Testimony Submitted to the U.S. Senate Committee on Finance
Preserving Integrity, Preventing Overpayments and Eliminating Fraud
in the Unemployment Insurance System

Testimony Submitted by Paul Trause, Washington State Employment Security Commissioner

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Thank you Chairman Baucus, Ranking Member Hatch and members of the committee for the opportunity to testify today before the Finance Committee on the State of Washington's unemployment insurance system integrity efforts. I am Paul Trause, Commissioner of the Washington Employment Security Department.

As you may have heard over the course of the recession, Washington State has one of the healthiest and most stable unemployment benefits fund in the nation. Employers in our state have been willing to make the investment necessary to keep this fund healthy, in part, because of the high value we place on integrity. To ensure this trust, it is critical we preserve a level playing field for businesses and ensure claimants receive only the benefit to which they are entitled.

The vast majority of benefit overpayments and unpaid taxes are not due to fraud. In my state, 93 percent of our registered employers pay their taxes on time, and less than 5 percent of regular benefits are overpayments. Most of the issues we see are the result of errors and confusion. For example, fraud accounted for less than one half of 1 percent of regular benefit payments in 2010.

Fraud Detection

Let me first discuss fraud detection. In the past few years, our state legislature and Governor have worked to improve our laws and provide us with the framework required to pursue those employers and claimants who seek to defraud the system.

The state legislature has established clearer definitions of fraud – as well as a graduated penalty structure for claimants committing fraud. In addition to having to pay back fraudulently obtained benefits, claimants on the first occurrence of fraud are denied the possibility of receiving benefits for 26 weeks. For the second occurrence of fraud, they serve a 52 week denial period and are charged a 25% penalty of the amount overpaid. For third and subsequent occurrences of fraud, claimants are denied benefits for 104 weeks and must pay a 50% penalty. We believe that this approach serves as an active deterrent.

The Employment Security Department has also worked closely with the Legislature to strengthen laws curbing abuses by businesses seeking to "dump" their state unemployment insurance tax history and escape paying the taxes that they owe. We have also participated actively with the Legislature and multiple state agencies on a multi-year Underground Economy Task Force that targets businesses who gain unfair advantage by not covering their workers with legally required benefits and shirking their tax obligations.

Employers caught trying to manipulate their tax rates must pay the taxes they owe, late payment penalties, and late payment interest. They could also pay up to 10 times the difference between the amount of taxes they should have paid and the amount they did pay. They can then be assigned the delinquent tax rate, and must pay audit costs along with any related collection fees. Recommending schemes that help employers evade their taxes also is against the law. Offenders face a penalty of up to $5,000 per incident, plus audit costs and collection fees.

The Importance of Technology

We rely heavily on technology to implement our fraud fighting efforts. First, we regularly cross-match unemployment-insurance recipients against databases to identify individuals who either are ineligible, concealing wages or not able to engage in a legitimate job search. The matches we use include :

- National Directory of New Hire
- Department of Labor and Industries (Workers' Compensation)
- Department of Health (obituary)
- Department of Corrections
- Social Security Administration
- Employment Security Benefit Wage
- ESD employee cross match

These matches are responsible for uncovering half of all fraud related claims we uncover. We strongly support expanding the new hire database to include rehires.

Washington has established a unit that "mines" the data available to us to uncover organized fraud. For example, this group will identify instances where the same phone is used to file multiple claims, multiple claimants are claiming from a single address, the same Social Security number is being used in different fraudulent claims, and attempts are being made to obtain information from our system that indicate identify theft or preparation to file a fraudulent claim.

Another example of the importance of technology is our upgraded investigative case management system that allows us to direct investigations through fast path (no investigator necessary) and full path with full investigator involvement. This computer based systems is very efficient, enabling our investigative unit, the Office of Special Investigations (OSI) to complete the greatest number of investigations and reduce the amount of money leaving the trust fund fraudulently.

Although not high-tech, we use toll-free hot lines and our website to solicit tips from the public and other employers. These tips account for 17 percent of our investigations of claimant fraud and about 2.5 percent of our tax audits.

OSI's investigative efforts have been very successful, with $21.7 million dollars in overpayments detected by OSI in 2010.

Focused Audits of Employers

Audits are the primary tool we use to uncover employer fraud. Again, just as with workers, the vast majority of employers act responsibly. They want to pay what they owe. However, the department has a very active audit program to identify employers who are not paying their share. In 2008 we moved from scheduling audits based largely on random selection to an audit selection process designed to focus on employers who appeared likely to be misclassifying employees or not reporting wages.

The focused audit program stems from a legislative task force created by Governor Christine Gregoire in 2006. The task force was created to address the problem of an underground economy of businesses. These businesses typically are not licensed, do not pay workers compensation, do not contribute to unemployment Insurance, and/or fail to pay taxes.   This underground economy creates an unlevel playing field; businesses playing by the rules are placed at a competitive disadvantage (particularly in the construction industry). Additionally, consumers are being disadvantaged by substandard work.

This task force generated two continuing initiatives- a Cross-Agency Referral Committee and Cross-Agency Audit Training. Additionally, the task force's efforts helped us to identify five elements which have proven vital to focusing our audit selection:

- Utilize subject matter expertise
- Collect data
- Track audit results based on audit assignment type
- Identify industry specific compliance and reporting issues
- Emphasize and support Underground Economy audits

These elements create the foundation of our Focused Audit Program, and each has significantly contributed to the identification of misclassified workers and discovery of unpaid taxes in Washington State. All are subject to on-going evaluation of their contribution towards steady growth in audit outcomes. As we evaluate the usefulness of the information generated from each of these elements, our program continues to evolve.

As of 2010 the agency has a wide variety of audit types to address particular issues that may arise. We assign audits by computer matching data, unexplained changes in information reported to us, past audit experience, and staff knowledge. We also have forged much closer working relationships with other

state taxing agencies including the Departments of Revenue and Labor and Industries to identify businesses that are completely unregistered. Audit types include:

- Industry: Targeted by NAICS codes
- Blocked Benefit Claims: Generated from unemployment claims
- Random: Randomly selected per USDOL requirements
- Underground Economy: audits requested by tax investigations
- 1099: Generated from IRS leads
- Request: Requested by a District Tax Office
- Labor & Industries: Cross Agency Lead
- Department of Revenue: Cross Agency Lead
- Follow-up: District Tax Office request generated from a previous audit
- Large Payroll Company: Newly created category based on recent USDOL requirement changes
- Out-of-State: Business that use an out-of-state payroll company and therefore categorized as out-of-state but have an in-state location
- State Unemployment Tax Act (SUTA) Dumping: Employers who have a large percentage of the same employees one quarter as a different employer did for a prior quarter

We continue to revisit our audit assignment distribution. Our most recent data indicate that Underground Economy audits lead in discovering misclassified employees as well as additional taxes. We are in the process of formulating and proposing changes based on this information as well as the new U.S. Department of Labor Effective Audit Measure which will be mandatory as of 2014. For the future, we have plans to take all of the data from audit outcomes and other sources and combine it to identify indicators that point to likely audit candidates – not by industry, but by individual business.

As a result of Washington's enhanced audit program:

- We found 102 percent more misclassified workers and 60 percent more unreported taxes in 2010 than in 2009.
- The agency discovered 15,527 misclassified employees; 5,229 of those employees were from underground economy audits.
- In 2010, the Employment Security Department discovered over $2.9 million in unpaid taxes from audits and investigations; $1.65 million taxes from underground economy audits.

Deterrence through the Media

Regardless of the source of fraud, we believe that actively publicizing successful fraud prosecutions can work as a deterrent to future fraud. Because of confidentiality restrictions, we are limited in what we can report to the media – but recently, we had great success with a story about a claimant who stated that she was actively looking for work while she was out of state getting married. We couldn't use her

name, but the image of a woman stopping at a movie theater to apply for a job – while <u>on the way</u> to her wedding – captured the imagination of media outlets all over the state, and it generated widespread coverage.

Collecting Overpayments

As in other states, the vast majority of our overpayments to claimants are caused by error, not by fraud. We work aggressively to collect overpayments using existing databases to locate debtors, payment plans to encourage voluntary compliance, and, where that fails, legal tools such as liens and garnishments to compel payments. Washington is investigating entering into the Treasury Offset Program (TOPS) to allow the state access to federal funds to offset outstanding UI debts. We have recently created a small skip-tracing unit that appears to be particularly successful in locating hard-to-find people.

Over the past ten years, we have increased our recoveries by more than 300 percent. Each of our collectors return over $30 for each dollar we spend. By contrast, the American Collectors Association reports the median recovery is $1.17 for each dollar spent.

2010 represented a record-breaking year for Washington's collections efforts -$ 76 million in principal and interest recovered.

Preventing Overpayments

As important as collecting overpayments is, preventing them is more important. We believe there are three keys to preventing overpayments.

The first is improved technology; not just technology to improve our communication with employers, but also the underlying benefit payment systems themselves. Our basic benefit system is more than twenty years old and is mainframe-based. It does not provide the flexibility required to adjust to the demand placed on it by this recession. Our Internet claims system was put in place in 2000 and requires a long list of interface improvements to speed communication with our basic benefit systems and to provide increased edits to ensure information is complete and accessible. If we are given the ability to use recovered overpayments and delinquent contributions to increase integrity, we believe this authority should include the ability to use this money to improve our base technology infrastructure.

The second is education for both employers and claimants so they know what is required of them. We engage in extensive outreach efforts to educate employers - holding more than 70 workshops and forums throughout the state each year. Our statewide accountants and tax-preparer associations have been particularly helpful in our efforts.

We also offer a voluntary audit to review employer records and ensure that they are reporting correctly – without fear of penalty. If the review finds that the employer is not reporting correctly, we will not charge late-payment penalties. However, the employer does still have to pay taxes due and associated interest charges.

Third is the early detection and prevention of issues and speeding people's return to work through aggressive return-to-work assistance. We recognize that we will never have the resources to provide the optimal level of service to each claimant, but we are working to improve the methods we use to review claimants' job searches, assess their skills within the context of the labor market, and help them better target and carry out their job searches. We believe this is crucial to our ability to combat overpayments. In 2009, a peer-reviewed study by our labor market information branch revealed that these efforts returned people to work more quickly and increased earnings. From June 2010 through May of this year, more than 66,000 claimants received a job-search review. We strongly urge continued funding for reemployment activities.

We recognize that the faith of our businesses and worker community in the integrity of our fund is critical to its solvency. We believe the actions we have taken to prosecute and deter fraud and prevent and collect and prevent overpayments are essential.