



ANNUAL REPORT

FRAUD DETERRENCE AND DETECTION ACTIVITIES

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

TWENTIETH REPORT

JUNE 2014

TABLE OF CONTENTS

	<u>Page</u>
EXECUTIVE SUMMARY	1
BACKGROUND	2
APPROACH.....	2
 FRAUD DETERRENCE AND DETECTION ACTIVITIES	
STATE DISABILITY INSURANCE PROGRAMS	3
UNEMPLOYMENT INSURANCE PROGRAM	11
EMPLOYMENT TAX PROGRAMS	18
WORKFORCE SERVICES PROGRAM	25
INDEPENDENT OVERSIGHT ACTIVITIES	27
ENTERPRISE-LEVEL ACTIVITIES.....	30
ACRONYMS	32

EXECUTIVE SUMMARY

This report documents the Employment Development Department’s (EDD) fraud deterrence and detection activities for Calendar Year (CY) 2013, 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 2013, through the administration of its programs, EDD collected more than \$56.7 billion in employment taxes from over 1.3 million employers and issued benefit payments in excess of \$15.7 billion on over 6.2 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.¹

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 2013, 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	\$9,383,612 132 cases	\$27,371,876 158 cases	\$80,768,210 151 cases
Criminal Complaints Filed	\$407,701 19 cases	\$9,615,995 41 cases	\$45,033,030 22 cases
Completed Criminal Prosecutions	\$ 859,832 28 cases	\$9,202,643 27 cases	\$4,313,819 10 cases
Fraud Overpayments (OP) Established ²	\$5,543,552 766 OPs	\$188,678,548 163,196 OPs	N/A
Fraudulent Benefits Prevented	\$ 314,885	\$2,833,268	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 components³ include: monitoring reviews; an incident reporting system; single audits; program oversight; and regulatory controls.

¹ Management Antifraud Programs and Controls – Guidance to Help Prevent and Deter Fraud, American Institute of Certified Public Accountants, 2002, page 5.

² “Fraud Overpayments Established” includes overpayments established as a result of both criminal and administrative actions.

³ See WIA program details on pages 26-27.

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

BACKGROUND

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

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. In CY 2013, EDD collected more than \$56.7 billion in employment taxes and issued benefit payments in excess of \$15.7 billion to UI and DI claimants.

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 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 include up-front fraud prevention such as customer education, reviews of internal control systems, employer audits, internal systems audits 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) PROGRAMS

The SDI programs consist of two benefits, DI and Paid Family Leave (PFL). The DI benefits provide partial wage replacement for eligible California workers who are unable to work due to illness, injury, or pregnancy. Workers covered under SDI 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 SDI programs. During CY 2013, the DI program processed 701,940 claims and paid out over \$4.6 billion in benefits. The PFL program processed 217,620 claims and paid out over \$574 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, ten Field Office Integrity Specialists (FOIS) located throughout the State and two Program Integrity Analysts. The manager and the specialists oversee, coordinate, and conduct various staff education efforts and investigative activities involving suspicious claims in the SDI offices. The Program Integrity Analysts complete in-depth data analysis of various reports and develop procedures and forms to enhance program integrity efforts. The DI Branch staff work closely with ID's criminal investigators to combat fraud in the SDI programs.

Primary SDI 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. This notification is also presented to be acknowledged by the claimant when applying for benefits through SDI Online.
- **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 or practitioner 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.

The DI Branch oversees the panel of healthcare professionals that perform IMEs. The DI Branch screens applicants for this panel to ensure they have appropriate credentials. In addition, the DI Branch recruits new members to the IME panel to ensure there are appropriate numbers of specialists in all areas of the State and outside the State. The IMEs are used to validate the treating physician's diagnosis and prognosis, and as a means of controlling the duration of claims. The IMEs are also a useful tool in curtailing the loss of benefits in those cases where fraud or

abuse is suspected. In CY 2013, of the 10,708 IME results received, 485 (4.5 percent) of the claimants scheduled for an IME failed to appear, and 2,858 (26.7 percent) were found able to work on the date of the IME examination.

- **Monthly Doctor Activity Reports** provide a list of the top 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 automated monthly reports enable the Integrity Specialists to identify significant changes in claims activity and/or filing patterns, which may be indicators of fraud.
- Interface to the **Department of Motor Vehicles (DMV)** records allows identity verification for SDI Online claimants and medical providers.
- **Last employer address** information will be obtained from EDD's internal database. The ability to track and cross-match employer addresses through new reports will ensure that proper payments are made to the appropriate claimants.
- **New Employee Registry (NER) Benefit Cross-Match** interface will enable the DI Branch to use new hire information from California employers to identify claimants who improperly continue to receive benefits after they have returned to work. As a result of the NER cross-match interface, DI staff established seven overpayments in the amount of \$11,914 and PFL staff established five overpayments in the amount of \$6,197.
- The **Address Integrity** component of SDI Online ensures only the rightful owner of the claim makes a change of address to a claim. As a security and fraud detection measure, a letter is sent to the old address to notify the claimant when the SDI programs receive a request for a change of address.
- Secure **Health Insurance Portability and Accountability Act Compliant Online Claim Filing** reduces the risk of confidential information lost in the mail and reduces exposure for misuse.
- **Identity Management Software** authenticates and authorizes external users (customers) who set up external user accounts. The system creates an online profile for each external user and will encrypt and store the user identification/password, profiles, and credentials in an enterprise Identity Management System. The solution will validate and authenticate external users' logon credentials and allow authenticated users to access system functionality and improve SDI staff's ability to detect fraud.
- **Automated Tolerance Indicators** (flags) that are associated with the certifying healthcare provider's license number assist staff to 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 DI and PFL claims when a prior UI claim period overlaps the dates that DI benefits are claimed. When alerted by a stop payment flag DI and PFL staff block the overlapping period 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. This report is generated by checking the Social Security Numbers (SSN) of all claimants against SSNs of individuals reported as deceased nationwide. The DI Branch has access to this information through EDD's Tax Branch interface with the Social Security Administration. This report enables the DI Branch to identify and recover benefits paid subsequent to the date of death that may not otherwise have been discovered. When there is a material disparity between data provided on the owner of a particular SSN and that shown on EDD's Single Client Data Base for that SSN, DI Branch researches that SSN in the Social Security Administration's Death Index.
- **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, identifying 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 a reverse address directory, etc. have been developed as cross-match devices.
- The **Doctor Activity Tracking System** tracks the status of investigations involving potential doctor⁴ or doctor impostor⁵ 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 are certified by a particular doctor. Analysis of the claims listed on the report can lead to discovery of fraudulent claims or program abuse.
- The **DI and PFL Quality Control Reviews** test a random, statistically valid, sample of DI and PFL benefit payments annually for accuracy, completeness, and compliance with the CUIC, Title 22 of the California Code of Regulation and DI Branch policy. For CY 2013, DI and PFL Quality Compliance staff resumed conducting DI and PFL quality control reviews after a temporary suspension of reviewing claims resulting from assisting with the implementation of SDI Online. During the absence from reviewing claims, Quality Compliance staff reviewed its processes and incorporated new elements which arose from implementation of the SDI Online system.
- **Medical Board Notifications** identify healthcare providers whose licenses have been revoked or suspended. This information, supplied by the Medical Board of

⁴ Doctors who knowingly certify claims for individuals who are not disabled.

⁵ Someone other than the doctor signs the doctor's name on DI and PFL claim forms.

California, helps ensure that claims are not certified by improperly licensed healthcare providers and alerts EDD to potential fraudulent situations.

- **Board of Chiropractic Notifications** identifies 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 of the California Code of Regulations permits EDD 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 EDD 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 ID's Criminal Intelligence Unit (CIU). In addition, allegations can be reported via the EDD Web site (www.edd.ca.gov). This reporting option provides the ability to report fraud and other sensitive information (SSNs, etc.) in a secure environment. The number of SDI program fraud allegations reported through the Hot Line and online are as follows: 1,093 allegations in CY 2011, 2,226 allegations in CY 2012, and 1,982 allegations in CY 2013.
- The **Truncation of Claimant SSNs** to only the last four digits to help to deter identity theft and protect the confidentiality of information assets. With the implementation of SDI Online, the most frequently used forms were updated and the SSN truncation was added to these forms as well.
- **Electronic Benefit Payment** provides an electronic payment system for disbursing of SDI benefit payments. The Electronic Benefit Payment provides claimants immediate access to their benefits and eliminates fraud associated with theft or loss of paper warrants.
- **Program Integrity Training** is provided to all new hires to heighten staff awareness and develop capacity to detect and deter fraud and abuse in the SDI 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 who perform program integrity functions and work closely with the FOIS, receive specialized training.

- **Online DI Program Integrity Awareness Training** module was developed by the FOIS. In addition to classroom training, field office staff is able to take the online Refresher Program Integrity training at their work station.
- **Automated Detection Reports** developed collaboratively with ID's CIU permit 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. New reports have also been made available to ID through SDI Online to help detect and prevent fraud and abuse.
- An **Educational Outreach Campaign** to the California medical community led by SDI's Education Outreach Unit enhances physicians'/practitioners' and employers' understanding of DI and PFL benefits and their role in the claim filing process. The educational programs are geared to the California medical community including both resident physicians/practitioners and physicians/practitioners in practice. Much of this is accomplished through various professional organizations that are specialty focused or geographic. This effort enhances the integrity of the SDI 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 due to a non-work related disability or the need to care for a family member with a serious health condition. It also helps to minimize the occurrence of medical certifications that extend the disability duration beyond normal expectancy.

A focused marketing effort was aimed to coincide with the implementation of SDI Online to show the benefits of electronic submission of forms for claimants, employers and physicians/practitioners.

- **Formal Identity Alert Procedures** were provided to staff for handling DI and PFL claims with an Identity Alert flag. The EDD places an automated "flag" on potentially compromised SSNs identified by employers/employer agents, ID, or UI Branch. When a claim with an Identity Alert flag is processed, SDI program integrity staff conducts an in-depth review to ensure that the claimant is the true wage earner.
- **Medical Training** provided to field office staff is a comprehensive online eLearning Adobe presentation of medical information and case study training intended to educate and enhance staff's knowledge of disabling medical conditions and medical terminology. This training allows the staff to communicate more effectively with physicians/practitioners when discussing and obtaining additional medical information regarding an SDI claim. The medical terminology training provides staff with a better understanding of a diagnosis. It assists them in determining the severity and expected length of a disability with more confidence, and taking appropriate action to control claim duration or potential abuse of the programs.

- **Fraud Penalty Assessment** of 30 percent on overpayments resulting from claimant fraud.
- **Confidentiality Training Module** developed to reinforce management of EDD’s confidential and sensitive information and appropriately document potential fraudulent activity.
- **Impostor Fraud Training** provided to staff in an effort to curtail fraud and abuse. Tools are provided to assist in identifying abusive or fraudulent activity and the appropriate referral process.

In addition to the fraud deterrence and detection tools, the following special claim processing safeguards and automation techniques unique to the PFL program are currently being utilized:

- The requirement to submit a birth certificate, adoption or foster care certification on all bonding claims for which no medical evidence of a birth exists.
- 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 2011 THROUGH 2013

The following table illustrates the SDI programs’ dollar value and case number results for the last three years:

	<u>2011</u>	<u>2012</u>	<u>2013</u>
Cases Under Investigation	\$4,296,385 126 cases	\$3,273,344 103 cases	\$9,383,612 132 cases
Criminal Complaints Filed	\$521,996 21 cases	\$873,657 29 cases	\$407,701 19 cases
Completed Criminal Prosecutions	\$620,484 22 cases	\$664,003 20 cases	\$859,832 28 cases
Fraud OP Established	\$7,262,447 1,434 OPs	\$1,968,184 387 OPs	\$5,543,552 766 OPs
Fraudulent Benefits Prevented	\$3,172,510	\$1,169,307	\$314,885

- During CY 2013, ID investigated 132 cases representing a potential fraud amount of \$9,383,612. These investigations focused on the following case types: impostor fraud/identity theft (21 cases representing \$3,554,919); altered or forged documents (47 cases representing \$1,119,153); and medical practitioner fraud (7 cases representing \$3,157,036). The remaining 57 miscellaneous cases, representing \$1,552,504 included working while certifying for benefits and other case types.
- In CY 2013, ID filed 19 criminal complaints representing potential fraudulent benefits in the amount of \$407,701. The ID has continued its emphasis on the more complex fraud cases such as impostor/identity theft that take longer to investigate.
- During CY 2013, ID completed 28 criminal prosecutions representing fraudulent benefits in the amount of \$859,832. These completed prosecutions primarily involved altered and forged medical, counterfeit checks, impostors and working while certifying for benefits.
- In CY 2013, the DI and PFL staff established a cumulative total of 766 fraud overpayments in the amount of \$5,543,552.
 - The DI program established 407 fraud overpayments totaling \$3,262,005 on claims associated with claimants who were prosecuted.
 - The DI program established 357 fraud overpayments that were not attributed to prosecutions. These overpayments, totaling \$2,280,473 were the result of administrative actions applied by DI staff, such as false statement overpayments.
 - The PFL program established two fraud overpayments that were not attributed to prosecuted claimants. These overpayments, totaling \$1,074 were the result of enforced administrative remedies available to the DI program, such as false statement overpayments.
- In CY 2013, departmental anti-fraud efforts stopped \$3,219,979 in fraudulent SDI benefits from being paid. Of this total, \$2,905,094 is attributable to the SDI programs' 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 \$314,885 in fraudulent benefits was prevented through ID's ongoing investigations of identity theft, forgeries, and medical practitioner fraud.
- In 2013, 64 doctors certified to a high volume of activity. After review by the DI Branch and ID, it was concluded that 31 doctors' certifications were justified and no fraud or abuse was detected. In the remaining 33 cases, 2 cases are under investigation by ID, 29 cases are pending further evaluation by the FOIS, while the remaining 2 cases have been evaluated by the FOIS resulting in placement of one Tolerance Indicator.

FUTURE DI PROGRAM ENHANCEMENTS

The EDD continues to monitor, research, and investigate systems and activities in order to detect and prevent fraud within the SDI programs. As the SDI programs move to an electronic Web-based application for delivering SDI services to its clients, the need to maintain the security and integrity of the program is a high priority. The following describes fraud detection and prevention system enhancements to the SDI programs that are currently being developed:

- With the implementation of **SDI Online**, the DI Branch has the ability to manage fraud and abuse through automated programs and business logic. The DI Branch will continue to develop new reports and automated detection and prevention measures for new instances of fraud and abuse.
- The **SSN Verification** through Social Security Administration's records is being pursued by DI. If approved by the Social Security Administration, the claimant's SSN will be verified during the claimant's identification process, to detect potential fraud prior to filing an SDI claim.
- The **Benefit Audit Review** matches wages reported quarterly by employers to DI benefits paid within the same period. Through this review, the SDI programs will be able to detect when claimants have been fraudulently collecting benefits while working. Overpayments and penalties will be established and collected as a result of this process, protecting the solvency of the Disability Insurance Fund. The reviews will be performed quarterly.

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 2013, the UI program processed 5.3 million initial claims (this includes all new, transitional, additional regular and extensions claims, and work share claims), of which 3.3 million were new claims (this includes all new and transitional regular and extension claims), and paid a total of \$10.6 billion in benefits. These figures include the regular UI program in addition to the four federal extended benefit programs: Emergency Unemployment Compensation (EUC) Tiers I, II, III, and IV, which respectively began July 2008, November 2008, and November 2009 (both Tiers III and IV); the Federal-State Extended Benefits program, which began February 2009; and the Federal Additional Compensation (also known as \$25 weekly Stimulus Payments), which began February 2009 and ended in 2010.⁶

In July 2013, EDD announced that California was no longer eligible for Tier IV benefits. California fell below the federal requirement of a three month unemployment rate average of 9 percent or higher in order to continue to file for Tier IV extensions. The last effective date claimants could file a Tier IV extension was August 11, 2013. As of January 1, 2014, all other EUC federal extensions have ended unless Congress enacts further legislation. The last payable week ending date for all EUC extensions was December 28, 2013.

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 misrepresentation⁷ or willful nondisclosure of facts.
- **30 Percent Fraud Penalty Assessment** on any overpayments resulting from claimant fraud.
- **Bi-weekly Claim Certification** by claimants of their continued eligibility for benefits. This process requires the claimants to certify the accuracy and truthfulness of the statements made and that they understand that the law provides penalties for making false statements to obtain benefits.
- The **UI Benefit Accuracy Measurement Program** (also known as UI Quality Control) is an independent review of a random sample of claims throughout the year 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 ID for follow up. Beginning in January 2013, the National Directory of New Hires was cross-matched with UI claimants in order

⁶ Although the provisions for the Federal Additional Compensation ended in 2010, residual payments were made in 2011 because some claims were found eligible through the appeal process.

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

to detect claimants who began working but did not report these wages while receiving unemployment benefits.

- The **Benefit Audit Process** matches wages reported quarterly by employers to UI benefits paid within the same period. Through this process, the UI 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 **NER Benefit Cross-Match** 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, on a daily basis, the new hire information with EDD's records of claimants currently collecting UI benefits. Through this process, EDD is able to detect fraud and other eligibility issues up to six months earlier than through EDD's benefit audit process, allowing EDD to protect the UI Trust Fund by reducing the amount of dollars overpaid to claimants.
- **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 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 United States 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 United States.
- An **SSN Verification** provides real time (online) access to the Social Security Administration's records. The claimant's SSN is verified during the claimant's identification process, to detect potential fraud prior to filing a UI claim.
- The **DMV** provides real time (online) access to its database to verify a claimant's California driver's license or identification card number, prior to filing a UI claim. This part of the identity verification process is used to prevent identity theft fraud in the UI program.
- 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 EDD with this information will better ensure that proper payments are made to the appropriate individual.
- 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 ID's CIU. In addition, allegations can be reported via EDD's Web site (www.edd.ca.gov). This reporting option provides the ability to report fraud and other sensitive information (SSNs, etc.) in a secure environment. The number of UI program fraud allegations reported through the Hot Line and online are as follows: 7,901

allegations in CY 2011, 6,798 allegations in CY 2012, and 4,792 allegations in CY 2013.

- The **Identity Management System (IdM)** is an automated system that allows claimants to select a PIN in order to obtain personal claim information through the IVR telephone system, which is available 24-hours a day, seven days a week. The IdM was established to protect claimants' confidential information. Without a PIN, claimants are unable to access their personal and confidential claim information through the IVR system.
- 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 EDD 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 EDD 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 EDD to require a claimant to provide identity verification documentation upon request.

The Identity Alert Process is funded by both federal and State monies. Approximately 55 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 \$4.9 million.

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

- 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 (e.g., SSN and DMV verifications) 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 EDD 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 EDD's Web site (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 EDD’s Web site.

- Partnering with other states that have also experienced increases in UI impostor fraud. The EDD 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 for employers, as part of an ongoing **public education campaign** that includes information on how they can prevent and detect UI impostor fraud. Success in preventing, detecting, and deterring UI impostor fraud is dependent upon a strong partnership with the employer community.
- In December 2012, EDD began generating daily reports to detect internal fraudulent activities by EDD employees. These reports identify instances when an Integrity and Accounting Division employee updates a claimant's base wage file when there is not a current claim on the Single Client Data Base. A Re-computation Manager is responsible for performing a full review of each item listed on the report to determine if the update to the base wage file was for a valid and necessary reason.

RESULTS/ACCOMPLISHMENTS DURING CY 2011 THROUGH 2013

The following table illustrates the UI program’s results for the last three years:

	<u>2011</u>	<u>2012</u>	<u>2013</u>
Cases Under Investigation	\$20,393,902 147 cases	\$26,703,723 184 cases	\$27,371,876 158 cases
Criminal Complaints Filed	\$5,689,965 38 cases	\$5,475,321 32 cases	\$9,615,995 41 cases
Completed Criminal Prosecutions	\$6,230,137 29 cases	\$5,349,333 22 cases	\$9,202,643 27 cases
Fraud OP Established	\$261,648,720 225,891 OPs	\$245,554,283 201,636 OPs	\$188,678,548 163,196 OPs
Fraudulent Benefits Prevented By ID	\$1,414,838	\$6,418,708	\$2,833,268

- During CY 2013, ID investigated a total of 158 ongoing and new UI fraud cases representing potential fraudulent benefit payments in the amount of \$27,371,876. These investigations focused on the following case types: impostor fraud/identity theft (19 cases representing \$6,681,147); working while certifying for benefits (82 cases representing \$1,582,771); forgery – taking over another’s claim (24 cases representing \$392,648); and conspiracy between employer and claimant to certify for benefits (1 case representing \$5,746). The remaining 32 miscellaneous cases, representing \$18,709,564, included counterfeit checks and the use of multiple SSNs by one person.
- In CY 2013, ID filed 41 Criminal Complaints representing potential fraudulent benefits in the amount of \$9,615,995. During 2013, ID gave priority to investigating complex fraud cases involving the most egregious violations and the highest overpayments.

- In CY 2013, ID completed 27 criminal prosecutions representing fraudulent benefits in the amount of \$9,202,643. These cases are very large and complex both in terms of volume of claims and dollar value. Consequently, these investigations and prosecutions span several years.
- During CY 2013, UI program staff established a total of 163,196 fraud overpayments totaling \$188,678,548.
 - A total of 47,935 fraud overpayments totaling \$31,441,695 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 the benefit audit process, 25,788 overpayments were established, totaling \$18,648,748. The NER cross-match established 22,147 overpayments, totaling \$12,792,947. Because the NER cross-match allows EDD to detect fraud and other eligibility issues up to six months earlier than through the benefit audit process, the average amount of overpayment is \$578 compared to \$723 for a benefit audit overpayment, a variance of \$145. This is an average savings, or benefit overpayment avoidance, of \$3.2 million annually. Based on findings through the Benefit Accuracy Measurement system, the top two leading causes of fraud overpayments are unreported work and earnings during the bi-weekly benefit certification and misreported separation information at the claim filing point.
 - UI program staff established fraud overpayments on 73 cases of identity theft totaling \$264,228.
 - A total of 115,188 fraud overpayments were established that were not attributed to the Benefit Audit or NER cross-match system or identity theft. These overpayments, totaling \$156,972,625, were established for a variety of reasons including retroactive disqualifications of miscellaneous eligibility issues and unreported work and earnings that were not discovered through the Benefit Audit cross-match system.
- In compliance with California regulations, UI program staff imposed disqualifications and overpayments on 782 cases totaling an additional \$1,600,471 in non-fraud overpayments when claimants failed to comply with EDD's request for identity verification information and there was insufficient information to determine the real owner's identity.
- In CY 2013, ID identified \$2,833,268 in fraudulent benefits that were referred to UI Branch for assessment of administrative penalties and collection of overpayments due to fraud. These violations were determined to be unsuitable for prosecution based on the amount of overpayment, number of weeks of violation, unavailability of witnesses and records, and other factors identified by prosecuting authorities. The violations included claimant failure to report work and earnings while certifying for benefits, stolen identity, employer collusion with employees, and altered or forged documents.
- In June 2010, EDD launched the first phase of a new Web option called Internet Continued Claims Filing (EDD Web-CertSM) which enables many claimants to

complete and submit their bi-weekly continued claim forms online, instead of the mail-only option. Going paperless helps claimants by reducing common fill-in errors that can cause benefit delays. The Web certification method also creates a more efficient delivery system. It allows claimants to certify for benefits online and reduces the time between the mail-in certification process and payments processing time.

- In November 2010, EDD launched the first phase of a new telephone certification service called Telephone Continued Claims Filing (EDD Tele-CertSM) which gives the majority of claimants a new self-service option to complete their bi-weekly continued claim forms via telephone. Again, a paperless option for the continued claim form helps customers avoid some of the common fill-in errors that occur with the hard-copy, mail-in version of the form and cause payment delays. The new telephone service is available 24-hours a day, seven days a week.
- The UI Modernization Project was created to enhance service delivery, increase fraud detection and prevention, improve program integrity, and build a more flexible and responsive infrastructure to operate the UI program. This automation project also enhances EDD's anti-fraud components to ensure that benefits are paid properly and that employers' reserve accounts are charged appropriately. The UI Modernization project is comprised of two sub-projects, the Call Center Network Platform and Application Upgrade (CCNPAU) and Continued Claims Redesign (CCR) projects.
 - The CCNPAU Project, completed in June 2011, replaced EDD's outdated call center system with a more updated enterprise call center system infrastructure. This new system has a management information system that reports call activity, enabling EDD to capture call history and call data for fraud detection and prevention. Additionally, the CCNPAU project implemented new self-service IVR features, including the ability to certify for continued claims by phone via EDD Tele-CertSM.
 - The CCR Project released for internal EDD staff use on September 3, 2013, redesigned EDD's Continued Claims Certification process that is a bi-weekly process during which a claimant's continued eligibility for UI benefits is determined and payments are made accordingly via mailed paper forms or by EDD Web-CertSM or Tele-CertSM. The CCR project enhances the telephonic certification established by the CCNPAU subproject (EDD Tele-CertSM), deploys a new enhanced Internet certification channel, redesigns the UI benefit payment system, and provides self-service capability. The system will validate claimant responses, eliminate rework and the need to reissue forms, and enable UI staff to ask clarifying questions to determine if eligibility issues exist. The new system will handle all payments, including adjustments. This will allow EDD to redirect staff to focus on other service areas and better ensure that EDD meets federal payment timeliness requirements. This project also provides for a new client database, new tools for fraud detection, and efficiencies to EDD's process for managing Internet web content and customer e-mail.

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 toward an electronic system, such as Web-based applications for delivering UI services to its 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:

- **Fraudulent Claim Profiles** are being established to institute ongoing system checks for identification of claims that fit fraud patterns.
- The **UI Modernization Project** created new reporting mechanisms to enhance fraud prevention and detection. For example, an internal Fraud Alert Report includes alerts on potential UI fraud activity for pre-existing triggers. Once the report is finalized, ID staff will monitor the report and investigate the potential fraudulent activities.
- The **CCR Project** will provide new UI online services for claimants to certify for continued benefits, reopen existing claims, and manage their UI claim account information. The expanded self-service functions should assist the EDD in meeting federal performance guidelines for benefit payment timeliness as more claimants use the self-services. The schedule for the release of these enhancements is currently being developed.
- The **EDD Customer Account Number** is a federal mandate requiring states to discontinue using claimants' SSN for identification to further protect claimants' personal information. The EDD will assign a 10-digit EDD Customer Account Number that will be used on EDD-issued documents and by claimants to register for a PIN in the IdM system to access their personal and confidential information when the new IVR system is released.
- The **UI Separation Information Data Exchange System (UI SIDES)** will create a nationally-standardized Web-based system for multi-state employers and/or third party administrators to access and complete requests for UI information. The UI SIDES will reduce the amount of time it takes for employers to complete requests, such as the Notice of Initial Claim Filed (DE 1545) which is currently being mailed to employers, thus providing EDD with information to detect fraudulent activity earlier in the claim filing process. The UI SIDES is scheduled for implementation in March 2015.
- The **Treasury Offset Program**, administered by the Bureau of Fiscal Service in the United States Department of Treasury, allows states to collect delinquent State UI benefits overpayment liabilities from claimants by offsetting their federal income tax refunds. The EDD is currently developing the necessary program updates to begin participation in the Treasury Offset Program in September 2014.

EMPLOYMENT TAX PROGRAMS

The EDD is one of the largest tax collection agencies in the United States, collecting UI, DI, Employment Training Tax, and State Personal Income Tax withholdings. Only the Internal Revenue Service (IRS) collects more payroll tax dollars than EDD. During 2013, EDD collected \$56.7 billion in California payroll taxes from over 1.3 million employers.

The EDD Tax Branch's mission is to work with employers to collect state employment taxes and data to support the employment security, child support, and Personal Income Tax programs. The EDD is committed to reducing unfair business competition and protecting the rights of workers by coordinating the joint enforcement of tax, labor, and licensing law; detecting and deterring employment tax violations in the underground economy; and educating customers to increase compliance with tax laws. The EDD has field presence throughout the State and also conducts out-of-state audits to provide enforcement, education, and assistance. The Tax Branch takes a blended approach to combating the underground economy through the following:

- **Outreach and Education** – The Tax Branch has a variety of methods for outreach and education targeted and accessible to employers, employees, tax professionals, and the general public. The outreach and education is tailored towards encouraging and maximizing voluntary compliance and deterring businesses from operating in the underground economy.
- **Administrative** – The Tax Branch has administrative methods of enforcing the payroll tax laws: the Tax Audit Program issues assessments for payroll taxes due and any applicable penalties and interest to employers located in the State and to employers out-of-state, having California workers. When appropriate, penalties for intent to evade and/or fraud may be applied. The Tax Branch performs follow-up audits to confirm continued compliance. The Tax Branch continually works on identifying new and different methods to promote and verify prospective compliance.
- **Criminal** – The ID has a specialized law enforcement unit that investigates criminal violations of the CUIA, the California Penal Code, and the United States Code for federal prosecution. They conduct criminal investigations involving employer collusion in the underground economy, employer failure to register and report wages paid to employees, and collaborate on Workers' Compensation Insurance investigations related to state payroll tax violations. They conduct surveillance, perform undercover operations, interview witnesses, initiate search warrants, and submit completed investigations to prosecutors to convict individuals who commit employment tax fraud. The Tax Branch and ID leverage resources, share best practices, and work together to combat the underground economy.

The following are some Tax Branch specific efforts in combating the underground economy:

- In 2013, the **Tax Audit Program** conducted 6,749 audits and investigations, resulting in assessments totaling \$155,808,394, and identified 102,479 unreported employees. The EDD has the authority to issue assessments that are **immediately** delinquent and collectable if it is determined that the collection of the assessment is

jeopardized by the delays that occur with the normal assessment process. The Tax Audit Program and Legal Office work together to properly establish and collect on these types of assessments.

- The **Interagency Tax Collection Committee** is an alliance with EDD, Franchise Tax Board (FTB), Board of Equalization (BOE), IRS, Attorney General, State Controller and various county recorders. It provides a forum to share common collection practices in order to increase compliance and resolve collection issues. It also allows the agencies to meet and share information about their collection programs, focusing on common, competing and overlapping functions including bankruptcy, lien, and levy issues. It is intended to foster communications and allow collection staff to meet their counterparts, establish working relationships, and encourage cooperation on common tax collection issues.
- The **Joint Enforcement Strike Force (JESF)** was established in October 1993, by Executive Order W-66-93 to combat the underground economy by pooling resources and sharing data among the State agencies charged with enforcing licensing, labor, and payroll tax laws. On January 1, 1995, Section 329 was added to the CUC, which placed the provisions of the Executive Order into law. The EDD is the lead agency for the JESF. The JESF is responsible for enhancing the development and sharing of information necessary to combat the underground economy, to improve the coordination of enforcement activities, and to develop methods to pool, focus, and target enforcement resources.

The JESF is empowered and authorized to form joint enforcement teams when appropriate to utilize the collective investigative and enforcement capabilities of the JESF partners. The partners include, but are not limited to the: EDD; Department of Industrial Relations (DIR); Department of Consumer Affairs - Contractors State Licensing Board, Bureau of Automotive Repair, and Bureau of Security Investigative Services; Department of Insurance; Department of Justice; FTB; BOE; Department of Labor (DOL); Alcoholic Beverage Control; IRS; district attorneys throughout California; and local law enforcement. The EDD's enforcement efforts undertaken by the JESF to combat the underground economy include:

- Conducting unannounced site inspections to identify employers operating in the underground economy by interviewing owners, managers, and workers. The goal is to identify and bring into compliance individuals and businesses in the underground economy that are in violation of payroll tax, labor, and licensing laws.
- Utilizing various databases, income tax return analysis, along with informant information to conduct in-depth desk investigations of employers suspected of operating in the underground economy. When noncompliance is detected, the case is referred to the Tax Audit Program.
- Collaborating efforts between EDD and IRS to allow for an exchange of case information regarding unreported wages and/or misclassified workers. This multiagency compliance approach presents a united effort to taxpayers and their representatives that both the federal and State agencies work together to enforce tax laws.

- Targeting of industries known for high levels of noncompliance with licensing, labor, and payroll tax laws.
- Pursuing administrative actions to address employer noncompliance detected via the JESF efforts, or for cases warranting criminal investigation, ID's Criminal Tax Enforcement Program works with law enforcement agencies and the JESF partner agencies to identify and prosecute those responsible for the criminal activities.
- The **Labor Enforcement Task Force (LETF)** was initially formed in 2005 as the Economic and Employment Enforcement Coalition (EEEC) and began operating as the Labor Enforcement Task Force in January of 2012. The LETF is responsible for ensuring that California workers receive proper payment of wages and are provided a safe work environment; ensuring that California receives all employment taxes, fees, and penalties due from employers; eliminating unfair business competition by leveling the playing field; and making efficient use of State and federal resources in carrying out its mission. The DIR leads this multi-agency coalition. The LETF partners include the: DIR; EDD; Department of Consumer Affairs – Contractors State Licensing Board and Bureau of Automotive Repair; BOE; California Department of Insurance; and State Attorney General and district attorneys throughout California.

The JESF and LETF are similar in mission, vision, and goals, with the focus of JESF primarily on tax law, and LETF's focus on labor law. However, in late 2013, the JESF and LETF began an administrative collaboration effort called the LETF/JESF Collaborative Enforcement Partnership. This was done to improve communication between the two programs by holding joint strategic executive meetings and bi-weekly operational meetings. The JESF and LETF will leverage the strengths of each program and deploy the statewide staffing of the combined enforcement teams. By doing so, the LETF/JESF Collaborative Enforcement Partnership will be able to target industries with a broader reach throughout California.

- The **FedState Tax Partnership** is an ongoing alliance between the FTB, EDD, BOE, and IRS. The mission of the FedState Tax Partnership is to develop and maintain a partnership that increases tax compliance and provides greater convenience to taxpayers. The FedState Tax Partnership goals include: enhancing taxpayer access to information and services; reducing taxpayers' burden; increasing voluntary compliance; increasing the sharing of taxpayer data among the partner agencies to enhance compliance activities; enhancing communication among the tax partner agencies regarding current and long-range agency specific projects; and identifying opportunities to leverage resources among the partner agencies.

This partnership is an enduring alliance which works towards an increasingly convenient, effective and streamlined tax system that provides user-friendly service to taxpayers and improves tax compliance for the State of California. The FedState Tax Partnership is a virtual "agency consolidation" of purpose and taxpayer service, that: shares data for compliance purposes; focuses on the taxpayer; achieves leverage through combined resources; and embodies a solid collaborative partnership.

- The **Compliance Development Operations (CDO)** within the Tax Branch identifies and makes assessments of UI rate differences when reserve accounts are transferred by employers attempting to unlawfully attain lower UI tax rates through rate manipulation schemes. The CDO screens and provides lead development for out of state, in-state, industry specific, and other forms of allegations. In addition, CDO also captures allegations of non-compliance submitted through the Underground Economy Fraud Hotline, correspondence, and electronic mail, which are screened and referred for audit. The CDO serves as the primary lead development organization for the Tax Audit Program and includes the following programs:
 - The **Employment Enforcement Task Force (EETF)** works with the JESF participating agencies and conducts joint on-site business inspections in response to allegations received about employers operating in the underground economy. The EETF is the first program implemented by the JESF and was created to help meet the legislative intent for this strike force.
 - The **Tax Enforcement Group (TEG)** develops audit leads by conducting desk investigations of businesses in a variety of industries using various databases and income tax return analysis to detect noncompliance and fraud.
 - The **LETF** works with participating agencies to carry out LETF's mission and conducts joint on-site business inspections to determine if an audit referral is needed.
 - The **Lead Development and Program Support Group (LDPSG)** captures allegations of non-compliance submitted via the Underground Economy Fraud Hotline, correspondence, and electronic mail. The allegations are screened and forwarded to the appropriate CDO group or the Tax Audit Program for follow-up. The LDPSG also develops tax audit leads on out-of-state employers with operations in California and leads received through certain inter-agency lead exchange agreements.
 - A **Questionable Employment Tax Practices Program (QETP)** - During CYs 2010 and 2011, EDD had a pilot program under which they used the IRS QETP case information to issue assessments for amounts owed to EDD. In 2012, the pilot program ended and EDD began referring these cases to their Tax Audit Program as audit leads.
 - The **UI Rate Equity Group (UIREG)** identifies situations involving the CUIC Sections 135.2 and 1061. The UIREG makes assessments of UI rate differences when reserve accounts are transferred by employers attempting to circumvent the UI experience rating system to inappropriately gain a favorable UI rate.

COMPLIANCE DEVELOPMENT OPERATIONS AND RELATED AUDIT AND INVESTIGATION RESULTS DURING CY 2011 THROUGH 2013

Statistics for the EETF, TEG, LETF, and LDPSG programs are included in this section but it does not include statistics for the UIREG program for consistency with the previous

year's reporting. The UIREG program statistics are included in a separate section on page 24 of this report.

The following table illustrates CDO's cumulative activities and lead development results of all CDO programs combined for the last three years:

	<u>2011</u>	<u>2012</u>	<u>2013</u>
Joint Inspections	1,357	2,599	1,876
EDD Audit Referrals	509	1,166	1,419
EDD Payroll Tax Audits	630	678	919
EDD Payroll Tax Assessments	\$43,659,074	\$36,348,078	\$35,528,993
Previously Unreported Employees	3,908	13,226	18,024
Cases w/Fraud Penalty Assessed	51	67	40
Assessments on Fraud Cases	\$8,287,094	\$9,131,000	\$3,701,542

The following table illustrates the audit and investigation results through non-CDO lead sources of employer fraud cases for the last three years:

	<u>2011</u>	<u>2012</u>	<u>2013</u>
Cases w/Fraud Penalty Assessed	81	159	66
Unreported Employees	1,323	7,622	10,775
Assessments on Fraud Cases	\$15,667,152	\$32,306,402	\$17,139,033

The following table illustrates EETF's results for the last three years:

	<u>2011</u>	<u>2012</u>	<u>2013</u>
Joint Inspections	324	1,472	807
EDD Audit Referrals	177	406	470
EDD Payroll Tax Audits	132	208	251
EDD Payroll Tax Assessments	\$9,326,603	\$8,762,202	\$9,918,286
Unreported Employees	547	2,815	2,716
Cases w/Fraud Penalty Assessed	23	31	19
Assessments on Fraud Cases	\$3,838,209	\$3,253,090	\$1,546,578

The following table illustrates TEG's results for the last three years:

	<u>2011</u>	<u>2012</u>	<u>2013</u>
EDD Audit Referrals	87	285	253
EDD Payroll Tax Audits	67	131	175
EDD Payroll Tax Assessments	\$11,699,336	\$8,942,761	\$6,285,275
Previously Unreported Employees	1,899	3,034	3,458
Cases w/Fraud Penalty Assessed	6	7	6
Assessments on Fraud Cases	\$3,423,355	\$2,414,328	\$1,080,816

The following table illustrates EEEEC's (2011) and LETF's (2012 and 2013) results*:

	<u>2011</u>	<u>2012</u>	<u>2013</u>
Joint Inspections	1,033	1,127	1,069
EDD Audit Referrals	214	475	696
EDD Payroll Tax Audits	240	181	214
Self-Audit Program	196	36	0
EDD Payroll Tax Assessments	\$4,674,574	\$7,508,385	\$6,414,504
Unreported Employees	699	2,144	1,483
Cases w/Fraud Penalty Assessed	22	29	15
Assessments on Fraud Cases	\$1,025,530	\$3,463,582	\$1,074,148

* Please note that the figures shown above for 2011 are EEEEC CY statistics while the EEEEC Annual Report provides statistics on a State Fiscal Year basis. Consequently, the numbers in this report will not match with the EEEEC Annual Report State Fiscal Year numbers.

The following table illustrates the number of audits and investigations completed as a result of the QETP project over the last three years. There were no QETP cases with fraud found in 2012.

	<u>2011</u>	<u>2012</u>	<u>2013</u>
EDD Payroll Tax Cases	5	51	65
EDD Payroll Tax Assessments	\$82,197	\$274,066	\$827,771
Average Liability Change	\$16,439	\$5,374	\$12,735
Unreported Employees	45	442	738

The following table illustrates the number of allegations received and processed by the LDPSG for the last three years:

	<u>2011</u>	<u>2012</u>	<u>2013</u>
Underground Economy Fraud Hotline**	2,210	2,097	2,745
Underground Economy Mailbox (e-mail)**	462	419	1,341
Correspondence	466	140	225
Total	3,138	2,656	4,311

**The number of allegations received and processed from the Underground Economy Fraud Hotline and the Underground Economy Mailbox (e-mail) were previously reversed in error for years 2011 and 2012. The table above now displays these figures correctly.

The following table illustrates the number of audits and investigations completed as a result of out-of-state referrals by the LDPSG over the last three years. There were no out-of-state cases with fraud found in 2012.

	<u>2011</u>	<u>2012</u>	<u>2013</u>
EDD Payroll Tax Cases	31	107	214
EDD Payroll Tax Assessments	\$2,413,049	\$10,860,663	\$12,083,157
Average Liability Change	\$77,840	\$101,502	\$56,463
Unreported Employees	718	4,791	9,629

The following table illustrates the UIREG workload accomplishments for the last three years.

	<u>2011</u>	<u>2012</u>	<u>2013</u>
CUIC, Section §1061			
Payroll Tax Investigations	154	158	246
Payroll Tax Assessments	\$5,806,377	\$6,731,440	\$9,347,095
Average Liability Change	\$37,704	\$42,604	\$37,996
CUIC, Section §135.2			
Payroll Tax Investigations	1	17	3
Payroll Tax Assessments	\$9,656,938	\$263,066	\$0
Average Liability Change	\$9,656,938	\$15,474	\$0

In 2013, ID conducted additional tax enforcement activities independent of JESF.

- The ID investigated a total of 151 ongoing and new payroll tax evasion fraud cases representing a potential tax liability of \$80,768,210. The investigations focused on the following case types: payroll tax fraud (146 cases representing potential tax liability of \$77,950,415) and LETF (5 cases representing potential tax liability of \$2,817,794). The LETF cases represent investigations conducted on employers in the industries identified by LETF.
- The ID filed 22 criminal complaints representing a potential tax liability of \$45,033,030.
- The ID completed 10 criminal prosecutions representing a potential tax liability of \$4,313,819.
- Prevention/Tax Money Collected by EDD: the ID referred 7 conviction cases with tax liabilities in the amount of \$355,000 to EDD's Collection Division for recovery.

WORKFORCE SERVICES 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 EDD guides the sub-granting of WIA funds received from 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 WIA, and applicable federal, State, and local rules and regulations, and require corrective action 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 sub-recipients 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 under 20 Code of Federal Regulations Section 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 United States 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 sub-recipients 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 each grantee adheres to the terms and conditions of their grant with EDD.

- **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 2013

The Compliance Resolution Unit 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, and American Recovery and Reinvestment Act funds. Although the American Recovery and Reinvestment Act program has ended, activity continues to resolve those fraud and abuse cases.

During CY 2013 the Compliance Resolution Unit processed 187 cases, 113 of which were resolved. At the end of the year, 74 on-going cases for a total of \$7,286,930 in questioned costs remained open in various stages of the State resolution process.

- The \$7,286,930 applies to 12 of the 74 cases for which EDD has been able to determine the potential disallowance.
- The remaining 62 cases are in various stages of resolution and fact-finding by the Compliance Resolution Unit, Workforce Services Division, LWIA or other sub-grantees. These activities may also involve investigations by local law enforcement, DOL, or the Office of Inspector General.

INDEPENDENT OVERSIGHT ACTIVITIES

The EDD's Policy, Accountability and Compliance Branch (PACB) 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 PACB 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 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, taxes; and internal fraud by EDD employees.

The PACB 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 PACB'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 PACB 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.

- **Technical Assistance** is provided by the PACB to EDD staff prior to and during the system design phase of automation projects 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.
- **On-site Monitoring Reviews of WIA and Disaster Relief** are 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 PACB 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.

- The **WIA and Disaster Relief Incident Reporting** provide a reporting and follow-up process for allegations of program fraud and abuse. The PACB 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.
- **Criminal Fraud Investigations** are conducted by ID to prevent, detect, and deter fraud committed against the UI, DI and 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/or criminal prosecution.

The PACB utilizes several methods to detect fraud in EDD 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 allegations of fraud against the UI program, the DI program, and other programs administered by EDD.

- The EDD Web site (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 PACB participates in task forces with other State and federal law enforcement agencies such as the California Department of Insurance, FTB, IRS, DOL, United States Postal Inspectors, and prosecutors.
- The Audit and Evaluation Division conducts forensic accounting and audit examinations in response to requests for assistance from ID.
- The results of PACB's investigative activities for CY 2013, as well as the previous two CYs are covered in the DI, UI, and Employment Tax sections of this report.
- The ID's CIU develops strategic and tactical intelligence for investigative planning and case identification, and assists program managers 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 is 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 that EDD can use to counter these trends and patterns can then be developed or enhanced.

The use of EDD's Business Intelligence Competency Center is helping CIU to utilize complex software to improve data mining to prevent and detect fraud in EDD. The Business Intelligence Competency Center is used to improve CIU's fraud detection efforts by conducting in-depth data analyses and identify patterns and trends that will serve as potential indicators of fraudulent activity.

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 2013, 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 ID, jointly with both the UI and DI programs, has begun to identify claim or payment characteristics that are indicative of fraud. The ID contributed to the development of the new SDI Online and CCR projects to ensure fraud detection rules are placed in the systems at the development stage. 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 ID and the Audit and Evaluation Division 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 ID is now partnered with Tax Branch staff to develop a strategy for addressing fictitious employer schemes responsible for perpetrating fraud against EDD. The objective is to identify potential fictitious employer schemes based on thorough and ongoing evaluation of the characteristics/elements of such schemes. The identification of these schemes allows EDD to increase detection and eliminate fraudulent UI and DI benefit claims filed against EDD.
- The ID has continued to foster joint investigative activities with DOL and the United States 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.
- The ID has partnered with the State Treasurer's Office to obtain direct online access for retrieving and printing State Treasurer's Office processed warrants. This partnership allows immediate review of paid and non-paid warrants and increases ID's ability to effectively investigate criminal activity.

Automated Fraud Detection and Prevention Tools Under Consideration

- Electronic linkage of the Tax and the UI systems to enhance EDD's ability to detect fraud.
- Automated interfaces with other governmental agency databases.
- Visual intelligence analysis software was acquired by ID to address the increasing complexities and sophistication of criminal activity. This state-of-the-art software delivers data storage, analysis, visualization and dissemination capabilities that will enable EDD to increase the value of massive amounts of information. This product gives EDD the ability to discover networks, patterns, and trends across increasing volumes of structured and unstructured data. This intelligence can help identify, predict, prevent and disrupt fraudulent activities.

Coupled with an intuitive intelligence data management application that allows for the capture, control, and analysis of multisource data, it addresses the analyst's daily challenge of discovering and uncovering networks, patterns, and trends in today's increasing volumes of complex structured and unstructured data.

- A comprehensive program integrity initiative built around a cloud-based fraud detection service solution. In 2013, ID requested and was award a grant from DOL to implement this comprehensive program integrity initiative. This solution will analyze employer, claimant, and claims data to identify potential overpayments and fraudulent activities. This solution uses advanced analytics to flag or alert ID staff to potential fraud, create prediction models that can be used to anticipate future fraudulent activity, and employ a geospatial component to produce graphical displays.

ACRONYMS

BOE	Board of Equalization
CCR	Continued Claims Redesign
CCNPAU	Call Center Network Platform and Application Upgrade
CDO	Compliance Development Operations
CIU	Criminal Intelligence Unit
CUIC	California Unemployment Insurance Code
CY	Calendar Year
DI	Disability Insurance
DIR	Department of Industrial Relations
DMV	Department of Motor Vehicles
DOL	Department of Labor
EDD	Employment Development Department
EEEC	Economic and Employment Enforcement Coalition
EETF	Employment Enforcement Task Force
EUC	Emergency Unemployment Compensation
FOIS	Field Office Integrity Specialist
FTB	Franchise Tax Board
ID	Investigation Division
IdM	Identity Management System
IME	Independent Medical Examination
IRS	Internal Revenue Service
IVR	Interactive Voice Response
JESF	Joint Enforcement Strike Force
LDPSG	Lead Development and Program Support Group
LETF	Labor Enforcement Task Force
LWIA	Local Workforce Investment Area
NER	New Employee Registry
OP	Overpayment
PACB	Policy, Accountability and Compliance Branch
PFL	Paid Family Leave
PIN	Personal Identification Number
QETP	Questionable Employment Tax Practices Program
SDI	State Disability Insurance
SSN	Social Security Number
TEG	Tax Enforcement Group
UI	Unemployment Insurance
UIREG	Unemployment Insurance Rate Equity Group
UI SIDES	Unemployment Insurance Separation Information Data Exchange System
WIA	Workforce Investment Act

This report was prepared by the Policy, Accountability and Compliance Branch of the
California Employment Development Department

Labor and Workforce Development Agency

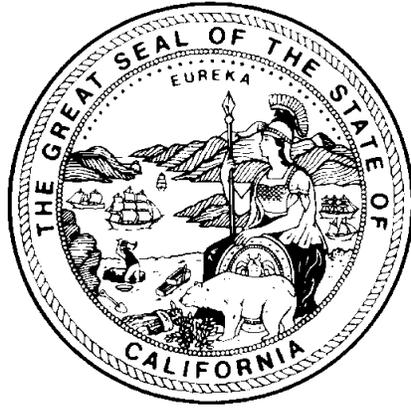
SecretaryDavid Lanier

Employment Development Department

DirectorPatrick W. Henning Jr.

For more information, please call (916) 654-7249.

EDD is an equal opportunity employer/program. Auxiliary aids and services are available upon request to individuals with disabilities. Requests for services, aids, and/or alternate formats need to be made by calling 916-654-7249 (voice) or TTY users, please call the California Relay Service at 711.



STATE OF CALIFORNIA

LABOR AND WORKFORCE DEVELOPMENT AGENCY

EMPLOYMENT DEVELOPMENT DEPARTMENT