



ANNUAL REPORT

FRAUD DETERRENCE AND DETECTION ACTIVITIES

*A REPORT TO THE
CALIFORNIA LEGISLATURE*

TWENTY-FOURTH 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) 2017, as required by California Unemployment Insurance Code (CUIC) Section 2614.

The EDD's major program responsibilities include Unemployment Insurance (UI), State Disability Insurance (SDI), Employment Tax Collection, and Workforce Innovation and Opportunity Act Title I (WIOA) programs. During 2017, through the administration of its programs, EDD collected more than \$73 billion in employment taxes from over 1.4 million employers and issued benefit payments in excess of \$11.5 billion on over 2.2 million UI and SDI 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 is diligent in pursuing state and federal funds to support its fraud prevention and detection efforts.

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 2017, EDD's comprehensive anti-fraud activities in the SDI, UI, Tax, and WIOA programs identified fraud (in dollars), as follows:

<u>Description</u>	SDI Program	UI Program	Tax Program	WIOA Program
Cases Under Investigation	\$12,911,367 129 cases	\$44,336,788 140 cases	\$97,305,930 144 cases	\$10,808,220 57 Cases
Criminal Complaints Filed	\$640,950 16 cases	\$838,788 12 cases	\$2,654,885 13 cases	N/A
Completed Criminal Prosecutions	\$1,912,988 16 cases	\$10,809,663 21 cases	\$4,683,279 22 cases	N/A
Fraud Overpayments (OP) Established ²	\$6,642,670 563 OPs	\$136,359,985 123,078 OPs	N/A	N/A
Fraudulent Benefits Prevented	\$734,586	\$4,461,182	N/A	N/A

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

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

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

BACKGROUND INFORMATION

Section 2614 of the CUIIC 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 three large employee benefit programs that include: UI, Disability Insurance (DI), and Paid Family Leave (PFL) programs. In 2017, these three programs paid claimants in excess of \$11.5 billion.

The EDD is also one of California's largest tax collection agencies and is responsible for administering the Employment Tax Collection program that collects four different types of payments. These payments include: employer-paid UI and Employment Training Taxes; and employee-paid Personal Income Tax and SDI contributions. The Employment Tax Collection program also processes quarterly wage reports from the state's 1.4 million employers. The Employment Tax Collection program is credited for collecting more than \$73 billion in taxes and contributions.

Finally, EDD is also responsible for administering several training programs authorized by the federal WIOA program, and provides employment services to job seekers throughout the state in America's Job Centers of California.

As with any high-value program, the temptation to defraud the system for personal gain is present. For example:

- Employers may not fully pay their employment taxes as required by law;
- Claimants may claim benefits while working;
- Impostors may falsely use identities of workers to obtain a fraudulent claim;
- Physicians may certify a disability inappropriately; and
- Claimants or physicians may submit forged documents.

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.

Anti-fraud activities within EDD include:

Prevention	Detection	
<ul style="list-style-type: none"> • Customer Education • Internal Control Reviews • Employer Audits • Internal System Audits • Fiscal Monitoring • Fraud Detection Efforts 	<ul style="list-style-type: none"> • Analyzing Employer Data • Internal Checks & Balances • Evidence Seizure • Cross-matching Data • Interagency Efforts • Fraud Hot Line • Surveillance 	<ul style="list-style-type: none"> • Undercover Operations • Computer Forensics • Serving Warrants • Interviews • Reviewing Medical Data • Arrests & Prosecutions

PROGRAM ACTIVITIES

The following provides more detailed information on the specific activities performed by each major program to prevent and detect fraud.

State Disability Insurance Program

The SDI program includes two benefits: the DI and PFL programs. The DI benefits provide partial wage replacement for eligible California workers who are unable to work due to illness, injury, or pregnancy. Workers covered under SDI are potentially eligible for PFL benefits when they are unable to work because of the need to care for a seriously ill child, parent, spouse, registered domestic partner, parent-in-law, grandparent, grandchild, or sibling, or to bond with a new minor child within the first year of birth or placement by adoption or foster care.

The following are some program highlights for CY 2017:

	Claims Processed	Benefits Paid
DI program	689,141	\$5.5 billion
PFL program	259,756	\$788.9 million

The EDD monitors, researches, and investigates new systems and activities to detect and prevent fraud and improve benefit payment accuracy in the SDI program. The SDI Program Integrity Unit oversees, coordinates, and conducts various staff education efforts and investigative activities involving suspicious claims in the SDI offices. The unit staff 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 EDD’s Investigation Division (ID) criminal investigators to combat fraud in the SDI program.

Primary SDI fraud deterrence and detection tools include a number of different tactics such as key notifications to claimants, data sharing with key partners, conducting systematic reviews, training and outreach, etc.

Claimant Interactions

1. Claimant Notification

This notification provides claimants the legal consequences for willfully making a false statement or knowingly concealing a material fact in order to obtain benefits. This notification is provided on the claim form declaration statement and is signed by the claimant when applying for benefits. This notification is also presented to be acknowledged by the claimant when applying for benefits through SDI Online.

2. Address Integrity

This is a component of SDI Online that ensures only the rightful owner of the claim makes a change of address to a claim. As a security and fraud detection measure, a letter is sent to the prior address to notify the claimant when the SDI program receives a request for a change of address.

3. Identity Management Software

This software authenticates and authorizes external users (customers) who set up external user accounts. The system creates an online profile for each external user and will encrypt and store the user identification/password, profiles, and credentials in an enterprise Identity Management System. The system validates and authenticates external users' logon credentials and allows authenticated users to access system functionality and improve SDI staff's ability to detect fraud.

4. In-Office Eligibility Review Process

This process 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. Regulations provide precise time frames and procedures for conducting interviews to ensure claimants' rights to due process are protected.

5. Truncation of Claimant Social Security Number

The SDI program is in the process of transitioning to the use of only the last four digits of a claimant's Social Security Number (SSN) to help deter identity theft and protect the confidentiality of information assets. The DI Branch continues to review forms where the SSN can be truncated or removed.

6. Electronic Benefit Payment Process

The electronic benefit payment process allows EDD to pay claimants using debit cards or direct deposit transfer options, providing claimants immediate access to their benefits and eliminating fraud associated with theft or loss of paper checks.

7. Identity Alert Procedures

These procedures instruct staff assigned to process DI and PFL claims on how to verify a claimant's identity when an SSN has been reported as being compromised. Staff will conduct an in-depth review to ensure the claimant is the true wage earner before allowing benefits to be paid.

8. Password Reset Process

The EDD launched Benefit Programs Online (BPO), a single login that EDD customers use to access SDI Online and UI Online, on October 16, 2017. It included a new password

reset process utilizing a unique “Reset Password” link. The link is sent directly to the user’s registered email address to deter potential imposter fraud and to ensure the payment of benefits to the appropriate person.

Data Sharing

1. Department of Motor Vehicles Interface

This data interface with Department of Motor Vehicles records helps the DI Branch to verify the identity of SDI Online claimants and medical providers.

2. New Employee Registry Benefit Cross-Match

The New Hires interface is used by the DI Staff to validate that new hires have not returned to work and continued to receive benefits. The New Hire interface also allows DI Branch staff to identify overpayments established against new hires. In CY 2017, as a result of the New Employee Registry cross-match interface, DI staff established eleven overpayments in the amount of \$25,780. No overpayments were established for PFL benefits.

3. Unemployment Insurance/Disability Insurance Overlap Flags

These flags automatically stop payments on DI and PFL claims when a prior UI claim period overlaps the dates that DI benefits are claimed. The DI and PFL staff then block the overlapping period pending an eligibility determination, thereby preventing potentially improper payments.

Medical Providers

1. Independent Medical Examinations

These examinations provide EDD with a second medical opinion regarding the claimant’s ability to perform their 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 required to verify the identity of the claimant appearing for the examination.

The Independent Medical Examinations (IME) are used to validate the treating physician’s diagnosis and prognosis, and as a means of controlling the duration of claims. The IMEs are also a useful tool in curtailing the loss of benefits for valid claims that are suspected of fraud or abuse. In CY 2017, of the 9,451 IME results received, 409 (4.3 percent) of the claimants scheduled for an IME failed to appear, 3,377 (35.7 percent) were found able to work on the date of the IME examination, and 5,665 (59.9 percent) were found disabled.

2. Automated Tolerance Indicators

These indicators (flags) are associated with the certifying healthcare provider's license number and 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 created to assist in the adjudication and payment of these claims.

3. Doctor Activity Tracking System

This system tracks the status of investigations involving potential doctor or doctor impostor fraud cases. The system ensures that appropriate follow up occurs; and documents and evaluates accomplishments.

4. Department of Consumer Affairs Notifications

These notifications identify medical practitioners whose licenses have been revoked or suspended. The information, provided by the following medical practitioner boards, helps ensure claims are not certified by improperly licensed medical practitioners and alerts EDD to potential fraud:

- Medical Board of California
- Board of Chiropractic Examiners
- Board of Optometry
- Board of Podiatric Medicine
- Board of Psychology
- Board of Registered Nursing
- Dental Board of California
- Osteopathic Medical Board of California
- Physician Assistant Board

Reviews and Reports

1. Disability Insurance Quality Control Reviews

These reviews are conducted on a quarterly basis using a statistically valid sample of DI benefit payments annually for accuracy, completeness, and compliance with the state law and DI Branch policy.

2. Benefit Audit Review

These audit reviews match wages reported quarterly by employers to DI benefits paid within the same period. Through this review, the SDI program is able to detect when claimants have been fraudulently collecting benefits while working. These reviews are performed quarterly.

3. Monthly Doctor Activity Report

This report provides a list of the top doctors certifying the highest total amount of benefits. This automated monthly report enables staff to identify significant changes in claims activity and/or filing patterns, which may be indicators of fraud.

4. State Disability Insurance Online Security Features

These security features provide physicians and medical practitioners the ability to certify DI and PFL claims through secure electronic channels. These channels reduce the risk of losing confidential information in the mail and reduces exposure for misuse.

5. Decedent Cross-Match Reports

These reports check the SSNs of all claimants against SSNs of individuals reported as deceased nationwide. This report enables the DI Branch to identify and recover benefits paid subsequent to the date of death. In CY 2017, of the 749 Decedent Cross-Match Reports received, 571 (76.2 percent) required no further action, 129 (17.2 percent) required additional actions with potential overpayment of \$377,247, and three (0.4 percent) were submitted to ID for further investigation.

6. Automated Detection Reports

These reports are developed collaboratively with ID's Criminal Intelligence Unit and the DI Program Integrity Unit, and permit staff to detect unusual patterns of activity in the SDI benefit payment system involving addresses, issuance of multiple payments, and multiple claims filed by the same claimant within a specified period of time.

7. Address and Phone Number Pattern Reports

These reports help identify other DI claims with the same address and/or phone number as the claimant, medical practitioner, and/or employer. Analysis of the claims listed on the report may lead to discovery of fraudulent claims or program abuse.

8. Employer Pattern Reports

These reports also help identify other DI claims having the same employer. Analysis of the claims listed on the report may lead to discovery of fraudulent claims or program abuse.

9. User Pattern Reports

These other reports identify SDI Online claims processed by a specific user or DI staff. Analysis of the claims listed on the report may lead to discovery of internal fraud.

Training and Outreach**1. Program Integrity Training**

This training is provided to all employees to heighten staff awareness and develop capacity to detect and deter fraud and abuse in the SDI program.

2. Medical Training

This training, provided to field office staff, includes a comprehensive Adobe presentation of medical information and case study training intended to educate and enhance staff's knowledge of disabling medical conditions and medical terminology. This training allows the staff to communicate more effectively with physicians/practitioners when discussing and obtaining additional medical information regarding an SDI claim. Medical terminology training provides staff with a better understanding of a diagnosis, and assists in determining the severity and expected length of a disability as well as the appropriate action to control claim duration or potential abuse of the program.

3. Information Security and Privacy Awareness Training

This training module is designed by Information Security Office to help educate all users of EDD data about basic security threats and vulnerabilities, as well as responsibilities regarding the protection of the confidentiality, integrity, and availability of EDD information and information assets.

4. Impostor Fraud Training

This training provides tools to assist in identifying abusive or fraudulent activity and explains the appropriate referral process. In the context of EDD fraud an impostor is defined as someone who represents themselves as another to obtain a benefit. The impostor is generally assuming the identity of another to collect benefits to which they are not legally entitled.

5. Education and Outreach to Stakeholders

Education and outreach to the California medical and employer communities, led by SDI's Education and Outreach Unit, enhances physicians'/practitioners' and employers' understanding of DI and PFL benefits and their role in the claim filing process. These efforts target the California medical and employer community and enhance the integrity of the SDI program by improving the quality of medical and employer information EDD receives to process claims.

This ensures benefits paid are consistent with the claimant's inability to perform their regular or customary work due to a non-work related disability or their need to care for a family member with a serious health condition. It also helps to minimize the submission of medical certifications that extend the disability duration beyond normal expectancy.

6. Birth Certificate Requirement for Paid Family Leave Claims

This requires claimants to submit a birth certificate, adoption or foster care certification on all bonding claims for which no medical evidence of a birth exists.

7. Digitizing Claim Documents for Paid Family Leave Claims

The PFL automated system includes a scanning process that digitizes all claim documents. To assist in detecting possible forgeries, claims examiners are able to compare current signatures of claimants and physicians on these documents with documents submitted previously by the same claimants and/or physicians.

State Disability Insurance Results and Accomplishments

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

SDI Program Results	<u>2015</u>	<u>2016</u>	<u>2017</u>
Cases Under Investigation	\$15,673,875 113 cases	\$17,087,901 125 cases	\$12,911,367 129 cases
Criminal Complaints Filed	\$1,219,295 13 cases	\$547,767 12 cases	\$640,950 16 cases
Completed Criminal Prosecutions	\$1,046,475 13 cases	\$3,370,879 21 cases	\$1,912,988 16 cases
Fraud Overpayments Established	\$20,224,345 3,427 OPs	\$10,457,047 945 OPs	\$6,642,670 563 OPs
Fraudulent Benefits Prevented By ID	\$671,991	\$1,310,998	\$734,586

The following provides more detailed information on the actions cited in the previous table regarding fraud in the SDI program in CY 2017.

- There were 129 cases potentially representing \$12,911,367 investigated. These investigations focused on the following case types:
 - Impostor fraud/identity theft (26 cases representing \$5,713,866);
 - Altered or forged documents (33 cases representing \$1,150,823);
 - Medical practitioner fraud (6 cases representing \$274,582); and
 - Working while certifying for benefits (49 cases representing \$1,776,770).
 - The remaining 15 cases, representing \$3,995,324, included fictitious employer registration on which claims were based, false injury certified by claimant, forgery by taking over the claim of another person, multiple social security numbers used by one person, self-employment, and miscellaneous violations.

- The ID filed 16 criminal complaints representing potential fraudulent benefits in the amount of \$640,950. The ID has continued its emphasis on the more complex fraud cases such as impostor/identify theft that take longer to investigate.

- The ID completed 16 criminal prosecutions representing fraudulent benefits in the amount of \$1,912,988. These completed prosecutions primarily involved altered and forged medical records, counterfeit checks, impostors, and working while certifying for benefits.
- Both DI and PFL staff established a cumulative total of 563 fraud overpayments in the amount of \$6,642,670.
 - The DI program established 295 fraud overpayments totaling \$3,856,372 on claims associated with claimants who were prosecuted.
 - The DI program established 268 fraud overpayments not attributed to prosecutions. These overpayments, totaling \$2,786,298 were the result of administrative actions applied by DI staff, such as false statement overpayments.
 - The PFL program established zero fraud overpayments.
- Anti-fraud efforts stopped \$2,820,701 in fraudulent SDI benefits from being paid. Of this total, \$2,086,115 is attributable to the SDI programs' anti-fraud efforts such as IMEs, verification of SSN ownership with deletion of improper base period wages, and all referrals to ID resulting in convictions or administrative actions which prevented payment of further benefits. Payment of approximately \$734,586 in fraudulent benefits was prevented through ID's ongoing investigations of identity theft, forgeries, and medical practitioner fraud.
- During 2017, there were 72 doctors that certified an unusually high number of claims. A review concluded 28 doctors' certifications were justified and no fraud or abuse was detected. In the remaining 44 doctors' certifications, 2 doctors are under investigation by ID and have a tolerance indicator, and 42 are pending further evaluation by staff.

Future State Disability Insurance Program Enhancements

As the SDI program continues to use an electronic web-based application for delivering services to its clients, the need to maintain the security and integrity of the program is a high priority. The following describes fraud detection and prevention system enhancements to the SDI program currently under development:

1. Utilizing Business Logic

With the implementation of SDI Online, the DI Branch has the ability to identify and address fraud and abuse through automated programs and business logic. The DI Branch will continue to develop new reports and automated detection and prevention measures to combat fraud and abuse.

2. Reinstatement of the Pending Investigation Flag

This flag is being pursued by the DI Branch, which would be attached to any claim pending criminal investigation and would prevent DI staff from taking any actions that may potentially compromise an active investigation.

3. Benefit Systems Modernization

This effort will consist of a full replacement of the UI and SDI benefit systems, which has not been done in decades. This will be a modern, stable, and fully automated system for EDD's benefit programs. It is anticipated that this system will have data analytics and other fraud prevention and detection tools. The ultimate goal of this effort is to ensure EDD can pay benefits timely and accurately, while protecting our benefit programs against any potential fraud.

Unemployment Insurance 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 are willing to accept employment. During CY 2017, the UI program processed 2.6 million initial claims, of which 1.3 million were new claims, and paid a total of \$5.3 billion in benefits.

California's economy has shown steady improvement in 2017 and overall UI claims are trending downward compared to 2016. However, UI claims and benefit levels are still higher than pre-recessionary years.

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 issuing specific notifications and performing various data cross matching, among other activities.

Notifications

1. Claimant Information

Notifications to the claimant include the *Unemployment Insurance Benefits: What You Need to Know* booklet and *Step-by-Step Guide: How to Certify for Ongoing Unemployment Benefits*. These notifications explain the requirements to file, and certify for UI benefits, including how to correctly report work and wages.

Additionally, claimants are informed about UI claim eligibility requirements and the legal consequences of willful misrepresentation or willful nondisclosure of facts as referenced in the claimant handbook *A Guide to Benefits and Employment Services*, which is also available online. Claimants are also notified of the legal consequences for willfully making a false statement or knowingly concealing a material fact in order to obtain benefits. This notification is provided on the claim form declaration statement and is signed by the claimant when applying for benefits. This notification is also presented to be acknowledged by the claimant when applying for benefits through UI Online.

2. Continued Claim Certification

This certification is completed by claimants every two weeks to attest to their continued eligibility for UI benefits for each week that they claim. This process requires 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. Notification of this requirement is provided on the continued claim certification declaration statement. Claimants sign under penalty of perjury that the information they provide when applying for benefits is true and correct, to the best of their knowledge. This notification is also presented to claimants when applying for

benefits through UI Online. Claimants must check a box in UI Online to indicate their electronic signature.

3. Employer Notification

Notification is issued to the last employer through the *Notice of Unemployment Insurance Claim Filed* (DE 1101CZ) when claimants file a new claim. If the employer contends that the claimant is not entitled to UI benefits and the employer's reserve account should not be charged, this notice instructs the employer how to protest the claim.

Employers may also choose to receive and respond to electronic notifications through the State Information Data Exchange System (SIDES). This nationally-standardized web-based system allows employers, including multi-state employers and third party administrators, to access and complete requests for UI information. This notice is mailed to tax-rated employers who paid wages in the Base Period of the UI claim. The form is mailed to the respective employer after the first benefit payment is made to the claimant advising them of the amount of potential charges to their reserve account. This form also provides the employer with an opportunity to request a ruling for possible relief of charges.

The SIDES system provides a secure and timely way for employers to electronically exchange UI eligibility information about former employees with EDD. Employers can upload supporting documentation and receive an electronic time stamp for submission of information to EDD. Fifty (50) states participate in SIDES, in one or more exchanges, with their state's employer community.

Data Sharing and Reviews

1. Unemployment Insurance Benefit Accuracy Measurement Program

This 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.

2. Quarterly Benefit Audits

These audits match 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 and failing to report their work and wages when certifying for UI benefits. This is the most common form of fraud committed against the UI program. 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 basis. The EDD utilizes an employer compliance database to track benefit audit forms that have been mailed and returned by employers.

3. New Employee Registry Benefit Cross-Match

This 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.

4. Interstate Cross-Match

This process cross-matches wages reported quarterly by employers outside of California 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 outside of California. 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 basis.

5. Social Security Number Verification Process

This 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.

6. Department of Motor Vehicles Verification Process

This verification provides real time (online) access to its database to verify a claimant's California driver's license or identification card number prior to filing a UI claim. This part of the identity verification process is used to prevent identity theft fraud in the UI program.

7. Last Employer Address Information

This information is obtained from EDD's internal database. The ability to crossmatch employer addresses with this database rather than relying upon the customer to provide EDD with this information helps ensure that proper payments are made to the appropriate individual.

8. Identity Alert Process

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.

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.

For every staff dedicated to this function, there is an estimated corresponding savings to the UI Trust Fund of more than \$7.6 million. The tools utilized by EDD to specifically prevent UI imposter fraud include:

- Stopping benefit payments on active UI claims that are associated with compromised SSNs until the identity of the claimant is confirmed.
- 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 information in a tax publication titled the *California Employer's Guide*.
- Partnering with other states that have also experienced increases in UI impostor fraud. The EDD continues to work 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 fraud. Success in preventing, detecting, and deterring UI fraud is dependent upon a strong partnership with the employer community.

9. Internal System Reports

These reports are generated daily to detect internal fraudulent activity by EDD employees. These reports identify instances when employees update a claimant's base wage file when there is not a current claim on the UI program's Single Client Data Base. A manager is responsible for performing a full review of each item listed on the report to determine if the update to the base wage file was for a valid and necessary reason.

Technology Improvements

1. Unemployment Insurance Online Features

The EDD's newest benefit payment system, UI Online, created new self-service functions, increased fraud detection and prevention tools, improved program integrity,

and built a more flexible and responsive infrastructure to operate the UI program. This automation system also enhanced EDD's anti-fraud components to ensure that benefits are paid properly and that employers' reserve accounts are charged appropriately.

2. Call Center Management Information System

The EDD Call Center System has a management information system that reports call activity, enabling EDD to capture call history and call data for fraud detection and prevention. Additionally, the call center system has implemented new self-service Interactive Voice Response features, including the ability to certify for continued claims by phone via EDD Tele-CertSM.

3. State Information Data Exchange System

The UI SIDES created a nationally-standardized web-based system for multi-state employers and/or third party administrators to access and complete requests for UI information. Fifty (50) states participate in SIDES, in one or more exchanges, with their state's employer community.

The EDD implemented SIDES in California in 2015, and added additional enhancements in 2016, allowing employers to receive and respond electronically to the *Notice of Unemployment Insurance Claim Filed (DE 1101CZ)*, through a "separation information exchange." This reduces errors common with paper forms, eliminates mail fraud, and provides employers with a standardized format to ensure that the required information is communicated to the EDD.

The EDD continues to encourage employer participation in SIDES by providing tip cards, fact sheets, video tutorials, and social media blasts. The SIDES information is available at EDD's dedicated webpage at www.edd.ca.gov/SIDES.

Information Sharing and Marketing

1. Customer Account Number

The EDD randomly assigns a 10-digit EDD Customer Account Number to claimants to use when registering for UI Online services. Notification of this number is mailed to claimants when they file a claim. The notification also promotes the use of UI Online and provides basic instructions on how to set-up an account. Claimants are able to use the EDD Customer Account Number as an identification reference in place of their SSN, and the number is printed as a claimant identifier on certain EDD-issued documents.

2. Fraud Prevention Campaign

The EDD inserted fraud prevention materials with claimants' Continued Claim Certification forms for one month of each calendar quarter of 2017. The materials reminded claimants that failure to report work and wages will result in disqualifications, overpayments that must be repaid, and penalties. In addition, these notices advise

claimants that EDD collects employment data from employers on newly hired and rehired employees to reduce fraud, as well as information on child support collection for the Department of Child Support Services for the location of parents who are delinquent on child support obligations. To support these efforts, the EDD implemented the Tips to Avoid UI Payment Delays, Overpayments, and Penalties webpage. This webpage is also available in Spanish.

3. Employer Education

Employers play an important role in the EDD's fraud prevention efforts. To educate employers, the *How to Protect Your Business from Higher Unemployment Insurance (UI) Taxes* video was released on April 17, 2017. This video focuses on preventing fraud by encouraging employers to immediately report all new hires and rehires to the EDD. To further support these efforts, a corresponding web page was implemented.

4. Integrity Marketing Campaign Literature

In September 2014, EDD was awarded a federal grant to fund a fraud prevention education and outreach program. The EDD conducted an extensive marketing campaign to employers and claimants to inform them of the top causes of improper UI benefit payments and UI fraud, the consequences of committing fraud in the UI program, and how to avoid them. Although the Integrity Marketing Campaign ended in February 2016 when the grant funds were exhausted, the EDD has materials available to educate claimants and employers via online as well as handouts at various forums. The EDD is also diligent in pursuing state and federal funds to support its fraud prevention and detection efforts.

5. The Integrity Marketing and Outreach Team

This team developed a video for employers, *"How to Protect Your Business from Higher Unemployment Insurance (UI) Taxes."* This video was released in April 2017 and we continue to analyze views. In addition, the department also continues to develop new videos and reference materials for both employers and claimants.

Unemployment Insurance Results and Accomplishments

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

UI Program Results			
	<u>2015</u>	<u>2016</u>	<u>2017</u>
Cases Under Investigation	\$21,665,486 128 cases	\$43,441,050 169 cases	\$44,336,788 140 cases
Criminal Complaints Filed	\$7,439,245 19 cases	\$841,728 20 cases	\$838,788 12 cases
Completed Criminal Prosecutions	\$1,320,939 20 cases	\$5,440,166 25 cases	\$10,809,663 21 cases
Fraud Overpayments Established	\$105,243,760 111,879 OPs	\$109,583,219 115,246 OPs	\$136,359,985 123,078 OPs
Fraudulent Benefits Prevented By ID	\$2,184,502	\$414,948	\$4,461,182

The following information provides some of the highlights that resulted in the actions cited in the previous table regarding fraud in the UI program in CY 2017.

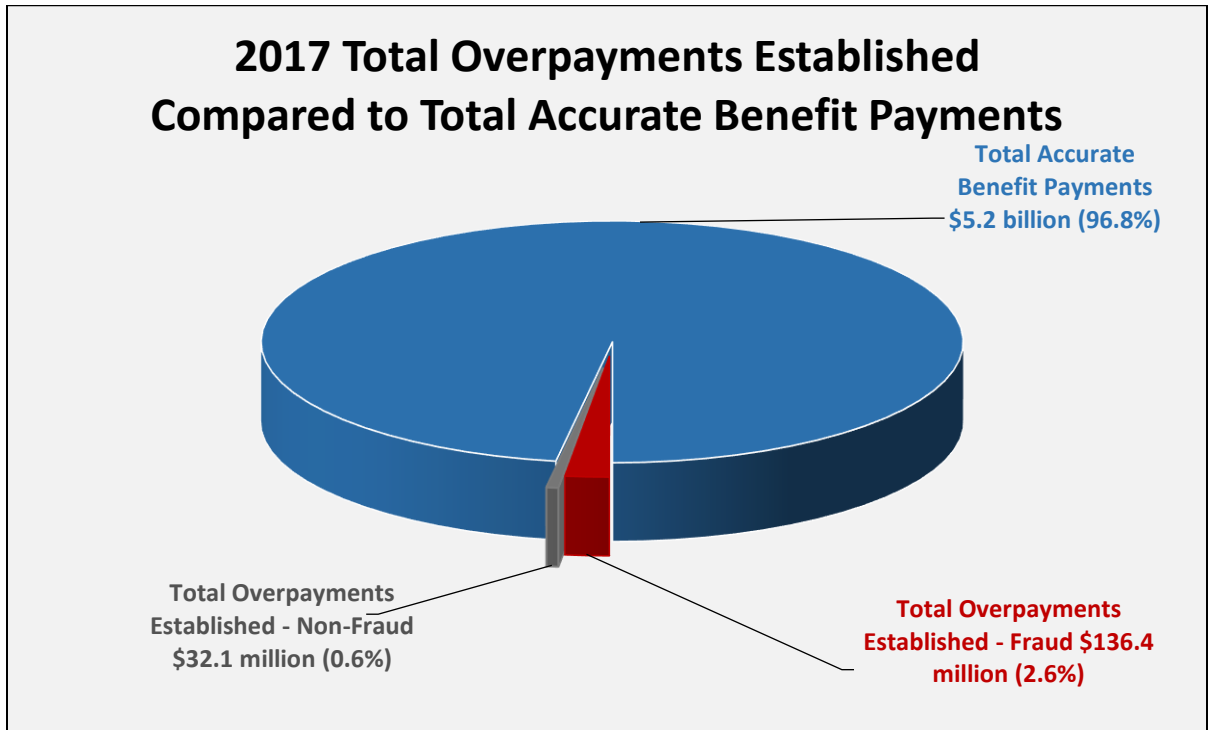
- There were 140 ongoing and new UI fraud cases representing potential fraudulent benefit payments in the amount of \$44,336,788. These investigations focused on the following case types:
 - Impostor fraud/identity theft (18 cases representing \$6,469,293);
 - Working while certifying for benefits (71 cases representing \$1,022,161);
 - Forgery by taking over another’s claim (10 cases representing \$154,735), and Fictitious employer registrations (32 cases representing \$36,494,205). The remaining nine cases, representing \$196,392, include multiple SSNs used by one person, self-employment, and miscellaneous violations.
- The ID filed 12 criminal complaints representing potential fraudulent benefits in the amount of \$838,788. During 2017, ID gave priority to investigating complex fraud cases involving the most egregious violations and the highest overpayments.
- The ID completed 21 criminal prosecutions representing fraudulent benefits in the amount of \$10,809,663. 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.

- The ID prevented the payment of \$4,461,182 in fraudulent benefits. This amount refers to remaining unpaid balances on the suspected claims that would have been paid had ID not taken preventive action.
- Other violations on separate cases that were unsuitable for prosecution were referred to the UI Branch for assessment of administrative penalties and collection of overpayments. 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 mitigating factors identified by prosecuting authorities. These violations included individual suspects who failed to report work and earnings while certifying for benefits, filed claims with stolen identity, employer collusion with employees, and altered or forged documents.
- In compliance with California regulations, UI program staff imposed disqualifications and overpayments on over 1,000 cases totaling an additional \$3.1 million 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 September 2014, EDD implemented the Treasury Offset Program administered by the Bureau of Fiscal Service in the United States Department of Treasury. The Treasury Offset Program allows states to collect delinquent state UI benefit overpayment liabilities from claimants by offsetting their federal income tax refunds. In CY 2017, EDD collected approximately \$64.3 million in Treasury Offset Program overpayment liabilities. This total includes approximately \$35.6 million in actual benefit overpayments, \$14.3 million in interest, \$10.7 million in penalties, and \$3.7 million in court costs.

Fraud Overpayments

The following provides additional information regarding UI fraud prevention and detection results related to overpayments:

- The UI program staff established over 123,000 fraud overpayments totaling \$136.4 million in CY 2017. When compared to the \$5.3 billion in benefits paid during this year, the fraud overpayments represent 2.6 percent of all payments.



- A total of almost 90,000 fraud overpayments totaling \$84 million were established as a result of the benefit audit cross-match system, the New Employee Registry cross-match, and the Interstate cross-match processes. The following chart provides the number and dollar amount of fraud overpayments detected using the three data cross-match tools:

Method of Detection	Fraud Overpayments Established	
	Number	Dollars
Benefit Audit Cross-Match	64,104	\$64,350,247
New Employee Registry Cross-Match	24,798	\$18,027,011
Interstate Benefit Cross-Match	821	\$1,616,335
Total	89,723	\$83,993,593

- Because the New Employee Registry 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 \$727 compared to \$1,004 for a benefit audit overpayment, a variance of \$277.

This is an average savings, or benefit overpayment avoidance, of \$6.9 million annually. Based on findings through the Benefit Accuracy Measurement system, the top two leading causes of fraud overpayments are unreported work and earnings during the bi-weekly benefit certification and misreported separation information at the claim filing point.

- The UI program staff established fraud overpayments on 357 cases of identity theft totaling \$1.7 million. A total of 33,000 fraud overpayments were established that were not attributed to the Benefit Audit or New Employee Registry cross-match system or identity theft. These overpayments, totaling \$50.7 million, 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.

Future Unemployment Insurance Program Enhancements

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

1. State Information Data Exchange System Enhancements

The SIDES, originally implemented in 2015 and enhanced in 2016, contains the following “exchanges” that reduce errors, common with paper forms, and provide employers with a standardized format to ensure that the following required information is communicated to EDD:

- Separation Information;
- Earnings Verification;
- Monetary and Potential Charges; and
- Determination/Appeal Format.

Since the implementation of the separation information exchange in SIDES is still relatively new for businesses, the EDD is focusing efforts towards marketing the many benefits of SIDES to encourage business participation. The EDD will begin exploring

different marketing strategies to reach a larger audience. It is the EDD's objective in 2018 to meet established performance goals for increasing participation and usage of SIDES in the business community to maximize the number of electronic communications received by employers.

2. National Directory of New Hires

The EDD anticipates implementing the National Directory of New Hires Cross-Match for UI Claims in June 2018. This nationally maintained database will allow the EDD to identify and investigate claimants receiving UI benefits who have returned to work outside California. The use of the National Directory of New Hires Cross-Match should assist in reducing the number and amount of overpayments made to claimants.

3. Mortality Data Crossmatch

This Mortality Data Crossmatch process matches UI claimant records with the Social Security Administration's Death Master File that the EDD receives from the Department of Commerce National Technical Information Service. This list is provided on a monthly basis and a thorough review of the list is conducted to identify individuals who were reported to the Social Security Administration as deceased during the life of their claim and remain in continued claim status. By utilizing a crossmatch between the EDD's UI claimant data and the Death Master File, the EDD will be better equipped to proactively detect and prevent UI fraud and improper benefit payments, reducing the impact of loss to the UI Trust Fund. This new crossmatch will be implemented in June 2018.

4. New Employee Registry Re-Run

To further reduce improper payments resulting from claimants incorrectly or failing to report work and wages, in the fall of 2018, the EDD will implement re-running the original New Employee Registry records from California employers a second time through the State Directory of New Hire Cross-Match process. This will identify any SSNs that have UI claim activity not detected during the first run because the claimant had not yet certified for UI benefits. The New Employee Registry Re-Run will occur daily approximately four weeks after the original daily New Employee Re-Run.

5. Benefit Overpayment Collection Automation Project

The Benefit Overpayment Collection Automation solution will expand the Accounting and Compliance Enterprise System and provide a robust, secure, and integrated automated collection system for overpayment liability collection, storage, and account management with added functionality, such as levy automation, to increase the overall effectiveness of the benefit overpayment collection program. The Benefit Overpayment Collection Automation system will replace the outdated Benefit Overpayment Collection System and allow the EDD to utilize the advanced collection tools within the Accounting and Compliance Enterprise System. Automating the Benefit Overpayment Collection System will increase the recovery of UI benefit overpayments thereby replenishing the UI Fund, which will contribute to the overall fiscal stability of the UI Program.

The Benefit Overpayment Collection Automation solution will also provide improved access and additional services to claimants. These improved services will reduce the time and effort required to interact with the EDD, provide self-service options, alternative payment options such as Electronic Funds Transfer, automated and customized letters, and will improve overall collection functionality. In addition, the new system will search the Financial Institution Record Match information and automatically issue bank levies, based upon established business rules. The issuance of bank levies will be a new collection tool used for the collection of benefit overpayments.

The Benefit Overpayment Collection Automation is scheduled to be implemented by late 2018.

6. Benefit Systems Modernization

This effort will consist of a full replacement of the UI and SDI benefit systems, which has not been done in decades. This will be a modern, stable, and fully automated system for EDD's benefit programs. It is anticipated that this system will have data analytics and other fraud prevention and detection tools. The ultimate goal of this effort is to ensure EDD can pay benefits timely and accurately, while protecting our benefit programs against any potential fraud.

Employment Tax Program

The EDD is one of the largest tax agencies in the United States, collecting UI tax, DI withholdings, Employment Training Tax, and State Personal Income Tax withholdings. Only the Internal Revenue Service (IRS) collects more payroll tax dollars than the EDD. In 2017, the EDD received over \$73 billion in California employment taxes, penalties, and interest from over 1.4 million employers.

The Tax Branch ensures the integrity of the employment tax program by collaborating with our customers to provide efficient, responsive, and innovative services. The EDD is committed to reducing unfair business competition and protecting the rights of workers by coordinating the joint enforcement of tax, labor, and licensing laws; detecting and deterring employment tax violations in the underground economy; and educating customers to increase compliance with tax laws. The EDD has staff presence throughout the state and also conducts out-of-state audits to provide education, assistance, and enforcement. The Tax Branch takes a blended approach to combating the underground economy through the following:

- **Outreach and Education**

The Tax Branch has a variety of methods for outreach and education targeted and accessible to employers, employees, tax professionals, and the general public. The outreach and education is tailored towards encouraging and maximizing voluntary compliance and deterring businesses from operating in the underground economy.

- **Administrative**

The Tax Branch has administrative methods of enforcing the employment tax laws: the Audit Program issues assessments for payroll taxes due and any applicable penalties and interest to employers located in the state and to out-of-state employers with California workers. When appropriate, penalties for intent to evade and/or fraud may be applied. The Tax Branch performs follow-up audits to confirm continued compliance and continually works on identifying new and different methods to promote and verify prospective voluntary compliance.

- **Criminal**

The Tax Branch and ID leverage resources, share best practices, and work together to combat the underground economy. The ID identifies, investigates, and prosecutes fraud within EDD's various programs and internal operations. The ID has a specialized law enforcement unit that investigates criminal violations of the CUIIC, the California Penal Code, and the United States Code for federal prosecution. They conduct criminal investigations involving employer collusion in the underground economy, employer failure to register and report wages paid to employees, and collaborate on Workers' Compensation Insurance investigations related to state payroll tax violations. They conduct surveillance, perform undercover operations, interview witnesses, initiate

search warrants, and submit completed investigations to prosecutors to convict individuals who commit employment tax fraud.

The EDD determines if the convicted party made restitution, is still on active probation, and obeys all laws with respect to the future filing of returns and payments. The conviction itself and the collection of the tax liabilities play an integral part in deterring the underground economy.

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

1. Audit Program

In 2017, this program conducted 7,937 audits and investigations, resulting in assessments totaling \$249,981,712* and identified 461,279* unreported employees.

*In Calendar Year 2017, the Audit Program completed two cases with extremely large assessments and a large number of unreported employees which resulted in these figures being much higher than usual.

2. Interagency Tax Collection Committee

This committee is an alliance with the EDD, Franchise Tax Board, California Department of Tax and Fee Administration (formerly Board of Equalization), IRS, Attorney General, State Controller and various county recorders. It provides a forum to share common collection practices in order to increase compliance and resolve collection issues. It also allows the agencies to meet and share information about their collection programs focusing on common, competing, and overlapping functions including bankruptcy, lien, and levy issues. It is intended to foster communication and allow collection staff to meet their counterparts, establish working relationships, and encourage cooperation on common tax collection issues.

3. Joint Enforcement Strike Force

The Joint Enforcement Strike Force (JESF) was established in October 1993, by Executive Order W-66-93, to combat the underground economy by pooling resources and sharing data among the state agencies charged with enforcing licensing, labor, and payroll tax laws. On January 1, 1995, Section 329 was added to the CUIC, which placed the provisions of the Executive Order into law. The EDD is the lead agency for the JESF. The JESF is responsible for enhancing the development and sharing of information necessary to combat the underground economy, to improve the coordination of enforcement activities, and to develop methods to pool, focus, and target enforcement resources.

The JESF is empowered and authorized to form joint enforcement teams, when appropriate, to utilize the collective investigative and enforcement capabilities of the JESF partners. The partners include, but are not limited to:

- Employment Development Department

- Department of Industrial Relations
- Department of Consumer Affairs - Contractors State License Board, Bureau of Automotive Repair, and Bureau of Security Investigative Services
- California Department of Insurance
- Department of Justice
- Franchise Tax Board
- California Department of Tax and Fee Administration
- Department of Labor
- Alcoholic Beverage Control
- Internal Revenue Service
- District Attorneys throughout California
- Local law enforcement

The EDD's enforcement efforts undertaken by JESF to combat the underground economy include:

- Conducting unannounced site inspections to identify employers operating in the underground economy by interviewing owners, managers, and workers. The goal is to identify and bring into compliance individuals and businesses in the underground economy that are in violation of payroll tax, labor, and licensing laws.
- Utilizing various databases, income tax return analysis, along with informant information, to conduct in-depth investigations of employers suspected of operating in the underground economy. When noncompliance is detected, the case is referred to the EDD's Audit Program.
- Collaborating efforts between the EDD and the IRS to allow for an exchange of case information regarding unreported wages and/or misclassified workers. This multiagency compliance approach presents a united effort to taxpayers and their representatives that both the federal and state agencies work together to enforce tax laws.
- Targeting of industries known for high levels of noncompliance with licensing, labor, and payroll tax laws.
- Pursuing administrative actions to address employer noncompliance detected via the JESF's efforts, or for cases warranting criminal investigation, ID's Criminal Tax Enforcement Program works with law enforcement agencies and JESF partner agencies to identify and prosecute those responsible for the criminal activities.

4. Labor Enforcement Task Force

The Labor Enforcement Task Force (LETF) was initially formed in 2005 as the Economic and Employment Enforcement Coalition and began operating as the Labor Enforcement

Task Force in January of 2012. The LETF is responsible for ensuring that California workers receive proper payment of wages and are provided a safe work environment, ensuring that California receives all employment taxes, fees, and penalties due from employers, eliminating unfair business competition by leveling the playing field, and making efficient use of state and federal resources in carrying out its mission. The Department of Industrial Relations leads this multi-agency coalition. The LETF partners include:

- Department of Industrial Relations
- Employment Development Department
- Department of Consumer Affairs – Contractors State License Board, and Bureau of Automotive Repair
- California Department of Tax and Fee Administration
- California Department of Insurance
- State Attorney General
- District Attorneys throughout California

5. FedState Tax Partnership

This partnership is an ongoing alliance between the Franchise Tax Board, the EDD, the California Department of Tax and Fee Administration, and the IRS. The mission of the FedState Tax Partnership is to increase tax compliance and provide greater convenience to taxpayers. The FedState Tax Partnership goals include: enhancing taxpayer access to information and services, reducing taxpayers' burden, increasing voluntary compliance, increasing the sharing of taxpayer data among the partner agencies to enhance compliance activities, enhancing communication among the tax partner agencies regarding current and long-range agency specific projects, and identifying opportunities to leverage resources among the partner agencies.

6. Compliance Development Operations

The Compliance Development Operations (CDO) is a program within the EDD's Tax Branch whose functions include conducting on-site business inspections as part of JESF and LETF operations and screening allegations received from task force partners to determine suitability for on-site inspections. In addition, the CDO captures allegations of non-compliance submitted through the Underground Economy Fraud Hot Line, correspondence, and electronic mail. These are screened and referred for inspection or audit.

Compliance Development Operations and Related Audit and Investigation Results

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

CDO Cumulative Lead Development Activities and Results			
	<u>2015</u>	<u>2016</u>	<u>2017</u>
Joint Inspections	1,488	1,481	1,410
EDD Audit Referrals	1,954	1,868	948
EDD Payroll Tax Audits	1,248	1,030	806
EDD Payroll Tax Assessments	\$45,521,593	\$37,779,911	\$31,401,790
Previously Unreported Employees	22,352	13,931	9,093
Cases w/Fraud Penalty Assessed	46	19	23
Assessments on Fraud Cases	\$7,849,492	\$3,881,608	\$8,639,773

The CDO's JESF inspection group works with the JESF participating agencies and conducts joint on-site business inspections in response to allegations received about employers operating in the underground economy. The following table illustrates the JESF inspection group's results for the last three years:

JESF On-site Business Inspection Results			
	<u>2015</u>	<u>2016</u>	<u>2017</u>
Joint Inspections	583	600	569
EDD Audit Referrals	421	424	446
EDD Payroll Tax Audits	454	387	335
EDD Payroll Tax Assessments	\$16,914,651	\$15,646,390	\$11,282,878
Previously Unreported Employees	6,147	4,530	3,536
Cases w/Fraud Penalty Assessed	20	12	5
Assessments on Fraud Cases	\$4,623,767	\$2,148,204	\$1,844,485

The CDO's LETF inspection group works with participating agencies to carry out the LETF's mission and conducts joint on-site business inspections to determine if an audit referral is needed. The following table illustrates the LETF's results for the last three years:

LETF On-site Inspection Results			
	<u>2015</u>	<u>2016</u>	<u>2017</u>
Joint Inspections	905	881	841
EDD Audit Referrals	451	546	494
EDD Payroll Tax Audits	440	381	420
EDD Payroll Tax Assessments	\$11,935,391	\$12,016,208	\$14,225,275
Previously Unreported Employees	5,588	3,429	3,130
Cases w/Fraud Penalty Assessed	20	7	16
Assessments on Fraud Cases	\$2,604,330	\$1,733,404	\$4,196,742

The Tax Enforcement Group within the CDO develops audit leads by conducting desk investigations of businesses in a variety of industries using various databases and income tax return analysis to detect non-compliance and fraud. The following table illustrates the Tax Enforcement Group's results for the last three years:

Desk Investigation Results	<u>2015</u>	<u>2016</u>	<u>2017</u>
EDD Audit Referrals	136	39	8
EDD Payroll Tax Audits	167	95	51
EDD Payroll Tax Assessments	\$8,755,812	\$5,091,155	\$5,893,637
Previously Unreported Employees	3,585	1,561	2,427
Cases w/Fraud Penalty Assessed	5	0	2
Assessments on Fraud Cases	\$593,253	N/A	\$2,598,546

The Complex Case Group (formerly Lead Development and Program Support Group) captures allegations of non-compliance submitted via the Underground Economy Fraud Hot Line, correspondence, and electronic mail. The allegations are screened and forwarded to the appropriate CDO group or the EDD Audit Program for follow-up. The following table illustrates the number of allegations received and processed by the Complex Case Group for the last three years:

Allegations Received and Processed	<u>2015</u>	<u>2016</u>	<u>2017</u>
Underground Economy Fraud Hot Line	2,993	1,112	1,641
Underground Economy Mailbox (e-mail)	1,578	2,121	1,668
Correspondence	200	211	204
Total	4,771	3,444	3,513

Non-CDO Audit and Investigation Results

The following table illustrates the results of additional audits and investigations in which the Audit Program found fraud on cases that were initiated from non-CDO leads for the last three years:

Fraud Audit and Investigation Results From Non-CDO Leads	<u>2015</u>	<u>2016</u>	<u>2017</u>
Cases w/Fraud Penalty Assessed	89	65	48
Previously Unreported Employees	7,135	4,941	3,991
Assessments on Fraud Cases	\$42,484,291	\$15,436,440	\$15,250,652

The following are the out-of-state audit results for the last three years:

Out-Of-State Audits Completed			
	<u>2015</u>	<u>2016</u>	<u>2017</u>
EDD Payroll Tax Audits	144	137	122
EDD Payroll Tax Assessments	\$5,990,020	\$4,578,008	\$2,557,264
Average Liability Change	\$41,597	\$33,416	\$20,961
Unreported Employees	6,783	4,173	2,119

The Questionable Employment Tax Practices Program (QETP) was initiated in 2007 as a collaborative effort between the EDD and IRS. A Memorandum of Understanding was created to allow for exchange of case information. These cases are excellent audit leads for the EDD since the employers in these cases concurred with the IRS findings regarding unreported wages and/or misclassified workers. The following table illustrates the results of the QETP Program for the last three years:

QETP Results from IRS Leads			
	<u>2015</u>	<u>2016</u>	<u>2017</u>
EDD Payroll Tax Audits	43	30	22
EDD Payroll Tax Assessments	\$1,925,719	\$448,150	\$943,509
Average Liability Change	\$44,784	\$14,938	\$42,887
Previously Unreported Employees	249	238	202
Cases w/Fraud Penalty Assessed	1	0	0
Assessments on Fraud Cases	\$28,139	N/A	N/A

The Tax Branch makes assessments of UI rate differences when reserve accounts are transferred by employers attempting to circumvent the UI experience rating system to inappropriately gain a lower UI rate. The following table illustrates the Tax Branch’s workload accomplishments in this area for the last three years:

Results - Experience Rating Exploitation			
	<u>2015</u>	<u>2016</u>	<u>2017</u>
CUIC Section 135.2 (2 or more businesses combining)			
EDD Payroll Tax Investigations	3	0	3
EDD Payroll Tax Assessments	\$0	\$0	\$159,821
Average Liability Change	\$0	\$0	\$53,274
CUIC Section 1061 (business transfers)			
EDD Payroll Tax Investigations	281	125	69
EDD Payroll Tax Assessments	\$7,535,189	\$5,034,950	\$6,077,157
Average Liability Change	\$26,816	\$40,280	\$88,075

In 2017, ID conducted the following tax enforcement activities independent of JESF:

- The ID investigated a total of 144 ongoing and new payroll tax evasion fraud cases representing a potential tax liability of \$97,305,930.
- The ID filed 13-criminal complaints representing a potential tax liability of \$2,654,885.
- The ID prosecuted 22 criminal cases resulting in convictions with a potential tax liability of \$4,683,279.
- The ID is now partnered with staff from the Tax and UI Branches to develop a strategy for addressing fictitious employer schemes responsible for perpetrating fraud against EDD. The objective is to identify potential fictitious employer schemes based on a thorough and ongoing evaluation of the characteristics/elements of such schemes. The identification of these schemes allows EDD to increase detection and eliminate fraudulent UI and DI benefit claims filed against EDD.

7. License Suspensions/Holds Requested

There are three types of licenses that the EDD can request other state agencies to suspend/hold if the licensee is delinquent in paying amounts due to the EDD:

➤ **Contractors State License Board License Hold**

Business and Professions Code Section 7145.5 authorizes the Contractors State License Board to take disciplinary action against a license holder. Once the Board receives the request from the EDD to place a hold, the Board will suspend the license. In addition, the Board will search their database for all licenses with the same personnel of record and suspend those licenses as well. The licenses remain suspended until the delinquency that led to the suspension has been resolved.

➤ **Alcohol Beverage Control Liquor License Hold**

Business and Professions Code Section 24049 authorizes the EDD to request from the Alcohol Beverage Control a hold to be placed on certain types of liquor licenses. A hold establishes a priority for the EDD to any monies received from the sale of the liquor license and prevents the transfer of a liquor license from the seller to a buyer until the conditions of the hold have been met.

➤ **Farm Labor Contractor License Hold**

The EDD is authorized by Section 1141 of the CUI to notify the Labor Commissioner of the Department of Labor (DOL) Standards Enforcement in writing that a Farm Labor Contractor is delinquent in payment of worker contributions either by self-assessment or by a final EDD assessment. Labor Code Section 1690.1 authorizes the Labor Commissioner to refuse to issue or renew any license until the licensee has fully paid the amount of the delinquency.

The following table illustrates the number of license suspensions/holds that the EDD requested during the last three calendar years:

License Holds Requested			
Type of Hold	<u>2015*</u>	<u>2016*</u>	<u>2017</u>
Contractors	631	557	578
Liquor	111	88	40
Farm Labor Contractor	8	15	16

*Figures reported in 2015 and 2016 were the number of license holds in place which included prior year holds that hadn't been resolved.

The following table illustrates the number of criminal restitution cases monitored and the payments received by the EDD on those cases during the last three calendar years:

Restitution Cases			
	<u>2015</u>	<u>2016</u>	<u>2017</u>
Criminal Restitution Cases Monitored	79	84	91
Payments Received on Restitution Cases	\$1,022,994	\$329,584	\$2,459,397

The following table illustrates audit assessed amounts that were collected by the EDD during the last three years:

Amounts Assessed by Audits			
	<u>2015</u>	<u>2016</u>	<u>2017</u>
Audit Assessed Amounts Collected	\$23,470,682	\$26,806,926	\$31,010,643

Future Employment Tax Program Efforts

1. Joint Training for JESF and LETF Staff

In calendar year 2018, joint training is planned for JESF and LETF staff. The training will include sharing of best practices among other things.

2. Special Operations to Target Noncompliance

Special operations are being planned by CDO to target industries that currently have a high rate of noncompliance.

3. Education and Outreach for Recreational Cannabis Employers

Due to the recent legalization of recreational cannabis, the Tax Branch will be conducting education and outreach across the state to promote voluntary compliance by employers in this industry.

Workforce Services Program

The EDD administers the federally funded WIOA program in California. The WIOA program provides funding to local entities that provide employment and training opportunities. The EDD guides the sub-granting of WIOA funds received from DOL and provides general program direction to local administrative entities that deliver services to eligible clients via a statewide system of WIOA Local Workforce Development Areas (LWDA) and other grantees. The WIOA superseded the Workforce Investment Act and took effect in July 2015.

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

Workforce Innovation and Opportunity Act Activities

1. Monitoring Reviews

These reviews determine whether programs operate in compliance with WIOA, and applicable federal, state, and local rules and regulations, and impose corrective action for any deficiencies.

2. Local Workforce Development Areas Administrative Entity Sub-recipient Monitoring

Each LWDA administrative entity, as a condition of receiving WIOA funds, is required to maintain and operate a monitoring system that ensures that each of its 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 LWDA administrative entities and all other recipients of WIOA funding.

3. Incident Reporting System

This system provides reports of fraud, abuse, and criminal activity within the WIOA program. Each local administrative entity, as a condition of receiving WIOA funds, participates in this system by being alert to indications and allegations of WIOA-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.

4. Single Audits

Single Audits are required of LWDA administrative entities and their subcontractors that expend an aggregate of \$750,000 or more in federal funds. Further, commercial subcontractors that expend \$750,000 or more in federal funds to operate a WIOA 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 no less than once every two years. Audit findings of local sub-recipients are resolved by the local administrative entity. Audit findings of the local administrative entities and other direct grantees are resolved by EDD. The EDD may also conduct ad hoc WIOA audits as warranted.

5. Workforce Services Division

Program staff in this division oversee the delivery of services by WIOA funded organizations. Staff provide ongoing programmatic, fiscal, and technical assistance to WIOA funded projects. Staff also review WIOA 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.

6. Regulatory Controls

These controls provide for additional fraud protection. The DOL provides a Hot Line to report fraud and abuse complaints. This Hot Line functions as a national control point. Another control point is that the WIOA program prohibits contracting or doing business with any agency that has been disbarred (e.g., license revoked, de-certified). Additionally, the WIOA regulations have established controls against nepotism.

Wagner-Peyser Activities

The EDD also administers the federally funded Wagner-Peyser Act program in California. The Wagner-Peyser Act program provides funding for EDD field staff to provide employment services throughout California. The EDD staff deliver services to eligible customers statewide through the America's Job Centers of CaliforniaSM network, while providing job matching services to the employers of California.

The primary tool used directly by customers (both job seekers and employers) is the California Job Opening Browse System (CalJOBSSM). Through CalJOBS, clients can utilize the system themselves, and EDD staff can refer job seekers to jobs, workshops, and appointments. The system can also be used to track services for the federally mandated participant reports. The EDD ensures that client data is kept confidential, and works with the vendor to ensure that CalJOBS maintains its program integrity and security. The program integrity components related to CalJOBS include:

1. Access to Confidential Data

Access to confidential data is limited by various internal safeguards which have been implemented, including system generated reports listing suspicious activity, redacting job seekers' SSNs in the system, removing confidential data from any standard reports, and giving job seekers the option to suppress their contact and personal information. Job seekers may omit personal information on résumés and provide it only to employers with whom they would like to share it.

2. Employer Vetting

This vetting is completed on every employer granted access to the system. Because postings are generated by employers, vetting is critical to protecting users. This validation process includes a confirmation that each employer who registers is a California employer with verified identifiers including a valid California tax identification number. Starting on December 4, 2017, an automated vetting solution was implemented within CalJOBS. Employers that provide information that matches the identifiers are automatically verified and granted access to CalJOBS. Employers that provide information that does not match revert to the manual review process, which can take up to 72 hours.

Once an employer is vetted and granted access to CalJOBS, there are automated features in place to report suspicious activity. A small percentage of employers were identified as fraudulent in 2017 and were immediately locked out and prevented from accessing the system. Legitimate California employers continue to have the option to search for and contact qualified candidates through internal CalJOBS messaging. The EDD continues to closely monitor and immediately respond to suspicious employer activity in order to ensure California jobseekers are protected. Stronger warning messages and additional cautionary language informing job seekers of the dangers of potentially fraudulent employers and information on how to detect them have also been added to the CalJOBS website.

3. Document Management and Scanning

This functionality was implemented in 2015 as a CalJOBS enhancement, reducing the need for paper files. The replacement of hard copy files eliminates the need for job seekers to carry documents with them every time they are provided services, reduces the chances of lost or misfiled documents, and increases efficiency in managing the documents both locally and remotely.

4. System Controls

To ensure security in the system and maintain data integrity, the CalJOBS system is equipped with various levels of access that are defined by several privilege groups within the system. The privilege groups give users access to confidential and non-confidential data depending on the privilege group they are associated with. In order to maintain access and ensure changes are minimal, the creation of these privilege groups are determined by Workforce Services Management. This internal control allows the state to maintain the security and data integrity of the data housed in the CalJOBS system.

Workforce Services Results and Accomplishments

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 WIOA, Workforce Investment Act, and American Recovery and Reinvestment Act funds. Although the American Recovery and Reinvestment Act and Workforce Investment Act programs have ended, staff continue to resolve fraud and abuse cases associated with these programs.

During CY 2017 the Compliance Resolution Unit processed 121 cases, 64 of which were resolved, resulting in the recovery of \$715,135 in non-federal funds from Local Workforce Development Areas or sub-grantees. At the end of the year, 57 ongoing cases for a total of \$10,808,220 in questioned costs remained open in various stages of the state resolution process.

- The \$10,808,220 represents 18 of the 57 cases for which EDD has been able to determine the potential disallowance.
- The remaining 39 cases are in various stages of resolution and fact-finding.

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 against EDD's programs through partnerships with internal and external entities.

Fraud in EDD programs covers a variety of offenses, such as:

- Fictitious employer registrations to establish future fraudulent UI and DI claims;
- Forgery of claim documents;
- Identity theft or impostor claimants using the wage credits of others;
- Impostors taking over the claims of individuals who are deceased or returned to work;
- False certifications by medical practitioners and claimants;
- Underground economic activities to evade paying taxes such as underreporting or failure to report employee wages and taxes; and
- Internal fraud by EDD employees.

The PACB performs audits in accordance with the Generally Accepted Government Auditing Standards and the International Standards for the Professional Practice of Internal Auditing, which are promulgated by the Comptroller of the United States and the Institute of Internal Auditors. 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 activities are performed by the PACB to assist in the fraud deterrence and detection efforts. Many of these activities cited under the specific EDD program areas are performed with the assistance of PACB criminal investigators, auditors, and compliance monitors.

1. Independent Internal and External Audits

These audits are conducted of departmental operations and recipients of federal funds such as LWDA's 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.

2. Independent Internal Control Audits

These audits assist organizations 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.

3. On-Site Monitoring Reviews

As required under federal law, on-site reviews are conducted of WIOA funding recipients to determine fiscal and program compliance. The EDD is required to perform scheduled on-site monitoring reviews of sub-recipients and sub-grantees of federally funded programs, including WIOA and Disaster Relief funded services.

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.

4. Incident Reporting

The incident reporting system under the WIOA provides a means for individuals to report allegations of program fraud and abuse, as well as a process in which these allegations are reviewed. The PACB receives and tracks incident reports and submits them to the DOL for its review. The DOL will determine whether to conduct the investigation itself, or refer the reports back to EDD for investigation and appropriate action.

5. Criminal Fraud Investigations

The EDD's Criminal investigators conduct these investigations to prevent, detect, and deter fraud committed against the UI, SDI, Tax Collection, 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 for individuals who might be contemplating committing fraud. Court ordered restitution and imprisonment or probation also act as a fraud deterrent. 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 ID's Internal Affairs cases is the initiation of adverse action against EDD employees. The adverse action process includes suspensions, demotions, reductions in pay, dismissal from state service, and/or criminal prosecution.

6. Published Website to Report Fraud

The EDD website (www.edd.ca.gov) has a link to an electronic fraud reporting form. The form allows the public to report allegations of fraud against programs administered by EDD.

7. Participation in Task Forces

The PACB participates in task forces with other state and federal law enforcement agencies such as the California Department of Insurance, Franchise Tax Board, IRS, DOL, United States Postal Inspectors, and local prosecutors.

8. Forensic Examinations

The Audit and Evaluation Division conducts forensic accounting and audit examinations in response to requests for assistance from ID.

9. Strategic and Tactical Intelligence Gathering

The ID's Criminal Intelligence Unit develops strategic and tactical intelligence for investigative planning and case identification, and assists program managers in identifying areas to prevent and detect fraud. This unit works with EDD program managers to identify characteristics of fraud and uses technology to screen claims for potential fraudulent activities. The unit is currently gathering and analyzing data from claims filed and investigative cases worked to gain insight into the fraudulent trends being employed against EDD. This information will help identify strategies that EDD can use to counter this fraudulent activity.

10. Business Intelligence Competency Center

The EDD's Business Intelligence Competency Center is a data warehouse that helps the ID's Criminal Intelligence Unit utilize complex software to improve data mining to prevent and detect fraud against EDD's programs. This data warehouse is used to improve fraud detection efforts by conducting in-depth data analyses to identify patterns and trends that will serve as potential indicators of fraudulent activity.

11. Link Analysis

The EDD ID is currently utilizing a product to help EDD investigate potentially collusive activities. The product displays the relationships between people, places and events involving suspected fraudulent activity.

ENTERPRISE-LEVEL ACTIVITIES

The EDD embraces 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 that are ongoing, new and enhanced partnerships undertaken during CY 2017, as well as those activities that are under consideration for future implementation.

Ongoing Efforts

1. Fraud Penalty Assessment

A monetary penalty of 30 percent is assessed on overpayments resulting from claimant fraud in the UI and SDI programs.

2. Personal Identification Number and Identity Management System

These technology features provide telephone identification, authentication, and authorization services via EDD's Interactive Voice Response system improving claimant privacy by preventing unauthorized access to confidential data. The systems are available 24-hours a day, seven days a week.

Claimants select their Personal Identification Number the first time they use the Interactive Voice Response system to obtain payment information by matching personal identifying information. As an additional security and fraud detection measure, claimants are sent a notice when their Personal Identification Number is established or changed. Claimants are required to enter their SSN and four-digit Personal Identification Number each time they request confidential payment information for their UI and SDI benefits.

3. Education and Outreach

Increased marketing efforts to educate the public on the consequences associated with committing fraud is ongoing. The EDD also publishes a summary of recent fraud convictions detected by the EDD and prosecuted to the fullest extent of the law. These convictions are for both UI and SDI benefit fraud, and tax evasion schemes.

The EDD posts these summaries of recent fraud prosecutions on the EDD public website under the title of Recent Fraud Prosecutions. During the CY 2017, the website received a total of 54,727 views and is available directly through the link:

http://edd.ca.gov/About_EDD/EDD_Actively_Prosecutes_Fraud.htm

4. Toll-free Fraud Tip Hot Line 800-229-6297 and Website

This toll-free hot line provides employers and individuals a designated telephone number to report alleged fraud directly to ID's Criminal Intelligence Unit. In addition,

allegations can be reported via the EDD website (www.edd.ca.gov). These reporting options provide individuals the ability to report fraud in a secure environment.

The number of SDI program fraud allegations reported through the hot line were: 2,120 allegations (CY 2015); 2,609 allegations (CY 2016), and 2,019 allegations (CY 2017). The number of UI program fraud allegations reported through the hot line were: 3,164 allegations (CY 2015); 3,696 allegations (CY 2016); and 2,685 allegations (CY 2017).

New and Enhanced Partnerships

1. Internal Partnerships

The ID, jointly with both the UI and DI programs, continues to identify claim or payment characteristics that are indicative of fraud. The ID uses built-in SDI Online and California Unemployment Benefit Services applications fraud detection rules to more easily identify fraud. Additionally the ID enjoys a close partnership with staff in UI, DI and Tax to work collaboratively to combat fraud in the respective programs.

An expanded partnership between ID and the EDD's 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 maintains a valuable partnership with Tax Branch staff to develop a strategy for addressing fictitious employer schemes responsible for perpetrating fraud against EDD. This partnership identifies the characteristics and elements used to establish fictitious employers that improves timely detection of these schemes and eliminates fraudulent UI and SDI benefit claims filed against EDD.

2. External Partnerships

The ID has continued to foster joint investigative activities with the DOL, Office of Inspector General, 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 and enforcement agencies to publicize joint investigative, arrest, indictment, and prosecution actions, with the intent of deterring fraud perpetrators.

Activities Under Consideration

1. New Data Sharing Interfaces

The EDD is considering new options for data sharing interfaces with government agencies such as incarceration data, or a more Department-wide use of the Social Security Administration's decedent data.

2. A New Identity Management System

The EDD is also considering a new identity management system to provide a more robust approach to validate the true identity of those applying for UI or SDI benefits online or via the telephone.

ACRONYMS

CalJOBS SM	California Job Opening Browse System
CDO	Compliance Development Operations
CUIC	California Unemployment Insurance Code
CY	Calendar Year
DI	Disability Insurance
DOL	Department of Labor
EDD	Employment Development Department
ID	Investigation Division
IME	Independent Medical Examination
IRS	Internal Revenue Service
JESF	Joint Enforcement Strike Force
LETf	Labor Enforcement Task Force
LWDA	Local Workforce Development Area
OP	Overpayment
PACB	Policy, Accountability and Compliance Branch
PFL	Paid Family Leave
SDI	State Disability Insurance
SIDES	State Information Data Exchange System
SSN	Social Security Number
UI	Unemployment Insurance
WIOA	Workforce Innovation and Opportunity Act Title I

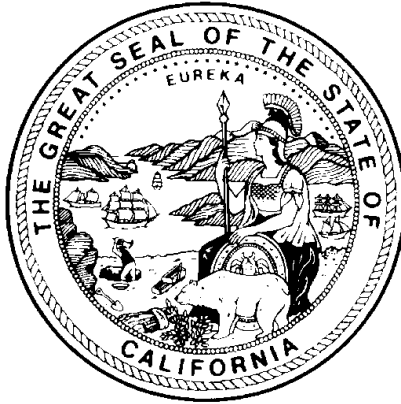
This report was prepared by the Policy, Accountability and Compliance Branch of the
California Employment Development Department

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

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



STATE OF CALIFORNIA

LABOR AND WORKFORCE DEVELOPMENT AGENCY

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