



ANNUAL REPORT

FRAUD DETERRENCE AND DETECTION ACTIVITIES

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

TWELFTH 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) 2005, 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, Job Service (JS), and Workforce Investment Act (WIA) programs. During 2005, through the administration of its programs, EDD collected more than \$40 billion in employment taxes from over 1.2 million employers and issued benefit payments in excess of \$8.4 billion on over 2.3 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 2005, EDD's comprehensive anti-fraud activities identified fraud (in dollars) in the DI, UI, and Tax programs, as follows:

<u>Description</u>	<u>DI Program</u>	<u>UI Program</u>	<u>Tax Program</u>
Cases Under Investigation	\$ 10,048,046 204 cases	\$ 17,048,818 83 cases	\$ 72,541,722 123 cases
Criminal Complaints Filed	\$ 345,726 22 cases	\$ 1,994,251 15 cases	\$ 4,763,824 19 cases
Completed Criminal Prosecutions	\$ 478,653 12 cases	\$ 7,287,065 17 cases	\$ 11,936,295 28 cases
Fraud Overpayments (OP)	\$ 3,678,479 1,135 OPs	\$ 104,081,174 145,534 OPs	N/A
Fraudulent Benefits Prevented	\$ 3,133,852	\$ 11,938,565	N/A
Underground Economy Assessed Liabilities	N/A	N/A	\$ 35,952,394

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 opportunities. 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 the Department. The final section of this report highlights enterprise-wide efforts in progress and under consideration to prevent, detect, and deter fraud.

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 20-21.

BACKGROUND

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

In CY 2005, EDD collected more than \$40 billion in employment taxes and issued benefit payments in excess of \$8.4 billion to UI and DI claimants. The EDD administers the UI, DI, JS, and WIA programs. Through its Employment Tax Collection Program, EDD collects UI and Employment Training Tax, and DI and Personal Income Tax withholding for the State of California.

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

APPROACH

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

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

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

FRAUD DETERRENCE AND DETECTION ACTIVITIES

DISABILITY INSURANCE (DI) PROGRAM

The EDD is continuing its comprehensive, multi-faceted approach to combating fraud and improving accuracy in the DI program. During CY 2005, the DI program processed 877,513 claims and paid out over \$3.7 billion in benefits. This includes 154,424 claims and nearly \$234 million in benefits from the new Paid Family Leave (PFL) component of the DI program which began processing claims on July 1, 2004.

Workers covered under the DI 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 child within the first year of birth or placement by adoption or foster care into the family. PFL benefits are calculated in the same manner as DI but are limited to a maximum of six weeks during a 12-month period.

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

Primary DI program fraud deterrence and detection tools include:

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

Although the primary use of IMEs is the validation of the treating physician's prognosis and a means of controlling the duration of claims, IMEs are also a useful tool in curtailing the loss of benefits in those cases where fraud or abuse is suspected. In CY 2005, of the 32,466 IME results received, 2,947 (9.1 percent) of the claimants scheduled for an IME failed to appear, and 10,210 (31.5 percent) were found able to work on the date of the 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 reports enable the FOIS to identify significant changes in claims activity and/or filing patterns, which may be indicators of fraud.

- **Automated Tolerance Indicators** (flags) that are associated with the certifying healthcare provider's license number help staff identify and track claims on which fraud or abuse is suspected or has previously been detected. They also alert staff to refer to special instructions that have been created to assist in the adjudication/payment of claims on which a Tolerance Indicator has been attached.
- **UI/DI Overlap Flags** generate an automated stop pay on both UI and DI claims when a prior UI claim period overlaps the dates that DI benefits are claimed. DI blocks payment pending an eligibility determination, thereby helping in the prevention of potentially improper payments.
- **Decedent Cross-Match Reports** identify benefit payments issued after the date of death of DI claimants by checking the Social Security Numbers (SSN) of all DI claimants against SSNs of individuals reported as deceased by the Department of Health Services. The report enables DI Branch to identify benefits paid subsequent to the date of death that may not otherwise have been discovered.
- **Address/Name Change Reports** record all changes of the claimant names or addresses by date and operator identification, as a means to identify claim manipulation, or "hijacking" by employees committing internal fraud.
- 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 DI claims that any particular doctor has certified. Analysis of the claims listed on the report can lead to discovery of fraudulent claims or program abuse.
- **DI Quality Control Reviews** test a random sample of up to 1,200 DI warrants for accuracy, completeness, and propriety. These reviews detect the nature and extent of improper payments, reveal operating weaknesses, and serve as a check on employee fraud or collusion. Claims that appear fraudulent are referred to investigators for follow up.
- **Medical Hotsheet Reports** identify healthcare providers whose licenses have been revoked or suspended. This information, supplied by the Medical Board of California, helps ensure that claims are certified by properly licensed healthcare providers and alerts EDD to potential fraudulent situations.
- The **DI Personal Identification Number (PIN) System** provides identification, authentication, and authorization services via EDD's Interactive Voice Response

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.

(IVR) system. The system enhances security of the IVR system and improves claimant privacy by preventing unauthorized access to confidential data.

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

- The **In-Office Eligibility Review Process** provided for in Title 22, California Code of Regulations, permits the Department to require claimants suspected of fraud, who are currently receiving benefits, to submit to an in-person interview before a decision is made regarding their continued eligibility to receive benefits. The process provides the claimant with a fair and equitable opportunity to be heard in person and enables the Department to gather additional information before making its decision. The regulations provide precise time frames and procedures for conducting interviews to ensure that claimants' rights to due process are protected.
- An **EDD Toll-free Fraud Tip Hot Line**, (800) 229-6297, provides employers or individuals a designated telephone number to report alleged fraud directly to the ID's Criminal Intelligence Unit (CIU). The number of DI program fraud allegations reported through the Hot Line is as follows: 688 allegations in CY 2002, 849 allegations in CY 2003, 931 allegations in CY 2004, and 695 in CY 2005. Effective February 2005, fraud allegations were also reported via the EDD Web site (www.edd.ca.gov). An additional 328 allegations were received by the Hot Line operators in this manner.
- The **Truncation of Claimant SSNs** to only the last four digits on DI benefit checks helps to deter identity theft and protect the confidentiality of information assets.
- **Program Integrity Training** is provided to all new hires to heighten staff awareness and capacity to detect and deter fraud and abuse in the DI program. New hires are initially exposed to the concepts and tools during new employee orientation shortly after being hired and once again in greater detail during formalized training. In addition, field office staff designated as Program Integrity Single Points of Contact (PI SPOC), who perform PI functions and work closely with the FOIS, receive specialized training.
- **Automated Detection Reports** developed collaboratively with ID's CIU permit CIU to detect unusual patterns of activity in the DI benefit payment system involving addresses, issuance of multiple checks, and multiple claims filed by the same claimant within a specified period of time.
- An **Educational Outreach Campaign** to the California medical community led by the EDD Medical Director's Office is designed to enhance understanding of the purpose of the DI program and their role in the claim filing process. This effort is expected to enhance the integrity of the DI program 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. It is also expected to minimize occurrences of medical certifications that extend the disability duration beyond normal expectancy.

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

- Requirement for submission of the birth certificate, adoption or foster care certification on all bonding claims.
- The PFL automated system includes a scanning process that provides an online viewable copy of all claim documents. To assist in detecting possible forgeries, claims examiners are able to compare signatures of claimants and physicians with past documents submitted 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.

RESULTS/ACCOMPLISHMENTS DURING CY 2003 through 2005

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

	<u>2003</u>	<u>2004</u>	<u>2005</u>
Cases Under Investigation	\$ 4,005,662 176 cases	\$ 6,039,275 200 cases	\$ 10,048,046 204 cases
Criminal Complaints Filed	\$ 302,852 9 cases	\$ 2,688,535 7 cases	\$ 345,726 22 cases
Completed Criminal Prosecutions	\$ 498,431 14 cases	\$ 95,595 15 cases	\$ 478,653 12 cases
Fraud Overpayments ⁵ (OPs)	\$ 3,486,055 1,283 OPs	\$ 3,738,595 1,283 OPs	\$ 3,678,479 1,135 OPs
Fraudulent Benefits Prevented	\$ 6,712,402	\$ 7,869,849	\$ 3,133,852

- During CY 2005, 204 cases potentially representing \$10,048,046 were investigated. These investigations focused on the following case types: impostor fraud/identity theft (21 cases representing \$2,599,920); altered or forged documents (100 cases representing \$769,797); and medical practitioner fraud (13 cases representing \$5,805,470). The remaining 70 miscellaneous cases, representing \$872,859, included impostor fraud/forgery enabled by taking over the claim of another, counterfeit checks, and fictitious employers.
- In CY 2005, ID filed 22 Criminal Complaints representing potential fraudulent benefits in the amount of \$345,726. The ID has continued their emphasis on the

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

more complex fraud cases such as imposter/identity theft that take longer to investigate.

- During CY 2005, ID completed 12 criminal prosecutions representing fraudulent benefits in the amount of \$478,653. These completed prosecutions primarily involved altered and forged medical and working while certifying for benefits.
- In CY 2005, the DI program established a cumulative total of 1,135 fraud overpayments in the amount of \$3,678,479.
 - The DI program established 579 fraud overpayments totaling \$1,875,225 on claims associated with claimants who were prosecuted.
 - The DI program established 556 fraud overpayments that were not attributed to prosecutions. These overpayments, totaling \$1,803,254 were the result of administrative actions applied by the DI program, such as false statement overpayments.
- In CY 2005, departmental anti-fraud efforts stopped \$3,133,852 in fraudulent DI benefits from being paid. Of this total, \$529,046 is attributable to DI program anti-fraud efforts such as IMEs, verification of SSN ownership with deletion of improper base period wages, and all referrals to ID resulting in convictions or administrative actions which prevented payment of further benefits. Payment of approximately \$2,604,806 in fraudulent benefits was prevented through ID's ongoing investigations of identity theft, forgeries, and medical practitioner fraud.
- In 2005, 71 doctors certified to over \$1 million in benefits. In 42 cases, after review by the DI Branch and/or ID, it was concluded that the doctors' high volume of activity was justified and no fraud or abuse was detected. In the remaining 29 cases, 5 are under investigation by ID; a Tolerance Indicator has been established for three doctors, and 24 are pending further evaluation by the FOIS.

RECENT DI PROGRAM ENHANCEMENTS

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

- **On-Line DI Program Integrity Awareness Training** was developed by the FOISs in 2005. In addition to classroom training, field office staff will have the opportunity in 2006 to take the on-line portions of the Refresher Program Integrity training at their work station.
- **Medical Refresher Training** provided to field office staff by DI's Medical Director is a comprehensive presentation of medical information intended to educate and update knowledge of disabling medical conditions and medical terminology. This information allows the staff to communicate more effectively with medical providers when discussing and obtaining additional medical information regarding a disability claim. The information provides staff with a better understanding of the diagnoses,

assists them in determining with confidence the severity and expected length of a disability, enables them to read and understand the medical side of the claim form with more confidence, and take appropriate action to control claim duration or potential abuse of the DI program.

- **Formal ID Alert Procedures** were provided to staff for handling DI and PFL claims with an ID Alert flag. The Department flags potentially compromised SSNs identified by employers/employer agents, and ID, or UI Branch. When a claim with an ID Alert flag is processed, DI program integrity staff conducts an in-depth review to ensure that the claimant is the true wage earner.
- **PFL Quality Control Reviews** were developed to test a random sample of PFL warrants for accuracy, completeness, and propriety. These reviews detect the nature and extent of improper payments, reveal operating weaknesses, and serve as a check on agency employee fraud or collusion. Claims that appear fraudulent are referred to investigators for follow up.
- 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.
- An **Interactive On-Line Fraud Reporting** form was placed on the EDD Web site. It provides the ability to report fraud and other sensitive information (SSNs, etc.) in a secure environment.

UNEMPLOYMENT INSURANCE (UI) PROGRAM

The EDD is committed to maintaining the integrity of the UI Program. During CY 2005, the UI Program processed 1,420,834 new claims and paid a total of \$4.77 billion in benefits.

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 misrepresentation⁶ or willful nondisclosure of facts.
- **30 Percent Fraud Penalty Assessment** on any overpayments resulting from claimant fraud.
- **Weekly Claim Certification** by claimants of their continued eligibility for benefits. This process requires the claimant's signature certifying to the accuracy and truthfulness of the statements made and that he/she understands that the law provides penalties for making false statements to obtain benefits.
- **UI Quality Control** is an independent review of a random sample of 1,100 claims to test the effectiveness of procedures for the prevention of improper UI payments. These reviews detect the nature and extent of improper payments, reveal operating weaknesses, and serve as a check on agency employee fraud or collusion. Claims that appear fraudulent are referred to investigators for follow up.
- The **Benefit Audit Process** matches wages reported quarterly by employers to UI benefits paid within the same period. Through this process, the UI benefits program is able to detect when claimants have been fraudulently collecting benefits while working. Overpayments and penalties are established and collected as a result of this process, protecting the solvency of the UI Trust Fund. These matches are performed on a quarterly and annual basis. The EDD utilizes an employer compliance database to track benefit audit forms that have been mailed and returned by employers.

Future programming enhancements will combine the existing benefit audit process with the New Employer Registry (NER) Benefit Cross-Match to enable EDD to detect fraud sooner. (Refer to **Recent UI Program Enhancements** in this report for additional information regarding the NER Benefit Cross-Match.)

- **Verification of a Claimant's Right to Work** enables EDD to identify claimants who do not have legal authorization to work in the United States (U.S.), thus preventing payments to individuals who are not eligible for benefits. The Systematic Alien Verification for Entitlement process enables EDD to link with the database of the U.S. Citizenship and Immigration Services (formerly Immigration and Naturalization

⁶ To willfully provide false information or withhold information that affects the payment of UI benefits.

Service) to submit both initial and additional verification queries to obtain information necessary to reduce improper payments to individuals who do not have legal authorization to work in the U.S.

- A **SSN Verification System** cross-matches UI records with the Social Security Administration's (SSA) records. At the initial claim filing point, SSNs are verified using the confirmed data in our database and the SSA's automated State Verification and Exchange System process. In addition, the SSN Verification Process provides information to the requesting state when the verified owner of the SSN is deceased.
- 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: 1,445 allegations in CY 2002, 1,220 allegations in CY 2003, 1,406 allegations in CY 2004, and 2,270 in CY 2005. The increase in allegations for CY 2005 is attributed to the assignment of additional staff to take Hot Line calls. Effective February 2005, fraud allegations were also reported via the EDD Web site (www.edd.ca.gov). An additional 830 allegations were received by the Hot Line operators in this manner.
- The **UI Personal Identification Number (PIN)** is an automated system that allows claimants to select a PIN in order to obtain personal claim information through the Interactive Voice Response (IVR) system, which is available seven days a week, 24-hours a day. The UI PIN was established to protect claimants' confidential information. Without a PIN, claimants will be unable to access their personal and confidential claim information through the IVR.
- Changes to the **UI benefit check** were implemented as part of the Department's ongoing commitment to deter identity theft and to protect the confidentiality of its information assets. The heading "SSA NO." was removed from the face of the UI benefit check and the 9-digit SSN is no longer printed on the face of the check. In its place, **only** the last 4 digits of the claimant's SSN will display.
- The EDD has always used various measures to ensure the true identity of a claimant for UI benefits. Since April 2003, however, **UI Impostor Fraud Prevention** was enhanced with the implementation of EDD's Identity Alert Process. The process, developed to reduce the risk of identity theft fraud, was implemented when employers and/or employers' payroll agents contacted the Department to report that their records containing confidential employee information had been compromised. The Identity Alert Process was designed to protect the worker and employer from ongoing fraud and to ensure proper payments of UI benefits.

When a claim is initiated into the Identity Alert Process, no payments are issued until the Department obtains the information needed to validate the identity of the individual filing the UI claim. The UI Identity Regulations, signed by the governor in December 2003, revised prior regulatory language to allow the Department to require a claimant to provide identity verification documentation upon request.

The tools utilized by EDD to prevent UI Impostor Fraud include:

- Flagging potentially compromised SSNs identified by employers/employer agents and EDD's ID. If a new claim is filed using one of the flagged SSNs, the claim is initiated into the Identity Alert Process and a request for identity information is mailed to the claim filer, the last employer, and the base period employer(s).
- Stopping benefit payments on active UI claims that are associated with compromised SSNs until the identity of the claimant is confirmed.
- Implementing enhanced screening procedures during the claim filing process to better authenticate the identity of claimants and to ensure only the true owner of the identity will receive UI benefits.
- Utilizing a variety of communication methods to provide information to all California employers on how to protect and properly destroy confidential personnel information and assist the Department in preventing UI fraud. This includes published articles in the California Employer's Guide (DE 44-Tax publication) as well as the California Employer Newsletter (Quarterly-Tax publication).
- Updating the EDD Web site (www.edd.ca.gov) with information on UI impostor fraud and identity theft assists both employers and employees. The brochures **"How You Can Prevent Unemployment Insurance Impostor Fraud"** (designed for employers) and **"Protect Your Identity and Stop Unemployment Insurance Impostor Fraud"** (designed for employees) can be viewed as well as downloaded and printed from the EDD Web site.
- Partnering with other states that have also experienced increases in UI impostor fraud. The Department has worked closely with other states to identify common patterns and trends, share anti-fraud processes, and resolve fraud cases where the parties have a connection to multiple states.
- Utilizing internal workgroups to evaluate the effectiveness of existing anti-fraud systems, identify enhancements, and develop new methods for detecting, deterring and preventing fraud. Currently, UI staff, in partnership with ID and the Audit and Evaluation Division (A&ED), are exploring data mining tools to actively identify patterns, data elements, and trends to detect and prevent potentially fraudulent UI claims earlier in the process.

RESULTS/ACCOMPLISHMENTS DURING CY 2003 through 2005

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

	2003	2004	2005
Cases Under Investigation	\$ 28,231,545 190 cases	\$ 77,526,097 106 cases	\$ 17,048,818 83 cases
Criminal Complaints Filed	\$ 14,249,173 31 cases	\$ 3,410,552 21 cases	\$ 1,994,251 15 cases
Completed Criminal Prosecutions	\$ 2,779,158 14 cases	\$ 63,275,339 22 cases	\$ 7,287,065 17 cases
Fraud Overpayments (OPs) est.	\$143,737,723 122,173 OPs	\$ 89,477,742 103,171 OPs	\$104,081,174 145,534 OPs
Fraudulent Benefits Prevented By Investigation Division	\$ 21,231,560	\$ 19,437,721	\$ 11,938,565

- During CY 2005, ID investigated a total of 83 ongoing and new UI fraud cases representing potential fraudulent benefit payments in the amount of \$17,048,818. These investigations focused on the following case types: impostor fraud/identity theft (51 cases representing \$16,661,305); working while certifying for benefits (15 cases representing \$76,942); forgery – taking over another’s claim (6 cases representing \$120,579); and conspiracy between employer and claimant to certify for benefits (3 cases representing \$35,058). The remaining 8 miscellaneous cases, representing \$154,934, included counterfeit checks and the use of multiple SSNs by one person.
- In CY 2005, ID filed 15 Criminal Complaints representing potential fraudulent benefits in the amount of \$1,994,251. This amount is low compared to the total potential fraudulent benefits on cases under investigation (\$17,048,818), because of loss of experienced investigation staff through attrition. With reduction in staff, the ID gave priority to investigating complex fraud cases involving the most egregious violations and the highest overpayments. During 2005, three of the thirteen peace officer positions in this program were vacant; those positions have now been filled. Comprehensive background investigations and mandated peace officer training are required for each new investigator hired.
- In CY 2005, ID completed 17 criminal prosecutions representing fraudulent benefits in the amount of \$7,287,065.
- During CY 2005, UI program staff established a total of 145,534 fraud overpayments totaling \$104,081,174.
 - 113,634 fraud overpayments totaling \$70,519,686 were established as a result of the benefit audit cross-match system.
 - UI program staff established fraud overpayments on 3,319 cases of identity theft totaling \$10,000,732.

- A total of 28,581 fraud overpayments were established that were not attributed to the benefit audit cross-match system or identity theft. These overpayments, totaling \$23,560,756, were established for a variety of reasons including retroactive disqualifications of miscellaneous eligibility issues and unreported earnings that were not discovered through the benefit audit cross-match system.
- In addition, in compliance with California regulations, UI program staff imposed disqualifications and overpayments on 2,447 cases totaling an additional \$4,128,186 in non-fraud overpayments when claimants failed to comply with the Department's request for identity verification information and there was insufficient information to determine the real owner's identity.
- In CY 2005, ID prevented approximately \$11,938,565 in benefits paid from UI claims that were filed by impostors based upon the identity and wage credits of full-time active employees.
 - The ID prevented \$4,772,278 in benefits from being paid on UI claims associated with ongoing criminal investigations.
 - The ID prevented \$6,986,071 in benefits from being paid on UI claims based on information received by the CIU. These claims are not associated with ongoing criminal investigations.
 - The ID prevented \$180,216 in benefits from being paid on UI claims filed through the Internet e-apply process. These claims are not associated with ongoing criminal investigations.

RECENT UI PROGRAM ENHANCEMENTS

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

- The **NER Benefit Cross-Match** will enable EDD to use new hire information from California employers to identify claimants who improperly continue to receive benefits after they have returned to work. This is accomplished by matching the new hire information with the Department's records of claimants currently collecting UI benefits. Through this process, EDD will be able to detect fraud and other eligibility issues up to six months earlier than through the Department's current benefit audit process, allowing EDD to protect the UI Trust Fund by reducing the amount of dollars overpaid to claimants. NER Benefit Cross-Match programming efforts are currently underway.
- **On-line** (real-time) verification of the claimant's SSN and California driver's license or identification card numbers, during initial claim filing, by accessing the SSA and

California's Department of Motor Vehicles (DMV) databases, to detect potential fraud prior to filing a UI claim.

- **Web-Based Claim Filing (WBCF)** project is reengineering the UI claim filing process to improve claimant authentication and the collection of claimants' eligibility information. This project is augmented with federal grants and once completed, will integrate the on-line (real-time) verification of a claimant's SSN and DMV license and identification card numbers, and create a cohesive process to detect potential fraud earlier in the claim filing process. This will allow EDD to conduct data cross-matches directly with the SSA and California's DMV as well as obtain last employer address information from EDD's internal Tax Accounting System (TAS). Cross-matching information with these entities, and the ability to cross-match employer addresses with EDD's TAS database rather than relying upon the client to provide the Department with this information, will better ensure that proper payments are made to the appropriate individual.
- The **Address Integrity Project** will ensure that only the rightful owner of the claim makes a change of address to a claim. As a security and fraud detection measure, a letter will be sent to the old address to notify the claimant that EDD has received a request for change of address.
- **Fraudulent Claim Profiles** are being established to institute ongoing system checks for identification of claims that fit fraud patterns.
- The **Continued Claims Redesign Project** provides claimants with the option to certify for UI benefits by telephone or the Internet, and will allow for the collection of additional client data and creation of a new client database for fraud detection.
- The **Call Center Network Platform and Application Upgrade Project** provides EDD with more detailed call information for trend analysis to improve fraud detection, as well as other automation enhancements. This upgrade will provide historical tracking data on prior calls from the caller's phone number, caller ID, calls associated with the supplied SSN, and a single management information system that reports all call activity in order to detect and deter fraud.
- The **Combat Identity Theft Project** will develop and implement data mining software that will be used to improve EDD's ability to prevent and detect identity theft in the UI program. This project is funded in part by a Department of Labor grant. The software will be used to improve UI fraud detection by conducting in-depth data analyses and automatically identifying patterns and trends that will serve as probable indicators of fraudulent activity. The data mining software will be used by other organizations within EDD to develop predictive models to improve decision-making and reduce fraud.
- As part of an ongoing **public education campaign**, EDD developed a "toolkit" for employers that includes information on how they can prevent and detect UI impostor fraud. Success in preventing, detecting, and deterring UI impostor fraud is greatly dependent upon a strong partnership with the employer community.

EMPLOYMENT TAX PROGRAMS

The EDD is one of the largest tax collection agencies in the United States, collecting UI and Employment Training Tax, and DI and Personal Income Tax withholding. Only the Internal Revenue Service (IRS) collects more payroll tax dollars than EDD. During 2005, EDD collected over \$40 billion in California payroll taxes from over 1.2 million employers.

As with the benefit programs, EDD's approach to employment tax fraud deterrence and detection involves independent oversight and investigative activities, plus extensive efforts within the Tax Branch to ensure integrity and accuracy of this program. Tax Branch efforts focus on increasing voluntary compliance with the tax laws through education, cooperation, and enforcement. To achieve this goal, the Tax Branch conducts a Taxpayer Education and Assistance program, actively participates with employer organizations on issues of concern, and conducts various enforcement activities. The major components of the Tax Branch enforcement program include:

- The **Tax Audit Program** educates employers and provides them with an incentive to voluntarily comply with State employment tax laws. Individual employers are selected for audit based on certain criteria. Most commonly, an employer is audited when a former employee files a claim for UI or DI benefits, and the former employer has not reported the wages to EDD, or paid the required employment taxes. During 2005, EDD audited 3,080 employers. The audits revealed that 81.1 percent of the employers audited made an error in reporting wages on tax returns. In addition, the audits revealed that 129 (4.2 percent) of the 3,080 audits, resulting in employment tax assessments of \$20,588,582, had done so with intent to evade.
- The **Joint Enforcement Strike Force (JESF)** combats the underground economy by pooling resources and sharing data among the State agencies that enforce licensing, labor, and tax laws. The JESF on the Underground Economy was formed by Executive Order in 1993 and codified in 1994. The members of JESF include EDD (lead agency), the Department of Consumer Affairs, the Department of Industrial Relations (DIR), the Franchise Tax Board (FTB), the Board of Equalization, the Department of Insurance (DOI), and the Department of Justice.

The JESF obtains information indicating that a business may be operating illegally. Sources of information include informants who use established hot lines, complaints from legitimate businesses, and comparison of data in various databases maintained by member agencies.

Four special projects, entitled the Employment Enforcement Task Force (EETF), the Construction Enforcement Project (CEP), the Janitorial Enforcement Project (JEP), and the newest effort, the Economic and Employment Enforcement Coalition (EEEC) were implemented since the formation of JESF. The EEEEC was created in addition to EDD's existing efforts under JESF on the Underground Economy. The EEEEC is designed as a partnership of enforcement agencies, which will identify the most egregious offenders operating in the underground economy for targeted workplace enforcement.

RESULTS/ACCOMPLISHMENTS DURING CY 2003 through 2005

Statistics for the EETF, CEP, JEP, the Targeted Industries Partnership Program (TIPP) and EEEEC programs are included in this section. The tables below indicate that EDD’s audit referrals and payroll tax audit numbers were lower in 2005 than previous years. This is due to a reduction in staffing dedicated to project activities, primarily as a result of attrition without the ability to hire behind vacancies because of the state hiring freeze. Between 2003 and 2005, EDD’s staffing dedicated to these activities was reduced by over 42 percent. Specifically in CY 2005, these programs experienced a reduction of six journey level staff due to retirements, extended leave of absence, promotional opportunities, and redirection. However, despite reduced staffing, EDD’s JESF focused their enforcement and audit efforts on the most egregious violators. As a result, payroll tax assessments in EETF were up significantly in 2005 as compared to 2004 numbers. In December 2005, the EETF program backfilled three vacant positions and expect the new agents to be fully trained and operational by January 2006.

- In 2005, EETF inspected 342 businesses for payroll tax and Labor Code violations. Any business suspected of operating in the underground economy is subject to inspection although EETF focuses on industries known to have a high degree of noncompliance such as auto repair, bars, car washes, construction, and restaurants. The inspections resulted in the issuance of 336 citations totaling \$2,333,261 for various violations of the Labor Code. In 2005, 280 EETF audits were completed, resulting in assessments of \$11,238,855⁷ in unpaid employment taxes, penalties, and interest. In addition, 3,403 previously unreported employees were identified.

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

	<u>2003</u>	<u>2004</u>	<u>2005</u>
Joint Inspections	582	441	342
Payroll Tax Audits	408	339	280
Payroll Tax Assessments	\$ 7,558,369	\$ 9,706,037	\$ 11,238,855
Labor Code Citation Amounts	\$ 3,078,300	\$ 2,126,950	\$ 2,333,261
Previously Unreported Employees	3,553	3,512	3,403

- In 2005, CEP referred 124 construction industry employers for audit. Completed audits resulted in assessments for \$14,274,962 in unpaid employment taxes, penalty, and interest. In addition, 2,681 unreported employees were identified.

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

	<u>2003</u>	<u>2004</u>	<u>2005</u>
Audit Referrals	293	188	124
Payroll Tax Audits	268	270	126
Payroll Tax Assessments	\$ 12,387,778	\$ 16,155,481	\$ 14,274,962
Previously Unreported Employees	5,382	5,317	2,681

⁷ Total unpaid employment taxes equal \$35,952,394 assessed as a result of all Underground Economy Operations (UEO) activities.

- In 2005, JEP referred 4 janitorial industry employers for audit. Completed audits resulted in assessments for \$813,643 in unpaid employment taxes, penalty, and interest. In addition, 384 unreported employees were identified.

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

	<u>2003</u>	<u>2004</u>	<u>2005</u>
Audit Referrals	26	16	4
Payroll Tax Audits	31	34	14
Payroll Tax Assessments	\$ 1,387,451	\$ 3,929,320	\$ 813,643
Previously Unreported Employees	1,654	2,706	384

- In 2005, the TIPP program referred 34 employers for audit. Completed audits resulted in assessments for \$1,999,737 in unpaid employment taxes, penalty, and interest. In addition, 1,561 unreported employees were identified.

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

	<u>2003</u>	<u>2004</u>	<u>2005</u>
Audit Referrals	121	61	34
Payroll Tax Audits	149	78	54
Payroll Tax Assessments	\$ 7,778,466	\$ 3,136,531	\$ 1,999,737
Previously Unreported Employees	3,917	2,062	1,561

- The EDD’s UEO conducts additional tax enforcement activities independent of the Strike Force. In 2005, these other UEO programs referred 72 employers for audit. Completed audits resulted in assessments for \$6,366,363 in unpaid employment taxes, penalty, and interest. In addition, 1,882 unreported employees were identified.
- In 2005, EEEEC inspected 668 businesses for payroll tax and Labor Code violations and referred 64 employers for a payroll tax audit. The EEEEC has been mandated to focus its resources within seven industries including agriculture, construction, car wash, janitorial, race tracks, and restaurants. In 2005, 8 EEEEC audits were completed, resulting in assessments of \$1,258,834 in unpaid employment taxes, penalties, and interest. In addition, 333 previously unreported employees were identified.
- In 2005, EDD’s ID conducted additional tax enforcement activities independent of JESF.
 - The ID investigated a total of 123 ongoing and new payroll tax evasion fraud cases representing a potential tax liability of \$72,541,722.
 - The ID filed 19 criminal complaints representing a potential tax liability of \$4,763,824.

- The ID completed 28 criminal prosecutions representing a potential tax liability of \$11,936,295.
- The ID referred 20 conviction cases with tax liabilities in the amount of \$11,936,295 to EDD Collection Division for recovery. The ID delivered restitution checks (received at sentencing hearings) in the amount of \$334,100 to the Collection Division. To date, the Collection Division has recovered an additional \$29,777 on these cases.

RECENT TAX PROGRAM ENHANCEMENTS

The UEO and Audit Programs have coordinated efforts to bring **the Courier Industry** into compliance. Approximately 337 mandatory audit leads have been set up as priority audits. The Audit Program began contacting employers for these audits in September 2003. The UEO and Audit Programs are coordinating efforts with other departments in the California Labor and Workforce Development Agency to ensure compliance for Worker's Compensation Insurance and other issues. In 2005, the Audit Program completed 232 of the 337 courier cases, resulting in \$34,767,728 assessed for non-compliance. In addition, there were 14,986 additional drivers found to be employees. The Courier Industry focus has been instrumental in effecting change in the industry and promoting compliance.

Nearly 400 leads have been generated when there was an indication of State Unemployment Tax Act (SUTA) dumping otherwise known as UI rate manipulation. In late 2005, the UI Rate Manipulation Team, formed in 2003, was reassigned back to the Area Audit Offices to help work and train additional auditors in these specialized audit techniques. There have been 44 rate manipulation cases worked and assessed with liability changes in excess of \$180 million to date. Most of these cases are pending before the California Unemployment Insurance Appeals Board. Approximately \$3 million of these liabilities have been collected. The UI Rate Manipulation Team has continued to monitor the reporting of the businesses who were engaged in rate manipulation and although most chose to litigate the liability rather than pay it, many are reporting properly on a prospective basis. Stopping these large employers from continuing to SUTA dump has caused them to pay over \$100 million in UI taxes into the UI fund over and above the amount they would have paid had they continued their rate manipulation activities.

Outreach and education efforts are also underway to get the word out that SUTA dumping and UI Rate Manipulation will not be tolerated in California. Information about UI rate manipulation and the SUTA dumping legislation (Chapter 827, Statutes of 2004) is available on EDD's Web site. Various articles have also appeared in the [California Employer](#). Outreach events were held with various groups, including the Office of the California Attorney General, the California Society of Certified Public Accountants, the California BAR Taxation Litigation Subcommittee, the Department of Labor (DOL), the National Association of State Workforce Agencies, the National Association of Professional Employer Organizations, as well as EDD's internal stakeholders including the ID Criminal Tax Evasion Program Management Team.

The EEEEC was established in 2005 as a joint effort by state and federal agencies to combat the underground economy. Member agencies include EDD, DIR, Contractors State License Board (CSLB), and the U.S. DOL – Wage and Hour Division. The EEEEC's education and enforcement efforts are intended to enhance fair business competition, by targeting employers who gain an unfair advantage through violation of state and federal labor, licensing, and employment laws. The coalition conducts vigorous and targeted enforcement against employers operating in the underground economy to help level the playing field and restore the competitive balance to law abiding businesses and their employees. The EEEEC is mandated to focus education and enforcement efforts on seven industries including agriculture, construction, car wash, garment, janitorial, race track, and restaurant.

EMPLOYMENT AND TRAINING PROGRAMS

WORKFORCE INVESTMENT ACT (WIA) PROGRAM

The EDD administers the federally funded WIA Program in California. The program provides funding to local entities that provide employment training opportunities. The Department guides the subgranting of WIA funds received by EDD 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 reviews of a sample of local administrative entity activities. The program integrity components related to the WIA program include:

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

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

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

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

- **Workforce Investment Division** program staff oversees the delivery of services by WIA funded organizations. Staff provide ongoing programmatic and fiscal technical assistance to WIA funded projects. Staff review WIA grantee participant and financial records to ensure that they follow applicable State and federal requirements, and they ensure that each grantee adheres to the terms and conditions of their grant with the Department.
- **Regulatory Controls** provide for additional fraud protection. The DOL provides a Hot Line telephone number (800) 347-3756 to report fraud and abuse complaints. This 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. Additionally, the WIA regulations have established controls against nepotism.

RESULTS/ACCOMPLISHMENTS DURING CY 2005

The results presented in this section represent resolution activities for both the WIA and Welfare-to-Work (WtW) programs. Although the WtW program ended on January 23, 2004, actions to resolve WtW fraud and abuse cases continue.

During CY 2005, there were 195 open cases, of which 147 were resolved, resulting in recovery of \$149,760 in nonfederal funds recovered from LWIAs or subgrantees. At the end of the year, 48 cases with a total value of \$2,670,551 remained open in various stages of the State resolution process as follows:

- The \$2,670,551 applies to 26 of the 48 cases for which EDD has been able to determine the potential disallowance.
- Of the remaining 22 cases with undetermined potential disallowance, 16 cases are undergoing fact finding/investigation by DOL/OIG, local law enforcement, or a LWIA; one case is under investigation by the ID; two cases are pending appeal; and three cases have been referred to DOL for closure.

INDEPENDENT OVERSIGHT ACTIVITIES

The EDD's Program Review Branch (PRB) performs independent departmental oversight activities of EDD programs, including fraud detection and deterrence. Fraud detection and deterrence are accomplished through sound internal control structures, internal and external audits, risk assessments, detailed Quality Control reviews, and criminal investigations. The PRB has increasingly taken an active role to identify and combat fraud within and across EDD's programs. Through partnerships with internal and external entities, PRB performs an essential role to prevent, detect, and deter fraud. This section addresses the various components of PRB's fraud deterrence and detection activities. Many of these activities are also included under the specific EDD program areas.

- **Independent Internal and External Audits** are conducted of departmental operations and recipients of federal funds such as LWIA and community-based organizations over which EDD has administrative and program responsibility. These audits are performed at the request of EDD management, or in response to issues that arise as a result of program monitoring activities or incident reports. The PRB performs internal audits in accordance with either the "International Standards for the Professional Practice of Internal Auditing" or "Generally Accepted Government Auditing Standards." These standards require that the auditors have sufficient knowledge to identify indicators of fraud.
- **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. Internal controls are primarily developed during the system design phase, through technical assistance provided prior to and during system implementation. 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. Audit independence is achieved by reporting to a level in the organization that allows the internal audit activity to fulfill its responsibilities. The audit standards governing these audits also require auditors to include an evaluation of the systems of control used to detect illegal activities and deter fraud.
- **Information Technology (IT) Audits** are conducted of EDD's automated systems by auditors who are specially trained in this field. These IT audits ensure that automated system controls are built into new or upgraded systems and stay operational throughout the life of the system. During CY 2005, PRB performed an audit of Tax Branch's compliance with global security policies, practices, and procedures. The purpose of the audit was to independently assess Tax Branch's controls over data integrity and safeguarding information assets from misuse, loss, destruction, fraud, as well as protecting assets from monetary loss. The resulting findings and recommendations helped reduce the Department's risk of fraud in the Tax program.

In addition, PRB conducted a limited scope review of the system controls utilized to restrict, monitor, detect, and/or prevent inappropriate (non-business) access and usage of Tax Branch's two major systems: TAS and the Base Wage Data Base

(BWDB). The resulting findings and recommendations helped reduce the Department's risk of fraud in the Tax program.

Finally, PRB performed a limited scope review of the controls over releasing, using, and safeguarding BWDB information by outside entities (external customers). This review was the direct result of several discussions in the Director's Office regarding the extent of UI claim identity theft and fraudulent claims. The resulting findings and recommendations helped reduce the Department's risk of fraud in the Tax program.

The following highlights some of the additional anti-fraud efforts undertaken by PRB during CY 2005:

- The PRB and the Information Security Office are working with the IT Branch to establish an independent Security Audit Logging and Monitoring System (SALMS) in order to capture all business application and system auditable events. These include logging of view, query, inquiry, and transaction activities (e.g., add, delete, and update) to enable the detection of attempts to access unauthorized UI and Tax confidential data. The SALMS project will establish a baseline set of IT security logging and audit review requirements that can be used for all of the EDD UI and Tax Benefit systems, including event log file retentions, auditable event definition; log data file transfer protocols; and log file and server access security.
- The PRB is conducting a preliminary survey of nine EDD systems as part of the EDD's ongoing efforts to improve the security controls used to protect its confidential information and to better comply with the National Institute of Standards and Technology and other federal requirements. The purpose of the preliminary survey is to determine the access and audit trail controls in place for each of the nine systems.
- **On-site Monitoring Reviews of WIA and Disaster Relief** is conducted to determine fiscal and program compliance. The EDD is required by DOL to perform scheduled on-site monitoring reviews of sub-recipients and sub-grantees of federally funded programs including WIA and Disaster Relief.

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

- **WIA/Disaster Relief Incident Reporting** provides a reporting and follow-up process for allegations of program fraud and abuses. The PRB receives and tracks incident reports, and submits them to DOL for its determination whether to conduct the investigation itself, or refer the reports back to EDD for investigation. Based on DOL's determination, EDD may investigate the incident and take appropriate action against the grant recipients.

- **Quality Control Reviews** are mandated for the UI benefit program. The PRB also conducts a similar Quality Control review for the DI program. The UI and DI Quality Control processes detect fraud by verifying that EDD staff are following proper payment procedures.

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

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

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 assessments, 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, and dismissal from State service.

Fraud includes such offenses 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; false certifications by medical practitioners and claimants; contract violations under WIA; underground economy tax evasion such as underreporting or failure to report employee wages; and internal fraud by EDD employees.

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

- The Fraud Tip Hot Line, telephone number (800) 229-6297, is available for the public to report employer tax evasion and allegations of fraud against the UI program, the DI program, and other programs administered by EDD.

- The Claimant Address Report, more commonly referred to as "Claimant ZIP Code Report," lists the mailing addresses within a particular postal ZIP Code area used by claimants to receive benefits. The report identifies mailing addresses where multiple claimants are receiving possible fraudulent payments.
- Participation in Task Forces with other state and federal law enforcement agencies such as the DOL, DOI, FTB, IRS, U.S. Postal Inspectors, and prosecutors.
- In collaboration with state and federal investigators, A&ED conducts forensic accounting and audit examinations to examine bank records, and personal and employer financial records.

The results of PRB's investigative activities for CY 2005 as well as the previous two CYs are covered in the DI, UI, and Employment Tax sections of this report.

RECENT INDEPENDENT OVERSIGHT ENHANCEMENTS

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

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

This effort is an ongoing challenge due to the advances of technology and the increased sophistication of criminal perpetrators seeking to defraud EDD.

Automated Data Analysis: The PRB is developing staff expertise in using automated software to conduct complex, comprehensive data analysis.

ENTERPRISE-LEVEL ACTIVITIES

The EDD has increasingly taken an enterprise-wide approach to identify and combat fraud within and across programs. Additionally, EDD is continually seeking new approaches to prevent, detect, and deter fraud, through partnerships with both internal and external entities. This section summarizes enterprise-level anti-fraud efforts undertaken during 2005, and those activities that are under consideration for future implementation.

The areas for enhanced anti-fraud efforts include:

New and Expanded Internal and External Partnerships

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

Recent Internal and External Partnership Enhancements

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

Automated Fraud Detection and Prevention Tools Under Consideration

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

- Voice Print Technology - An automated Voice Print technology enhancement to identify claimants when they call to certify for benefits by telephone.
- Electronic linkage of the Tax and the UI systems to enhance EDD's ability to detect fraud.
- Enhance the Fictitious Employer Detection System that 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.
- Establish automated links to other governmental agencies.
- Combat Identity Theft – The EDD submitted a Supplemental Budget Request (SBR) to DOL requesting \$500,000 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 SBR was approved and PRB and UI Branch are working jointly to evaluate data mining software to implement a front-end detection system to identify potentially fraudulent UI claims.

ACRONYMS

A&ED	Audit and Evaluation Division
CEP	Construction Enforcement Project
CIU	Criminal Intelligence Unit
CUIC	California Unemployment Insurance Code
CY	Calendar Year
DI	Disability Insurance
DMV	Department of Motor Vehicles
DOI	Department of Insurance
DOL	U.S. Department of Labor
EDD	Employment Development Department
EEEC	Economic and Employment Enforcement Coalition
EETF	Employment Enforcement Task Force
FOIS	Field Office Integrity Specialist
FTB	Franchise Tax Board
ID	Investigation Division
IME	Independent Medical Examination
IRS	Internal Revenue Service
IT	Information Technology
IVR	Interactive Voice Response
JEP	Janitorial Enforcement Project
JESF	Joint Enforcement Strike Force
JS	Job Service
LWIA	Local Workforce Investment Area
NER	New Employer Registry
OIG	Office of the Inspector General
PFL	Paid Family Leave
PI SPOC	Program Integrity Single Points of Contact
PIN	Personal Identification Number
PRB	Program Review Branch
QC	Quality Control
SALMS	Security Audit Logging and Monitoring System
SBR	Supplemental Budget Request
SSA	Social Security Administration
SSN	Social Security Number
SUTA	State Unemployment Tax Act
TAS	Tax Accounting System
TIPP	Targeted Industries Partnership Program
UEO	Underground Economy Operations
UI	Unemployment Insurance
WBCF	Web Based Claim Filing
WIA	Workforce Investment Act
WtW	Welfare-to-Work

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

Program Review Branch

Deputy DirectorRhonda R. English

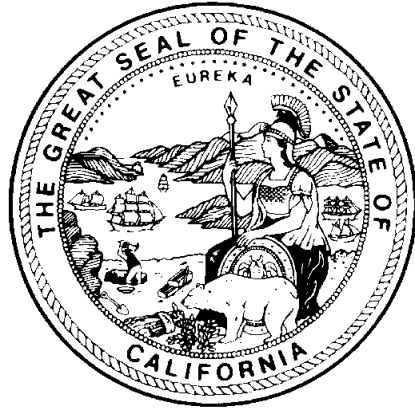
Investigation Division

Chief.....Barbara S. Milton

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

The California State Employment Development Department (EDD), as a recipient of federal and state funds, is an equal opportunity employer/program and is subject to Section 504 of the Rehabilitation Act and the Americans with Disabilities Act (ADA).

You can obtain information about accommodations for disabilities by contacting your local EDD office. The number is listed in the telephone directory under "State of California, Employment Development Department."



STATE OF CALIFORNIA

LABOR AND WORKFORCE DEVELOPMENT AGENCY

EMPLOYMENT DEVELOPMENT DEPARTMENT