



ANNUAL REPORT

FRAUD DETERRENCE AND DETECTION ACTIVITIES

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

EIGHTEENTH REPORT

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EXECUTIVE SUMMARY

This report documents the Employment Development Department’s (EDD) fraud deterrence and detection activities for Calendar Year (CY) 2011, as required by California Unemployment Insurance Code 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 2011, through the administration of its programs, EDD collected more than \$51 billion in employment taxes from over 1.3 million employers and issued benefit payments in excess of \$22 billion on over 7.4 million UI and DI claims.

To protect the integrity of its programs, EDD enforces the California Unemployment Insurance Code 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 2011, 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	\$ 4,296,385 126 cases	\$ 20,393,902 147 cases	\$ 47,023,693 186 cases
Criminal Complaints Filed	\$ 521,996 21 cases	\$ 5,689,965 38 cases	\$ 7,948,481 27 cases
Completed Criminal Prosecutions	\$ 620,484 22 cases	\$ 6,230,137 29 cases	\$ 3,269,475 18 cases
Fraud Overpayments (OP)	\$ 7,262,447 1,434 OPs	\$ 261,648,720 225,891 OPs	N/A
Fraudulent Benefits Prevented	\$ 3,172,510	\$ 1,414,838	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 components² 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 EDD. The final section of this

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

² See WIA program details on pages 25-26.

report highlights enterprise-wide efforts in progress and under consideration to prevent, detect, and deter fraud.

BACKGROUND

The California Unemployment Insurance Code 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 2011, EDD collected more than \$51 billion in employment taxes and issued benefit payments in excess of \$22 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 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 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 Hotline; 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 DI program, and the Paid Family Leave (PFL) program. The DI program provides partial wage replacement for eligible 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 SDI program. During CY 2011, the DI program processed 726,493 claims and paid out over \$4.5 billion in benefits. The PFL program processed 205,833 claims and paid out over \$515 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 and 2 Program Integrity Analysts. The manager and the FOIS oversee, coordinate, and conduct various staff education efforts and investigative activities involving suspicious claims in the DI and PFL 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 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 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 EDD Medical Director's Office oversees the panel of healthcare professionals that perform IMEs. The EDD Medical Director screens applicants for this panel to ensure they have appropriate credentials. In addition, the EDD Medical Director 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.

Although the primary use of IMEs is the validation of the treating physician's diagnosis and 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 2011, of the 29,164 IME results received, 1,729 (5.9 percent) of the claimants scheduled for an IME failed to appear, and 8,897 (30.5 percent) were found able to work on the date of the IME examination.

- **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 automated monthly 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 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 by checking the Social Security Numbers (SSN) of all claimants against SSNs of individuals reported as deceased by the Department of Public Health. The report enables 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 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. As a result of these enhancements, 24 referrals were made to the FOIS for further action in CY 2009 and 106 in CY 2010, and 268 in CY 2011.

- The **Doctor Activity Tracking System** tracks the status of investigations involving potential doctor³ or doctor impostor⁴ 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.
- **DI Quality Control Reviews** test a random, statistically valid, sample of DI benefit payments annually for accuracy, completeness, and compliance with the California Unemployment Insurance Code, Title 22 of the California Code of Regulation and DI Branch policy. These reviews detect the nature and extent of inaccurate payments, reveal opportunities for process improvement, and serve to identify potential fraud. As a result of these reviews and special claims projects, eight referrals were made for further action in CY 2011.
- **PFL Quality Control Reviews** test a random, statistically valid, sample of PFL benefit payments annually to verify that a claimant has met essential eligibility requirements and that benefits have been paid accurately in compliance with the California Unemployment Insurance Code and Title 22 of the California Code of Regulations. These reviews detect the nature and extent of inaccurate payments, reveal opportunities for process improvement, and serve to identify potential fraud. As a result of these reviews, one referral was made for further action in CY 2011.
- **Medical Board Notifications** 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 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.

³ Doctors who knowingly certify claims for individuals who are not disabled.

⁴ Someone other than the doctor signs the doctor's name on DI claim forms.

- 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). The number of SDI program fraud allegations reported through the Hot Line is as follows: 670 allegations in CY 2009, 790 allegations in CY 2010 and 1,093 allegations in CY 2011.
- Fraud allegations were also reported via the **EDD Web site** (www.edd.ca.gov). It provides the ability to report fraud and other sensitive information (SSNs, etc.) in a secure environment. An additional 760 allegations in CY 2009, 966 allegations in 2010, and 2,055 allegations in 2011 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.
- **Electronic Benefit Payment (EBP)** provides an electronic payment system for disbursing of DI and PFL benefit payments. The EBP 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 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 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 are 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.
- An **Educational Outreach Campaign** to the California medical community led by the EDD Medical Director's Office in partnership with SDI's Education Outreach Unit

enhances medical providers' understanding of the DI and PFL programs and their role in the claim filing process. The educational programs are geared to the California medical community including both resident physicians and physicians in practice. 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 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.

- **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 by the EDD Medical Director 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 medical providers when discussing and obtaining additional medical information regarding a DI or PFL 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 take appropriate action to control claim duration or potential abuse of the programs.

The EDD Medical Director's Office is available to consult with staff concerning unusual medical conditions by providing guidance on how to establish and employ duration control measures.

- **Fraud Penalty Assessment** of 30 percent on overpayments resulting from claimant fraud.
- **Education and Outreach** is provided to medical providers and public/private employers regarding program information and practices, as well as, their key role in verifying claimant information to ensure proper payment of benefits and continued integrity of the Disability Fund.
- **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 2009 through 2011

The following table shows the SDI program’s dollar value and case number results for the last three years:

	<u>2009</u>	<u>2010</u>	<u>2011</u>
Cases Under Investigation	\$ 4,250,647 127 cases	\$ 4,417,761 126 cases	\$ 4,296,385 126 cases
Criminal Complaints Filed	\$ 749,890 23 cases	\$ 525,446 21 cases	\$ 521,996 21 cases
Completed Criminal Prosecutions	\$ 904,411 14 cases	\$ 759,984 25 cases	\$ 620,484 22 cases
Fraud Overpayments ⁵ (OP)	\$ 2,691,401 631 OPs	\$ 3,601,131 806 OPs	\$ 7,262,447 1,434 OPs
Fraudulent Benefits Prevented	\$ 4,413,636	\$ 3,270,000	\$ 3,172,510

- During CY 2011, ID investigated 126 cases representing a potential amount of \$4,296,385. These investigations focused on the following case types: impostor fraud/identity theft (14 cases representing \$1,508,282); altered or forged documents (50 cases representing \$1,166,397); medical practitioner fraud (7 cases representing \$152,630); and counterfeit checks (1 case representing \$32,025). The remaining 54 miscellaneous cases, representing \$1,437,051 included working while certifying for benefits and other case types.

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

- In CY 2011, ID filed 21 Criminal Complaints representing potential fraudulent benefits in the amount of \$521,996. The ID has continued its emphasis on the more complex fraud cases such as impostor/identity theft that take longer to investigate.
- During CY 2011, ID completed 22 criminal prosecutions representing fraudulent benefits in the amount of \$620,484. These completed prosecutions primarily involved altered and forged medical, counterfeit checks, impostors and working while certifying for benefits.
- In CY 2011, the DI and PFL programs established a cumulative total of 1,434 fraud overpayments in the amount of \$7,262,447.
 - The DI program established 739 fraud overpayments totaling \$4,216,238 on claims associated with claimants who were prosecuted.
 - The DI program established 685 fraud overpayments that were not attributed to prosecutions. These overpayments, totaling \$3,038,144 were the result of administrative actions applied by the DI program, such as false statement overpayments.
 - The PFL program established 10 fraud overpayments that were not attributed to prosecuted claimants. These overpayments, totaling \$8,065 were the result of enforced administrative remedies available to the DI program, such as false statement overpayments.
- In CY 2011, departmental anti-fraud efforts stopped \$3,172,510 in fraudulent SDI benefits from being paid. Of this total, \$3,105,423 is attributable to SDI 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 \$67,087 in fraudulent benefits was prevented through ID's ongoing investigations of identity theft, forgeries, and medical practitioner fraud.
- In 2011, 55 doctors certified to a high volume of activity which included 28 that already had a Tolerance Indicator established based on a previous review. In 12 cases, after review by 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 43 cases, 4 are under investigation by ID; 1 evaluation has been completed; and 38 cases are pending further evaluation by the FOIS.

FUTURE DI PROGRAM ENHANCEMENTS

The **DI Automation Project** will provide claimants, medical providers, and employers the ability to file claim information via the Internet and provide claimants online access to claim status and payment history, thus improving access to services and delivery. The new system will provide DI Branch the ability to manage fraud and abuse through automated programs and business logic. In addition, the DI Automation Project will provide the following enhancements:

- **SSN Verification** through Social Security Administration's records. The claimant's SSN will be verified during the claimant's identification process, to detect potential fraud prior to filing a DI claim.
- Interface to the **Department of Motor Vehicles (DMV)** records to allow DI program integrity staff to verify a claimant's California driver's license or identification card number.
- **Last employer address** information will be obtained from EDD's internal database. The ability to track and cross-match employer addresses rather than relying upon the claimant to provide EDD with this information will ensure that proper payments are made to the appropriate individuals.
- **New Employee Registry (NER) Benefit Cross-Match** interface will enable 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.
- The **Address Integrity** component of the DI Automation Project will ensure 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 DI Branch has received 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 will create 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 then validate and authenticate external users' logon credentials and allow authenticated users to access system functionality and improve DI Branch's ability to detect fraud.
- The **Benefit Audit Review** matches wages reported quarterly by employers to DI benefits paid within the same period. Through this review, the DI program 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 DI 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 2011, the UI program processed 6.5 million initial claims, of which 4.6 million were new claims and paid a total of \$17.1 billion in benefits. These figures include the regular UI program in addition to the four federal extended benefit programs: Emergency Unemployment Compensation 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

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.
- **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.
- 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.

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.

- 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 U.S.
- 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 is 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.
- 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: 2,999 allegations in CY 2009, 4,197 allegations in CY 2010, and 4,100 allegations in CY 2011.
- Fraud allegations were also reported via the **EDD Web site** (www.edd.ca.gov). An additional 3,326 allegations in CY 2009, 4,679 allegations in CY 2010, and 3,801 allegations in CY 2011 were received by the Hot Line operators in this manner.
- The **UI PIN** is an automated system that allows claimants to select a PIN in order to obtain personal claim information through the 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 are unable to access their personal and confidential claim information through the IVR system.

- With the exception of the Pacific Center office in Anaheim, the Call Center Network Platform and Application Upgrade Project was implemented in all six of the Primary Call Centers and eight Primary Adjudication Centers by February 2011. The Pacific Center was converted to the new platform in June 2011. 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 provides historical tracking data on prior calls from the caller's phone number, caller identification, calls associated with the supplied SSN, and a single management information system that reports all call activity in order to detect and deter fraud.
- In July 2011 EDD began issuing UI benefit payments via the EDD Debit CardSM using an electronic payment system. The EDD Debit CardSM is the new and more efficient way of delivering UI, DI and PFL benefit payments faster, easier, and more securely. It also provides customers with a direct deposit transfer option once they have received their card. The EDD Debit CardSM program is modeled after the best practices of other states that have implemented electronic payments for UI benefits and provides reduced program costs and improved claimant satisfaction.
- 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 \$3.4 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 the EDD 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 the EDD 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.
- Utilizing internal workgroups to evaluate the effectiveness of existing antifraud systems, identify enhancements, and develop new methods for detecting, deterring and preventing fraud. Currently, UI Branch, in partnership with ID and the Audit and Evaluation Division, 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 2009 through 2011

The following table shows the UI program's results for the last three years:

	2009	2010	2011
Cases Under Investigation	\$ 18,172,722 116 cases	\$ 11,573,397 118 cases	\$ 20,393,902 147 cases
Criminal Complaints Filed	\$ 230,688 21 cases	\$ 1,080,329 20 cases	\$ 5,689,965 38 cases
Completed Criminal Prosecutions	\$ 9,223,340 20 cases	\$ 1,297,710 22 cases	\$ 6,230,137 29 cases
Fraud Overpayments (OP) est.	\$ 138,301,528 129,148 OPs	\$ 250,805,366 188,946 OPs	\$ 261,648,720 225,891 OPs
Fraudulent Benefits Prevented By Investigation Division	\$ 504,264	\$ 3,435,897	\$ 1,414,838

- During CY 2011, ID investigated a total of 147 ongoing and new UI fraud cases representing potential fraudulent benefit payments in the amount of \$20,393,902⁸. These investigations focused on the following case types: impostor fraud/identity theft (22 cases representing \$6,333,483); working while certifying for benefits (80 cases representing \$1,126,410); forgery – taking over another’s claim (25 cases representing \$257,046); and conspiracy between employer and claimant to certify for benefits (1 case representing \$5,746). The remaining 19 miscellaneous cases, representing \$12,671,216, included counterfeit checks and the use of multiple SSNs by one person.
- In CY 2011, ID filed 38 Criminal Complaints representing potential fraudulent benefits in the amount of \$5,689,965. During 2011, ID gave priority to investigating complex fraud cases involving the most egregious violations and the highest overpayments.
- In CY 2011, ID completed 29 criminal prosecutions representing fraudulent benefits in the amount of \$6,230,137. 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 2011, UI program staff established a total of 225,891 fraud overpayments totaling \$261,648,720.
 - A total of 82,746 fraud overpayments totaling \$53,557,692 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, 55,799 overpayments were established, totaling \$39,068,327. The NER cross-match established 26,947 overpayments, totaling \$14,489,365. 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 \$538 compared to \$700 for a benefit audit overpayment, a variance of \$162. This is an average savings, or benefit overpayment avoidance, of \$4.4 million annually. Based on findings through the Benefit Accuracy Measurement system, the top two leading causes of fraud overpayments are misreported separation information at the claim filing point and unreported work and earnings during the bi-weekly benefit certification.
 - UI program staff established fraud overpayments on 232 cases of identity theft totaling \$820,622.
 - A total of 142,913 fraud overpayments were established that were not attributed to the Benefit Audit or NER cross-match system or identity theft. These overpayments, totaling \$207,270,406, 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.

⁸ Total does not equal case type detail due to rounding off to whole dollars

- In addition, in compliance with California regulations, UI program staff imposed disqualifications and overpayments on 1,282 cases totaling an additional \$4,772,056 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 2011, ID identified \$1,414,838 in fraudulent benefits that were referred to the 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.

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 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 **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. Until the Continued Claims Redesign Project is completed, the following interim solutions allow claimants to certify for benefits.
 - **Internet Continued Claims Filing (EDD Web-CertSM)** – In June 2010, EDD launched the first phase of a new Web option for many customers to complete and submit their bi-weekly continued claim forms, instead of the mail-only option. Going paperless helps customers 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.

- **Telephone Continued Claims Filing (EDD Tele-CertSM)** – In November 2010, EDD launched the first phase of a new telephone certification service 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 **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 United States Department of Labor (DOL) 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 collects more payroll tax dollars than EDD. During 2011, EDD collected \$51 billion in California payroll taxes from over 1.3 million employers.

The 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.

The **Compliance Development Operations (CDO)** within the EDD Tax Branch Field Audit and Compliance Division serves as primary lead development organization for the Employment Tax Audit program, concentrating on identifying employers who participate in the underground economy. The CDO leverages 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 very effective in producing 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 playing field for all employers and aid in protecting employee rights to UI and DI 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, the Department of Insurance, and the Department of Justice. The Internal Revenue Service, Franchise Tax Board and Board of Equalization are not members of JESF but are active participants.

The JESF obtains information through a number of sources which indicate that a business may be 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)** is the primary joint enforcement effort undertaken by JESF partner agencies. The EETF conducts joint on-site business 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 mandated programs that focus on identifying underground economy activity. These programs include the Construction Enforcement Project and the Janitorial Enforcement Project. Additionally, TEG staff investigates businesses in a variety of industries in an effort to detect payroll 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 payroll tax laws. The EEEC was created as a multi-agency enforcement program consisting of investigators from EDD, Department of Industrial Relations (Division of Labor Standards Enforcement and California Occupational Safety and Health), Contractors State Licensing Board, and DOL. Each agency as an expert in its own field and collaborates to educate business owners and employees on state and federal labor, licensing, and payroll tax laws; conducts vigorous and targeted enforcement against labor payroll tax law violators; helps level the playing field and restore competitive equity for law abiding businesses and their employees. The EEEC 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, auto body repair, pallet manufacturing and restaurant. These industries were selected for targeting by the EEEC 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, licensing and payroll tax laws.

The EEEC was abolished at the end of 2011 and was transformed into a new organization, the **Labor Enforcement Task Force**, headed by the Department of Industrial Relations.

- The **Lead Development and Program Support Group** captures allegations of non-compliance submitted via the Underground Economy Fraud Hotline, correspondence, and electronic mail. The allegations are screened and forwarded to EEEC (now the Labor Enforcement Task Force), EETF, TEG, or the Tax Audit program.
- The **Out of State Audit Lead Development Process**, within the Lead Development and Program Support Group, provides coordinated geographical packages of leads on employers that maintain their business records outside of California. Packages of approximately seven employer leads, all within the same geographical area are distributed to the area audit offices.

- The **Questionable Employment Tax Practices Program**, within the Lead Development and Program Support Group, continued to produce positive results in 2011. The Questionable Employment Tax Practices Memorandum of Understanding allows for exchange of case information between EDD and the Internal Revenue Service. The EDD uses Internal Revenue Service case information to issue assessments for amounts owed to EDD. This saves time associated with conducting an audit and sends a strong message to the employer community on the risks of non-compliance.
- The **UI Rate Equity Group** identifies situations involving the California Unemployment Insurance Code, Sections 135.2 and 1061 and where applicable, makes assessments of UI rate differences when reserve accounts are transferred by employers who attempt to obtain a competitive business advantage by gaining a favorable UI rate.

The EDD **Tax Audit Program** reviews business entities' records to determine the level of compliance with payroll tax laws governing the reporting of wages and payment of taxes, and works with employers to gain long-term prospective voluntary compliance. Audit leads are obtained from various sources, including developed lead referrals from CDO, employee UI and DI obstructed benefit claims. The Tax 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 Tax Audit program levies compliance assessments for the amount of deficient payroll taxes under-reported and makes determinations regarding the application of penalties due to negligence, intentional disregard, intent to evade, and fraud.

The Tax 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 2009 through 2011

Statistics for the EETF, TEG, and EEEEC and Lead Development and Program Support Group programs are included in this section. The CDO and the Tax Audit program were greatly impacted in 2011 by reduced staff resources.⁹ Due to the hiring freeze, a number of positions remained unfilled. Also, for much of 2011, a number of staff from both programs were redirected to implement the Accounting and Compliance Enterprise System and provide assistance by answering calls at the Taxpayer Assistance Center in response to the extremely high volume of incoming calls. In CDO, the majority of staff who were redirected to assist in these efforts came from TEG, UI Rate Equity Group, and Questionable Employment Tax Practices program. As a result of the redirection in 2011, CDO results for these programs were lower than normal and the Tax Audit program conducted fewer audits and investigations.

⁹ All of the Tax program's statistical tables on Pages 21-23 will reflect lower totals in 2011 compared to previous years due to a reduction and redirection of staff.

Overall, the cumulative activities and results of these program areas over the past three years are as follows:

CDO Lead Development Results – Combined Statistics All CDO Programs

	<u>2009</u>	<u>2010</u>	<u>2011</u>
Joint Inspections	1,346	404	1,357
EDD Audit Referrals	833	566	509
EDD Payroll Tax Audits	768	1,258	630
EDD Payroll Tax Assessments	\$ 45,274,817	\$ 168,598,851	\$ 43,659,074
Previously Unreported Employees	10,670	10,355	3,908
Cases w/Fraud Penalty Assessed	124	85	51
Assessments on Fraud Cases	\$ 18,458,863	\$ 24,354,382	\$ 8,287,094

- In 2011, EETF inspected 324 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. In 2011, 132 EETF audits were completed by EDD, resulting in assessments of \$9,326,603 in unpaid payroll taxes, penalties, and interest. In addition, 547 unreported employees were identified.

The following table shows the EETF’s results for the last three years:

	<u>2009</u>	<u>2010</u>	<u>2011</u>
Joint Inspections	388	210	324
EDD Audit Referrals	388	219	177
EDD Payroll Tax Audits	360	224	132
EDD Payroll Tax Assessments	\$ 17,922,866	\$ 13,677,364	\$ 9,326,603
Unreported Employees	4,119	2,745	547
Cases w/Fraud Penalty Assessed	31	36	23
Assessments on Fraud Cases	\$ 4,843,378	\$ 12,353,238	\$ 3,838,209

- In 2011, the TEG conducted investigations and referred 87 cases to the Tax Audit program. The 67 completed audits resulted in assessments for \$11,699,336 in unpaid payroll taxes, penalty, and interest. In addition, 1,899 unreported employees were identified.

The following table shows the TEG’s results for the last three years:

	<u>2009</u>	<u>2010</u>	<u>2011</u>
EDD Audit Referrals	211	166	87
EDD Payroll Tax Audits	158	154	67
EDD Payroll Tax Assessments	\$ 13,090,250	\$ 11,962,537	\$ 11,699,336
Previously Unreported Employees	3,628	2,792	1,899
Cases w/Fraud Penalty Assessed	18	12	6
Assessments on Fraud Cases	\$ 4,202,112	\$ 4,012,282	\$ 3,423,355

- In 2011, EEEEC¹⁰ inspected 1,033 businesses for licensing, payroll tax, and labor code violations and referred 214 employers for an EDD payroll tax audit. In 2011, 240 EEEEC audits were completed, resulting in assessments of \$4,674,574 in unpaid payroll taxes, penalties, and interest. In addition, 699 unreported employees were identified. In 2011, EEEEC continued the “Self Audit Program.” One hundred ninety-six employers were enrolled in this program which focuses on allowing employers with compliance issues which were too small to be cost effective for an EDD audit to report the wages of their misclassified workers. In the event the employer did not report the unreported workers, EEEEC Agents issued assessments. The program proved to be an excellent tool to improve customer service and enforcement.

The following table shows EEEEC’s results for the last three years:*

	<u>2009</u>	<u>2010</u>	<u>2011</u>
Joint Inspections	958	184	1,033
EDD Audit Referrals	234	181	214
EDD Payroll Tax Audits	250	147	240
Self Audit Program	89	234	196
EDD Payroll Tax Assessments	\$ 14,255,701	\$ 10,853,878	\$ 4,674,574
Unreported Employees	2,923	2,750	699
Cases w/Fraud Penalty Assessed	75	37	22
Assessments on Fraud Cases	\$ 9,413,373	\$ 7,988,862	\$ 1,025,530

* Please note that this report includes EEEEC Calendar Year statistics while the EEEEC Annual Report provides statistics on a State Fiscal Year. Consequently, the numbers in this report will not match with the EEEEC Annual Report State Fiscal Year numbers.

The following table shows the number of audits and investigations completed as a result of out of state referrals over the last three years: *

	<u>2009</u>	<u>2010</u>	<u>2011</u>
EDD Payroll Tax Cases	184	61	31
EDD Payroll Tax Assessments	\$ 29,202,188	\$ 2,077,638	\$ 2,413,049
Average Liability Change	\$ 158,707	\$ 34,060	\$ 77,840
Unreported Employees	4,413	1,865	718

* Note that this table contains results of cases developed by EEEEC, EETF, and TEG.

The following table shows the number of investigations completed as a result to the Questionable Employment Tax Practices project over the last three years:

	<u>2009</u>	<u>2010</u>	<u>2011</u>
EDD Payroll Tax Investigations	50	68	5
EDD Payroll Tax Assessments	\$ 1,388,821	\$ 1,218,893	\$ 82,197
Average Liability Change	\$ 27,776	\$ 17,925	\$ 16,439
Unreported Employees	245	161	45

¹⁰ The statistics referenced in the above table represent only those EEEEC joint inspections where EDD participated.

The following table shows the number of allegations received and processed by the Lead Development and Program Support Group for the last three years:

	<u>2009</u>	<u>2010</u>	<u>2011</u>
Underground Economy Fraud Hotline	415	503	462
Underground Economy Mailbox (email)	2,380	2,527	2,210
Correspondence	488	496	466
Total	3,283	3,526	3,138

The following table illustrates the UI Rate Equity Group workload accomplishments for the last three years:

	<u>2009</u>	<u>2010</u>	<u>2011</u>
California Unemployment Insurance Code Section §1061			
Payroll Tax Investigations	438	363	154
Payroll Tax Assessments	\$ 31,329,784	\$ 19,475,913	\$ 5,806,377
Average Liability Change	\$ 71,529	\$ 53,653	\$ 37,704
California Unemployment Insurance Code Section §135.2			
Payroll Tax Investigations	10	7	1
Payroll Tax Assessments	\$ 24,102,586	\$ 109,332,628	\$ 9,656,938
Average Liability Change	\$ 2,410,259	\$ 15,618,947	\$ 9,656,938

- The Tax Branch as a whole in 2011 conducted 2,592 audits and investigations, resulting in assessments totaling \$82,474,471, and the identified 22,833 unreported employees. These enforcement efforts send a strong message to employers regarding the risks of failing to report employee wages and pay contributions due.

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

	<u>2009</u>	<u>2010</u>	<u>2011</u>
Cases w/Fraud Penalty Assessed	143	195	81
Unreported Employees	6,685	6,136	1,323
Assessments on Fraud Cases	\$ 48,389,394	\$ 42,515,159	\$ 15,667,152

In 2011, EDD’s ID conducted additional tax enforcement activities independent of JESF.

- The ID investigated a total of 186 ongoing and new payroll tax evasion fraud cases representing a potential tax liability of \$47,023,693¹¹. The investigations focused on the following case types: payroll tax fraud (181 cases representing potential tax liability of \$44,023,343) and EEEEC (5 cases representing potential tax liability of \$3,000,349). The EEEEC cases represent investigations conducted on employers in the industries identified by EEEEC.

¹¹ Total does not equal case type detail due to rounding off to whole dollars.

- The ID filed 27 criminal complaints representing a potential tax liability of \$7,948,481. The criminal complaints were filed on payroll tax fraud (26 complaints representing tax liability of \$6,922,776) and EEEEC (1 complaint representing a tax liability of \$1,025,705). The EEEEC case represents an investigation conducted on an employer that is among the industries identified by the EEEEC.
- The ID completed 18 criminal prosecutions representing a potential tax liability of \$3,269,475.
- Prevention/Tax Money Collected by EDD: the ID referred 15 conviction cases with tax liabilities in the amount of \$3,269,475 to EDD's Collection Division for recovery.

WORKFORCE SERVICES PROGRAMS

The EDD administers the federally funded Workforce Investment Act (WIA) and American Recovery and Reinvestment Act (ARRA) programs in California. The WIA and ARRA programs provide funding to local entities that provide employment training opportunities. The EDD guides the sub-granting of WIA and ARRA 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 and ARRA funds is accomplished through a combination of processes that EDD requires of the local administrative entities. In addition, DOL may occasionally conduct specialized WIA and ARRA 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 and ARRA programs include:

- **Monitoring Reviews** determine whether programs operate in compliance with the WIA, ARRA, 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 and ARRA 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 and ARRA programs. 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 and ARRA funds, participates in this system by being alert to indications and allegations of WIA- and ARRA-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 and ARRA 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 and ARRA audits as warranted.

- **Workforce Services Division** program staff oversee the delivery of services by WIA and ARRA funded organizations. Staff provide ongoing programmatic and fiscal technical assistance to WIA funded projects. Staff also review WIA and ARRA 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 2011

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 ARRA funds.

During CY 2011 the Compliance Resolution Unit processed 184 cases, 111 of which were resolved. At the end of the year, 73 on-going cases for a total of \$2,121,927 in questioned costs remained open in various stages of the State resolution process.

- The \$2,121,927 applies to 9 of the 73 cases for which EDD has been able to determine the potential disallowance.
- The remaining 64 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 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, 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.

- **On-site Monitoring Reviews of WIA, ARRA, 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, ARRA, 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.

- **WIA, ARRA, and Disaster Relief Incident Reporting** provides 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 PACB's 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 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 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) 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 an individual or individuals may be receiving potentially fraudulent payments.

- The PACB participates in task forces with other State and federal law enforcement agencies such as the California Department of Insurance, Franchise Tax Board, Internal Revenue Service, DOL, United States Postal Inspectors, and prosecutors.
- In collaboration with ID and federal investigators, the Audit and Evaluation Division conducts forensic accounting and audit examinations to examine subpoenaed bank records and personal and employer financial records.

The results of PACB's investigative activities for CY 2011, as well as the previous two CYs are covered in the DI, UI, and Employment Tax sections of this report.

The **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 the Audit and Evaluation Division 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 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 probable indicators of fraudulent activity.

Additionally, PACB's Audit and Evaluation Division utilizes CIU-developed information in its risk assessment process to prepare EDD's Audit Plan. This enables the Audit and Evaluation Division to schedule audits in areas most vulnerable to fraud, thereby making the most effective use of EDD's audit resources. Conversely, the Audit and Evaluation Division 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.

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 2011, 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. 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 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.
- 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 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 PACB to develop predictive models to improve decision-making and reduce fraud. See page 17 for additional information on this initiative.

ACRONYMS

ARRA	American Recovery and Reinvestment Act
CDO	Compliance Development Operations
CIU	Criminal Intelligence Unit
CY	Calendar Year
DI	Disability Insurance
DMV	Department of Motor Vehicles
DOL	Department of Labor
EBP	Electronic Benefit Payment
EDD	Employment Development Department
EEEC	Economic and Employment Enforcement Coalition
EETF	Employment Enforcement Task Force
FOIS	Field Office Integrity Specialist
ID	Investigation Division
IME	Independent Medical Examination
IVR	Interactive Voice Response
JESF	Joint Enforcement Strike 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
SDI	State Disability Insurance
SSN	Social Security Number
TEG	Tax Enforcement Group
UI	Unemployment Insurance
WIA	Workforce Investment Act

This report was prepared by the Policy, Accountability and Compliance Branch of the
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Labor and Workforce Development Agency

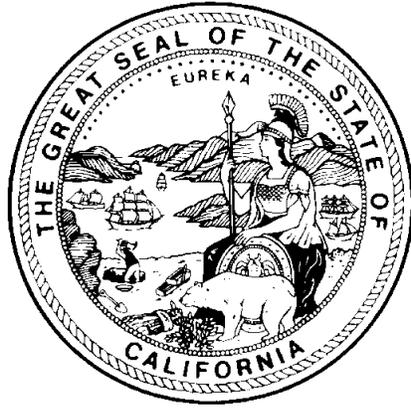
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Employment Development Department

Director.....Pam Harris

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.



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