fulfill its responsibilities.

The following addresses the various components of PRB's fraud deterrence and detection activities. Many of these activities are also included under the specific EDD program areas.

- **Independent Internal and External Audits** are conducted of departmental operations and recipients of federal funds such as LWIA and community-based organizations over which EDD has administrative and program oversight responsibility. These audits are performed at the request of EDD management, or in response to issues resulting from EDD program monitoring activities or received incident reports.
- **Independent Internal Control Audits** assist the organization in maintaining effective controls by evaluating their effectiveness and efficiency. The EDD considers a strong system of internal controls to be a major deterrent to internal fraud. The PRB provides technical assistance to EDD staff prior to and during the system design phase to ensure appropriate internal controls are developed and in place. The EDD believes that it is more cost effective to build controls into the system, as opposed to raising internal control issues during an audit, which may require system redesign.

- **Information Technology (IT) Audits** are conducted of EDD's automated systems by auditors who are specially trained in this field. These IT audits ensure that automated system controls are built into new, upgraded or existing systems and remain operational throughout the life of the system.
- A **Security Audit Logging and Monitoring System (SALMS)** is being established to capture all business application and system auditable events within a pilot application. These include logging of view, query, inquiry, and transaction activities (e.g., add, delete, and update) to enable the detection of attempts to access unauthorized UI and Tax confidential data. The SALMS project will establish a baseline set of IT security logging and audit review requirements that can be used for all of the EDD's UI and Tax Benefit systems, including event log file retentions; auditable event definition; log data file transfer protocols; and log file and server access security.
- **On-site Monitoring Reviews of WIA and Disaster Relief** is conducted to determine fiscal and program compliance. The EDD is required by DOL to perform scheduled on-site monitoring reviews of sub-recipients and sub-grantees of federally funded programs including WIA and Disaster Relief.

The monitoring reviews include regularly scheduled examinations of both fiscal and programmatic systems and records. This oversight provides EDD with an opportunity to ensure that internal control structures are in place and that they function as prescribed. The PRB, therefore, provides fraud deterrence by continually ensuring that proper safeguards are in place to discourage fraudulent activity. Monitors are alert to symptoms and conditions that may be indicators of illegal activities.

- **WIA/Disaster Relief Incident Reporting** provides a reporting and follow-up process for allegations of program fraud and abuses. The PRB receives and tracks incident reports, and submits them to DOL for its determination whether to conduct the investigation itself, or refer the reports back to EDD for investigation. Based on DOL's determination, EDD may investigate the incident and take appropriate action against the grant recipients.
- **Quality Control Reviews** are mandated for the UI benefit program. The PRB also conducts a similar Quality Control review for the DI and PFL programs. The UI, DI and PFL Quality Control processes detect fraud by verifying that EDD staff are following proper payment procedures.

In conducting the UI, DI and PFL Quality Control processes, each week, a random sample of payments for each program is reviewed to verify that proper procedures were employed by EDD during claim processing, and to ensure that adequate documentation to support claimant eligibility is available at EDD claim filing offices, employer sites, and, in some cases, medical facilities. These detailed examinations provide information from various sources that may indicate fraudulent activity, which is then referred to EDD's ID.

- **Criminal Fraud Investigations** are conducted by PRB's ID to prevent, detect, and deter fraud committed against the UI Program, the DI Program, the Tax Programs, and other programs administered by EDD. The ID develops cases for criminal prosecution at the county, state, and federal level.

Whenever appropriate, EDD seeks prosecution of perpetrators that commit fraud against EDD programs. Publication of the prosecutions and the heightened awareness of EDD's actions against both external and internal fraud provide a deterrent effect. Fraud deterrence also includes court ordered restitution and imprisonment or probation for individuals who commit fraud against EDD programs. Restitution includes recovery of benefit overpayments, tax liabilities, penalties, interest, investigation costs, and any other monies determined by the court to be owed to EDD by an entity or individual.

A deterrent used in internal affairs cases is the initiation of adverse action against EDD employees. The adverse action process includes suspensions, demotions, reductions in pay, dismissal from State service, and criminal prosecution.

The PRB utilizes several methods to detect fraud in departmental programs, provide leads to identify additional fraud, or obtain evidence in an investigation. Such methods include:

- The Fraud Tip Hot Line, telephone number (800) 229-6297, is available for the public to report employer tax evasion and allegations of fraud against the UI program, the DI program, and other programs administered by EDD.
- The EDD Web site ([www.edd.ca.gov](http://www.edd.ca.gov)) has a link to a fraud reporting form so the public can report, via the internet, allegations of fraud against programs administered by EDD.
- The Claimant Address Report, more commonly referred to as "Claimant ZIP Code Report," lists the mailing addresses within a particular postal ZIP Code area used by claimants to receive benefits. The report identifies mailing addresses where multiple claimants are receiving potentially fraudulent payments.
- PRB participates in task forces with other state and federal law enforcement agencies such as the DOL, DOI, FTB, IRS, U.S. Postal Inspectors, and prosecutors.
- In collaboration with the ID and federal investigators, A&ED conducts forensic accounting and audit examinations to examine subpoenaed bank records, and personal and employer financial records.

The results of PRB's investigative activities for CY 2007 as well as the previous two CYs are covered in the DI, UI, and Employment Tax sections of this report.

- The **Criminal Intelligence Unit (CIU)** was created within ID to develop strategic and tactical intelligence for investigative planning and case identification, and to assist program managers and oversight functions to identify areas of focus to prevent and detect fraud. The CIU works with EDD program managers to identify characteristics

of fraud and uses technology to screen claims for potential fraudulent activities. The CIU and A&ED are currently gathering and analyzing data from claims filed and investigative cases worked to gain insight into the fraudulent trends and patterns being employed against EDD. Strategies the Department can use to counter these trends and patterns can then be developed or enhanced.

Additionally, A&ED utilizes CIU developed information in its risk assessment process to prepare EDD's Audit Plan. This enables PRB to schedule audits in areas most vulnerable to fraud, thereby making the most effective use of EDD's audit resources. Conversely, A&ED will provide information obtained during the course of its audits to CIU, such as internal control strengths and weaknesses, to further enhance CIU's efforts in developing strategic and tactical intelligence.

- **Automated Data Analysis:** The PRB is developing staff expertise in using automated software to conduct complex, comprehensive data analysis. The PRB has received training, procured equipment and software and is presently building the data marts and configuring the system for data analysis.

## **ENTERPRISE-LEVEL ACTIVITIES**

The EDD has increasingly taken an enterprise-wide approach to identify and combat fraud within and across programs. Additionally, EDD is continually seeking new approaches to prevent, detect, and deter fraud, through partnerships with both internal and external entities. This section summarizes enterprise-level anti-fraud efforts undertaken during 2007, and those activities that are under consideration for future implementation.

The areas for enhanced anti-fraud efforts include:

### **New and Expanded Internal and External Partnerships**

- The EDD ID, jointly with both the UI and DI programs, has begun to identify claim or payment characteristics that are indicative of fraud. This has enabled automated trend analyses as a method to identify potential fraudulent claims/payments, which trigger additional steps to determine legitimacy of suspect claims.
- An expanded partnership between EDD ID and A&ED has enabled more thorough and timely analysis of large volumes of accounting data as a tool to identify and analyze perpetrators' fraudulent activities and develop investigative leads.
- The EDD ID has continued to foster joint investigative activities with DOL and the U.S. Attorney, as a means to develop and share fraud leads, and more effectively investigate and prosecute perpetrators of fraud.
- The ID coordinates with partner investigative/enforcement agencies to publicize joint investigative, arrest, indictment, and prosecution actions, with the intent of deterring fraud perpetrators.

### **Recent Internal and External Partnership Enhancements**

- Expanded EDD investigator participation in local level task forces to enhance local level collaboration.
- Enhanced partnerships with other state and federal agencies to share fraud leads, anti-fraud methodologies, and activities.
- Increased marketing efforts to educate the public on the consequences associated with committing fraud.
- Developed a cross-program approach to fraud detection, deterrence, and prevention activities. The ID works closely with the UI and DI programs to develop joint strategies for early detection and prevention of fraud. Results of these efforts are anticipated to reduce the amount of dollars paid out on fraudulent claims.

### **Automated Fraud Detection and Prevention Tools Under Consideration**

- Direct Deposit - A new automated Direct Deposit system for claimants to have their UI or DI benefit checks deposited directly into their bank accounts.

- Electronic linkage of the Tax and the UI systems to enhance EDD's ability to detect fraud.
- Enhancement of the Fictitious Employer Detection System – This system identifies potential employer/claimant fraud involving the establishment of fictitious employer accounts and fictitious claimants. The system contains certain characteristics that are fairly common among employers and claimants involved in fictitious employer schemes. The identification and addition of new characteristics to the system will increase EDD's ability to detect and deter fraud. An employer-tracking file serves as the basis to identify such employers and/or claimants.
- Automated interfaces with other governmental agency databases.
- Combat Identity Theft – A Supplemental Budget Request (SBR) was approved for the purchase and installation of data mining software and computer equipment to improve EDD's ability to prevent, deter, and detect identity theft in the UI program. The software will be used to improve UI fraud detection by conducting in-depth data analyses and automatically identifying patterns and trends that will serve as probable indicators of fraudulent activity. The data mining software will be used by the PRB to develop predictive models to improve decision-making and reduce fraud. See page 15 for additional information on this initiative.

## ACRONYMS

A&ED	Audit and Evaluation Division
CDO	Compliance Development Operations
CEP	Construction Enforcement Project
CIU	Criminal Intelligence Unit
CRU	Compliance Resolution Unit
CUIC	California Unemployment Insurance Code
CY	Calendar Year
DHS	Department of Health Services
DI	Disability Insurance
DIR	Department of Industrial Relations
DMV	Department of Motor Vehicles
DOI	Department of Insurance
DOL	U.S. Department of Labor
EDD	Employment Development Department
EEEC	Economic and Employment Enforcement Coalition
EETF	Employment Enforcement Task Force
FOIS	Field Office Integrity Specialist
FTB	Franchise Tax Board
ID	Investigation Division
IME	Independent Medical Examination
IRS	Internal Revenue Service
IT	Information Technology
IVR	Interactive Voice Response
JEP	Janitorial Enforcement Project
JESF	Joint Enforcement Strike Force
LWIA	Local Workforce Investment Area
NER	New Employee Registry
OIG	Office of the Inspector General
PFL	Paid Family Leave
PI SPOC	Program Integrity Single Points of Contact
PIN	Personal Identification Number
PRB	Program Review Branch
ROI	Reports of Investigation
SALMS	Security Audit Logging and Monitoring System
SBR	Supplemental Budget Request
SDI	State Disability Insurance
SSA	Social Security Administration
SSN	Social Security Number
TAS	Tax Accounting System
TEG	Tax Enforcement Group
UI	Unemployment Insurance
VSD	Vital Statistics Division
WIA	Workforce Investment Act
WtW	Welfare-to-Work



This report was prepared by the Program Review Branch of the  
California Employment Development Department

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For more information, please call (916) 227-0691.

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