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UNEMPLOYMENT FRAUD AND ABUSE

HEARING

BEFORE THE

SUBCOMMITTEE ON HUMAN RESOURCES

OF THE

COMMITTEE ON WAYS AND MEANS
HOUSE OF REPRESENTATIVES

ONE HUNDRED SEVENTH CONGRESS

SECOND SESSION

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UNEMPLOYMENT FRAUD AND ABUSE

TUESDAY, JUNE 11, 2002

HOUSE OF REPRESENTATIVES,
COMMITTEE ON WAYS AND MEANS,
SUBCOMMITTEE ON HUMAN RESOURCES,
Washington, DC.

The Subcommittee met, pursuant to notice, at 4:02 p.m., in room B–318 Rayburn House Office Building, Hon. Wally Herger (Chairman of the Subcommittee) presiding.

[The advisory and revised advisory announcing the hearing follow:]

ADVISORY

FROM THE COMMITTEE ON WAYS AND MEANS

SUBCOMMITTEE ON HUMAN RESOURCES

FOR IMMEDIATE RELEASE
June 4, 2002
No. HR–15

CONTACT: (202) 225–1025

Herger Announces Hearing on Unemployment Fraud and Abuse

Congressman Wally Herger (R–CA), Chairman, Subcommittee on Human Resources of the Committee on Ways and Means, today announced that the Subcommittee will hold a hearing on efforts to reduce fraud and abuse of the Nation's Unemployment Compensation (UC) system. **The hearing will take place on Tuesday, June 11, 2002, in room B–318 Rayburn House Office Building, beginning at 2:00 p.m.**

In view of the limited time available to hear witnesses, oral testimony at this hearing will be from invited witnesses only. Witnesses will include representatives of the U.S. Department of Labor, U.S. General Accounting Office, U.S. Department of Labor Office of the Inspector General, and other UC fraud and abuse experts. However, any individual or organization not scheduled for an oral appearance may submit a written statement for consideration by the Committee and for inclusion in the printed record of the hearing.

BACKGROUND:

The UC program provides benefits to unemployed workers who have a history of employment. Within a broad Federal framework, each State designs its own benefits program and imposes taxes on employers to pay for regular UC benefits. A separate Federal tax is imposed on employers to fund the Federal responsibilities under the system, including support of administrative expenses, loans to States, and the Federal half of extended benefits for certain workers. In fiscal year 2002, the U.S. Department of Labor projects that 11.8 million laid-off workers will receive UC benefits for an average of 15.5 weeks. With an average weekly benefit amount of $244, more than $44 billion in benefits will be paid.

Despite the size and expense of the UC program, in recent years program integrity activities have received relatively little Federal attention. Several factors—including State funding of regular benefits, perceived Federal underfunding of anti-fraud and related administrative activities, and a strong economy—are often cited as reasons. Congress recently addressed one concern through the passage of legislation providing additional Federal funds to States, which may be used for additional program integrity activities, among other purposes. As signed into law on March 22, 2002, this legislation (P.L. 107–147) provided for the immediate distribution of $8 billion in surplus Federal UC funds to States, among other provisions.

In announcing the hearing, Chairman Herger stated: "During the recent economic slowdown, the Nation's Unemployment Compensation program has been an important safety net for millions of hard-working Americans who lost their jobs. Congress recently strengthened that safety net by providing up to an additional 13 weeks of unemployment benefits nationwide. While we provide benefits to millions of unemployed American workers and their families, we also have oversight responsibilities to ensure benefits are going to the right people. That's part of the reason we also provided States an additional $8 billion in Federal funds to support anti-fraud efforts, among other purposes. This hearing will review current anti-fraud efforts and additional measures to better ensure program integrity."

FOCUS OF THE HEARING:

The hearing will focus on waste, fraud, and abuse involving UC benefits and consider additional measures to better ensure program integrity.

DETAILS FOR SUBMISSION OF WRITTEN COMMENTS:

Please Note: Due to the change in House mail policy, any person or organization wishing to submit a written statement for the printed record of the hearing should send it electronically to *hearingclerks.waysandmeans@mail.house.gov,* along with a fax copy to (202) 225–2610, by the close of business, Tuesday, June 25, 2002. Those filing written statements who wish to have their statements distributed to the press and interested public at the hearing should deliver their 200 copies to the Subcommittee on Human Resources in room B–317 Rayburn House Office Building, in an open and searchable package 48 hours before the hearing. The U.S. Capitol Police will refuse sealed-packaged deliveries to all House Office Buildings.

FORMATTING REQUIREMENTS:

Each statement presented for printing to the Committee by a witness, any written statement or exhibit submitted for the printed record or any written comments in response to a request for written comments must conform to the guidelines listed below. Any statement or exhibit not in compliance with these guidelines will not be printed, but will be maintained in the Committee files for review and use by the Committee.

1. Due to the change in House mail policy, all statements and any accompanying exhibits for printing must be submitted electronically to *hearingclerks.waysandmeans@mail.house.gov,* along with a fax copy to (202) 225–2610, in Word Perfect or MS Word format and MUST NOT exceed a total of 10 pages including attachments. Witnesses are advised that the Committee will rely on electronic submissions for printing the official hearing record.

2. Copies of whole documents submitted as exhibit material will not be accepted for printing. Instead, exhibit material should be referenced and quoted or paraphrased. All exhibit material not meeting these specifications will be maintained in the Committee files for review and use by the Committee.

3. Any statements must include a list of all clients, persons, or organizations on whose behalf the witness appears. A supplemental sheet must accompany each statement listing the name, company, address, telephone and fax numbers of each witness.

Note: All Committee advisories and news releases are available on the World Wide Web at http://waysandmeans.house.gov/.

The Committee seeks to make its facilities accessible to persons with disabilities. If you are in need of special accommodations, please call (202) 225–1721 or (202) 226–3411 TTD/TTY in advance of the event (four business days notice is requested). Questions with regard to special accommodation needs in general (including availability of Committee materials in alternative formats) may be directed to the Committee as noted above.

* * * NOTICE—CHANGE IN TIME * * *

ADVISORY

FROM THE COMMITTEE ON WAYS AND MEANS

SUBCOMMITTEE ON HUMAN RESOURCES

FOR IMMEDIATE RELEASE
June 6, 2002
No. HR–15–Revised

CONTACT: (202) 225–1025

Change in Time for Subcommittee Hearing on Unemployment Fraud and Abuse

Congressman Wally Herger (R–CA), Chairman, Subcommittee on Human Resources, Committee on Ways and Means, today announced that the Subcommittee hearing on efforts to reduce fraud and abuse of the Nation's Unemployment Compensation system scheduled for Tuesday, June 11, 2002, at 2:00 p.m., in room B–318 Rayburn House Office Building, **will be held instead at 4:00 p.m.**

All other details for the hearing remain the same. (See Subcommittee Advisory No. HR–15, dated June 4, 2002.)

Chairman HERGER. Good afternoon and welcome to today's hearing on fraud and abuse in the Nation's unemployment compensation (UC) program.

As we all know, unemployment benefits provide a much-needed safety net to millions of hardworking Americans, especially in tough economic times like we have seen in the past year. This year alone, nearly 12 million laid-off workers will receive an estimated $44 billion in unemployment benefits. That is twice what we spend on cash welfare every year, and with far less fanfare.

Recently, we expanded the unemployment safety net by providing up to 13 additional weeks of unemployment benefits nationwide. In a number of States with particularly high unemployment, we made benefits available even longer to help families that were hardest hit. Already, an estimated 1.4 million workers are receiving these extended benefits.

Providing this extra help in tough times is part of our job, and Congress and the Administration have certainly answered the call this year. We also have a responsibility to make sure these funds are well spent and are going to intended recipients who earn their displaced worker benefits. Unfortunately, that does not always happen.

For example, the U.S. General Accounting Office (GAO), citing U.S. Department of Labor (DOL) statistics, will describe how last year, $2.4 billion in unemployment benefit overpayments occurred. Over the past 10 years, overpayments averaged $1.8 billion per year, or a whopping $18 billion in misspent funds over that period. These staggering numbers reflect just the overpayments we know about. We can be sure more are out there waiting to be uncovered through better oversight.

Specific examples of abuse already uncovered are troubling. For example, GAO notes that in just four States, almost 3,000 fraudulent unemployment benefit claims totaling about $3.2 million were paid to individuals using Social Security numbers that did not exist or belonged to deceased individuals.

Further investigation by GAO identified nine Social Security numbers being used by approximately 700 individuals as proof of eligibility for employment. Seven of the Social Security numbers belonged to deceased individuals, and apparently the individuals involved are illegal aliens.

Misused unemployment program funds represent taxes paid by employers and constitute lost wages for all employees. Everyone loses when unemployment benefits are the subject of fraud and abuse.

In the law extending unemployment benefits this year, we also provided States with tremendous new resources, a total of $8 billion. These surplus Federal unemployment funds can pay for new benefits or be used to improve anti-fraud and other program integrity efforts. While many States are still deciding how to use these new resources, we will highlight that strengthening program integrity is one smart use that benefits taxpayers, workers, and beneficiaries alike.

We thank all of our witnesses for joining us today to review current anti-fraud efforts and how we can improve the system so that it best serves American workers.

Without objection, each Member will have the opportunity to submit a written statement and have it included in the record at this point. Mr. Cardin, would you like to make an opening statement?

[The opening statement of Chairman Herger follows:]

Opening Statement of the Hon. Wally Herger, a Representative in Congress from the Sate of California, and Chairman

Good afternoon and welcome to today's hearing on fraud and abuse in the nation's unemployment compensation program.

As we all know, unemployment benefits provide a much needed safety net to millions of hardworking Americans, especially in tough economic times like we've seen in the past year. This year alone, nearly 12 million laid off workers will receive an estimated $44 billion in unemployment benefits. That's twice what we spend on cash welfare every year, and with far less fanfare.

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Providing this extra help in tough times is part of our job, and Congress and the Administration have certainly answered the call this year. But we also have a responsibility to make sure these funds are well spent, and are going to intended recipients who worked to earn their displaced worker benefits.

Unfortunately, that doesn't always happen.

The General Accounting Office, citing Department of Labor statistics, will describe how last year $2.4 billion in unemployment benefit overpayments occurred. Over the past ten years, overpayments averaged $1.8 billion per year or a whopping $18 billion in misspent funds over that period. And these staggering numbers reflect just the overpayments we know about. We can be sure more are out there waiting to be uncovered through better oversight.

Specific examples of abuses already uncovered are troubling. For example, GAO notes in their testimony that in just 4 States, almost 3,000 fraudulent unemployment benefit claims totaling about $3.2 million were paid to individuals using Social Security numbers that did not exist or belonged to deceased individuals.

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We thank all of our witnesses for joining us today to review current anti-fraud efforts and how we can improve the system so that it best serves American workers.

Mr. CARDIN. Thank you, Mr. Chairman. Let me join you in looking forward to our witnesses today. Obviously, any time that Unemployment Insurance (UI) funds are used for purposes that are not permitted under the law, we want to join you in any type of corrections for fraud and abuse.

Mr. Chairman, let me tell you that there are many ways that we think we should be looking at and focusing our attention on, whether the Unemployment Insurance funds that are collected or

should be collected are used for their rightful purposes. Clearly, fraud and abuse among beneficiaries is wrong. We need to make sure that our States have the adequate tools in order to deal with that.

Let me just also point out that an individual who is entitled to Unemployment Insurance benefits who is denied benefits, that is also an area that we need to take a look at.

You mentioned that we have a report from, I believe you said GAO, that indicates that those that are using wrongful Social Security numbers amount to about $3.2 million annually. Well, we know in 1998, there were $600 million of benefits that should have been paid that were not paid under the Unemployment Insurance law because claimants did not have the adequate information presented mainly through their employers in order to get these benefits.

So, I think we need to take a look at not just the fraud and abuse on the beneficiary side, but also the mistakes that are being made on the employers' side to make sure that the right benefits are being paid under law.

Let me also indicate that fraud and abuse can take place on the revenue side. Employers are supposed to submit the revenues, the Unemployment Insurance funds, for their workers. We know that there is misclassification of certain employees as independent contractors. I think that is another area that we need to take a look, to make sure that we are collecting the appropriate revenues under the Unemployment Insurance funds.

Lastly, let me point out that I think any hearing today, at this time, taking place on Unemployment Insurance benefits has to take a look at the long-term unemployed Americans. We have many people who are reaching the end of their extended benefits that we recently passed. We need to take a look to make sure that those people who are unemployed, who are unable to find unemployment because of the state of our economy, are protected under the safety net that you mentioned in your opening statement. I would hope that at this hearing we will also have an opportunity to take a look to see whether that is working the way Congress intended.

Thank you very much, Mr. Chairman.

[The opening statement of Mr. Cardin follows:]

Opening Statement of the Hon. Benjamin L. Cardin, a Representative in Congress from the State of Maryland

Mr. Chairman, I look forward to hearing our witnesses' suggestions on reducing fraud and improving the administration of the unemployment insurance system. If people are receiving benefits that they are not entitled to, then we should take all necessary steps to address any potential fraud.

However, in evaluating program integrity, we must remember that benefits are sometimes denied inappropriately, just as they are sometimes paid inappropriately. For example, a recent study found that roughly $600 million in unemployment insurance benefits were wrongfully denied in fiscal year 1998.

Sometimes employers provided inaccurate information regarding an applicant's wages and other times the local unemployment agency made errors in assessing an individual's eligibility. The report, which we will hear about later today, suggests that very few of the wrongfully denied claims resulted from errors made by applicants.

This committee needs to know how the Department of Labor is responding to that analysis so we can ensure that jobless Americans are receiving the benefits to which they are entitled.

We also need to recognize that fraud can occur on the revenue side of the unemployment system as well as on the payment side. If UI taxes are not paid when due, the system will become under-funded. One area of particular concern pointed out by a recent report commissioned by the Department of Labor is the misclassification of certain employees as independent contractors, for whom employers do not pay unemployment taxes. Mr. Chairman, let me conclude by mentioning the fact that the 13-week extension of unemployment benefits that we passed in March just expired for those jobless workers who first filed for the extension. The Federal legislation included a potential 2nd round of extended unemployment benefits, but very few States will qualify for that second 13 weeks.

I hope any discussion of additional UI reforms will consider the fate of those long-term unemployed Americans who are still looking for work, especially since the number of workers who have been unemployed for six months or longer has tripled over the last year. I also strongly believe that we should address barriers to low-wage and part-time workers receiving unemployment benefits.

Thank you.

Chairman HERGER. Thank you, Mr. Cardin.

Before we move to our testimony, I want to remind our witnesses to limit their oral statements to 5 minutes. However, without objection, all of the written testimony will be made a part of the permanent record.

For our first witness today, we are honored to have the Honorable D. Cameron Findlay, Deputy Secretary of the U.S. Department of Labor, accompanied by the Honorable Emily Stover DeRocco, Assistant Secretary, Employment and Training Administration (ETA) for the U.S. Department of Labor. Thank you so much. With that, if you would testify, please.

STATEMENT OF HON. D. CAMERON FINDLAY, DEPUTY SECRETARY, U.S. DEPARTMENT OF LABOR, ACCOMPANIED BY HON. EMILY STOVER DEROCCO, ASSISTANT SECRETARY, EMPLOYMENT AND TRAINING ADMINISTRATION

Mr. FINDLAY. Thank you, Mr. Chairman and Ranking Member Cardin. I am very happy to appear before you today to discuss the ways in which we are trying to reduce overpayments and fraud in the Unemployment Insurance system.

I ask that my written testimony be included in the record, but I will just summarize for you all a few of the key points.

Obviously, as you said, the Unemployment Insurance system is the key to the economic security of our Nation. To carry out the vital mission of this program, it is essential that benefits are paid properly to eligible workers and that systems are in place to minimize overpayments, fraud, and abuse. As you probably know, improving financial management is a major initiative within the President's management agenda. I heard the same numbers that the Chairman quoted a few minutes ago, and they sounded very high to me, as well. So, a few months ago, I convened a task force within the U.S. Department of Labor to begin getting at the problem of overpayments. I would like to share with you today some of the solutions we are pursuing.

At the outset, it is important to define the problem we are talking about and to recognize that there are different categories of overpayments. According to data from our Employment and Training Administration for 2001, 8.2 percent of all unemployment bene-

fits, for a total of $2.45 billion, are classified as overpayments. This total can really be broken down into four categories.

First, approximately $385 million can be attributed to what we call technical eligibility issues, for instance, payments made to individuals who did not adequately document their job search, but were actually searching for jobs and otherwise meet the eligibility requirements.

Second, $120 million of the total can be attributed to overpayments made in the absence of fraud, but which the State agency affirmatively chooses not to recover. For example, if an employer inadvertently overstates the income of an employee and the claimant is not at fault, many States elect not to recover this sort of overpayment.

Third, $1.37 billion of the total can be classified as non-fraud overpayments that are potentially recoverable.

Finally, $580 million can be attributed to fraud or abuse within the system.

While integrity of the program has been a longstanding priority of the DOL, as this Committee knows, much of the work to ensure integrity must be done by the States, which have primary responsibility for administering the UI program. States already carry out benefit payment control activities to identify and collect UI overpayments, such as cross-matching information within various computer databases. In 2001, States were able to use these sorts of cross-matches to establish for recovery some $227 million. While this is a significant figure, it is not large enough, and the DOL is working with States to enhance their computer cross-matching capabilities to increase even further the identification and collection of overpayments.

Cross-matching UI benefit records with existing State new hire directories provides a much quicker determination that claimants have gone back to work, thus preventing claimants who do find work from continuing to claim benefits. The 1996 welfare reform legislation required employers to report all new employees within 20 days of the date of hire. The new hire directories thus provide more real-time hiring data, and the DOL is actively encouraging States to use these directories. However, currently, only one-half of the States are doing so.

The DOL is also seeking legislation to provide access for State UI agencies to the National Directory of New Hires, which will permit States to find claimants who work in other States or who work for employers that report their hires in other States. We would like to thank the Committee for including such legislation in the Temporary Assistance for Needy Families (TANF) reauthorization bill that recently passed the full House.

Another promising cross-matching opportunity involves Social Security data. The DOL is working to implement a data exchange system that will allow States to verify Social Security numbers during the initial claims process, which will, in turn, lead to a reduction of fraudulent claims filed with false identification.

Given the promise that all these sorts of data-matching holds, the Administration has requested $10 million in the fiscal year 2003 budget to help States gain access to all data that can improve the detection and recovery of UI overpayments. I might say that is

about a 28-percent increase over the past few years in terms of the amount of money we are devoting to integrity.

The DOL is also sponsoring in 2003, a National Integrity Conference with the National Association of State Workforce Agencies, to exchange best practices and help States do their job.

In addition to this $10 million request, enactment of the Temporary Emergency Unemployment Compensation Act provided $8 billion in Reed Act funds to the States. This legislation provided States with substantial funds they can use for their integrity efforts, and we have certainly suggested to States they ought to use the Reed Act funds in that way.

Finally, we have proposed a major reform of the UI program in the President's budget that would enhance the incentive for States to devote the proper attention to overpayments. If States understand how their administrative expenditures pay off in collecting overpayments, they may increase such expenditures. Currently, their administrative moneys are essentially constrained by Federal contributions.

Mr. Chairman and Members of the Subcommittee, I hope we have provided you with a good picture of the scope of the problem and of our efforts to combat it. I would be pleased to answer any questions you might have.

[The prepared statement of Mr. Findlay follows:]

Statement of the Hon. D. Cameron Findlay, Deputy Secretary, U.S. Department of Labor

Mr. Chairman and distinguished Members of the Subcommittee, I appreciate the opportunity to appear before you today to discuss federal and state efforts to reduce overpayments, fraud, and abuse in our nation's Unemployment Insurance (UI) benefit payment program.

The UI program is key to the economic security of our nation. As the primary source of temporary, partial wage replacement for workers laid off and seeking jobs, UI is an important stabilizer during economic downturns. About 3.4 million workers currently are claiming regular UI benefits—a 30% increase over this time in 2001 and a 90% increase over this time in 2000. An additional 1.4 million workers currently are claiming temporary extended unemployment compensation pursuant to the 13-week UI program extension enacted by Congress on March 8, 2002.

To maintain the vital mission of the UI program, it is essential that benefits are paid promptly to eligible workers and that integrity systems are in place to minimize overpayments, fraud, and abuse. As you probably know, improving financial management is a major initiative within the President's Management Agenda (PMA), the President's plan to improve government performance and efficiency. Under the PMA, the Office of Management and Budget has identified UI overpayments as one of the Department of Labor's primary financial management challenges. As a member of the President's Management Council, I am charged with implementing the PMA at the Department of Labor, and I personally take this UI issue very seriously. I have convened a task force comprised of, among other individuals, officials from the Employment and Training Administration, or ETA, our agency that administers the UI program, and our Office of Chief Financial Officer, to develop a plan to address this issue. I am pleased to share with you today some of the solutions that we currently are pursuing.

Overpayments, Fraud, and Abuse: An Overview

At the outset, it is important to define the scope of this problem and to recognize that there are different categories of UI overpayments, each of which calls for a different response. According to ETA's Benefit Accuracy Measurement (BAM) data for calendar year 2001, 8.2% of all unemployment benefits, or a total of $2.45 billion, are classified as overpayments. Of this $2.45 billion, approximately $385 million can be attributed to technical eligibility issues, primarily meeting a State's work search requirements. In other words, many UI payments, while technically "overpayments"

under current state eligibility definitions within the UI program, are made to individuals who failed to meet certain technical eligibility requirements but otherwise meet the primary UI eligibility requirements of being unemployed through no fault of their own and wanting to work. For instance, a payment made to a claimant who failed to maintain sufficient documentation concerning his ongoing work search requirements would be considered an "overpayment" under the BAM program. States, however, would not necessarily seek recovery of such an overpayment.

An additional $120 million of the $2.45 billion in total UI overpayments for 2001 can be attributed to overpayments made in the absence of fraud or abuse which the State agency chooses not to recover. For example, an employer may inadvertently overstate quarterly wages, resulting in an impermissibly large UI payment made to a claimant. Because there is no fault on the part of the individual claimant in such an instance, many states would not attempt to recover such an overpayment. $1.37 billion of the $2.45 billion in total overpayments are classified as nonfraud overpayments that are recoverable. These include cases such as where an initial finding of eligibility is reversed following an employer's appeal, and where a claimant has erroneously reported earnings.

Finally, $580 million of the $2.45 billion in total UI overpayments for 2001, or 1.9% of total UI payments for that year, was attributable to fraud or abuse within the UI program. By any standard, these figures add up to a lot of money. That is why the Department of Labor has been hard at work on the problem.

New Initiatives To Address the UI Overpayment Problem

Integrity of the UI program is a priority for the Department of Labor and the Administration. However, much of the work to ensure that integrity must be done by the states, which, as you know, actually administer the UI program. States already carry out various Benefit Payment Control activities to identify and collect UI overpayments, such as cross-matching information within various computer databases. In 2001, states used various computer cross-matches to establish for recovery as UI overpayments some $227 million—or about 32% of the total established for recovery that year. While this is a significant figure, the Department is encouraging states to enhance their computer cross-matching capabilities to increase even further the identification and collection of UI overpayments.

Let me give you some examples of how cross-matching improves the detection and collection of UI overpayments. The largest single cause of UI overpayments involves individuals who are collecting UI benefits while working. Indeed, approximately 31% of the overall BAM estimate of overpayments in 2001 was due to such individuals. Because UI wage records are reported quarterly, there is a significant lag period before these types of overpayments can be identified via the traditional wage/benefits cross-match. UI overpayments are often the result.

Cross-matching UI benefit records with new-hire directories offers a promising opportunity to reduce this lag period, thus preventing claimants who find work from continuing to claim UI benefits. The Personal Responsibility and Work Opportunity Reconciliation Act of 1996 (PRWORA) required the development of such new-hire directories for the purpose of locating parents delinquent in child support payments. Under this statute, employers are required to report all new employees within as few as 20 days of the date of hire. In addition, PRWORA permits states to access their new-hire directories for UI purposes. Because of its usefulness in UI overpayment prevention and detection, the Department is actively promoting the use of new-hire directories by all states. However, currently, only about half of the states are utilizing these directories. I pledge to this Subcommittee that the Department will redouble its efforts in the future so that more states will take advantage of this important tool.

As you know, some claimants find work out-of-state or work for multi-state employers that report employment and wages to a different state. The Department is working to prevent abuses of such systems, which could include allowing state UI agencies access to information in the National Directory of New Hires. Any action would be done in a way that protects personal information. We commend the Committee for including such access in the Temporary Assistance for Needy Families reauthorization bill (HR 4737).

Another promising cross-matching opportunity involves Social Security data. States recently have implemented systems to take UI claims over the telephone and Internet. While these innovations have enabled states to handle significant increases in claims volume, states now need new tools to verify the identities of claimants filing electronically. The Department is working to implement a data exchange system that will give states access to Social Security Administration data during the initial claims process. This system will lead to a reduction of fraudulent claims filed with false identification. The Social Security Administration will also benefit by hav-

ing access to benefit information that will help reduce overpayments within the Supplemental Security Income program.

Given the promise that data cross-matching holds, the Administration has requested $10 million in the FY 2003 budget to help states gain access to all data that can improve the detection and recovery of UI overpayments. Also, recognizing the need to emphasize the problem and promote best practices, the Department in 2003 will sponsor a national integrity conference with the National Association of State Workforce Agencies to identify and disseminate successful practices, studies, and integrity information.

The Department will develop a new operational definition of UI overpayments and set a new Government Performance and Results Act (GPRA) goal for addressing overpayments. We are working to develop a definition of overpayments that is comparable among states and covers most recoverable overpayments. This new definition will more accurately describe UI overpayments by recognizing those errors that are technical in nature (e.g., based on insufficient documentation of work search) and excluding those overpayments that are non-detectable on a cost-effective basis. This is not an attempt to redefine the problem out of existence, but rather to recognize that, as I explained earlier, a significant portion of UI payments technically considered "overpayments" under current program definitions is being paid to claimants who meet the primary UI eligibility requirements.

Finally, we have proposed a major reform of the UI program in the President's budget that shifts responsibility for funding the administration of the program from the federal government to the states. Since UI is paid based on state law, states are in a better position to determine costs of running the program to reduce overpayments, fraud, and abuse. Also, insufficient funding for state administration in the past has caused states to reduce their integrity activities, because they are unable to reduce their core activities of paying benefits and collecting taxes and wage records. States will have a strong incentive to address overpayments, fraud, and abuse under this new system, as state funds spent on reducing abuse may result in savings in state funds used for benefit payments.

Funding for These Initiatives

In addition to the $10 million request noted previously, enactment of the Temporary Emergency Unemployment Compensation Act—and the resulting $8 billion "Reed Act" distribution of federal unemployment funds to states—has provided states with substantial funds that may be used to make UI program improvements, including implementing initiatives that address UI overpayment, fraud, and abuse. The Department of Labor has suggested that states consider using these Reed Act funds for, among other purposes, improving UI claims filing and payment methods and reducing UI overpayment, fraud, and abuse.

The initiatives described above can be developed and implemented with these Reed Act funds. Using these funds for these initiatives requires an appropriation by each state legislature. Some states already have appropriated Reed Act funds to pay for technology and system upgrades, and we will encourage other states to do so.

Conclusion

Mr. Chairman and Members of the Subcommittee, I trust that we have provided you with a clear picture of the scope of the UI overpayment problem and the Department of Labor's efforts to work with the states to address this important problem. We appreciate your longstanding commitment to the integrity of the UI program, and we request your continued support in our ongoing efforts to minimize overpayments, fraud, and abuse within the UI program. Thank you for the opportunity to testify today. I will be pleased to answer any questions that you may have about my Department's efforts to reduce overpayments, fraud, and abuse in the UI program.

Chairman HERGER. Thank you very much, Mr. Findlay. Now, the gentleman from Louisiana, Mr. McCrery, to inquire.

Mr. McCRERY. Thank you, Mr. Chairman.

Mr. Findlay, as you probably know, this Subcommittee has been very active in trying to ferret fraud and abuse in a number of programs. One of those that we pay particular attention to at the behest of the GAO is Supplemental Security Income (SSI). The GAO

has said for a number of years that the SSI Program has a high risk of fraud and abuse, so we have focused on that. I am going to read to you a number of things that we have done in the SSI Program to try to prevent fraud and abuse. I would like, when I conclude, for you to tell me if the States are doing any of these kinds of things to prevent fraud and abuse in the UI system.

For SSI, for example, we have tried to ensure that prisoners do not receive benefits by creating a bounty system, rewarding prisons for reporting their inmate rosters for comparison with SSI rolls. We have barred fugitive felons and probation and parole violators from receiving benefits, and providing information sharing to make this effective.

We encourage death matches to ensure benefits stop when individuals die or that others are not claiming benefits based on a deceased person's records; denying benefits for 10 years for those who claim benefits in more than one State, offsetting Federal income tax refunds or other benefits to recover overpayments, providing for enhanced recovery of overpayments, and mandating recovery of overpayments for those who commit fraud. In other words, no hardship waivers for those who commit fraud.

Creating penalties for false and misleading statements made in the attempt to claim benefits. Restricting eligibility of non-citizens. For UI, for example, there are some who are here who are not eligible to work. Are we making sure that those who work illegally then do not get hired or lose their job and claim UI benefits?

Encouraging information sharing between Federal and State agencies charged with administering benefits or that have information that could better ensure the right people are getting the right benefits.

Are the States doing any of these kinds of things to try to prevent fraud and abuse? Is your DOL cooperating with the States to try to do some of these kinds of things?

Mr. FINDLAY. Whether States are doing each one of those things, I think we would have to get back to you in writing, but let me say this.

The measures relating to prisoners, while extremely effective in the SSI context, may be less important in this context, Congressman. The reason is that by its very nature, our program usually runs out after 13 weeks, and so by the time an individual is in prison, usually, the benefits have run out. Some States have done some analysis to see whether prisoners are receiving unemployment benefits, and they have found that the number is exceedingly small. So, I think that things dealing with prisoners, while very important in other contexts, may be a little less important here.

Mr. McCRERY. While it may be less important, it is also a fairly easy thing to do, to match lists.

Mr. FINDLAY. Yes, and some States do cross-matches with correctional facilities. We certainly are willing to consider that and to work with States to do that. I would not want to give this Committee the impression that is going to pay off as much as some of the other measures that we are talking about.

Mr. McCRERY. No.

Mr. FINDLAY. States are required to verify alien status with the Immigration and Naturalization Service (INS), so States are doing

that. In general, aliens, under certain circumstances, can receive unemployment benefits if they have INS work authorization, but those that should not be receiving it generally are not.

In terms of some of the other questions you asked about fraud, all of our States are required to impose penalties for fraud and to work to ferret out fraud and, obviously, not to pay people that they believe to be defrauding the system.

Then in terms of some of the offsets. States are doing offsets from income tax refunds and other sorts of payments that States might be making. On a State-by-State basis, I think I would have to go back to our people and get more detailed information for you.

[The information follows:]

CROSS–MATCHING

States currently cross-match benefit information with various computer databases, primarily wage and benefit records and new hire directories. It is important to note that unemployment insurance (UI) has a number of controls:

- There must be employment reported by an employer. UI is time limited for each claim. Each week must be claimed.
- Benefit Accuracy Measurement data has not indicated any significant problem with overpayments to these populations.
- Every state imposes a penalty for fraud, including holding the claimant ineligible for a set period of time.
- Most states with income taxes intercept refunds to retire UI overpayments.
- Many states do "death matches." It doesn't produce significant numbers.

Also, states do have techniques for minimizing payments to prisoners and ineligible aliens. Among them:

- Some states crossmatch with local and state correctional institutions. Data indicates this is not very productive.
- States are required to verify alien status with the Immigration and Naturalization Service (INS). (In general, aliens can collect UI if they have INS work authorization.)

Mr. McCRERY. Thank you, Mr. Chairman.

Chairman HERGER. Thank you. The gentleman from Maryland, the Ranking Member, Mr. Cardin, to inquire.

Mr. CARDIN. Thank you, Mr. Chairman.

Mr. Findlay, I believe the DOL has developed a UI overpayment system called the Benefit Accuracy Measurement, or BAM, to try to determine nationwide the extent of overpayments. Do you have any similar effort or plan in regards to the accuracy of the tax payments that employers are making, as to whether there is an underpayment of the tax payments for unemployment insurance benefits?

Mr. FINDLAY. I am fairly certain that our performance measures require States to ensure the accuracy of tax payments, but beyond that, I do not know the details of what our program is.

Mr. CARDIN. If you could make that available to our Committee, I would appreciate it, because we obviously want to make sure that we are collecting the right amount of revenue, as well as, making sure we are not overpaying the benefits.

[The information follows:]

ACCURACY OF EMPLOYER TAX PAYMENTS

Besides the performance measures mentioned below, State Work force Agencies are required by the Department's UI Audit Policy to audit 2% of the tax paying employers in their state each year.

- The Audit Policy requires the state UI agency to verify the existence of each business being audited.
- This requirement was included in the Audit Policy to help detect fictitious employer schemes.
- Many states have either developed computerized systems to help detect fictitious employer schemes or they use the Fictitious Employer Detection System, which was provided by the Employment and Training Administration.
- They also work very closely with the Department's Office of Inspector General to detect and prosecute the offenders.

In addition, states have modified their Employer Status Determination forms—the forms used to determine whether an employer is subject to the state's UI tax—and trained their employees to help identify employers who may be attempting to manipulate experience rates through a variety of different schemes that have been discovered over time.

Also, some employers are late in paying their taxes. When this happens, states routinely send dunning notices and impose penalty and interest on the employers. The amount of the penalty/interest varies from state to state.

For the quarter ending December 31, 2002, our reports show that, as of the due date of the reports, 632,000 employers were delinquent in paying contributions. This represents about 9% of all employers. However, it should be noted that many of these delinquent employers have since "paid up" due to state collection activities. Also, it needs to be noted that employers routinely go out of business with no assets—these will be included in the delinquencies.

As to detecting misclassification, a large part of the audit function noted above is aimed at detecting misclassifications. Also, if an individual files a claim and is denied because s/he was classified as an independent contractor, the individual has the right to review. If the review determines that the individual was in fact an employee, s/he is entitled to benefits.

Further, the Department sponsored research on this subject and a final report was issued in 2000 (*Study of Alternative Work Arrangements: Independent Contractors,* Planmatics, Inc.). Among the findings:

- The number one reason for misclassification is savings related to workers compensation/disability costs. A second reason is avoiding EEO type lawsuits and other laws associated with having employees.
- In the 9 states visited, the percent of audited employers with misclassified workers ranged from 10–30%.
- In the 9 states visited, the percentage of tax revenues underreported varied from 0.26% to 7.46%.
- Assuming a 1% level of misclassification over the period measured, the loss in revenue due to underreporting would be an annual average $198 million. About **80,000** workers annually are not receiving UI due to misclassification.

The Department developed the Tax Performance System (TPS), formerly called Revenue Quality Control, to assist in exercising its general oversight responsibilities toward the UI program and to help meet its responsibility to protect and maintain the soundness of the Unemployment Trust Fund. TPS divides tax operations into major functional components and specifies key performance objectives based on 3 dimensions of quality—timeliness, accuracy, and completeness. The tax functions reviewed include status determination, cashering, report delinquency, collections, field audit, and account maintenance. Monitoring tax activities has been a longstanding priority for the Department. National performance standards have been established for the following tax activities:

- Percent of new status determinations within 90 days of quarter end date;
- Percent of new status determinations within 180 days of quarter end date; and
- Accuracy of a sample of new status determinations.

The Department also tracks performance for:

Timeliness Measures

- Employer Report Filing Timeliness
- Securing Delinquent Reports Timeliness
- Resolving Delinquent Reports Timeliness
- Employer Payments Timeliness
- Successor Status Determination Timeliness

Quality Measures

- Delinquent Reports Resolution Quality

- Collection Actions Quality
- Turnover of Receivables to Tax Due
- Write-off of Receivables to Tax Due
- Accounts Receivable as a Proportion of Tax Due
- Field Audits Quality
- Field Audit Penetration, Employers
- Field Audit Penetration, Wages
- Percent Change as a Result of Field Audit

Accuracy Measures

- Posting New Determinations Accuracy
- Successor Determinations Accuracy
- Posting Successor Determinations Accuracy
- Inactivating Employer Accounts Accuracy
- Posting Inactivations Accuracy
- Employer Reports Processing Accuracy
- Employer Debits/Billings Accuracy
- Employer Credits/Refunds Accuracy
- Benefit Charging Accuracy
- Experience Rating Accuracy

Mr. CARDIN. The Chairman mentioned and you mentioned the fact that Congress in the recently passed legislation made $8 billion of Reed money available, Reed Act distributions, available to our States that can be used for integrity issues within the system. Do you know how the money is being spent by the States? Do you have any early reports to the Committee?

Mr. FINDLAY. What we have is precisely that, Congressman Cardin, early reports. The States have to pass legislation in order to use the Reed Act funds. We believe 12 States have done so so far. We also have asked the States, what are they going to do with the Reed Act money.

So far as I could tell from the chart that I read on the way over here, about half the States have plans, or have already put in place plans, to use some of the money for administration, which would, of course, help our integrity efforts. We know also that several States so far have indicated they intend to increase payment levels, as well. Beyond that, we really do not have very much information.

Mr. CARDIN. We have requested certain information be made available by GAO. I do not know when we are going to get that information presented to the Committee, but obviously, any information you can make available to us would be helpful.

Mr. FINDLAY. We would be happy to give you what we know, but as I say, until the States pass legislation, everything should come with a big caveat.

[The information follows:]

$8 BILLION REED ACT DISTRIBUTION

Enactment of the Temporary Emergency Unemployment Compensation Act has provided states with an enormous opportunity to make program improvements including initiatives that address fraud and abuse. The $8 billion "Reed Act" distribution of excess Federal unemployment funds to states can be used for the payment of benefits or for the administration of UI and services by the public Employment Service (ES) through the One-Stop system. The Department of Labor suggested that states consider using these Reed Act funds for the following purposes:

- Establishing a revolving fund for automation costs;
- Improving UI and ES performance;
- Improving UI claims filing and payment methods;
- Administering One-Stops; and
- Reducing UI fraud and abuse.

Using Reed Act funds for administration or services requires an appropriation by the state legislature. As you know, states are currently struggling with other issues such as budget deficits. Therefore, most states have not yet had the opportunity to appropriate their Reed Act funds. However, we have collected anecdotal information from most states regarding their plans. About a dozen states have appropriated Reed Act funds this year. Uses include:

- Paying for technology and system upgrades;
- Covering basic administration costs;
- Paying for additional reemployment services; and
- Paying for additional staff.

Another dozen states have appropriations in the legislative process, and a number have advised us they will seek appropriations during their next legislative session. Some states indicated they expect to leave all of the money in their trust funds to pay benefits, improve solvency, and avoid tax increases. Other states plan to leave a portion of their Reed Act money in their fund for these purposes. A couple of states would be borrowing but for the Reed Act distribution. Finally, a few states have enacted minor benefit increases or expansions since the date of the distribution.

Mr. CARDIN. Of course, States can use it to enhance benefits, and that is one of the areas that we were concerned, as to whether they, in fact, will do that or not. You are indicating seven States are at least planning to do that. You have got 1.4 million workers who are currently claiming extended unemployment benefits that we enacted last March. Do you have any idea of how many of these people will exhaust their extended benefits before they are able to find employment, and how many of these individuals will be covered under the second trigger in those States that meet the additional benefits?

Mr. FINDLAY. In terms of the first question, how many would exhaust before they could find employment, I do not think we do have that number because I think it would require a fairly complex calculation.

In terms of your second question, which I am momentarily forgetting, Congressman——

Mr. CARDIN. How many States would qualify for the trigger for the additional weeks of benefits beyond the extended benefits?

Mr. FINDLAY. Yes, we do have the answer to that. It is nine States: California, Idaho, Massachusetts, Michigan, New Jersey, Oregon, Pennsylvania, Washington, and Wisconsin.

Mr. CARDIN. So if you are in those States, you would then be entitled to additional benefits. So, there is a large number of people who will not be entitled to benefits, at least be in States that will not be entitled to benefits, and we do not know how many people are going to still be unemployed, unable to find employment that have exhausted their extended benefits.

Our preliminary information is that we are talking about hundreds of thousands of individuals who will exhaust their benefits, and be in States that do not provide additional benefits because the trigger that we are using, the insured rates, are difficult to meet in many of the States. I think it is something we need to take a look at, because we find that when times are very difficult, as you point out, some of the mis-payments are not fraudulent.

Some of these, the States do not want to recover for whatever reasons, and it seems to me, in difficult economic times, when benefits are not being made available to meet the needs that are out there, chances of mis-payments are higher and something we need

to make sure—we do not want anybody to receive payments they are not entitled to, but it would be also nice to have recommendations on changing the policy in order to meet the legitimate needs of the people who cannot find employment.

Thank you, Mr. Chairman.

Mr. FINDLAY. Thank you.

Chairman HERGER. Thank you. The gentlelady from Connecticut, Mrs. Johnson, to inquire.

Mrs. JOHNSON OF CONNECTICUT. Thank you, Mr. Chairman.

When do you expect the DOL will have the new operational definition of UI overpayments ready for use?

Mr. FINDLAY. We are putting together a new goal under the government Performance and Results Act (GRPRA). All of our goals for fiscal year 2003 should be in place about the beginning of fiscal year 2003, so I think we are looking at this autumn.

Mrs. JOHNSON OF CONNECTICUT. Have you done any studies or have you thought about doing any studies of those States that rely almost entirely on self-reporting of information for eligibility versus those States that check information?

Mr. FINDLAY. What we require at the Federal level is that States show us that they have a system that is reasonably calculated to ensure integrity of the system, and we do not typically mandate to States precisely how they do that, or we have not in the past.

I think our thumb has been on the scale a little bit too much in terms of benefit promptness in the past. I think we may want to suggest to States that they do more than they have, and we are not only reconstituting our GPRA goal, but we also will be redoing our performance measures for States. We, I think, all recognize in the DOL that we need to elevate the importance of these integrity issues as well as the payment promptness issues.

Beyond that, I do not want to get into the specifics of what we will be doing with States that do not do particular kinds of matches. I think it is fair to say that at the leadership level of the DOL, we want to be a little bit more prescriptive with States than we have been in the past in terms of carrying out these integrity efforts.

Mrs. JOHNSON OF CONNECTICUT. I think it would be useful to do some studies of States that have different systems of eligibility and those that do the matching and other things to confirm eligibility versus those that do not. I know in my State, we have gone to pretty much telephone registration for unemployment benefits and I think there is very little oversight of that system. So, I am interested in, as the DOL moves forward, you are really doing some comparative studies so we have some material on which to move forward to demonstrate the States' best practices and to hold them to a higher standard.

Do you have any information about whether States that cover part-time employees have more fraud problems than those that cover only full-time employees?

Mr. FINDLAY. I do not before me, but I am sure we can give you whatever we have got on that.

[The information follows:]

We do not have any empirical evidence to suggest that states which pay benefits to those seeking only part-time work have more fraud than those states which require full-time availability.

Mrs. JOHNSON OF CONNECTICUT. I hope you will look at that, because my guess is that there is no difference and that we are not having any more difficulty with part-time than full-time, but I think we need to know that, because over the course of events, I think the issue of part-time unemployment compensation for part-time unemployed is going to be an increasingly important issue for us to address. I think before we address that, we have to find a better way of making sure that unemployment compensation is going to those who are eligible and not going to those who are not eligible.

So, you could be a big help to us in refining more clearly what constitutes fraud and abuse. How do you know it? On what do you base your estimate, that really, a very small amount of the overpayment, about 25 percent or less, is actually fraud and abuse. Overpayments are a different problem, but fraud and abuse is intolerable.

Mr. FINDLAY. I think that is exactly our point, that overpayments are not overpayments. There are different types of overpayments, some of which deserve different responses than others. I would not think that it would be the DOL's priority to force States to spend a lot of time and effort going after people who are unemployed, looking for work, carrying out all the duties they are supposed to be carrying out in terms of looking for work, but used the wrong form for one of their job search documentation requirements.

Mrs. JOHNSON OF CONNECTICUT. Absolutely.

Mr. FINDLAY. On the other hand, at the other end of the spectrum, I think for fraud and abuse, fictitious employers, fictitious employees, or Social Security numbers that relate to people who are deceased, those are the sorts of areas that are absolutely clear. We should be devoting more efforts to.

Mrs. JOHNSON OF CONNECTICUT. Thank you.

Mr. FINDLAY. Thanks.

Chairman HERGER. Thank you. The gentleman from Texas, Mr. Doggett, to inquire.

Mr. DOGGETT. Thank you very much, Mr. Chairman.

I am pleased that we have your added input about the importance of addressing any fraud that might be in the system and undermine confidence in the system. I think it is equally as important that we recognize that workers who do become unemployed through no fault of their own and who cannot access the benefits they need, feel the system has acted in an abusive way to them.

At one of our earlier hearings, I inquired about the number of eligible individuals as a percent of total unemployment for the States over the last 20 years. The DOL was kind enough to provide that information, and I note in my own State of Texas that over the last 20 years, the number has varied from as low as 18 percent in several different years, never getting higher than 31 percent. So, there are a lot of workers out there who are unemployed that are not getting benefits.

There has been some indication by our staff that after the end of this week, there will only be about four States that will be triggered in on extended unemployment benefits. Is that right?

Mr. FINDLAY. I think, just before you arrived, Congressman, I said that number is nine States.

Mr. DOGGETT. Okay. I do not think that Texas is one of them.

Mr. FINDLAY. You are correct.

Mr. DOGGETT. I am wondering if you think we ought to revisit the trigger mechanism to determine whether those people who are jobless should be eligible for additional unemployment benefits.

Mr. FINDLAY. Let me address your first question first, which was on the recipiency rate. It is true that some people who are within the total unemployment rate do not receive unemployment benefits. These sorts of people are typically new entrants to the work force. A very large percentage of them are new entrants who have not actually been in a job before, and so they are not unemployed in the sense that they lost a job.

Another large percentage is re-entrants, which may well be men or women who stayed home to care for a child for a few years and are going back to work. Those are effectively like new entrants, in a sense.

Then job leavers, who leave of their own accord, voluntarily, who are not covered by the system.

If you set those aside, actually, a very large percentage of the job losers are eligible for and receive unemployment benefits. I think the figures that I saw said that 52 percent of the total unemployment rate is job losers and 46 percent of all total unemployed are eligible to receive unemployment benefits.

So really, given the current eligibility requirements, it is a pretty close fit and the recipiency rate is pretty close to where it ought to be——

Mr. CARDIN. Will the gentleman yield for one moment?

Mr. DOGGETT. Yes.

Mr. CARDIN. It is our understanding, though, there may be eight States that qualify today. Some of these States are going to trigger off at the end of the month so that it looks like there would be only four States by next month who would still be eligible.

Mr. FINDLAY. I am told that is correct, Congressman, and Congressman, on your second question about revisiting the trigger mechanism, I think in our view, it is premature. Typically, the unemployment insurance program is a 13-week program. Earlier this year, we together took a step that is extraordinary, which is extending it another 13 weeks. I think the idea is that the system should be one that also encourages people to continue looking for a job and getting back to work.

So, whether we want to take essentially a third bite at the apple now, we would like to see how the economy goes. There are some signs out there that the economy is doing better. The unemployment——

Mr. DOGGETT. Of course, for some of these individuals, the economy is not going very well if they have exhausted all their unemployment benefits. If I understand your testimony, and I respect whatever your opinion might be, but we are going to have four to six States next month that do not have any extended unemploy-

ment benefits, including my State of Texas. Your feeling is that we do not need to do anything about that at this point——

Mr. FINDLAY. I think——

Mr. DOGGETT. As far as unemployment benefits.

Mr. FINDLAY. I think it is premature to make that decision. Typically, the Temporary Emergency Unemployment Compensation Act is put in place by Congress during recessions, and it happened earlier this year because there had been a one quarter dip in GDP, gross domestic product. It happened previously, I believe, in the early nineties when there was a similar thing. So I think—I am sorry, if I could just finish these last few words.

Mr. DOGGETT. Sure.

Mr. FINDLAY. I think the norm is the unemployment insurance system that Congress enacted, which is a 13-week program, there have to be unusual circumstances for us to do that and right now, it is unclear whether those circumstances exist.

Mr. DOGGETT. Just one follow-up, if I might, on your earlier comment about the fact that we, of course—I think the logical inference from your comment was that you would never expect 100 percent of the unemployed would be covered, but my worry to you would be, you can take any given year in this data and there are vast variations between the States. As I said, in some years, in Texas, 72 percent of the unemployed got no benefits, whereas in other States, the same year, getting 60, 70 percent. How do you explain the variation?

Chairman HERGER. If the gentleman could conclude——

Mr. DOGGETT. That is the end of my question. How do you explain the variation?

Chairman HERGER. We are a minute over time here, but maybe we can respond. Could you very quickly respond?

Mr. FINDLAY. I think this is one that I would probably prefer to respond in writing——

Mr. DOGGETT. That would be fine.

Mr. FINDLAY. I do not have an answer for you right now, Congressman.

Mr. DOGGETT. Sure. Since you are giving it back to the States and their discretion, if you could address why you see such tremendous variations in the data that were supplied on March 18. Thank you very much.

Mr. FINDLAY. We would be happy to supply that.

[The information follows:]

RECIPIENCY

Most of the research done on UI recipiency concerns the marked decline in the U.S. average recipiency rate over the last 30 years. However, several studies have attempted to explain why there is such dramatic variation in recipiency rates among states. These studies demonstrate a strong relationship between implementing policy and administrative changes that tighten UI eligibility and sharp declines in recipiency rates. Changes include:

- Tightening qualification standards in specific professions;
- Lengthening disqualification periods for certain actions including voluntarily leaving a job;
- Increasing offsets of other income such as pensions;
- Increasing base qualifying wages; and
- Adopting more restrictive ability to work and other nonmonetary requirements;

In short, differences in state monetary and nonmonetary eligibility requirements are believed to be one of the main reasons for the wide variation in recipiency rates among states.

Other research indicates that the wage-replacement rate affects recipiency rates. States with high replacement rates provide a larger incentive to apply for benefits.

Finally, some research demonstrates that the economic and industrial make-up of the state impacts on recipiency rates. States with a larger number of union workers may have higher recipiency rates. (For more information, see *Analysis of Unemployment Insurance Recipiency Rates,* David Wittenburg et al).

Chairman HERGER. Again, Mr. Findlay, is it not correct, we do have 39 weeks of regular unemployment plus that we have added an additional 13 weeks to that, is that correct?

Mr. FINDLAY. Yes, that is correct.

Chairman HERGER. Thank you. With that——

Mr. CARDIN. Could the gentleman just yield for 1 minute, just to clarify that point. Is it not 26 plus 13?

Mr. FINDLAY. Exactly. Excuse me. I may have said a 13-week program. It is normally 26 weeks, plus we extend it for 13. Some States will have the opportunity to have an additional 13.

Chairman HERGER. Thank you. The gentleman from Pennsylvania, Mr. English, to inquire.

Mr. ENGLISH. Thank you, Mr. Chairman.

In reviewing the material that is being brought before the Subcommittee today, I wonder if you could comment on what are the most pronounced technical eligibility issues that have led to overpayment.

Mr. FINDLAY. I think, as I understand it, the sorts of issues we are talking about relate to job search issues; whether someone is registered with the employment service (ES), whether that person is properly documenting job searches, whether in a State that requires, say, four inquiries a week, the person only has documentation for three or only did three. These people are otherwise eligible for unemployment in the sense that they are unemployed and are ready, willing, and able to work.

Mr. ENGLISH. One of the areas where we have tried to micromanage the States in designing a UI system is in essentially requiring that the States impose search for work requirements. This is understandable, but I am wondering if you could comment on whether these provisions are unusually difficult to enforce for States.

Mr. FINDLAY. I guess I would answer that States impose different work search requirements and they enforce them in different ways. I do not know if I could characterize any of the requirements as unusually difficult to enforce, or——

Mr. ENGLISH. Is a search for work by an individual something that is inherently very easy to audit?

Mr. FINDLAY. Well, I think it is a little bit difficult to audit. You have to do it. There has to be some element of self-certification by the employee.

Mr. ENGLISH. I have a two-part question, and this has to do with the accuracy of the figures we are being given today. What percentage of the overpayments are you attributing to individuals who are collecting unemployment insurance payments, but are actually still gainfully employed?

Mr. FINDLAY. That number would be some portion of the $1.3 billion of non-fraud recoverable, and probably a large percentage of that. I do not have the exact percentage off the top of my head, but quite typically, what will happen is that an employee will be collecting unemployment benefits, will find a job, but there is a time lag before the employee reports new employment. Therefore, the person can get a couple extra checks while he or she is actually working.

Mr. ENGLISH. In your answer, you are identifying where they are participating in the formal economy and that brings me to the second point of my question. What percentage of the overpayments can be attributed to individuals who are participating in the informal or underground economy, having left a formal job, and are able to combine some income stream which is unreported with the unemployment benefits? Do you have any current measurement of that, or what sorts of estimates are built into this report?

Mr. FINDLAY. Certainly, there must be people out there who are participating in an underground economy and also collecting unemployment benefits. I just checked with my colleague, and we do not have any estimate as to what that percentage would be.

Mr. ENGLISH. Is it fair to say that the figures you are presenting here today, because you are not estimating or you are not giving us a very clear estimate of what you attribute to the underground economy, you may actually be substantially underestimating the number of overpayments that occur?

Mr. FINDLAY. As I said, I am certain that there are some claimants out there who are receiving income from mowing lawns, painting houses, doing work for cash, that sort of thing. Beyond that, I do not really have any very good estimate of how much that understates or overstates the problem.

Mr. ENGLISH. That is good to know. My final question is, in the testimony, actually, in the GAO report, it is noted that overpayments have changed relatively little over the last 10 years. To what do you attribute that?

Mr. FINDLAY. As I say, I think it is because the DOL and the States have not put as much of a focus on preventing overpayments as they have on ensuring prompt payments. I think that is a mistake. I think that at the Federal level, we should be doing more to ensure the integrity of the system. That is why we are planning a new GPRA goal, why we are planning new performance measures, why we have sought more money, and why, I think, that in the performance measures we place on the States, we will likely be asking them to do more to protect the integrity of the program.

Mr. ENGLISH. Thank you, Mr. Chairman.

Chairman HERGER. Thank you. The gentleman's time has expired. The gentleman from Michigan, Mr. Levin, to inquire.

Mr. LEVIN. As I understand it, the hearing is on this issue of overpayments and underpayments, and so forth, and I do not mean to minimize for certain that set of issues. I do think we want to be sure about proscriptive here, and I am sorry if I missed the earlier part of it. How many people have exhausted their benefits in the last 12 months, do you know?

Mr. FINDLAY. I do not know that number off the top of my head.

[The information follows:]

Number of exhaustions—12 months ending December 2001: 2.8 million.

Mr. LEVIN. How about the last 6 months?

Mr. FINDLAY. I think that it is in the hundreds of thousands who will be coming off the Temporary Emergency Unemployment Compensation Act in the next couple of weeks or so.

[The information follows:]

Number of exhaustions—6 months ending December 2001: 1.6 million.

Mr. LEVIN. Then what happens to them?

Mr. FINDLAY. Unless they are in a State that would trigger under the 4-percent trigger, they would cease receiving unemployment benefits.

Mr. LEVIN. Have you made any suggestions to this Congress as to what should happen to those people?

Mr. FINDLAY. As I discussed with Congressman Doggett a few minutes ago, we think that with the signs in the economy improving, that it is a little too early to say whether we want to have another emergency unemployment compensation system put in place. So, we have not suggested to Congress that they make any changes to current law.

Mr. LEVIN. Are you studying the present trigger mechanism?

Mr. FINDLAY. Under the emergency program or under the regular program or both?

Mr. LEVIN. Both.

Mr. FINDLAY. Under the regular program, we have proposed to this Committee, or to this Congress, as you all know, that the trigger be reduced, making it easier for States to trigger, as part of our comprehensive unemployment insurance reform proposal. In terms of what the appropriate trigger for the final 13 weeks in the Temporary Emergency Unemployment Compensation Act would go, we have not had any discussions about changing that trigger, to my knowledge, if new legislation were to be proposed.

Mr. LEVIN. You are having discussions with the Congress about changing the trigger, the basic. Where do those discussions stand?

Mr. FINDLAY. We had unveiled our proposal, and we are presently clearing the legislation through the Office of Management and Budget, OMB, for our comprehensive UI/ES, reform proposal, which would, among other things, lower the permanent trigger from 5 percent to 4 percent. It would make it easier for States to trigger on.

Mr. LEVIN. This is your comprehensive reform proposal?

Mr. FINDLAY. Yes, sir.

Mr. LEVIN. A new proposal is forthcoming?

Mr. FINDLAY. Yes. We certainly have shared with many people in the Congress the basic elements of the proposal, which would be to reduce the trigger, reduce over time the Federal unemployment tax from 0.8 percent to 0.2 percent, to turn over administration to the States largely, and to leave the Federal Government in place for loans and general oversight of the program. We would not have this kind of unique system where the Federal Government raises

money through a Federal tax and turns it over to the States to administer the States' programs.

Mr. LEVIN. So how does that portion differ from the previous reform proposal?

Mr. FINDLAY. It is very——

Mr. LEVIN. It sounds to me, we have seen it before.

Mr. FINDLAY. It is very similar, except that I think previous reform proposals had not proposed quite as much devolution to States of their own administration, and there are a couple of other small elements that are not worth talking about.

Mr. LEVIN. This provides more?

Mr. FINDLAY. More devolution, yes, sir.

Mr. LEVIN. Do you think that the change in the trigger should be held up until we discuss the rest of the reform package?

Mr. FINDLAY. Absolutely. No, I am just joking.

Mr. LEVIN. I think you are serious.

Mr. FINDLAY. I want to say, Congressman——

Mr. LEVIN. That has been the history of this up until now.

Mr. FINDLAY. I want to say that I like it better when I am sitting up there with you in the China Human Rights Commission than when I am down here and you get to ask the questions, but no, we believe it is a comprehensive reform——

Mr. LEVIN. I am just doing it constructively because we have been wrestling with these issues and we want your attention and your help. We have been struggling with these for years.

Mr. FINDLAY. If I could answer——

Mr. LEVIN. Four years——

Mr. FINDLAY. Let me answer your question seriously, because I gave a flip answer. We do think that we should have a comprehensive reform proposal that takes heed of all of these issues that we have raised with the unemployment insurance system. I think if we start taking piecemeal bits of it, just reducing the Federal unemployment tax, which employers would love, just increasing the trigger, which others would love, I think that is not a good way to make policy, and we ought to consider all these issues as a comprehensive whole.

Mr. LEVIN. Thank you. I appreciate your response.

Mr. FINDLAY. Thanks.

Chairman HERGER. Thank you very much.

Just as a comment, Mr. Findlay, you mentioned that about half of the States now compare their unemployment rolls with their State directory of new hires. The information in the State directory has been gathered from employers for use in collecting child support, in keeping with the 1996 Welfare Reform Law, so doing the match places no added burden on the employers and could save them money by reducing improper benefit payments. It appears from a variety of sources that a major source of the abuse occurs when unemployment claimants or recipients do not report their return to work. Therefore, running this match directly would appear to address that very problem. Would you have a comment on this?

Mr. FINDLAY. Yes. We think that the State new hire directories are absolutely key to reducing overpayments. They really get at several of the issues that we have been talking about here today. Currently, for whatever reason, only about half the States are

doing so. We are going to use some of our integrity money that we are asking for in the fiscal year 2003 budget to encourage more States to do so. While we have not formulated our performance measures, I would anticipate that our performance measures would encourage States even more to begin using these new hire directories because they are absolutely critical to reducing overpayments.

Chairman HERGER. I thank you very much. Are there any further questions? With that, I thank you very much, Mr. Findlay, for your testimony.

[Questions submitted by Chairman Herger to Mr. Findlay, and his responses follow:]

U.S. Department of Labor
Employment and Training Administration
Washington, DC 20210

The Honorable Wally Herger
Chairman, Subcommittee on Human Resources
Committee on Ways and Means
United States Senate
Washington, DC 20515

Dear Chairman Herger:

Thank you for your letter dated June 17, 2002, requesting additional information about the Department of Labor's efforts to increase prevention, detection, and recovery of unemployment insurance (UI) overpayments. Your letter was forwarded to the Employment and Training Administration for response because this office is responsible for oversight of the Federal-state UI program. Answers to your questions follow:

1. Does the Department have any specific proposals or suggestions to assist States in preventing or better recovering overpayments? Aside from matching [UI benefit payments] with the State Directory of New Hires, what are the most promising new approaches that have been tried in this area?

Response: As we have testified and as you have noted, use of data from State Directories of New Hires is a very valuable new tool for quick detection and possible prevention of UI overpayments. We believe that access to Social Security Administration data for verification of Social Security Numbers, names, and pension information will also prove to be of great value in preventing erroneous payments. These two new tools are the cornerstones of the Department's plans to assist states in preventing and detecting overpayments, and the administration has requested $10 million in the fiscal year 2003 budget to help states implement access to these data.

Follow-up activities (establishment of debt and collection efforts) after a potential overpayment has been detected through a computer crossmatch are very staff intensive, and due to Federal spending constraints, in recent years appropriations for these activities have been less than the administration's requests. The Unemployment Insurance and Employment Service Reform *New Balance* proposal, announced with the President's Budget for 2003, gives states overall responsibility for determining their own administrative funding levels and gives them the ability to target funding to benefit payment control activities at the levels that they believe are appropriate.

In addition, the $8 billion "Reed Act" distribution to states in 2002 gives states the opportunity to focus additional resources on benefit payment control activities. The Department has suggested that states consider using these funds for, among other purposes, improving UI claims filing and payment methods and reducing UI overpayments, fraud, and abuse. Some states already have appropriated Reed Act funds to pay for technology and system upgrades.

Additionally, there are several other systems/efforts underway that should have positive effects:

- **National Directory of New Hires.** Each state's access to new hire data is currently limited to the State Directory. Access to the National Directory of New Hires would make information available about Federal employment and provide access to data reported by multi-state employers that have chosen to report all wages to one state. We commend the Committee for including this access in the Temporary Assistance for Needy Families reauthorization bill (H.R. 4737).

- **Illegal Aliens.** To prevent overpayments to non-citizens, states use an Immigration and Naturalization Service (INS) automated system for verifying immigration status and work authorization. INS has installed enhanced verification capability in eight states that automatically generates a secondary inquiry when the identifying information is at variance with that provided by the claimant. Implementation of this automated process is underway in two additional states, and within the next 18 months, the remaining states should be included.
- **National Conference on UI Integrity.** The Department, along with the National Association of State Work force Agencies, is sponsoring a national integrity conference in 2003 to identify and disseminate successful practices, studies, and integrity information among the states.

2. When do you expect your negotiations with the Social Security Administration will result in an agreement to better share data to ensure the accuracy and validity of Social Security numbers provided in claiming unemployment benefits?

Response: The Department and the Social Security Administration (SSA) have reached agreement, and work is currently underway to establish a real time data exchange capability between SSA and each state UI agency. The telecommunications aspect of this exchange is expected to be completed in 2002. Each state will then have to install software to interface with their existing UI benefits system. We expect data exchanges with SSA to begin during the first half of 2003.

3. Please describe in greater detail the current performance standards and goals that are designed to enhance state recovery of overpayments. How has this changed in recent years?

Response: The Department requires each state to operate a unit for benefit payment control purposes with the following goals:

- Detect benefits paid due to state agency errors or due to willful misrepresentation or error by claimants;
- Deter claimants from obtaining benefits through willful misrepresentation; and
- Recover benefits obtained by fraud, willful misrepresentation, and other claimant errors.

The Department relies upon periodic on-site reviews of states' operating procedures to gauge the quality of performance in achieving these goals. Additionally, data analysis has focused on the recovery of overpayments—both fraud and nonfraud. These analyses compare the amount of overpayments recovered against the amount of overpayments established during a given year and initially 55% was set as a "desired level of achievement." In the mid 1990's, the Department recognized that this benchmark could provide a disincentive to establish as many overpayments as possible because recoveries were limited by staff capacity; therefore, the 55% goal was officially dropped from the UI performance measurement system. However, some states still use the 55% indicator as a goal.

It is very difficult to define a measure of performance related to overpayment prevention, detection, and recovery. As greater efforts are made to detect overpayments, such as using the State Directory of New Hires as the primary detection tool, the rate of overpayments may increase due to more efficient screening of potential cases for investigation, thereby reducing the number of false leads, while the average dollar amounts established per overpayment (in addition to the dollar amounts recovered) may decrease due to prompt interception before benefits are overpaid. In establishing measures related to overpayments, it is important to be sure that the incentives they create promote best practices. Our efforts to design new measures addressing UI benefit payment integrity are described below.

4. Your testimony mentions that the Department will be setting a new Government Performance and Results Act (GPRA) goal for addressing unemployment program overpayments. What is your timeline on developing and implementing that goal? Will the States be held accountable for this goal? If so how, and if not, why not?

Response: The Department is engaged in the development of a UI payment accuracy measure as part of a plan to improve UI program integrity and reduce overpayments. We are seeking state and stakeholder as well as OMB, OIG and GAO input regarding a measure. After development, we will establish a baseline and a new GPRA goal from which to measure improvements in payment accuracy nationwide. We plan to complete work on the goal by September 30, 2002. The goal, like other GPRA goals, will be expressed as a measure of aggregate national performance. The

Department is at the same time embarking on a review of the overall UI performance management system. This review will encompass all aspects of the performance system, including the development of measures related to overpayment prevention, detection, and recovery. We recognize, however, that applying nationwide goals across states will be difficult due to differences in states' laws that affect the potential for overpayments to occur.

Should you need clarification or explanation of the answers to your questions, please do not hesitate to contact me at (202) 693–2700 or have a member of your staff contact Grace Kilbane or Cheryl Atkinson in the Office of Workforce Security. They can be reached at 693–3200.

Sincerely,

Hon. Emily Stover DeRocco
Assistant Secretary

Chairman HERGER. I would like to call up our second panel, Sigurd R. Nilsen, Ph.D., Director of Education, Work force, and Income Security Issues at the U.S. General Accounting Office; the Honorable Gordon S. Heddell, the Inspector General at the U.S. Department of Labor; Miles Paris, Deputy Director of Program Support for the Illinois Department of Employment Security; Stephen Woodbury, Ph.D., Professor at Michigan State University; and Michael Lorsbach, Principal, On Point Technology, Incorporated.

I thank each of you for joining us this afternoon to testify on this important issue.

Mr. Nilsen.

STATEMENT OF SIGURD R. NILSEN, PH.D., DIRECTOR, EDUCATION, WORKFORCE, AND INCOME SECURITY ISSUES, U.S. GENERAL ACCOUNTING OFFICE

Dr. NILSEN. Thank you, Mr. Chairman and Members of the Subcommittee. I am pleased to be here today to discuss the findings from our draft report on UI overpayments prepared at the request of Chairman Herger, focusing on the extent and type of overpayments, the factors that contribute to overpayments, and Federal and State management issues that affect the ability of States to control overpayments.

Over the past 10 years, as we have heard earlier, the annual overpayment rate estimated by DOL's Quality Assurance System has remained fairly constant at about 8.4 percent. As UI payments have increased this past year with rising unemployment, overpayments reached $2.4 billion in 2001. The DOL data shows that of this $2.4 billion in overpayments, about a quarter, or $560 million, was attributable to fraud or abuse.

The primary sources of UI overpayments are, first, unreported earnings or benefit payments, accounting for 38 percent of overpayments, about $900 million, and the source of more than half the fraud or abuse reported in the program.

Second, eligibility issues, such as not being able or available for work, failing to register for employment services, or not looking for a new job, as required, account for about 36 percent of overpayments, or about $860 million.

Third, about 20 percent of overpayments, roughly $500 million, was due to becoming unemployed for reasons not covered by State law, such as being fired for cause.

Although some categories of overpayment are more difficult than others to detect or recover, DOL's analysis suggests that the States could have detected and recovered about $1.3 billion of the $2.4 billion in estimated overpayments in 2001. However, only $370 million was actually recovered.

Officials at DOL and in some States emphasize that overpayments are more likely to be recovered if they can be detected quickly. States generally recover a substantial proportion of the overpayments they detect by offsetting a claimant's current and future UI benefits. However, UI benefits tend to be paid out over a relatively short period of time, about 14 weeks on average, and current overpayment detection and recovery activities may begin long after individuals leave the rolls. This inability to verify eligibility information in a timely manner places the program at substantial risk for overpayments that may never be recovered.

Because States rely heavily on claimants' self-reporting of eligibility information, timely verification of this information using independent sources is key to limiting UI overpayments. For example, access to more timely sources of data, such as the State new hires data, can provide information on individuals' current employment status. States that use this data have reported that it is helpful in detecting overpayments more quickly. However, we found that the new hires data is not routinely used in all States. Two of the six States we visited do not currently use their new hires data to verify claimants' earnings or employment status. Yet, one of the States we visited reported that because the new hires data detects overpayments earlier than other detection methods, the size of its overpayment at the time of detection was reduced by nearly 75 percent.

The National Directory of New Hires would provide similar employment and earnings information on claimants across States to verify eligibility, but so far, access to this information is limited by statute, except, as we have heard, it is in the TANF reauthorization bill.

We also found that some States do not independently verify the receipt of income from benefit programs such as Workers' Compensation or Social Security disability payments, which can also affect UI eligibility. Further, in addition to verifying eligibility up front, the States need to more aggressively use these same sources of data to verify continuing eligibility.

The limited focus on overpayments has been fostered by DOL's approach to managing the UI program, which emphasizes quickly processing and paying UI claims with only limited attention to overpayment prevention, detection, and collection. For example, most of the first 12 performance measures, called Tier 1 measures by DOL, assesses whether States meet specified timeframes for certain activities and no measure in those 12 gauges the accuracy of UI payments. The DOL also gives Tier 1 measures more weight than the remaining 60 measures, called Tier 2 measures, which assess other aspects of State performance, including overpayment collection. Officials from most of the States we visited told us that the Tier 1 and Tier 2 measures make the UI program complex to administer and may contribute to an environment in which overpayment are more likely.

In conclusion, Mr. Chairman, the vulnerabilities that we have identified are attributable to a management approach in DOL and in many States that places greater emphasis on quickly processing and paying UI claims than on controlling program payments. Our work suggests that using more front-end automated data sources to verify claimant eligibility before overpayments are made is an effective and efficient method to protect program funds.

However, absent a change in the current approach to managing the UI program at both the Federal and the State level, it is unlikely that the deficiencies we identified will be sufficiently addressed. Without more active involvement from DOL in emphasizing the need to balance payment timeliness with payment accuracy, States may be reluctant to implement needed changes in their management philosophy and operations.

Mr. Chairman, this concludes my prepared statement. I will be happy to respond to any questions you or other Members of the Subcommittee may have.

[The prepared statement of Dr. Nilsen follows:]

Statement of Sigurd R. Nilsen, Ph.D., Director, Education Workforce, and Income Security Issues, U.S. General Accounting Office

Mr. Chairman and Members of the Subcommittee:

I am pleased to be here today to discuss the Department of Labor's Unemployment Insurance (UI) program, which is a key component in ensuring the financial security of America's workforce. The UI program is a federal-state partnership designed to partially replace lost earnings of individuals who become unemployed through no fault of their own and to stabilize the economy in times of economic downturn. The UI program paid about $30 billion in benefits in calendar year 2001 to workers who lost their jobs. The health of each state's UI program depends, in part, on the ability of the state to control its benefit payments by accurately determining individuals' eligibility for UI benefits in a timely manner. Inaccurate or untimely eligibility information may contribute to overpayments and fraud.

Reports from Labor's Office of Inspector General (OIG) and others have identified numerous aspects of the UI program that may be vulnerable to overpayments and fraud. Today, I will be providing information from our draft report that we have provided to Labor for its comment on our findings, conclusions, and recommendations. Our report is due to be issued in July 2002. I will discuss (1) the extent and type of overpayments in the UI program, including those that may be attributable to fraud or abuse; (2) the factors that contribute to overpayments in the UI program; and (3) the broader management issues that may affect the states' ability to effectively control their UI benefit payments.

To address these issues, we reviewed internal Labor guidance and documentation, performance plans and reports, performance data, as well as overpayment data from Labor's Benefit Accuracy Measurement (BAM) and Benefit Payment Control (BPC) systems. In addition, we conducted in-depth interviews with more than 100 management and line staff in Labor's headquarters and 6 regional offices, as well as UI officials in 6 states—California, Colorado, Illinois, Maryland, Massachusetts, and New York.[1] We selected these states based on numerous criteria, including performance data from the Department of Labor, size of their workforce, availability of overpayment detection and recovery tools, and geographic location. Finally, we spoke with other groups that are involved in unemployment insurance, such as employer representatives and the National Association of State Workforce Agencies.

In summary, our work shows that of the $30 billion in UI benefits paid in calendar year 2001, Labor estimates that this includes about $2.4 billion in overpayments, including $560 million attributable to fraud or abuse. Labor's analysis also suggests that the states could have detected and/or recovered about $1.3 billion of the total overpayments given their current policies and procedures. Labor based these estimates on data from its quality assurance system, which involves an in-

[1] We also interviewed the Utah UI Director by telephone because this state has been utilizing some practices that other states could use to verify claimants' eligibility for UI benefits, such as on-line access to the Social Security Administration's State Online Query system to verify the validity of individuals' social security numbers.

depth analysis of individual UI claims in each state. Labor's quality assurance data document numerous categories of overpayments, including individuals who work while receiving benefits, or misrepresent their identity. Other sources of overpayments include agency errors and inaccurate or untimely information provided by employers. Our work shows that management and operational practices at both the state and federal level contribute to overpayments in the UI program. At the state level, many states place a higher priority on quickly processing and paying UI claims than on taking the necessary steps to adequately verify claimants' initial and continued eligibility for UI benefits. As a result, we found that many states do not adequately verify information reported by claimants. At the federal level, we found that Labor's policies and directives emphasize quickly processing and paying claims, with only limited attention given to payment accuracy. While we recognize the importance of paying benefits to individuals in a timely manner, Labor's performance measurement system does not provide sufficient incentives and sanctions for states to balance the need for payment timeliness with the need for payment accuracy.

Background

The UI program was established by Title III of the Social Security Act in 1935 and is a key component in ensuring the financial security of America's workforce. This complex program, which is administered jointly by the federal Department of Labor's Employment and Training Administration and the states, provides temporary cash benefits to workers who lose their jobs through no fault of their own. Labor is responsible for monitoring state operations and procedures, providing technical assistance and training, as well as analyzing UI program data to diagnose potential problems. Although Labor provides oversight and guidance to ensure that each state operates its program in a manner that is consistent with federal guidelines, primary responsibility for administering the program lies with the states.

State claims representatives determine claimants' eligibility for UI benefits by gathering essential information, such as their identity, employment history, and other sources of income they may have. To enhance the efficiency and cost-effectiveness of their UI systems, many states have established centralized service centers that allow claimants to apply for benefits by telephone, fax, or the Internet, rather than in person at a local office. To be eligible for UI benefits in most states, claimants must (1) have worked for a specified amount of time in a job that is covered by the unemployment insurance program; (2) have left their prior jobs involuntarily (such as by employer layoff) or have quit their jobs for "good cause"; (3) be currently "able and available" for work, and, in most states, actively seeking work; (4) enroll in employment services or job training programs (in some states); and (5) be legally eligible to work—for example, noncitizens must be lawfully admitted to work in the United States, or lawfully present for other reasons. States are generally expected to provide benefits to the claimant within 14 to 35 days of application.

The UI program is funded through federal and state taxes levied on employers. States' taxes pay the actual unemployment insurance benefits, whereas administrative costs are generally financed through the federal tax. Labor holds these funds in the Unemployment Trust Fund of the U.S. Treasury. To obtain annual funding from Labor to administer their programs, states submit a request via their annual State Quality Service Plan (SQSP). Labor reviews each state's plan and makes adjustments in funding as necessary. In fiscal year 2001, Labor provided about $2.3 billion to states to administer their programs.

To ensure UI program integrity, Labor funds two principal kinds of activities for detecting and measuring UI overpayments at the state level—Benefit Payment Control and Benefit Accuracy Measurement. Each state is required to operate a benefit payment control division that is responsible for detecting and recovering overpayments. Each state is required to report overpayment data to Labor on a quarterly basis. By contrast, Labor's benefit accuracy measurement data is an estimate of the total overpayments in the UI program—in each state and the nation as a whole—based on an examination of a sample of paid and denied claims. Benefit accuracy measurement is one of the main quality assurance systems that Labor uses to assess payment accuracy in the program.

More Than $2 Billion in Overpayments Detected in 2001

Labor's data show that of the $2.4 billion in estimated overpayments about $1.3 billion could have been detected and/or recovered by the states in 2001 given their existing policies and procedures.[2] In contrast, the states reported that $650 million in overpayments were made in 2001, of which $370 million was actually recovered.

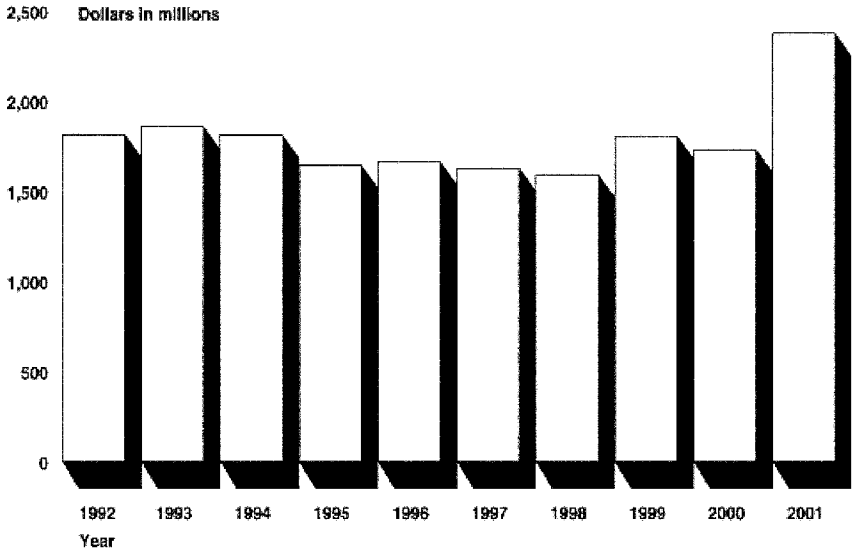
[2] These estimates are based on preliminary data from Labor available at the time of our review.

The difference in the overpayment figures produced by the two systems can be attributed to the fact that Labor's quality assurance estimate is based on a more comprehensive examination of individual UI claims than the states' benefit payment control activities can generally produce. Our analysis suggests that Labor's quality assurance system estimate is a more complete assessment of the true level of overpayments in the UI program, partly because the system provides a more in-depth review of individual UI cases and causes of payment errors. We are currently in the process of verifying the precision of these estimates.[3]

Overpayments Have Changed Little During the Last 10 Years

Over the past 10 years, the annual overpayment rate estimated by Labor's quality assurance system has remained fairly constant as a percentage of total benefits paid—ranging from a low of 7.9 percent in 2001 to 9.2 percent in 1999, and averaging about 8.4 percent during that period. Overpayments averaged about $1.8 billion per year and reached a high of $2.4 billion in 2001. (See fig. 1.)

Figure 1: Overpayments Estimated by Labor's Quality Assurance System, 1992 to 2001



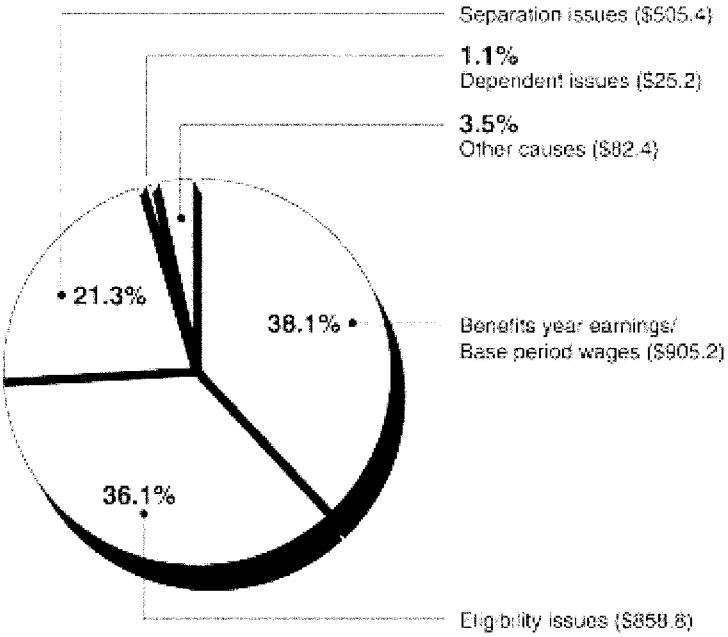
Source: Department of Labor quality assurance data.

The overpayments estimated by Labor's quality assurance data occur for a number of reasons. Some overpayments result from errors in claimants' reporting or the state agency's recording of important eligibility information, such as wages or other sources of income that a claimant obtained while receiving UI benefits ("benefit year earnings" or "base period wages"). Overpayments also occur because claimants are not able and/or available to work, fail to register for employment services as required by their state, or fail to look for a new job as required ("eligibility" violations). Claimants may also be overpaid because they become unemployed for reasons not covered by state law—such as being fired ("separation" issues). Finally, overpayments may occur due to erroneous reporting or recording of a claimant's dependent information ("dependency" issues), or other causes such as reversal of benefits paid due to an appeals decision ("other" causes). (See fig. 2.) The quality assurance data also classifies overpayments as being "fraud" or "nonfraud." Fraud can occur when claimants intentionally misrepresent eligibility information, employers file fraudulent claims, or state UI program personnel misuse their access to sensitive information. Of the total overpayments estimated by Labor in 2001, about $560 million (24 percent) were attributed to fraud. Of this amount, about $313 million (56 percent)

[3] We have not yet been able to obtain data on confidence intervals, so we are unsure of the precision of these estimates.

were due to unreported earnings. However, we found that the states differ substantially in how they define fraud. For example, some states may include overpayments resulting from unreported earnings such as fraud, while other states do not. Thus, state-to-state comparisons of the level of fraud in the UI program and the activities that constitute fraud are difficult to make.

Figure 2: Categories of $2.4 Billion in Overpayments Estimated by Labor's Quality Assurance System (2001)



Note: Numbers in parentheses are in millions of dollars.
Source: Labor's quality assurance data.

Although some categories of overpayments are more difficult than others to detect or recover, Labor's analysis suggests that the states could have detected and recovered about $1.3 billion of the $2.4 billion in estimated overpayments in 2001. In particular, Labor's data show that existing state processes and procedures could have detected more overpayments attributable to unreported recipient income and wages and payments to individuals who are not entitled to UI benefits due to the circumstances under which they became unemployed. Labor's analysis also suggests that other types of overpayments are likely to be detected by most states given their current policies and procedures. These include income from social security programs, unreported vacation or severance pay, and illegal aliens claiming benefits. Furthermore, Labor's analysis showed that a substantial proportion of the overpayments detected by the states could be recovered using commonly available procedures, such as offsetting claimants' current and future benefits, and intercepting other sources of income, such as state tax refunds. Labor determined that the remaining $1.1 billion in estimated overpayments could probably not be detected or recovered by the states due to limitations in their existing policies and procedures. For example, overpayments caused by state agency errors are generally not pursued for recovery.

Labor's Quality Assurance System Data Provide a More Complete Representation of UI Overpayments

In contrast to Labor's quality assurance overpayment estimate, the states' benefit payment control systems reported about $650 million in overpayments in 2001, of which about $370 million was recovered. Based on our analysis as well as analysis performed by Labor's Division of Performance Management, we believe that Labor's quality assurance system data represent a more complete assessment of the true level of UI overpayments than the benefit payment control figure reported by the

states. In particular, the quality assurance system is able to estimate all the potential overpayments that have occurred in each state's UI program because it is based on a statistically valid sample of UI claims from each state. Moreover, quality assurance investigators are able to conduct a more detailed, comprehensive analysis of each case reviewed than is typically possible for most states' benefit payment control operations. For example, investigators are generally able to spend more time verifying the accuracy of the claims information by personally contacting employers, claimants, and third parties. They also typically commit between 5 and 8 hours examining a single case, allowing for a more in-depth review of a claimant's eligibility. By contrast, the states' benefit payment control activities are often affected by factors that limit their ability to detect and/or recover overpayments. These factors include (1) limited staffing and funding and (2) a lack of access to timely data sources. Moreover, benefit payment control personnel are required to quickly examine thousands of cases to identify overpayments, thus potentially limiting their ability to thoroughly review cases for payment accuracy.

Overpayments Caused by Management and Operational Practices at the State and Federal Level

We identified various management and operational practices at both the federal and state level that contribute to UI overpayments. In particular, both Labor and the states tend to place primary emphasis on quickly processing and paying UI claims and may not sufficiently balance the need to make timely payments with ensuring payment accuracy. While we recognize the importance of providing UI benefits in a timely manner to individuals who are unemployed, our work suggests that Labor and the states do not always take the necessary steps to adequately verify claimants' initial and continuing eligibility for benefits. While some of the states we visited use automated data sources to determine if claimants are working or obtaining other benefits while receiving UI, others rely heavily on self-reported information from claimants to make payment decisions. In addition, we found that Labor's performance measures generally emphasize payment timeliness at the expense of payment accuracy. Moreover, Labor has been reluctant to link the states' performance on payment accuracy to the annual administrative funding process as a way of holding states accountable for performance. Despite these problems, we found that Labor is taking some actions to improve UI program integrity, such as working to help states obtain automated data sources essential to making more accurate and timely eligibility decisions.

States Do Not Always Balance Need for Payment Timeliness with Payment Accuracy

The emphasis that an agency places on critical program activities can be measured, in part, by the level of staff and other resources devoted to those activities. Consistent with stated program objectives, most of the states we visited place a primary emphasis on quickly processing and paying UI claims, but do not always balance this focus with adequate attention to program integrity. In particular, we found that program managers commonly moved staff assigned to program integrity activities (such as benefit payment control) to claims processing positions in response to increases in the number of UI claims being filed. For example, one state was using only 4 of the 16 positions (25 percent) it was allotted by Labor for benefit payment control. Only one of the six states we visited was fully staffing its benefit payment control operations. The remaining states had transferred staff into other positions, including claims processing. Another state stopped drawing its quality assurance sample for a period of time and moved staff responsible for these operations into claims processing positions when unemployment claims increased during the third quarter of 2001.[4] Many federal and state officials we interviewed told us that states move staff into claims processing roles from other positions because they lack funding to properly administer all the necessary activities of their UI programs.

States Vary in Their Use of Automation to Independently Verify Claimants' Information

While states differed in the level of staff and resources devoted to program integrity activities, we also found variation in the processes and tools they used to verify information that could affect a claimant's eligibility for UI benefits, such as identity, alien status, wages, employment status, or receipt of other federal or state benefits. All of the states we visited conduct basic computer matches that detect potential UI

[4] Several state officials told us that the number of UI claims have increased since the terrorist attacks of September 11, 2001, and have forced them to move staff resources from benefit payment control or benefit accuracy measurement activities into claims taking positions.

overpayments due to unreported earnings. For example, each state regularly conducts a "Wage/Benefit Crossmatch" that compares the database of UI claimants with the state's database of individuals' wages to identify UI recipients who may have unreported income in the same state in which they are receiving UI benefits. However, because state wage data are only available quarterly, the crossmatch relies on information that may be several months old by the time the match is conducted. This delay allows some overpayments to remain undetected for a long period of time. Officials at Labor and in some states emphasized that overpayments are more likely to be recovered if they can be detected quickly. States generally recover a substantial proportion of the overpayments they detect by offsetting a claimant's current and future UI benefits. However, UI benefits tend to be paid out over a relatively short period of time—about 14 weeks on average—and overpayment detection and recovery activities may begin long after individuals leave the UI rolls. This inability to obtain timely eligibility information places the program at substantial risk for overpayments that may never be recovered.

More timely sources of data than the "Wage/Benefit Crossmatch" exist to verify a claimant's employment status. State new hires data can provide information on individuals' current employment status.[5] States that use this data source have reported that it is helpful in detecting overpayments more quickly. However, we found that the new hires data are not routinely used in all states. Two of the six states we visited do not currently use their new hires data to verify claimants' earnings or employment status.[6] Yet, one of the states we visited reported that because the new hires data detect overpayments earlier than other detection methods, the size of its average overpayment at the time of detection has been reduced by nearly 75 percent, from about $2,800 to roughly $750. Labor's OIG has identified the new hire database as a potentially useful tool for detecting overpayments resulting from unreported income, which represents a substantial portion of the total UI overpayments each year.[7] Although Labor has encouraged each state to use its own new hires database for purposes of administering their UI program, a number of states nationwide still do not use it.

While the states' directory of new hires data are useful for verifying claimants' employment status, a main limitation is that they only identify this information for claimants within a given state. To detect unreported or underreported wages in other states, some states also use an "Interstate Crossmatch" that is facilitated by Labor.[8] However, this match also typically relies on wage data that are about 4 to 6 months old. Another type of match called the "Interstate Inquiry" allows states to check a claimant's UI and employment status in other states. However, this system can generally only be used to check individual claimants and is not designed to verify the status of large numbers of claimants simultaneously.

To enhance the ability of states to verify the status of claimants who could be working or receiving UI benefits in other states, many officials we spoke with advocated giving states access to the Office of Child Support Enforcement's National Directory of New Hires (NDNH). The NDNH is a comprehensive source of unemployment insurance, wage, and new hires data for the whole nation. However, current law limits access to the NDNH and does not permit individual states to obtain data from it for purposes of verifying claimants' eligibility for UI.[9] One possible alternative to the NDNH suggested by some officials for tracking interstate wages and UI benefit receipt is the Department of Labor's Wage Record Interchange System (WRIS). This system, which was developed in response to the Workforce Investment Act (WIA) of 1998, is a "data clearinghouse" that makes UI wage records available to states seeking employment and wage information on individuals in other states.[10] Certain federal officials and others familiar with WRIS told us that with some modification—such as incorporating the more timely new hires data from the states—WRIS could be a logical alternative to the NDNH because the computer network for

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[5] Each state is required to maintain a database of individuals who were recently hired to help state child support enforcement agencies locate non-custodial parents who owe child support payments.

[6] All states were required to create a state directory of newly hired employees as part of the Personal Responsibility and Work Opportunity Reconciliation Act of 1996. Each state's directory periodically reports state unemployment insurance, wage and new hires data to the National Directory of New Hires for purposes of locating noncustodial parents in other states who owe child support payments.

[7] See the U.S. Department of Labor, Office of Inspector General, Unemployment Insurance Integrity: Fraud and Vulnerabilities in the System (1P–03–315–0001–PE) March 31, 1999.

[8] This match is conducted using Labor's Interstate Connection Network.

[9] See 42 U.S.C. 653 (l).

[10] WRIS helps participating states track the employment status of individuals who have participated in WIA job training programs in other states.

sharing data among the states already exists. However, WRIS currently lacks important pieces of information (such as states' new hires data) that would make it most useful as an interstate verification tool. Moreover, in a recent report, we noted that some states have been reluctant to become involved with WRIS, partly because of concerns about the cost of administering the system.[11] Furthermore, we noted that if not all states participate, the value of WRIS will be diminished—even for participating states—because no data will be available from nonparticipating states' UI wage records.

Some States May Not Verify Claimants' Receipt of Other Programs' Benefits

Claimants' eligibility for UI benefits may be affected if they are receiving benefits from other state or federal programs. For example, claimants in some states are ineligible for UI benefits, or they may receive reduced benefits if they are receiving workers' compensation. Overpayments can occur if claimants do not accurately report the existence or amount of such benefits when they apply for UI, or if the state employment security agency fails to verify the information in a timely manner.[12] Only two of the six states we visited verify claimants' receipt of workers' compensation using independent sources of information. Moreover, at least one of these states only checks for receipt of workers' compensation if the claimant self-reports that they are currently receiving such benefits. Similarly, receipt of some federal benefits such as cash payments from Social Security programs may affect a UI claimant's eligibility for or amount of benefits.[13] For example, one state we visited requires claims representatives to ask claimants if they are currently receiving Social Security Disability Insurance (DI), which could reduce or eliminate the UI benefits they are eligible to receive. However, if a claimant states that he or she is not receiving DI benefits, then no further actions are taken to independently verify this information. Labor's quality assurance data estimate that in 2001, about $30 million in UI overpayments were due to unreported social security benefits, such as DI.

Some States Fail to Adequately Verify Claimants' Identity and Whether They Are Legal Residents

To ensure that UI benefits are paid only to individuals who are eligible to receive them, it is important that states verify claimants' identity and whether they are legal residents.[14] However, states may be vulnerable to fraud and overpayments because they rely heavily on claimants to self-report important identity information such as their social security number (SSN), or are unable to verify such information in a timely manner. Prior investigations by Labor's OIG demonstrate that the failure or inability of state employment security agencies to verify claimants' identity have likely contributed to millions of dollars in UI overpayments stemming from fraud. One audit conducted in four states (Florida, Georgia, North Carolina, and Texas) revealed that almost 3,000 UI claims totaling about $3.2 million were paid to individuals using SSNs that did not exist, or belonged to deceased individuals. Furthermore, the OIG concluded that illegal aliens filed a substantial proportion of these claims.[15]

We found that vulnerabilities remain with regard to verifying claimants' identity and citizenship status. For example, none of the six states we visited have access to the Social Security Administration's (SSA) State Online Query (SOLQ) system, which can be used to verify the identity of claimants applying for UI by matching their name, date of birth, and SSN in real time. At the time of our review, only two states had access to this system because they were participating in a pilot project with SSA. The states we visited generally use a batch file method in which large numbers of SSNs are periodically sent to SSA for verification.[16] This process

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[11] Labor agreed to fund WRIS for the first year of its operation, but has not committed to funding future years. The estimated annual cost of administering the system is $2 million. See Workforce Investment Act: Improvements Needed in Performance Measures to Provide a More Accurate Picture of WIA's Effectiveness, GAO–02–275, (Washington, D.C.: Feb. 1, 2002).

[12] State laws differ from one another in terms of how benefits that are received from other federal or state programs affect claimants' eligibility for UI benefits.

[13] The Social Security Administration is responsible for administering programs including the Old Age and Survivors Insurance, Supplemental Security Income, and Disability Insurance.

[14] Although some categories of noncitizens may be eligible for UI benefits, such as those authorized to work in the United States at the time they apply for benefits, others, including illegal aliens, are not. See Federal Unemployment Tax Act 3304 Section (a)(14)(A).

[15] See Department of Labor Office of Inspector General, Verification of Social Security Numbers Could Prevent Unemployment Insurance Payments to Illegal Aliens, 04–98–001–03–315, March 2, 1998.

[16] States report sending SSNs to SSA for verification in intervals ranging from daily to once per quarter (every 3 months).

tends to be less timely than online access for verifying claimants' initial eligibility for benefits. One state we visited reported that it does not perform any verification of the SSNs that UI claimants submit because a prior system it used for verifying SSNs identified only a small number of potential violations. In addition, all six states we visited rely mainly on claimants to accurately self-report their citizenship status when they first apply for UI benefits. State officials told us that they generally do not verify this information with the Immigration and Naturalization Service (INS) unless the claimant states that he or she is a noncitizen. Labor estimates that about $30 million in overpayments in 2001 were due to illegal alien violations.

Even if individuals do not misrepresent their identity or citizenship status to illegally obtain UI benefits, the potential for fraud and abuse may still exist. For example, one state we visited revealed that they, along with a bordering state, identified nine SSNs that are currently being illegally used by multiple individuals as proof of eligibility for employment. Upon further investigation, we determined that these SSNs are being used by approximately 700 individuals in at least 29 states, and that seven of the SSNs belonged to deceased individuals. Although we did not find any instances in which UI benefits were obtained by those individuals earning wages under these numbers, both state and federal officials agreed that the potential for these individuals to fraudulently apply for and receive UI benefits in the future was possible. At the Subcommittee's request, our Office of Special Investigations is currently investigating the use of these SSNs. Initial indications are that the individuals involved are illegal aliens.

States May Not Receive Timely Information from Employers

To varying degrees, officials from all of the six states we visited told us that employers or their agents do not always comply in a timely manner with state requests for information needed to determine a claimant's eligibility for UI benefits. For example, one state UI Director reported that about 75 percent of employers fail to respond to requests for wage information in a timely manner. In addition, a Labor OIG audit conducted between 1996 and 1998 revealed that 22 out of 53 states experienced a nonresponse rate of 25 percent or higher for wage requests sent to employers.[17] A more in-depth review of seven states in this audit also showed that $17 million in overpayments occurred in four of the states because employers did not respond to the states' request for wage information. We discussed these issues with an official from a national employer representative organization who told us that some employers may resist requests to fill out paperwork from states because they view the process as cumbersome, time-consuming, and cannot always see how fraud and UI overpayments can affect their tax rate. In particular, because employers are unlikely to experience an immediate increase in the UI taxes they pay to the state as a direct result of overpayments, they do not see the benefit in complying with state requests for wage data in a timely manner. Although Labor has taken some limited actions to address this issue, our work to date shows that failure of employers to respond to requests for information in a timely manner is still a problem.[18]

States Vary in Their Ability To Recover Overpayments

While most states recover a large proportion of their overpayments by offsetting claimants' current or future benefits, some of the states we visited have additional overpayment recovery tools for individuals who are no longer receiving UI. These tools include state tax refund offset, wage garnishment, and use of private collection agencies.[19] Some of these procedures, such as the state tax refund offset, are viewed as particularly effective. For example, one state reported overpayment collections of about $11 million annually between 1998 and 2000 resulting from this process. Other states have increased overpayment collections by allowing more aggressive criminal penalties for individuals who are suspected of UI fraud. For example, one state prosecutes UI fraud cases that exceed a minimum threshold as felonies instead of misdemeanors. Officials in this state told us that the threat of imprisonment

[17] See U.S. Department of Labor, Office of Inspector General, Examination of UI Benefit/Wage Crossmatch and Analysis of Employers Who Fail to Respond to the States' Requests for Weekly Wage Data (05–99–005–03–315) March 1999.

[18] Labor recently funded a grant to one state to facilitate more effective coordination and cooperation between the state and its employers. As a result of its actions, this state reported that about 80 percent of the state's employers comply with state requests for information in a timely manner.

[19] For UI claimants who have outstanding overpayments, the state tax refund offset allows a state to intercept the individual's state tax refund to recover an overpayment; wage garnishment allows the state to recover UI overpayments from an individual's paycheck when they return to work; and private collection agencies can pursue overpayments when the state has been unsuccessful in recovering using its *existing* collection procedures.

often encourages claimants suspected of fraud to make restitution for UI overpayments. According to state officials, this initiative resulted in $37 million in additional overpayment collections in calendar years 2000 and 2001. However, other states we visited lacked many of these tools. For example, one state relied primarily on offsets against current UI claims to recover overpayments because its laws and policies did not permit the use of many of the tools that other states have found to be effective for collecting overpayments from individuals who have left the UI rolls.

Labor's Management Places Insufficient Emphasis on Program Integrity

In general, Labor's approach to managing the UI program has emphasized quickly processing and paying UI claims, with only limited attention to overpayment prevention, detection, and collection. This approach is most evident in the priorities that are emphasized in Labor's recent annual performance plans, the UI program's performance measurement system, and the limited use of quality assurance data to correct vulnerabilities in states' UI operations. For example, Labor's recent annual performance plans required under the Government Performance and Results Act of 1993 have not included strategies or goals to improve payment accuracy in state UI programs. In addition, we found that Labor's system for measuring and improving UI program performance is primarily geared to assess the timeliness of various state operations.[20] Most of the first 12 performance measures (called "Tier I") assess whether states meet specified timeframes for certain activities, such as the percentage of first payments made to claimants within 14 to 35 days. However, none of the Tier I measures gauge the accuracy of UI payments. Labor also gives Tier I measures more weight than the remaining measures (called "Tier II"), which assess other aspects of state performance, including overpayment collections. Labor has developed national criteria specifying the minimum acceptable level of performance for most Tier I measures.[21] States that fail to meet the minimum established criteria are generally required to submit a "Corrective Action Plan" to Labor. Moreover, Labor has indicated that it may withhold the administrative funding of states that continually do not meet Tier I performance goals. By contrast, the Tier II measures do not have national minimum performance criteria and are generally not enforced as strictly by Labor. Labor could set Tier II criteria on a state-by-state basis and withhold funding in case of subsequent noncompliance.

Officials from most of the states we visited also told us that the Tier I and Tier II measures make the UI program complex to administer and may contribute to an environment in which overpayments are more likely. In particular, these officials told us that because the measures are so numerous and are designed to monitor a wide range of activities, it is difficult to place sufficient emphasis on more fundamental management issues, such as payment accuracy. There are currently more than 70 Tier I and Tier II measures that gauge how states perform in terms of the timeliness, quality, and accuracy of benefit decisions. Faced with competing priorities, some states tend to focus most of their staff and resources on meeting certain measures such as payment timeliness, but may neglect other activities such as those dealing with program integrity.

We believe, however, that Labor can do more to encourage states to balance payment timeliness with the need for payment accuracy in a manner that does not require the complete withholding of administrative funds. For example, under federal regulations covering funds to states, Labor may temporarily withhold cash payments, disallow costs, or terminate part of a state's administrative funding due to noncompliance with grant agreements or statutes.[22] Withholding or delaying a portion of these funds is one way Labor can potentially persuade states to implement basic payment control policies and procedures. In addition, while completing the annual budget process, Labor could prioritize additional administrative funding to states to help them achieve or surpass agreed upon payment accuracy performance levels.[23] However, we found that Labor is only using such tools to a limited degree to help states enhance their program integrity activities.

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[20] This system, called "UI Performs," was developed with input and coordination from the states. The system incorporates more than 70 performance measures to gauge states' performance, including the timeliness, quality, and accuracy of benefit decisions.

[21] The national minimum performance criteria are performance measures that are applied uniformly to all states.

[22] See 29 C.F.R. 97.43.

[23] See 20 C.F.R. 601.6.

Labor Has Not Fully Utilized Its Quality Assurance Data to Improve State Operations

Labor has also been reluctant to use its quality assurance data as a management tool to encourage states to place greater emphasis on program integrity. According to an internal agency performance report and Labor officials, quality assurance data should be used to identify vulnerabilities in state program operations, measure the effectiveness of efforts to address these vulnerabilities, and help states develop mechanisms that prevent overpayments from occurring.[24] However, as currently administered, Labor's quality assurance system does not achieve all of these objectives. In particular, Labor lacks an effective mechanism to link its quality assurance data with specific improvements that are needed in states' operations. For example, over the last decade, payment errors due to unreported income have consistently represented between 20 and 30 percent of annual UI overpayments. While Labor's quality assurance system has repeatedly identified income reporting as a vulnerable area, it has not always played an active role in helping states develop specific strategies for improving their performance in this area. Of particular concern to us is that the overpayment rate for the nation has shown little improvement over the last 10 years. This suggests that Labor and some of the states are not adequately using quality assurance data to address program policies and procedures that allow overpayments to occur.

Labor Gives Inadequate Attention to Overpayment Recoveries

Finally, Labor has given limited attention to overpayment collections. Currently, Labor requires states to collect at least 55 percent of all the overpayments they establish annually through their benefit payment control operations. This 55 percent performance target has not been modified since 1979 despite advancements in technology over the last decade, such as automatic state tax refund intercepts, that could make overpayment recovery more efficient. At the time of our review, only 34 out of 53 states met or exceeded the minimum standard of 55 percent. A small number of federal and state officials told us that states tend to devote the minimum possible resources to meet it each year. However, our work shows that Labor has not actively sought to improve overpayment collections by requiring states to incrementally increase the percentage of overpayments they recover each year.

Labor is Taking Actions To Improve Program Integrity

At the time of our review, Labor was continuing to implement a series of actions to help states with the administration of their UI programs. For example, Labor is helping states use the Information Technology Support Center (ITSC) as a resource for states to obtain technical information and best practices for administering their UI programs.[25]

Labor also provides technical assistance and training for state personnel, as well as coordination and support for periodic program integrity conferences. In its annual budget justification, Labor has requested a limited amount of funding for the states for program integrity purposes, such as $35 million in fiscal year 2001 for states to improve benefit overpayment detection and collection, eligibility reviews, and field tax audits. More recently, Labor has been developing a new payment accuracy indicator in its Annual Performance Plan for fiscal year 2003 for the states' UI programs that will establish a baseline measurement for benefit payment accuracy during 2002. Labor also plans to provide states with additional quality assurance data on the nature and cause of overpayments to help them better target areas of vulnerability and identify more effective means of preventing overpayments.

At the time of our review, Labor was also developing a legislative proposal to give state employment security agencies access to the NDNH to verify UI claimants' employment and benefit status in other states. Our analysis suggests that use of this data source could potentially help states reduce their exposure to overpayments. For example, if the directory had been used by all states to detect claimants' unreported or underreported income, it could have helped prevent or detect hundreds of millions of dollars in overpayments in 2001 alone.[26] In addition, Labor is working to develop an agreement with the Social Security Administration that would grant states access to SSA's SOLQ system. States that used this system would be able

[24] See Department of Labor, Employment and Training Administration, UI Performs 2000 Annual Report, p.9.

[25] ITSC is a collaborative effort involving the Department of Labor, state employment security agencies, private sector organizations, and the state of Maryland. It was created in 1994 to help states adopt more efficient, timely, and cost-effective service for their unemployment service claimants.

[26] This assumes that the top two categories of overpayments ("benefit year earnings" and "base period wages") were substantially reduced or eliminated by use of the NDNH.

to more quickly validate the accuracy of each claimant's SSN and identity at the time of application for UI benefits.

Conclusions

Despite the various efforts by Labor and some states to improve the integrity of the UI program, problems still exist. The vulnerabilities that we have identified are partly attributable to a management approach in Labor and many states that emphasizes quickly processing and paying UI claims without a similar focus on controlling program payments. While we recognize the importance of paying unemployed individuals in a timely manner, this approach has likely contributed to the consistently high level of overpayments over time, and as such, may have increased the burden placed on some state UI trust funds. As the number of UI claimants has risen over the last year, many states have felt pressured to quickly process and pay additional claims. The results of our work suggest that, in this environment, overpayments are not likely to abate and could increase.

Labor is taking some steps to improve UI program integrity by helping enhance existing state operations, such as working to obtain access to important data sources. Our prior work suggests that using more front-end automated data sources to verify claimant eligibility before overpayments are made is a more efficient method of protecting program funds than trying to recover overpayments after they have occurred. In the case of the UI program, access to data sources such as the NDNH or WRIS could help states reduce overpayments caused by unreported income, which accounts for more than one-third of the overpayments in 2001. However, absent a change in the current approach to managing the UI program at both the federal and state level, it is unlikely that the deficiencies we identified will be sufficiently addressed. In particular, without more active involvement from Labor in emphasizing the need to balance payment timeliness with payment accuracy, states may be reluctant to implement needed changes in their management philosophy and operations. With increased emphasis on payment accuracy, Labor's system of performance measures could help encourage states to place a higher priority on program integrity activities. Moreover, an effective strategy to help states control benefit payments will also require use of its quality assurance data to identify areas for improvement and work with the states to implement changes to policies and procedures that allow overpayments to occur. However, Labor must be willing to link state performance in the area of program integrity to tangible incentives and disincentives, such as through the annual administrative funding process. Ultimately, a coordinated effort between Labor and the states is needed to address the weaknesses we have identified and reduce the program's exposure to improper payments. Without such an effort, Labor risks continuing the policies and procedures that have contributed to consistently high levels of UI overpayments over the last decade.

Mr. Chairman, this concludes my prepared statement. I will be happy to respond to any questions you or other members of the Subcommittee may have.

GAO Contact and Staff Acknowledgments

For information regarding this testimony, please contact Sigurd R. Nilsen, Director, Education, Workforce, and Income Security Issues, at (202) 512–7215. Individuals who made key contributions to this testimony include Daniel Bertoni, Jeremy Cox, Cheryn Powell, and Salvatore Sorbello.

Related GAO Products

Workforce Investment Act: Improvements Needed in Performance Measures to Provide a More Accurate Picture of WIA's Effectiveness. GAO–02–275 Washington, D.C.: February 1, 2002.

Strategies to Manage Improper Payments: Learning from Public and Private Sector Organizations. GAO–02–69G. Washington, D.C.: October 2001.

Department of Labor: Status of Achieving Key Outcomes and Addressing Major Management Challenges. GAO–01–779. Washington, D.C.: June 15, 2001.

Unemployment Insurance: Role as Safety Net for Low-Wage Workers is Limited. GAO–01–181. Washington, D.C.: December 29, 2000.

Benefit and Loan Programs: Improved Data Sharing Could Enhance Program Integrity. GAO/HEHS–00–119. Washington, D.C.: September 13, 2000.

Supplemental Security Income: Action Needed on Long-Standing Problems Affecting Program Integrity. GAO/HEHS–98–158. Washington, D.C.: September 14, 1998.

Supplemental Security Income: Opportunities Exist for Improving Payment Accuracy. GAO/HEHS–98–75. Washington, D.C.: March 27, 1998.

Supplemental Security Income: Administrative and Program Savings Possible by Directly Accessing State Data. GAO/HEHS–96–163. Washington, D.C.: August 29, 1996.

Chairman HERGER. Thank you, Dr. Nilsen. Now, Mr. Heddell will testify.

STATEMENT OF HON. GORDON S. HEDDELL, INSPECTOR GENERAL, OFFICE OF INSPECTOR GENERAL, U.S. DEPARTMENT OF LABOR

Mr. HEDDELL. Good afternoon, Mr. Chairman and Members of the Subcommittee. Thank you for inviting me to testify today in my capacity as the Inspector General of the U.S. Department of Labor. I am pleased to discuss my office's assessment of the integrity of the Unemployment Insurance program.

Preserving the integrity of the UI program has been a longstanding concern of the Office of Inspector General (OIG). Our investigative casework and audits show that the program remains vulnerable to fraud, waste, and abuse, which result in millions in losses to the UI trust fund. Based on this body of work, we believe that more can be done by the DOL to strengthen the integrity of the program.

From an investigative perspective, we have focused on three types of unemployment insurance schemes involving fictitious or fraudulent employers, internal embezzlement, and identity theft.

Mr. Chairman, a fictitious employer scheme involves the creation of a company that exists only on paper with no actual employees, business operations, or cash outlays for taxes. In many of these cases, the individuals will operate in multiple States and include family, friends, or others who have been recruited to assume false identities in order to collect UI benefits.

Conversely, a fraudulent employer scheme usually involves a legitimate business with employees and valid business expenses. However, the employer actively engages in fraudulent activity, such as allowing non-employees to file claims against their company in exchange for a cut of the claimants' benefits.

In one illustrative case, an individual used 13 fictitious companies and 36 fictitious claimants, using names and Social Security numbers of deceased persons, to collect over $135,000 in UI benefits from California, $65,000 from Massachusetts, $16,000 from Nevada, and $15,000 from Texas.

Another type of scheme involves fraud and embezzlement committed by State personnel who administer the UI program. These schemes vary in complexity. A simple fraud arrangement may be the acceptance of a payoff by a State employee in exchange for approving an unauthorized UI claim. These arrangements, however, can mushroom into operations involving multiple individuals when State employees work with outside employers to certify false employment information. An illustration involves a New Jersey State employee who defrauded the State of $325,000 over a 7-year period by sending false wage and employment information to local unemployment offices to verify the employment of as many as 30 co-conspirators. In return, he received half of his co-conspirators' UI benefit checks.

Identity theft schemes are another means of defrauding the program. Under this type of scheme, individual identities are stolen to apply for UI benefits. In one case, a California man orchestrated

and then used an identity theft scheme designed to obtain UI benefits by filing over 30 fraudulent claims totaling more than $130,000. The stolen identities were obtained from customer transaction receipts printed by a Los Angeles public employees' credit union.

Mr. Chairman, in addition to these types of fraud schemes, there are internal control weaknesses and other vulnerabilities that impact the integrity of the UI system that we have identified. They include the DOL's ability to detect, recover, and reduce, overpayments; the misuse of administrative grant funds by States; the misclassification of workers and its impact on employers' payment of UI taxes; and the vulnerabilities created by telephone and Internet claims systems now in place by most States.

With respect to overpayments, we are concerned that the BAM system, which uses statistical sampling techniques to project the total UI benefit overpayments made, is not being utilized to reduce the number of overpayments.

In addition, we are concerned about the cross-matches conducted by States as part of their benefit payment control activities. States cross-match weekly UI benefit records with quarterly wage records in order to detect possible overpayments. An inherent weakness in this process is that States must rely on employers to provide detailed wage information. Our audit of seven States found that many employers failed to submit this information for a variety of reasons. As a consequence, we estimated $17 million in overpayments were not being detected in four of the seven States.

Mr. Chairman, another area of concern involves the use of UI administrative grant funds, which are issued to the States for the cost of processing unemployment claims, collecting UI taxes, and other activities. In just three OIG audits, we questioned costs of nearly $20 million related to improper uses of these funds.

Our work has also disclosed that not all employers voluntarily pay their fair share of UI taxes. Some employers intentionally misclassify their employees as independent contractors in order to hide the wages they pay out, or will utilize employee leasing companies in order to avoid paying benefits or taxes. Such activities result in lost contributions to State UI trust funds.

Finally, we are concerned about the unintended consequences that remote claims filing may have on the integrity of the program. Based on our audits and investigative casework, the OIG has made several recommendations to the DOL and the Congress for strengthening and enhancing the integrity of the UI program. Among our recommendations is the need to grant the OIG and the DOL unimpeded access to unemployment insurance, Social Security, and new hire data for fraud detection and program evaluation purposes, to enhance fraud detection and investigative training for State personnel, and to improve the UI cross-match system for detecting overpayments.

In conclusion, Mr. Chairman, my office will continue to provide oversight and conduct investigations to ensure that the UI program operates effectively and efficiently and that benefits go to only those who are eligible.

This concludes my statement, and I would be pleased to answer any questions you or any other Subcommittee Members may have. Thank you.

[The prepared statement of Mr. Heddell follows:]

Statement of the Hon. Gordon S. Heddell, Inspector General, Office of Inspector General, U.S. Department of Labor

Good afternoon, Mr. Chairman and Members of the Subcommittee. Thank you for inviting me to testify today in my capacity as the Inspector General of the U.S. Department of Labor. I am pleased to discuss my Office's assessment of the integrity of the Unemployment Insurance (UI) program. The views I express this afternoon may not be representative of those of the Department.

Administration and Oversight of the UI Program

Mr. Chairman, as you know, the UI program is vital in ensuring the financial security of America's workforce. This multi-billion dollar entitlement program, administered through a unique Federal-State partnership, provides temporary financial assistance to workers who lose their jobs through no fault of their own. Benefits are paid out so long as workers meet certain eligibility requirements. Funding for these benefits comes from employer taxes deposited into the Unemployment Trust Fund. States are primarily responsible for the collection of these taxes and the payment of benefits through State Workforce Agencies (SWAs), while the Department is charged with ensuring that states comply with applicable laws and regulations, and with providing oversight, policy guidance, and technical assistance to the states.

In addition to the Department, the OIG has certain oversight responsibilities regarding the UI program. Preserving the integrity of the UI program has been a long-standing concern of the OIG. Our investigative casework and audits show that the UI program remains vulnerable to fraud, waste and abuse, which result in millions in losses to the UI trust fund. We conduct periodic audits of the program that look at internal controls and program integrity, among others. We also engage in casework that identifies complex interstate UI fraud schemes, as well as single claimant fraud cases committed by federal employees or ex-military personnel. Based on this body of work, we believe that more can be done by the Department to strengthen the integrity of the UI program. We have highlighted UI program integrity as one of the top management issues facing the Department. Congress also recognized the importance of improving the integrity of the UI program in a 2001 report on Government mismanagement, as well as OMB in a report released last month on erroneous payments.

Fraud Against the UI Program

As with any multi-billion dollar benefit payment program, the UI program is vulnerable to fraud and abuse. We have focused our UI investigative activities on three types of schemes: 1) fictitious or fraudulent employer schemes; 2) internal embezzlement schemes; and 3) identity theft or imposter schemes. I will elaborate on each of these areas.

Fictitious/Fraudulent Employer Schemes

Mr. Chairman, a fictitious employer scheme involves creating a company that exists only on paper with no actual employees, business operations, cash outlays for taxes or any other normal business expenses. The intent is to have in place a company that is used to file fraudulent claims. In many of these cases, the individuals will operate in multiple states and include their family and friends, or individuals who have been recruited to assume false identities in order to collect UI benefits. Conversely, a fraudulent employer scheme usually involves a legitimate business with employees and valid business expenses. However, the employer actively engages in fraudulent activity such as laying off workers, only to return them to work under a cash system, or allowing non-employees to file claims against the company in exchange for part of the claimants' benefits. Unfortunately, mail, telephone, and Internet claims filing, which are designed to make the program run more effectively, can have the unintended effect of facilitating these types of schemes because they eliminate the need to fill out UI forms in person. In one case that is illustrative of how these schemes can result in significant losses to the UI program, an individual used 13 fictitious companies and 36 fictitious claimants using names and Social Security numbers of deceased persons to collect over $135,000 from California, approximately $65,000 from Massachusetts, $16,000 from Nevada, and over $15,000

from Texas. The individual submitted fraudulent interstate UI claims based on false reported wages, and then collected the benefit checks from various locations based on claims filed by mail.

Internal Embezzlement Schemes

Fraud and embezzlement of UI funds by state personnel who administer the program is another problem in the UI system. These schemes vary in complexity. A simple fraud scheme may be the acceptance of a payoff by a state UI employee in exchange for the approval of an unauthorized UI claim. These schemes, however, can mushroom into operations involving multiple individuals when state UI employees work with outside employers who certify false employment information. We believe that advanced technology, which has consolidated certain tasks into a single job that once had been handled by several people, has had the unintended effect of facilitating this type of fraud since it has eliminated certain controls by reducing the levels of peer review and supervisory oversight in UI offices. An illustration of this type of internal embezzlement involves a New Jersey state employee who sent false wage and employment information to local unemployment offices to verify the employment of as many as 30 co-conspirators. The scheme consisted of registering four fictitious companies with New Jersey for the purpose of "employing" his co-conspirators. The individual and his co-conspirators filed false UI applications claiming that they had been laid off from these companies and thus entitled to benefits. The state employee then verified their employment with UI offices and used a false name to disguise his involvement. In return, he received half of the co-conspirators' UI benefit checks.

Identity Theft or Imposter Schemes

Fraud against this program has also been carried out through identity theft. Under this type of scheme, individual identities are stolen and then used to apply for UI benefits. Identity theft victims are usually unaware that someone is using their identity. Unfortunately, fraud detection in these cases is complicated because any preliminary fraud screening that may be done would disclose that the employer and employee actually exist. An example of how such a scheme can operate involves our investigation of a California man who orchestrated an identity theft scheme designed to obtain UI benefits by filing over 30 fraudulent claims totaling more than $130,000. The stolen identities were obtained from customer transaction receipts printed by a Los Angeles public employees' credit union. This credit union, like others, uses Social Security numbers as customer account numbers. Victims of the scheme included 18 Los Angeles City and two Los Angeles County employees. The individual used the UI system to create fictitious employers and had the benefit checks sent to his home. Assisted by his girlfriend, he would then deposit the fraudulent UI checks into bank accounts that he controlled.

Internal Control Weaknesses and Other Vulnerabilities in the UI Program

Mr. Chairman, in addition to fraud schemes, there are a number of internal control weaknesses and other vulnerabilities that impact the integrity of the UI system. Over the years, OIG work has also identified weaknesses or vulnerabilities relative to: 1) overpayment detection, recovery and reduction; 2) misuse of administrative grant funds by states; 3) misclassification of workers and its impact on employers' payment of UI taxes; and 4) vulnerabilities created by telephone and Internet claims systems now in place by most states. In our opinion, these weaknesses can be compounded by the program's requirements that timely benefit payments be provided to unemployed workers.

Overpayment Detection, Recovery and Reduction

With respect to overpayments, Mr. Chairman, the OIG is concerned about the efficiency and effectiveness of the Department's activities to detect, recover, and reduce UI benefit overpayments. The Department funds two systems that measure UI benefit overpayments. The Benefit Accuracy Measurement (BAM) system uses statistical sampling techniques to project the total UI benefit overpayments made. The Benefit Payment Control (BPC) system at each state identifies and investigates benefit overpayments, establishes receivables, and collects overpayments.

Benefit Accuracy Measurement System

As part of our audit of the DOL FY 2001 financial statements, we noted that the BAM system projected overpayments of $2.3 billion for FY 2001. For the same period, actual overpayments identified by BPC totaled $669 million, or just one-third of the amount estimated by BAM activities. We also noted that overpayment rates

projected by BAM have remained relatively flat at approximately 8.5 percent over the past 12 years. This raises a concern that the BAM system is not being utilized to reduce the amount of overpayments.

To examine these seemingly divergent results more closely, the OIG is performing an audit of the Department's oversight role regarding UI benefit overpayments. Our ultimate objective is to assess BAM results and identify how the system can best be utilized to reduce the amount of overpayments.

Benefit Payment Control System

As part of their BPC activities, states routinely conduct crossmatches to compare weekly UI benefit payment records with quarterly wage records reported by employers in order to detect possible overpayments. When claimants are identified with both UI benefits and wages for the same period, a potential UI overpayment case is developed. This has historically been the most effective overpayment detection tool used by the states. However, a 1999 audit we conducted of the crossmatch systems in seven states—Illinois, Texas, California, New Jersey, Maryland, Kentucky and Florida—showed inherent weaknesses in this fraud detection method. Foremost among these weaknesses was the failure of employers to respond to the states' requests for detailed wage information. This information is critical because it provides specific information as to how much the claimant earned on a weekly basis, which states can then use to determine if an overpayment has occurred. As a consequence, we estimated $17 million in overpayments were not being detected in four of the seven states we audited. Many employers failed to respond because they either misunderstood the purpose of the request or were confused over who should respond.

To improve the UI benefit-wage crossmatch overpayment system, we recommended that:

- ETA provide policy guidance and direction to the SWAs to ensure that employers are reminded of their responsibility to respond to wage requests, and that adequate follow-up routinely occurs for those who fail to respond, particularly those with the highest potential for overpayments.
- ETA assume a leadership role in assuring that SWAs obtain timely access to the data of the National Directory of New Hires, established under the welfare reform legislation, and to fully incorporate that data into UI Benefit Payment Control operations.

ETA has agreed to take corrective action, and we will work with them to ensure that they implement our recommendations.

The Use of UI Administrative Grant Funds by States

Mr. Chairman, another area of concern involves the use of UI administrative grant funds. These funds are issued to the states for the costs of processing unemployment claims, collecting UI taxes, and all necessary related activities. State funding is based on the cost of proper and efficient administration and such other factors as the Secretary deems appropriate. In just three audits, we identified questioned costs of nearly $20 million related to improper uses of UI administrative grant funds. Included in the amount of questioned costs we identified were unallowable charges for direct and indirect costs, overcharges for state automatic data processing and information technology central service costs, and un-allocable maintenance and operating expenses relating to building space occupied by non-SWA personnel. Amid SWA complaints that administrative funding is inadequate, the inefficiency identified by our audits points to the need for more careful use of current funding to allow more to be done to enhance quality control and other essential functions.

Misclassification of Workers and Lost Contributions to State UI Trust Funds

Our work has also disclosed that not all employers voluntarily pay their fair share of UI taxes. Some employers intentionally misclassify their employees as independent contractors in order to hide the wages they pay out in order to avoid paying benefits or taxes. Employee leasing companies are another method used to avoid paying taxes. These companies lease workers back to client firms, serving as the employer of record for purposes of UI tax payments and experience-rating calculations. Losses to UI trust funds occur when companies purchase an inactive or defunct company that has few or no employees and very low tax rates. Upon purchasing this "shell" company, the employee leasing company obtains that company's lower UI rate and transfers employees from other affiliated entities to the lower UI tax-rated shell company, thereby avoiding higher taxes. This undermines the state's experience rating system, which is designed to assess UI tax rates based on an individual employer's history of UI tax assessments paid, versus benefits charged.

To combat these activities, SWAs rely on field audits to determine whether employers are reporting all UI-covered wages and paying their fair share of UI taxes. In March 1999, we reviewed the field audit practices of 12 states. We determined that if states adopted some of the best practices used by the top performing states, the identification of non-compliant employers could be improved. Among the best practices we found were: 1) selecting a significant percentage of employers based on Standard Industrial Classification codes that identify employers with the highest probability for non-compliance; and 2) implementing a blocked claims audit program that encourages the conversion of field audit investigations into audits. In response to the latter recommendation, ETA revised its reporting instructions to permit states to take credit for blocked claims audits. As a result of our audit, almost $16 million in additional taxes have been recovered as a result of ETA's implementation of our recommended actions.

Telephone and Internet Claims Systems

Over the last several years, almost all states have moved from traditional in-person claims services to telephone or Internet claims services, or both to improve the delivery of services. Shifting to remote claims filing via the telephone or Internet has reduced administrative costs for states, and users have cited the convenience, ease, and privacy it provides. However, we are concerned that as remote claims filing increases, the ability of states to monitor the integrity of the claims-filing process will be eliminated. Reducing or eliminating personal contacts during the initial claims filing process removes a first-line defense against fraud schemes. In addition, electronic claims filing effectively enlarges the potential universe of identity theft victims, and makes it easier to initiate multiple state schemes from a single location. We are concerned that this type of activity will only increase absent up-front identity or eligibility verification, or the implementation of proper controls and safeguards.

Current and Future OIG Work in the UI Program

Mr. Chairman, the OIG will continue to engage in proactive investigative casework, audits, and evaluations designed to improve the integrity of the UI program. The following is a brief description of our planned work in this area.

In FY 2003, we plan to conduct a comprehensive, nationwide initiative to help safeguard the integrity of the UI program. Our initiative will focus on identifying systemic weaknesses that make the program vulnerable to fraud and overpayments; identifying and disseminating information on best practices used by the states to detect fraud; and determining if UI administrative funding is used to its maximum effect. Specifically, we will continue to expand our investigative efforts to detect and investigate interstate, fraudulent employer schemes used to defraud the program. We will also continue to audit the Department's oversight role regarding UI benefit overpayments, and will follow up on our earlier audits that highlighted excessive charges by the Treasury Department to the UI trust fund to pay for the IRS' costs of administering the fund. Finally, we will begin looking into issues related to the solvency of state UI trust funds and how states have been using the $8 billion in Reed Act distributions they received in March.

Recommendations for Strengthening the UI Program

Based on our audits and investigative casework, the OIG has made several recommendations to the Department and the Congress for strengthening and enhancing the integrity of the UI program. Among our recommendations is the need to:

- Grant the OIG and the Department unimpeded access to UI, Social Security, and New Hire data for fraud detection and program evaluation purposes

  The OIG and the Department needs efficient access to data that is maintained by other agencies such as state UI and Social Security wage records; and wage data contained in databases such as the National Directory of New Hires. Such data would be used for two primary purposes: 1) to aid in our fraud detection and investigative efforts; and 2) to better help us and the Department assess program performance and return-on-investment. If we had routine and expeditious access to the centralized Social Security wage database, we could more efficiently and consistently verify eligibility of program applicants and whether their Social Security numbers are valid. This would aid in identifying potential overpayments and preventing millions of dollars in future losses.

- Enhance fraud detection and investigative training for state personnel

  In order to better detect fraud and abuse, state personnel who are responsible for benefit payment control, tax, and internal security need to be provided high-quality, consistent training. Any training should focus on fraud prevention and detection, information sharing regarding common fraud schemes, and dissemination of best practices used by the states. This transfer of knowledge will assist the states in their efforts to improve their enforcement and oversight capabilities.

- Improve the UI benefit-wage crossmatch overpayment system

  Although ETA has distributed to the states our 1999 audit report on the UI benefit-wage crossmatch overpayment system, ETA should implement a corrective action plan to address our findings and recommendations in order to detect the millions in overpayments that are being missed.

Conclusion

In conclusion Mr. Chairman, the UI program provides financial assistance to workers who lose their jobs through no fault of their own. It is vital, therefore, that the UI program function effectively and efficiently, and that UI benefits only go to those who are eligible to receive these benefits. My Office will continue to provide oversight and conduct investigations to this end. This concludes my full statement. I would be pleased to answer any questions you or any other Subcommittee Members may have.

Chairman HERGER. Thank you very much, Mr. Heddell. Now, Dr. Woodbury to testify.

STATEMENT OF STEPHEN A. WOODBURY, PH.D., PROFESSOR OF ECONOMICS, MICHIGAN STATE UNIVERSITY, EAST LANSING, MICHIGAN, AND SENIOR ECONOMIST, W.E. UPJOHN INSTITUTE FOR EMPLOYMENT RESEARCH

Dr. WOODBURY. Thank you, Mr. Chairman. The integrity of the unemployment insurance system has three aspects: Whether workers receive more benefits than they are entitled to under the law, whether workers receive less than they are entitled to under the law, and whether employers pay the taxes that they are obligated to pay under the law.

The UI overpayments have been tracked by the DOL since 1987 with the Benefit Accuracy Measurement system, or BAM program. In addition, the DOL is now implementing a Denied Claims Accuracy, or DCA program, to track the extent to which UI claims are incorrectly or wrongfully denied and, therefore, result in underpayment. To date, the only information on the extent of underpayments from incorrectly denied claims comes from a pilot study that the DOL conducted with the cooperation of five States in 1997–1998.

Regarding employer compliance, the DOL appears to have no immediate plans to implement a revenue quality control program, although it has discussed this in the past. Such a program would track the degree of compliance with the unemployment insurance payroll tax. Information does exist on the extent of employer compliance from one study that was conducted in Illinois in 1987.

My testimony focuses on findings from the Denied Claims Accuracy pilot study from 1997–1998 and about the extent of UI overpayments and underpayments that can be gleaned from that study. My hope is that by combining the DCA pilot data with the BAM data from the same States in the same time period, I can give you

a slightly more complete picture of UI overpayments and underpayments than BAM alone can give.

In my written testimony, I provide some background on how BAM and the DCA programs work. Briefly, under the BAM program, each State randomly samples a predetermined number of benefit payments each week and investigates each of those payments to determine whether the payment was proper. Investigations are performed by telephone and in person with the claimant, employers, and third parties in order to determine whether the payment complied with the laws and policies of the State.

In addition to giving estimates of overpayments, BAM yields estimates of the extent of underpayments made on paid claims. That is, an investigator may find that a payment was less than it should have been, and this will be recorded and reported. The BAM program has no way of estimating underpayments that result from UI claims that should have been paid, but were denied wrongfully.

The DCA program fills this main gap in the BAM program by drawing and investigating random samples of UI claims that were denied. Now, a UI claim can be denied for any of three broad reasons. It may fail the State's monetary eligibility criteria, that is, the worker may not have enough earnings in the base period. It may fail to meet the State's separation eligibility criteria, if a worker quits or is discharged, for example, rather than being laid off for lack of work. Or, the claim may fail to meet the non-separation eligibility criteria, meaning the worker may not have been able, available, and searching for work.

So, in both the denied claims pilot project 1997–1998 and the Denied Claims Accuracy program that is now starting, States drew or are drawing three random samples for monetary, separation, and non-separation denials and investigating each of those in a manner similar to the BAM.

Now, the findings of the Denied Claims Accuracy pilot project are displayed in table 1 of my written testimony. Just briefly, the five States that participated were Nebraska, New Jersey, South Carolina, West Virginia, and Wisconsin. These are the only States and the only time period for which data exists on the extent of underpayments caused by incorrect denials in addition to underpayments on paid claims and all types of overpayments.

Column two of the table shows that overpayments as a percentage of UI benefits paid ranged between 2.2 and 12 percent in those five pilot States that I mentioned, with a weighted average of 7-percent, roughly, in those States. That 7 percent average is a little below the national average overpayment rate of 8.6 that BAM found. So the pilot States seem to be fairly representative. They are slightly more accurate.

The BAM has found repeatedly that the main reason for these overpayments are three: Workers failing to report all or part of their earnings while they are claiming benefits; violations of the separation criteria, meaning simple error, generally, on the part of the agency; and workers failing to search for work as required by State law.

Column three shows the underpayments on paid claims that come from BAM. They are relatively low, one-half of 1 percent to 1.2 percent, with an average of 1 percent.

Column four is what is unique to the DCA pilot study. It shows that underpayments caused by wrongful denials range from 1.5 to 9 percent of total UI benefits paid in the five pilot States, with a weighted average of 3.4 percent. The underlying causes of underpayments vary with the type of wrongful denial, but employer underreporting of wages is the main cause of the wrongful monetary denials. Simple agency error is the main cause of wrongful separation and non-separation denials.

Now, how closely these five pilot States resemble the rest of the United States in their underpayments due to wrongful denials is unknown, but applying the average weight of underpayments caused by wrongful denials to the entire Nation suggests that the benefits lost from wrongful denials during fiscal year 1998 were in excess of $635 million.

Column five shows the sum of underpayments on unpaid claims and underpayments from wrongful denials. A comparison shows that in one State, underpayments actually exceed overpayments. In two, overpayments exceed underpayments, but by less than 33 percent. In the remaining two States, overpayments exceed underpayments more substantially. Over all in the five States, overpayments exceed underpayments by about 64 percent. That is, a dollar of underpayment is outmatched by about $1.64 of overpayment. This excess of overpayments relative to underpayments is substantially less than the picture that emerges if one examines the BAM data alone, and that would suggest that overpayments exceed underpayments by seven times or more.

I can see I am out of time, so I will end my statement there. Thank you.

Chairman HERGER. Thank you very much, and again, the rest of your comments can be submitted for the record.

Dr. WOODBURY. Yes.

Chairman HERGER. Thank you, Dr. Woodbury.

Dr. WOODBURY. Thank you.

[The prepared statement of Dr. Woodbury follows:]

Statement of Stephen A. Woodbury[1], Ph.D., Professor of Economics, Michigan State University, East Lansing, Michigan, and Senior Economist, W.E. Upjohn Institute for Employment Research

Unemployment Insurance Overpayments and Underpayments

The integrity of the Unemployment Insurance (UI) system has three aspects: whether workers, fraudulently or otherwise, receive more benefits than they are entitled to under the law, whether workers receive less than they are entitled to under the law, and whether employers pay the taxes that they are obligated to pay under the law (Skrable 1999).

UI overpayments have been tracked by the Labor Department since 1987 with the Benefit Accuracy Measurement (**BAM**) program. As a result, much is known about overpayment of UI benefits (see any of the UI PERFORMS Annual Reports published by the U.S. Department of Labor; for example, U.S. Department of Labor 1998, 1999).

In addition, the Department is now implementing a Denied Claims Accuracy (**DCA**) program to track the extent to which UI claims are incorrectly (or wrongfully) denied and therefore result in underpayments. To date, the only information on the extent of underpayments from incorrectly denied claims comes from a pilot study that the Department conducted with the cooperation of five states in 1997–98 (Woodbury and Vroman 1999, 2000).

[1] Opinions expressed are the author's.

Regarding employer compliance, the Department appears to have no immediate plans to implement a Revenue Quality Control program that would track the degree of compliance with the UI payroll tax. However, information on the extent of employer compliance does exist from a study conducted in Illinois in 1987 (Blakemore, Burgess, Low, and St. Louis 1996; Burgess, Blakemore, and Low 1998; see below).

This testimony focuses on findings about the extent of UI overpayments and underpayments from the five-state DCA pilot study of 1997–98. Combining the DCA pilot data with BAM data from the same states and time period gives a more complete picture of UI overpayments and underpayments—and hence of the UI program's integrity—than BAM alone can give.

How the Bam and DCA Programs Work

Under the BAM program, each state randomly samples a predetermined number of benefit payments each week (between 9 and 35, depending on the size of the state) and investigates each of those payments to determine whether the payment was proper. Investigations are performed by telephone and in-person with the claimant, employers, and third parties in order to to determine whether the payment complied with the laws and policies of the state. Because BAM randomly samples paid claims, the Department can estimate, on an annual basis, total overpayments in each state and nationally.

In addition to giving estimates of overpayments, BAM yields estimates of the extent of underpayments made *on paid claims.* That is, an investigator may find that a payment was less than it should have been, and this will be recorded and reported. However, BAM has no way of estimating underpayments that result from UI claims that should have been paid but were denied. BAM only samples and investigates UI payments; no payment exists when a claim is denied.

The DCA program fills the main gap in the BAM program by drawing and investigating random samples of UI claims that were denied. A UI claim can be denied for any of three broad reasons:

- The claim may fail to meet the state's **monetary eligibility criteria**; that is, the worker may not have earned enough during roughly the year before claiming benefits. This is a monetary denial.
- The claim may fail to meet the state's **separation eligibility criteria**; that is, the worker may have quit or been discharged for cause rather than being laid off due to lack of work. This is a separation denial.
- The claim may fail to meet the state's **nonseparation eligibility criteria**; that is, the worker may not have been able, available, and searching for work during the week in question. This is a nonseparation denial.

Accordingly, in both the DCA Pilot Project of 1997–98 and the DCA program that is now starting, states drew (or draw) three separate random samples—one of monetary denials, a second of separation denials, and a third of nonseparation denials. Each of these is investigated in a manner similar to that used to investigate paid claims under BAM, and the correctness of the denial is determined.

Findings from Five-State Pilot Project

Table 1 displays UI overpayments and underpayments for 1997–98 in the five states that participated in the DCA Pilot Project—Nebraska, New Jersey, South Carolina, West Virginia, and Wisconsin. These are the only states (and the only time period) for which data exist on the extent of underpayments caused by incorrect denials, in addition to underpayments on paid claims and all types of overpayments.

Column 2 shows that overpayments as a percentage of total UI benefits paid ranged between 2.2 and 12 percent in the five pilot states, with a weighted average of 7.2 percent in those states. This is slightly below the national average overpayment rate of 8.6 percent. The BAM reports show that the main reasons for these overpayments are (1) workers failing to report all or part of their earnings while claiming benefits, (2) violations of the separation eligibility criteria, and (3) workers failing to search for work as required by state law and policy.

Column 3 shows that underpayments on paid claims (again as a percentage of total UI benefits paid) ranged from 0.5 to 1.2 percent in the five pilot states, with a weighted average of 1.0 percent. This was very close to the national average underpayment rate of 0.9 percent.

Column 4 shows that underpayments caused by wrongful denials ranged from 1.4 to 9.0 percent of total UI benefits paid in the five pilot states, with a weighted average of 3.4 percent. The DCA reports show that wrongful monetary denials account for 39 percent of these underpayments, wrongful separation denials account for 36 percent, and wrongful nonseparation denials account for 25 percent. Also, the under-

lying causes of underpayments vary with the type of wrongful denial: Employer underreporting of wages is the main cause of wrongful monetary denials; agency error is the main cause of wrongful separation and nonseparation denials.

How closely the five pilot states resemble the rest of the United States in underpayments due to wrongful denials is unknown; however, applying the average rate of underpayments caused by wrongful denials to the entire nation suggests that benefits lost from wrongful denials during fiscal year 1998 were in excess of $635 million.

Column 5 shows the sum of underpayments on paid claims and underpayments from wrongful denials. A comparison of columns 5 and 2 shows that in one state (Nebraska) underpayments exceed overpayments. In two (West Virginia and Wisconsin) overpayments exceed underpayments by less than 33 percent. In the remaining two states (New Jersey and South Carolina) overpayments exceed underpayments more substantially. In the five pilot states overall, overpayments exceed underpayments by about 64 percent; $1.00 of underpayment is outmatched by $1.64 of overpayment. This excess of overpayments relative to underpayments is substantially less than the picture that emerges if one examines only the BAM data, which would suggest that overpayments exceed underpayments by 7 times or more. A view of the UI system's integrity that focuses only on paid claims (as BAM does) and that neglects the accuracy of denials is quite incomplete.

Implications

Because the BAM program samples and investigates only paid claims, BAM offers an incomplete picture of the extent of the UI program's integrity. In particular, the extent of underpayments cannot be appraised in the BAM program because BAM overlooks the correctness of denied UI claims. A denied claim never generates a payment, so it cannot be sampled under BAM. In effect, incorrectly denied claims slip under BAM's radar. The Labor Department is well aware of this point and is implementing the DCA program to fill the gap.

What can be done to improve the UI program's integrity? The UI system faces an obvious dilemma. Decisions must be made on whether to pay benefits to millions of UI claimants in a timely manner. Too much concern about overpayments is likely to result in states denying benefits to eligible claimants. Too much concern about underpayments is likely to result in states paying claimants who are in fact ineligible.

This dilemma notwithstanding, three policies would clearly improve the soundness and accuracy of the UI program. First, one of the three main reasons for overpayments is a worker's failure to search adequately for work (U.S. Department of Labor 1999). It follows that improved monitoring and enforcement of the work search test would improve the program's integrity. An obvious and direct approach would be to increase the resources available to the states to conduct eligibility review interviews. An alternative would be to expand the Worker Profiling and Reemployment Services System (WPRS), which has existed since 1994. There are good reasons for enforcing the work search test apart from UI program integrity: Available evidence suggests that workers who search more and (as a result) return to work sooner improve both their earnings and their likelihood of staying employed in the long run (Woodbury 2001).

Second, the DCA Pilot Project found that the most common reason for wrongful monetary denials is employer error—meaning essentially that an employer underreported or failed to report a worker's wages (Woodbury and Vroman 1999, 2000). Such underreporting has been documented in an extensive study involving random audits of Illinois employers (Blakemore, Burgess, Low, and St. Louis 1996). That study found that employers underreported the number of workers by over 13 percent and underreported UI taxable wages by over 4 percent. This represents a significant leakage of revenues from the system. Moreover, such underreporting has the effect of increasing the likelihood that workers will be wrongfully denied benefits because employer wage reports are the basis of determining a worker's monetary eligibility for UI benefits. A feasible and well-researched approach to mitigating this problem is to implement audits of firms that are most likely to be out of compliance with the law, as determined by a statistical model (Burgess, Blakemore, and Low 1998). Such a program would require resources, but the evidence suggests that those resources would be recovered several times over as a result of improved enforcement of the UI tax law.

Third, the DCA Pilot Project also found that the most common reason for wrongful separation and nonseparation denials is agency error—meaning an incorrect decision or action taken by UI personnel (Woodbury and Vroman 1999, 2000). In conducting the DCA Pilot Project, the project's monitors heard repeatedly that it was difficult to attract and retain qualified front-line UI personnel because the work is

difficult and the financial rewards meager compared with other available pursuits. But the accuracy of decisions about UI eligibility hinges on the skills, training, and experience of these front-line personnel. If integrity of the UI system is to improve, then more must be done to attract and retain qualified and experienced personnel. A commitment of additional resources for administering the UI system could meet this goal.

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Table 1.—Unemployment Insurance Overpayments and Underpayments in the Denied Claims Accuracy (DCA) Pilot Project States, 1997–98

State	(1) Total UI Benefits paid ($1,000s)	(2) Overpayments (as % of UI paid)	(3) Underpayments (as % of UI paid) on paid claims	(4) Underpayments (as % of UI paid) from wrongful denials	(5) Total
Nebraska	42,472	7.1	0.6	9.0	9.6
New Jersey	1,053,409	6.8	1.2	2.5	3.7
South Carolina	164,376	12.0	0.4	4.0	4.4
West Virginia	126,475	2.2	0.5	1.4	1.9
Wisconsin	465,148	7.9	0.8	5.2	6.0
Five-state total [a]	1,851,879	7.2	1.0	3.4	4.4
U.S. total	18,770,000	8.6	0.9	na	na

Sources: Columns 1, 2, and 3 are drawn from U.S. Department of Labor (1998, 1999). Column 4 is drawn from Woodbury and Vroman (1999, 2000). Column 5 is the sum of columns 3 and 4.

Note: [a] The figures in columns 2, 3, 4, and 5 are averages of the five pilot states, weighted by total UI benefits paid in each state.

Chairman HERGER. Now, Mr. Paris to testify.

STATEMENT OF MILES PARIS, DEPUTY DIRECTOR, PROGRAM SUPPORT, ILLINOIS DEPARTMENT OF EMPLOYMENT SECURITY, CHICAGO, ILLINOIS

Mr. PARIS. Thank you very much, Mr. Chairman and Members of the Subcommittee, for the opportunity to appear before you today. I apologize if some of my comments are repetitive from previous testimony.

I am here to discuss the Illinois Department of Employment Security's experience in using our State's new hire directory to detect cases in which individuals continued to claim unemployment benefits after returning to work. The directory has enabled us to reduce the amount of overpayments in many such cases, and we also believe helped in the recovery of those overpayments.

As you know, the 1996 welfare reform law required each State to have a new hire directory to strengthen its child support enforcement. When Illinois enacted legislation establishing its directory in 1997, it assigned the Department the responsibility for maintaining this directory. From the outset, the legislation authorized the Department to use the directory for unemployment insurance purposes.

Accordingly, in designing the directory, the Department incorporated an automatic cross-match with its Benefit Information System. The cross-match looks for individuals who have been reported as a new hire and continue to receive benefits after having been reported as a new hire.

When the cross-match identifies an individual who meets these criteria, the adjudication process begins. The local office in which the individual filed the claim is expected to resolve this matter within 14 days to determine whether there was an overpayment. The 14 days was a self-imposed timeframe to try to limit the amount of overpayment that was being incurred.

The Department's emphasis is on minimizing and recovering overpayments as opposed to penalizing the claimant. However, local offices will refer serious cases, for example, of repeat offenders, to the agency's Benefit Payment Control Unit for the possible institution of administrative fraud proceedings.

Prior to the institution of the new hire cross-match, the Department relied primarily on cross-matches between its benefits system and its wage record system, which is derived from employers' quarterly wage reports. We still use this wage records cross-match, and we think they are certainly still useful. However, employer wage reports are first due in the month following the close of the quarter and can take up to another month to be posted on the agency's wage record system. Consequently, a claimant could have been receiving overpayments for up to 5 months before the agency would have had a chance to discover the situation.

In contrast, the new hire reports are due within 20 days of the date of hire and posted to the system within days after receipt, at which point the cross-match occurs. By permitting early detection, new hire cross-match actually reduces the amount of overpayments. For example, for the fiscal year that just ended, the average overpayment detected by the wage record cross-match was $1,800. For the same period of time, the overpayments detected by the new hire cross match averaged $296.

We also believe that earlier detection also fosters the recovery process by enabling the Department to begin the process sooner when it is easier to find the claimant, and frequently while he or she is still employed and earning wages. The Department has recovered nearly 60 percent of the overpayments identified through the new hire cross-match since State fiscal year 1999, the first full year in which the Illinois new hire directory was operational.

While the new hire cross-match has been a substantial help in reducing and recovering overpayments, there are some holes. For example, multi-State employers may not necessarily choose to report their new hires to Illinois, which is their option, based on the law. Also, the Illinois directory will not reveal a claimant who finds work in one of Illinois' neighboring States.

Granting State unemployment insurance agencies access to the National Directory of New Hires would enable us to build upon the success we have had with the State directory and greatly assist other States. The National Association of State Work force Agencies strongly supports access to the national directory, as well. While the Subcommittee's recent TANF reauthorization package is outside the Department's jurisdiction, we greatly appreciate the fact that the package would grant us access to the national directory and look forward to working together toward that end.

Thank you for your time and attention. I would be happy to try to answer any questions.

[The prepared statement of Mr. Paris follows:]

Statement of Miles Paris, Deputy Director, Program Support, Illinois Department of Employment Security, Chicago, Illinois

Thank you, Mr. Chairman and members of the Subcommittee, for the opportunity to appear before you today. I am here to discuss the Illinois Department of Employment Security's experience in using our State's New Hire Directory to detect cases in which individuals continue to claim unemployment benefits after returning to work. The Directory has enabled us to reduce the amount of overpayments in many such cases and, we believe, has also helped in the recovery of those overpayments.

As you know, the 1996 welfare reform law required each state to have a new hire directory to strengthen child support enforcement. Illinois enacted legislation establishing its Directory in 1997 and assigned the Department the responsibility for maintaining the Directory. From the outset, the legislation authorized the Department to use the Directory for unemployment insurance purposes. Accordingly, in designing the Directory, the Department incorporated an automatic cross match with its benefit information system—the data base of individuals with unemployment benefit claims. The cross match looks for each individual who has 1) been reported as a new hire, 2) continued to receive benefits after having been reported as a new hire and 3) failed to report any earnings when certifying as to his or her eligibility for the week in which the hire was reported.

When the cross match identifies an individual who meets all three criteria, the Department's benefit system automatically notifies the individual that an issue has arisen with respect to his or her claim and issues a questionnaire to the individual and the employer, to establish the individual's precise return-to-work date. The claimant has the option of responding to the questionnaire in person, by mail or over the telephone.

The local office in which the individual filed the claim is expected to adjudicate the matter within 14 days, to determine whether there has been an overpayment. The Department's emphasis is on minimizing and recovering overpayments, as opposed to penalizing the claimant. Nevertheless, the local offices will refer egregious cases—*e.g.*, repeat offenders—to the agency's Benefit Payment Control Unit, for the possible institution of administrative fraud proceedings. Where the Department adjudicates an overpayment as a fraud, the law effectively disqualifies the claimant from receiving benefits for up to 26 weeks, in addition to requiring repayment of the wrongfully claimed amounts. The Department will also refer serious cases of fraud to the Attorney General's Office, for criminal prosecution.

Prior to the institution of the New Hire cross match, the Department relied primarily on cross matches between its benefit system and its wage record system, which is derived from employers' quarterly wage reports. Wage record cross matches are certainly still useful. However, employer wage reports are first due in the month following the close of the quarter and can take up to another month to be posted on the agency's wage record system. Consequently, a claimant could have been receiving overpayments for up to five months before the agency would even have a chance of discovering the situation. In contrast, the New Hire reports are due within 20 days of the date of hire and posted to the system within days after receipt, at which point the cross match occurs.

By permitting early detection, the New Hire cross match actually prevents overpayments from occurring. Data for the last completed state fiscal year illustrate the point. The average overpayment detected through the wage record cross match was $1,800. The average overpayment detected through the New Hire cross match, which identified over two-thirds again as many overpayments as the wage record cross match, was $296.

We believe that earlier detection also fosters the recovery process by enabling the Department to begin the process sooner, when it is easier to find the claimant, frequently while he or she is still employed and earning wages. The Department has recovered nearly 60 percent of the overpayments identified through the New Hire cross match since state fiscal year 1999—the first full year in which Illinois' New Hire Directory was operational.

While the New Hire cross match has been a substantial help in reducing and recovering overpayments, there are some holes. For example, multi-state employers may not necessarily choose to report their new hires to Illinois. Also, the Illinois directory will not reveal a claimant who finds work in one of Illinois' neighboring states, since those new hires would be reported to the other state. In addition, newly hired Federal workers are not reported to any state.

Granting state unemployment insurance agencies access to the National Directory of New Hires would enable us to build upon the success we have had with the State Directory and greatly assist other states. The National Association of State Workforce Agencies strongly supports access to the National Directory, as well. As a whole, the Subcommittee's recent TANF reauthorization package is outside the Department's purview. However, we greatly appreciate the fact that the package would grant us access to the National Directory and look forward to working together toward that end.

Thank you for your time and attention. I would be happy to try to answer any questions.

Chairman HERGER. Thank you very much for your testimony, Mr. Paris. Mr. Lorsbach, to testify.

STATEMENT OF MICHAEL LORSBACH, PRINCIPAL, ON POINT TECHNOLOGY, INC., LA GRANGE, ILLINOIS

Mr. LORSBACH. Thank you, Mr. Chairman. I appreciate the opportunity to testify before you today on fraud and abuse in the unemployment insurance program.

My background is out of 25 years of service in the unemployment insurance community. I began my career during the recession 1974 as a UI claims adjudicator. I became a UI fraud investigator, an investigative supervisor, and then moved to the information technology department, where I retained responsibility for auditing and fraud detection systems.

After 9 years with the Illinois Department of Employment Security, I moved to the private sector and have continued to work with UI agencies. Part of my current responsibility is to market a software package called the Benefit Audit Reporting and Tracking System, or BARTS. The BARTS is a package that has multiple auditing subsystems to detect fraud and improper payments and also has a case management system to automate the paperwork. The BARTS is installed in seven States.

It is in dealing with these States, including the customized installation of the software, that gives me the unique perspective that I bring to you today. Before I go on, let me say that in my experience, this problem is solvable. We will never get to 100 percent, but when a State takes ownership of the problem and implements tools and processes to address it, the results can be quite dramatic.

There are two primary issues that need to be addressed in order to deal with fraud and abuse in the UI program. First is that the States must take ownership of the problem. Over 20 years ago, the Employment and Training Administration began a program now called the Benefit Accuracy Measurement, or BAM, in order to uncover the sources and levels of fraud in the unemployment insurance system. At that time, many, maybe most, States had adamantly said that there was no fraud in the program. Over the years, States have accepted that there is fraud and abuse, but they continue to argue with or ignore the BAM figures.

I believe that it is time to declare that the BAM figures are reliable enough to serve as a foundation for new achievement goals for the State program. Let me take a short aside and explain.

The ETA sets goals for the States to meet. These goals then become the marching orders for the States. Largely, it is very important for an administrator to achieve these goals. The goals are the radar screen. One of the BAM figures is the number of people who are being improperly paid while working and collecting UI at the same time. If that figure were to translate into, say, $20 million over the course of a year, then the State should be held accountable for uncovering, say, 60 percent of that money, or $12 million. Establishing this clear and definable goal gets us on the radar screen.

Currently, the only goal that pertains to fraud and abuse is one that says that States should recover 55 percent of the overpayments that they identify. The unintended consequence of this is that it is easier to collect 55 percent of a smaller amount than that of a larger amount. In other words, if you discover less fraud, it is easier to make your collections goal.

I am sorry to say that I find this attitude rampant throughout the States. This goal is likely the largest single disincentive to detecting fraud and abuse. It should be eliminated immediately.

A UI administrator is one who must continuously react to and balance forces from multiple external sources while trying to manage a large and complex organization. If we want something to be done, we must get on their radar screen.

The second key to reducing fraud and abuse in UI is new information technology. Most States still use a software product that was developed and distributed by the ETA in 1975. It was wonderful in its day, but it is grossly inefficient in today's standard. In replacing these systems, we, meaning my firm, have shown that the output of fraud cases processed can be increased by 600 percent or more with no increase in staff. The return on investment in dollars saved is usually in 3 to 6 months. By the second year, the annual dollar return on investment can easily exceed 500 percent.

I firmly believe that for a very moderate cost, these efforts could be implemented and could go a long way to solving the fraud and

abuse problem in the unemployment insurance program. Thank you again for the opportunity to present my views.

[The prepared statement of Mr. Lorsbach follows:]

Statement of Michael Lorsbach, Principal, On Point Technology, Inc., La Grange, Illinois

The problem has been studied for over 20 years. No nationwide solutions have been offered

Fraud and abuse has been formally studied by the Department of Labor for over 20 years under a continuous program first called Random Audit, later Benefit Quality Control and now called Benefit Accuracy Measurement (BAM). The result of this ongoing study is consistent data that clearly defines the nature and level of improper payments, fraud and abuse in the Unemployment Insurance program. The issue then is not in defining the problem but in implementing a solution.

Since 1975, when the Employment and Training Administration (ETA) distributed a custom computer application to audit claimants, there has not been a serious systematic attempt to solve the problem. Over the past several years, the states have been granted supplemental budgets for Integrity processes but the money seems to have been absorbed with little or no impact on fraud and abuse.

BAM and its predecessors were established to obtain accurate figures on improper unemployment insurance payments. The Employment and Training Administration recognized that States had been unwilling to acknowledge the problem and as a result established the BAM program with a direct pipeline the ETA for both funding and data gathering.

We still live in the shadow of that denial. It is an uphill battle getting states to own the problem. The good news is that solid proven solutions do exist.

Most fraud and abuse is not debatable

1. The Problem must be Clearly Defined.

Part of the problem of why fraud and abuse has not been addressed is that the definition of the problem is almost endlessly debatable. What is an improper payment? Many issues depend on state law and vary subtly from state to state.

But, the largest cause of overpayments is not debatable in definition. Benefit Year Earnings, or working while collecting UI, accounted for $573 million in improper payment in CY2000. No one can deny that this abuse is a clear target.

End the debate. Other issues, Separation Reason, Work Search, etc., need to be and can be addressed but they cannot be used to cloud the issue of Benefit Year Earnings.

It must be made a priority

2. A Matter of Priority.

It is frequently said that SESA Administrators have an average tenure of 13 months. Upon entry to the job, most are not familiar with the UI program. Yet they set the pace and the priorities. I have spoken with Administrators who have no concept of improper payments, fraud control or program auditing. It is simply not on their radar screen.

Legislative and ETA initiatives are needed to bring integrity into the light. It should be declared that before a state can expect support for special program funds they must consider and demonstrate strong program integrity.

Tie goals to specific measurement

3. Goals and Accurate Measurement.

The primary measurement of how well SESA's perform, are called Desired Levels of Achievement (DLA). There is only one DLA that has to do with improper payments. This DLA says that states should collect 55% of the overpayments they identify. There are two fundamental problems with this measurement. The first is that it is not directed at identifying improper payments only at collecting them after they have been established. The second, an unintended consequence, is that it becomes a disincentive to identify improper payments. With a given staff allocation, it is much easier to meet one's collection rate if fewer overpayments are established.

This DLA should be eliminated. It should be replaced with goals established from BAM data. For example if BAM determines that a state has a 3% error rate due to Benefit Year Earnings then the state should identify say 70% of that 3%. If the state pays $500 million a year in benefits, to meet the goal the state would have to establish $10.5 million in overpayments.

Even if this DLA is not replaced it should be eliminated immediately. In my experience, it is a strong disincentive to fraud control.

The auditors must be independent

4. The Auditors Report to the Audited.

It is a primary tenant of auditing that an auditing group be independent and autonomous of the organization being audited. In almost every SESA this autonomy does not exist. In most states, Benefit Payment Control (BPC) is the auditing group responsible for the investigation of improper payments and fraud. BPC commonly reports to the Director who is responsible for the UI program. If the fraud figures become embarrassing, it is too easy for BPC to be toned down.

The auditor should be separate from the UI program. Auditors should be measured on the thoroughness of their audits. The State of Washington, Office of Special Investigations, which has shown exemplary progress in fraud control over the past decade, initiated and developed its processes while the auditing unit reported to the Director of Legal Services, a Division separate and equal to Unemployment Insurance.

The current systems for processing fraud are antiquated and ineffective

5. Systems are Antiquated.

In 1974 the Unemployment Insurance System Design Center, which was funded by the ETA, began distribution of a custom computer application for the detection of fraud and abuse in UI benefit payments. The system was a great leap forward in making the detection process more efficient. Most states adopted the software. The problem today is that most states still use it. It has been modified and updated by states but is still horribly ineffective by today's standards. Most employer complaints of being bothered by paperwork come from forms generated by this system.

Proven, effective system solutions exist

Highly automated computer systems exist and are very effective. These systems have a return on investment of three months. After a year or so when the new systems have been fully adapted it can be verified that they can produce an annual return of 600% or more. They have been proven to significantly reduce fraud and abuse by getting the word out that it will no longer be tolerated.

Integrity must wrap around the UI program

6. Integrate Integrity.

There was a time when land could be developed with Government funds and if the local community did not complain, no one cared about the impact on the environment. Now land cannot be developed without an environmental impact statement. I am sure that from this year forward, no bills will be debated in Congress without a discussion of its impact on homeland security.

Integrity must become the UI Program's point of light. No systems or applications should be defined and no funding should be approved without a study or statement on the impact to program integrity.

To solve the problem make the states accountable and install new software

In summary, the most critical pieces to solving fraud and abuse in the UI program are creating new performance measurements and installing improved technology. The performance measurement gets the problem on the screen. It forces everyone to pay attention.

New technology allows the rapid examination and processing of fraud and abuse with very little manpower. Case management systems that are fed by multiple types of audit including New Hire, can be tuned to also examine the other more debatable issues.

Installation of compatible software in every SESA would cost about $30 million and should save the Nation's employers about $700 million in UI taxes per year.

Michael Lorsbach is a Principal and owner of On Point Technology, Inc. Mr. Lorsbach began his career with the Illinois Department of Employment Security in 1974. Mike served as a Claims Adjudicator, BPC Investigator, and Information Technology Manager.

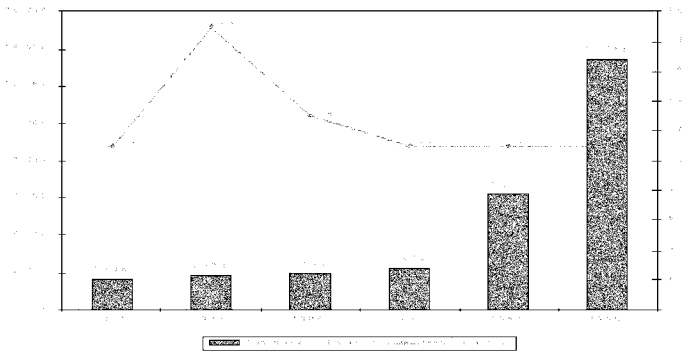
On Point is an information technology firm that is exclusively dedicated to the support of State Employment Security Agencies. On Point builds UI benefit payment, tax, and other UI support systems. On Point personnel have consulted with over 20 states. On Point is currently under contract with 4 SESA's.

On Point is the exclusive distributor of the Benefit Audit Reporting and Tracking System (BARTS). BARTS is a software package that performs multiple audits of

Unemployment Insurance programs, detects likely fraud and abuse then automatically manages the resulting cases. BARTS is installed in Alaska, Arizona, Illinois, Kentucky, New Jersey, Oregon and Washington.

Washington State
Employment Security Department
Office of Special Investigations

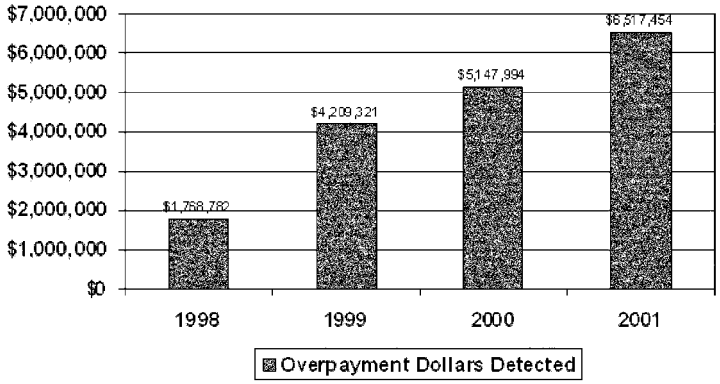
Impact of Automation



During the period from 1992 through 1999, the number of overpayment determinations rose from 2,200 to 13,388, while using the same number of staff (11). This represents an increased output of 609%.

State of *
Department of Employment

Impact of Automation



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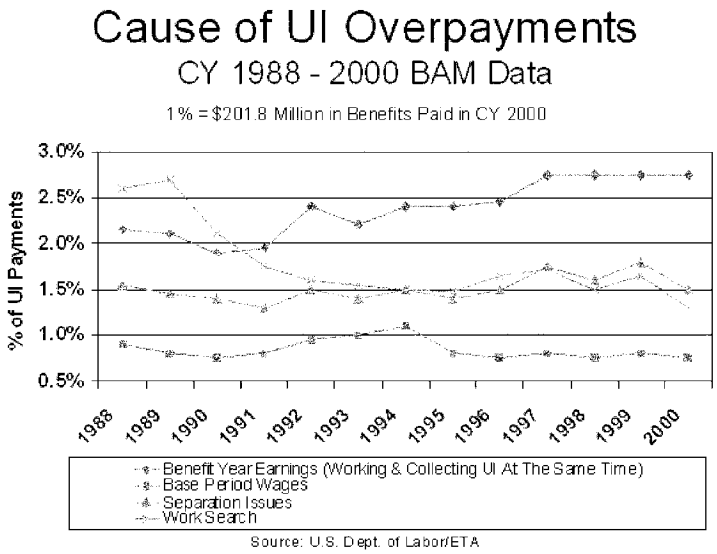

Chairman HERGER. Thank you, Mr. Lorsbach. I want to thank each of you for your testimony. Now, we will turn to questions. The gentleman from Kentucky, Mr. Lewis.

Mr. LEWIS OF KENTUCKY. Thank you, Mr. Chairman.

Dr. Woodbury, in your testimony, you cite one way to limit misspending is to better enforce the current requirement that unemployment benefit recipients search for work. You suggest that this would help more workers return to work sooner and improve their earnings and likelihood of staying employed in the long run, which all are positive effects. Could you tell us more about how we could better ensure unemployment benefit recipients are searching for work?

Dr. WOODBURY. Concretely, the recommendation is to give the States resources to perform more eligibility review interviews, that is, call workers in to ensure that they are working. The evidence, there is substantial research to show that workers who are called in for eligibility review interviews get moving and get jobs faster, and the long run benefits are clear, higher earnings and less unemployment over the long term.

Mr. LEWIS OF KENTUCKY. Do you have any idea how much in terms of additional administrative cost, expenses——

Dr. WOODBURY. I cannot speak to that, no.

Mr. LEWIS OF KENTUCKY. Thanks.

Chairman HERGER. The gentleman from Maryland, Mr. Cardin.

Mr. CARDIN. Thank you, Mr. Chairman.

I want to thank all of you for your testimony, all Members of our panel. I think it has been very helpful.

Dr. Nilsen, I am somewhat troubled by part of your statement where you seem to say the States need to balance the payment

timeliness with payment accuracy. One could interpret from that that you might be suggesting that they should withhold payments until they have adequate information to make sure errors are not made. I know that is not what you are intending——

Dr. NILSEN. No, that is correct, Congressman——

Mr. CARDIN. So, I thought I would give you a chance to clarify that.

Dr. NILSEN. Certainly, Congressman Cardin. It is just that in the past, the history of the program is that it is focused on moving checks out the door, which is great and it is what this system was set up to do. As we and others have testified, you need to make sure you are paying the right benefits to the right people to maintain the integrity of the program. This helps keep taxes down, makes sure that payments are being made to those people who are truly deserving of the UI benefits. So, it is not a matter of sacrificing one for the other, but it is focusing on the two sides and balancing so that you are sure you are getting the right benefits to the right people.

Mr. CARDIN. Thank you. I appreciate that clarification.

I am curious as to whether any of the Members of the panel want to comment on Dr. Woodbury's point, and that it seems like when we talk about the integrity of the system, we talk about overpayments, but we do not normally talk about the fact that employers are not paying everything they should in revenues or that individuals are not getting the benefits they are entitled to. To get a more balanced picture, all three should really be reviewed, and the way the U.S. Department of Labor has set up their models, it is more difficult to judge the other two areas of inaccuracy than it is on overpayments. Any comments, concerns, other than Dr. Woodbury, who expressed that in his statement? Dr. Nilsen?

Dr. NILSEN. No, we have not looked at that side of the program at this point.

Mr. CARDIN. Why not?

Dr. NILSEN. So far, we have not been asked to look at that aspect of the program.

Mr. CARDIN. Well, that will be corrected.

[Laughter.]

Mr. CARDIN. Does the Inspector General have any comments on that?

Mr. HEDDELL. I can say, Mr. Cardin, that from my office's perspective, of course, we would like to know that every worker is receiving the benefits that they are entitled to. In terms of unemployment benefits, we are, of course, very concerned about overpayments and that is predominantly where our focus has been.

Mr. CARDIN. Why would you not also be concerned about underpayments of revenues?

Mr. HEDDELL. Well, we——

Mr. CARDIN. That is hurting our system.

Mr. HEDDELL. As I was actually about to say, Mr. Cardin, we are concerned that every worker should get what they are entitled to——

Mr. CARDIN. Right.

Mr. HEDDELL. If there are, in fact, such workers, and I am sure that this does exist, that are underpaid; I agree that they should

get what they are entitled to. However, my office has not looked at this specifically where I could give you a definitive answer.

Mr. CARDIN. We will try to encourage that. I mean, Dr. Woodbury's numbers are rather alarming. The underpayment is as high as or higher than the actual dollar amount on the fraudulent overpayments. So certainly, we need to get more information in order to make good policy judgments here, so we would appreciate that.

Mr. Lorsbach, you make a very compelling point about the 55 percent. What would you substitute it with?

Mr. LORSBACH. I would substitute BAM figures. I would say that if we accept the BAM figures as they are, BAM says that a certain amount of people have been overpaid in a particular State. Take that figure and say that we are going to identify a given percent of those people and then collect the money as seriously as you can. There is no doubt about it, you want to get the money back, but you cannot restrict your identification based on your collection.

Mr. CARDIN. Thank——

Mr. LORSBACH. Is that not clear?

Mr. CARDIN. I understand what you are saying, and I think that makes more sense than the—I mean, I think you do make a very compelling argument on the 55 percent identified by the States. It is obviously in everyone's interest to collect as much of the overpayment that it makes sense to collect.

As I understand it from the first witness, there are some overpayments that there is no good policy reason to try to collect. I think everyone agrees on that. There is some amount of the overpayments that we do not really want to get recovered. It is not the individual's fault. It is the system's fault or the employer's fault and would create unusual hardship to go after. So, I think there are at least some payments that we do not want to try to collect.

That which we determine should be collected—should be collected, and the percentages could work, as you point out, to the disadvantage of the aggressive States, so it is something we need to certainly look at. Thank you.

Mr. HEDDELL. Mr. Cardin, in terms of underpayments by employers, we have raised concerns about employees who are not getting fair treatment under the system. One of the things that I point out in my full statement is the misclassification of workers and fraud as it relates to leasing companies and employers that are not paying their full share of taxes. These kinds of situations do have a detrimental impact on certain workers, particularly those workers that are in the lower economic and lower skilled areas. So it is something we are concerned about.

Mr. CARDIN. Thank you.

Chairman HERGER. Thank you very much, Mr. Cardin.

I just want to, for the record, state that while we and the American taxpayers are obviously very concerned about fraud, abuse, and overpayment, certainly for those who are not getting their unemployment benefits as they should there is equal concern, and this Committee wants to correct both sides.

Dr. Nilsen, I would appreciate your comment. Your points on pages 11 and 12 about relying on self-reports of information that might result in UC applicants not getting benefits are very impor-

tant. What sorts of information do we trust that applicants will tell us, even though their disclosing that information could result in their not getting the benefits they are seeking? I might note—this almost seems reminiscent of the old SSI Program under which we trusted prisoners to report that they were in jail so they could stop their SSI disability checks. Now we have a system in place, by the way, under which prison reports list inmates for matching so we better ensure that inmates are not getting SSI benefits. Would you comment, please?

Dr. NILSEN. Mr. Chairman, I think what our focus in the work that we have done indicates, that you need to verify the information up front as quickly as possible. There are people in self-reporting who do disclose information that, in fact, makes them ineligible for benefits. By and large, if people are trying to, in a sense, beat the system, they are not going to be the people who are going to be honest with you. So in taking claims, it is important we have systems in place that are available to verify the accuracy of employment, to check employment in other States, and equally important, to check the continuing claims after initial claims have been filed.

Right now, as you state, we have information on prisoners. None of the States we went to used that information to check on their UI beneficiaries at this point. Part of it is because of the timing of the program, but also we have been told that some of it is related to the cost.

As I said, if you do not have timely information in this program, people will already have gotten their benefits before you are able to identify that they are ineligible or that they have become employed and no longer eligible for benefits.

Chairman HERGER. Thank you, Dr. Nilsen.

Now, the gentleman from Washington, Mr. McDermott.

Mr. MCDERMOTT. Thank you, Mr. Chairman. I am sorry I am a little late getting here, but planes get here when they get here.

Coming from a State that has the highest unemployment in the country, one of the issues that has been troublesome to me, and I have watched this both in the State legislature and then here in the Congress, is this whole question of contract workers. You may have discussed all of that, but *Vizcaino v. Microsoft* came from our State, so we are very familiar with this whole issue.

It seems to me that one of the biggest problems in UI today is the classification of workers. In section 530 of the Revenue Act 1978, there is a paragraph that expressly prohibits the Internal Revenue Service (IRS) from issuing regulations that would help determine whether a worker is an employee or a contingent worker. Dr. Woodbury, could you explain to me how that got into the law, and why it is still there?

Dr. WOODBURY. I cannot explain that, but I do think that contract workers, independent contractors, do pose a challenge for the system. There is a study by Planmatics that suggests that 80,000 or so independent contractors per year would be eligible for benefits if they were properly classified as employees, so there clearly is a leakage there.

I think an even bigger challenge is perhaps that employers simply underreport wages of workers. They simply do not report to the

States that they have an employee, or they underreport the wages that they actually pay to an employee who is on the books as an employee, not misclassified. I think that is an even bigger challenge for the program, and I think——

Mr. McDERMOTT. So in terms of the numbers——

Dr. WOODBURY. I am sorry?

Mr. McDERMOTT. Yes, in terms of the numbers.

Dr. WOODBURY. In terms of revenues for the system, in terms of——

Mr. McDERMOTT. That is not a Federal responsibility to make sure that people are paying. That is a State responsibility.

Dr. WOODBURY. Yes. I think there are things the DOL could do, I believe, to help that.

Mr. McDERMOTT. You mean DOL could do things to encourage the States to do what is right?

Dr. WOODBURY. I believe so.

Mr. McDERMOTT. Under what mechanism?

Dr. WOODBURY. Well, the Revenue Quality Control program is the program that the U.S. Department of Labor has had on the books, in the wings, for over a decade now and has not implemented it. Revenue Quality Control would presumably audit either at random or by profiling likely abusers, employers who are abusing the system, and auditing them intensively. Presumably, that would create an incentive, if employers knew this program was out there, to be more compliant.

Mr. McDERMOTT. I guess I have watched——

Dr. WOODBURY. It is not a legislative change. That would be a change that the DOL would implement on a State-by-State basis, auditing of employers to ensure that they are complying with the unemployment insurance payroll tax.

Mr. McDERMOTT. Unemployment is paid for by the State. They pay the actual benefits. They collect the money and pay the benefits.

Dr. WOODBURY. They collect the money.

Mr. McDERMOTT. So, why does the Federal Government—why are we in here talking about this? What problem has come up that you think would make it necessary for us to wade into, because if there are overpayments, it seems to me it is in the States' interest to figure that out.

Dr. WOODBURY. Well, the existing research suggests that Revenue Quality Control would more than pay for itself in revenue. In other words, if the State did start auditing employers and trying to make sure that they were complying with the unemployment insurance payroll tax, the amount of resources it would take to run that program would be far less than the revenues that would be generated. So, why the States do not do this is a matter of incentives. The State agencies do not have the incentive to do it.

Mr. McDERMOTT. My brother ran the program in the State of Washington. They paid for themselves. It takes a governor who is willing to stand behind them.

Dr. WOODBURY. Yes.

Mr. McDERMOTT. Most of the governors are not enforcing it, and it strikes me that we may—I mean, this section 530 seems to me to be an egregious example of the Feds, on the one hand, telling

the States to do something and then not giving them rules and regulations, and winding up with 60 percent of the people not covered by unemployment compensation. I cannot understand, Mr. Chairman, why that is still in the law. I mean, whatever we do, we ought to take that out of the law and force the IRS and the employers to sit down and define who is an employee.

The *Vizcaino v. Microsoft* case, where you had one employee sitting next to another employee and they are doing exactly the same thing and one is a contract employee and one is getting benefits was, I mean, it was an open and shut case. Microsoft, of course, made all kinds of attempts to obfuscate that, but that kind of stuff and the changing work force, an unemployment system designed for the thirties, or the forties, or the fifties, or sixties work force simply is not responding to what is going on out there.

Now, I do not know whether it should be done at the Federal level or whether it should be done at the State level, but in a State where now have—we have gone through this. Our unemployment tends to be cyclical and we had this with timber and fishing and airplane production and we are now in one of the downs. We are going to have some problems in this country if we do not—because that is happening all over the place. All the industries are into this now.

Thank you, Mr. Chairman.

Chairman HERGER. I thank the gentleman.

I would like to comment. The question was whether or not the Federal Government has a responsibility in this? I think when we consider that the Federal Government every year collects Federal taxes and uses them to pay more than $2 billion to States to administer benefits and to prevent fraud and abuse, that very clearly, the Federal Government does have a responsibility to make sure that these benefits are going to the right people.

With that, I would like to thank each of our witnesses today for appearing before the Subcommittee. I regard this hearing as the first stage in our efforts to better ensure unemployment benefits are going to the intended recipients. Clearly, when literally billions of dollars are misspent every year, that is not the case. Especially given what we have learned, we cannot and will not stand by and let these problems go unaddressed.

I look forward to working with everyone interested, including our witnesses, States, and employers, to make sure that we better protect the integrity of these important benefits. I trust our witnesses will continue to provide useful insight, starting with answering any additional questions for the record we may have.

With that, this hearing stands adjourned.

[Whereupon, at 5:39 p.m., the hearing was adjourned.]

[Questions submitted by Chairman Herger to the panel, and their responses follow:]

U.S. General Accounting Office
Washington, DC 20548
June 24, 2002

Hon. Wally Herger
Chairman, Subcommittee on Human Resources
Committee on Ways and Means
House of Representatives

Dear Mr. Chairman:

This letter responds to your request that we address questions following the June 11, 2002 hearing on fraud and overpayments in the Unemployment Insurance (UI) program. We have restated each of your questions, followed by our answer below.

1. Based on our review, which aspects of the states' unemployment program procedures or processes are most susceptible to fraud and overpayments? Why?

As noted in our testimony, a substantial proportion of overpayments occur because of errors in reporting or recording claimants' wages or other income. Another significant source of overpayments are claimants who do not look for a new job as required by state law, or are not able and available to work ("eligibility" violations). Of the total $2.4 billion in overpayments estimated by Labor in 2001, about 24 percent were attributable to fraud. A primary reason for these overpayments is that many states place their primary emphasis on quickly processing and paying UI claims, and may not sufficiently balance the need to make timely payments with ensuring payment accuracy. Moreover, states may lack access to timely information that can affect claimants' eligibility for UI benefits, such as their identity, wages, and benefits from other Federal or state programs.

2. What tools or procedures would allow states to improve the integrity of their UI programs by preventing and detecting overpayments, and recovering them once they have occurred?

As noted in our testimony, the most efficient and effective method for states to prevent and detect overpayments is by consistently using automated systems that allow claims representatives to verify claimants' eligibility information at the point of application—before benefits are paid. In general, online access to databases containing information to verify claimants' identity, employment status, or other important information is the most useful tool for preventing and detecting overpayments. For example, the Social Security Administration's State Online Query System allows participating states to verify the identity of claimants applying for UI benefits in real time.[1] In lieu of online access, many states conduct periodic computer matches with other state and Federal agencies to verify information that claimants provide. Although such methods tend to be less timely than online access, they are still of value in detecting and recovering overpayments. Overall, the states that are most effective at recovering overpayments are those that have a wide variety of tools at their disposal, including state tax refund offset, wage garnishment, and access to private collection agencies. Ultimately, as emphasized in our testimony, the key to improving UI program integrity at the state level is a commitment from state UI managers to consistently use automated tools and other available mechanisms for determining claimants' initial and continuing eligibility for benefits.

3. What actions could the Department of Labor take to help states place a higher priority on UI program integrity issues? Does Labor have the authority to implement these actions? Are legislative changes needed to provide additional authority to stem further abuse?

Labor needs to more clearly emphasize the need for states to balance payment timeliness with payment accuracy. For example, as outlined in our testimony, Labor could revise its performance measures in a way that places greater emphasis on payment accuracy. Labor could also make better use of its quality assurance data to help states identify areas for improvement and work with states to changes policies and procedures that allow overpayments to occur. However, to be most effective, we believe that Labor must be willing to link state performance in the area of program integrity with tangible incentives and disincentives, such as through the annual administrative funding process. We believe that Labor has the authority to implement many of the improvements we discuss in our testimony and our forthcoming report. However, other changes that we discuss—such as providing all states with access to the National Directory of New Hires—would require legislation to implement.[2]

4. What changes, if any, are needed in Labor's management approach to the UI program that will allow it to implement the actions you have outlined?

While we recognize the importance of paying unemployment beneficiaries in a timely manner, we believe that Labor's approach to managing the UI program has historically emphasized quickly processing and paying UI claims without a similar

[1] Currently only two states (Utah and Wisconsin) use this system for their UI programs.

[2] Section 406 of the Personal Responsibility, Work, and Family Promotion Act of 2002 (H.R. 4737) would provide states with access to the National Directory of New Hires for purposes of verifying claimants' eligibility for UI benefits.

focus on controlling UI payments. Thus, our work suggests that program integrity issues should receive greater emphasis. Labor could facilitate this change in emphasis by linking the quality assurance process to the budget process and requiring states to meet specified performance levels as a condition of receiving administrative grants. In addition, under Federal regulations covering grants to states, Labor may withhold cash payments, disallow costs, or terminate part of a state's administrative grant due to non-compliance with grant agreements or statutes. Absent such a change, we believe that states may be reluctant to make similar modifications in their own management philosophy and operations, leaving the UI program vulnerable to continued high levels of overpayments. If you have any questions about this correspondence or wish to discuss the issue further, please contact me at (202) 512–7215, Daniel Bertoni at (202) 512–5988, or Jeremy Cox at (202) 512–5717.

Sincerely yours,

Sigurd R. Nilsen,
Director, Education, Workforce and Income Security Issues

U.S. Department of Labor
Office of Inspector General
Washington, DC 20210

Hon. Wally Herger
Chairman, Subcommittee on Human Resources
House Committee on Ways and Means
B–317 Rayburn House Office Building
Washington, DC 20515

Dear Chairman Herger:

Thank you for the opportunity to testify before your Subcommittee on my Office's effort to detect and investigate fraud, waste, and abuse within the Unemployment Insurance (UI) program. As requested, please find below our answers to your additional questions.

1. As was discussed at the hearing, it is very discouraging to hear that over $2 billion of taxpayer money was fraudulently claimed or improperly spent last year on unemployment benefits and that over the past decade $18 billion was misspent. The high numbers—starting with a continuously high level of known overpayments in the past 10 years, and increases last year—suggest a need for action instead of business as usual.

a. In recent years, what specific steps have you suggested the Department or the States take to better combat fraud and abuse? What specific initiatives do you now suggest the Department and States take to address fraud and abuse?

From an investigative perspective, we have recommended to the Department that state personnel who are responsible for benefit payment control and internal security be provided enhanced fraud detection and investigative training. This training should focus on fraud prevention, information sharing among states regarding common fraud schemes, and the dissemination of best practices utilized by high-performing states. We have been actively involved in conducting training sessions for state personnel based on our experience in investigating complex, multi-state fraud schemes. During this training, we note several "red flags" or indicators that are indicative of such schemes. In addition, in 1999, we developed a white paper for ETA discussing how UI fraud schemes operate, which was disseminated to the states. We believe that information to be useful to the states in carrying out their enforcement and oversight activities.

In addition, states should examine ways to enhance the integrity of the remote claims-filing process, which has made fraud detection more difficult. Some suggestions that states may want to utilize include: 1) conducting random in-person interviews of telephone or Internet claimants; and 2) improving the tracking of telephone numbers and mailing addresses used to file claims in order to look for patterns of voluminous calls from single numbers or mailings from the same addresses.

Our audit work has identified several internal control weaknesses and vulnerabilities that impact the integrity of the UI program, especially those relative to overpayments. In a 1999 audit, we found that the crossmatch systems used by seven states, which compares weekly UI benefit payment records with quarterly wage records, had inherent weaknesses. Foremost was the failure of employers to respond to state requests for detailed wage information. As a consequence, we estimated $17 million in overpayments were not being detected in just four of the seven states we audited.

To improve the crossmatch system, we recommended to the Department that policy and direction be provided to the states to ensure that: 1) employers are reminded of their responsibilities to respond to wage requests and follow up with those who routinely fail to respond; 2) states select for audit those claims with the highest potential for overpayments; and 3) states maintain a database of those employers who are sent wage requests, and when they are returned, follow up on non-responses. In addition, we recommended that the Department assume a leadership role in assuring that states obtain timely access to the data of the National Directory of New Hires, and to fully incorporate that data into UI Benefit Payment Control operations. The Department has agreed to take corrective action.

b. Similarly, in recent years what specific legislative initiatives have you proposed the Congress enact to better address fraud and abuse in this program? What legislative measures do you now suggest Congress consider to better prevent fraud and abuse?

As I mentioned in my full statement, one legislative recommendation to strengthen the UI program is to grant the OIG and the Department unimpeded access to UI, Social Security, and New Hire data for fraud detection and program evaluation purposes. Such data would be used for two primary purposes: 1) to aid in our fraud detection and investigative efforts; and 2) to better help us and the Department assess program performance and return-on-investment. Routine and expeditious access to the centralized Social Security wage database would enable us to more efficiently and consistently verify the eligibility of program applicants and determine whether their Social Security Numbers (SSNs) are valid. This would aid in identifying potential overpayments and preventing millions of dollars in future losses.

In addition, we believe that states should be granted access to the National Directory of New Hires database for fraud and overpayment detection purposes. As you know, states only have access to their own new-hire data, which limits a state's ability to detect those who commit fraud across state lines. If given access to this directory, states would be better able to detect these fraudulent schemes and other overpayments.

Finally, as discussed below under question 5, we believe that legislative consideration should be given to a process that would allow states to perform an up front determination of claimants' work status and verification of SSNs before payments commence.

2. Please describe any specific evidence that your office is aware of regarding States' screening to ensure that (1) prisoners, (2) fugitive felons, (3) probation and parole violators, and (4) individuals applying for benefits based on the record of a deceased individual do not access unemployment benefits.

The Department may more appropriately answer this question since we have not conducted any reviews in this area. Notably, eligibility for benefits for probation and parole violators depends on individual state law. We understand that some states do obtain death records from the SSA for validation of claims, but we do not have information as to which states are doing it.

3. What State and Federal measures are in place to determine whether individuals claim unemployment benefits in more than one State at the same time? If that occurs, what are State policies to address such double dipping?

My Office has not examined state policies regarding double dipping. Nevertheless, we are aware through our casework that reciprocal agreements do exist between and among some states (usually those that are contiguous). For example, a reciprocal agreement exists among Virginia, Maryland and the District of Columbia to exchange information and crosscheck claimants in those three jurisdictions.

We understand that states have signed an "interstate agreement" that specifies that they will take, process, and pay interstate claims. When an individual files a UI claim in any state, questions are asked about earnings. Based on the response, claimants will be advised to file an intrastate or an interstate claim. States will then run an interstate crossmatch each quarter that compares their interstate claims against all interstate claims filed. You may wish to contact the Department directly for more details about this interstate agreement.

4. How do States determine if a noncitizen ineligible to work in the U.S. is claiming unemployment benefits? What processes are in place to prevent, for example, a student or someone here on a tourist visa from working and then claiming unemployment benefits from that work? How many individuals who applied for unemployment benefits have been disqualified from receiving them for this reason in recent years?

Based on our prior audit work and the Department's own public information, individuals who file claims are asked by the states whether they are citizens of the United States. If a claimant states that he or she is a citizen, states must accept the declaration of citizenship. Utilizing the Systematic Alien Verification for Entitlements (SAVE) system, data on claimants who state they are not citizens are entered electronically into a file maintained by the INS to determine their alien status. Claimants are denied benefits if it is found that they are non-citizens ineligible to work in the U.S.

From what we have seen, states can do more to prevent UI benefit payments to ineligible claimants. In 1998, we conducted an audit of how effective Florida, Georgia, North Carolina, and Texas were in preventing UI payments to ineligible claimants, including illegal aliens. We found that the SAVE system has inherent limitations since it relies on self-reporting of citizenship by claimants. We found that screening SSNs was a more effective means of identifying illegal aliens who had filed for UI benefits, and that if coupled with INS screening, SSN verification would prevent many of the abuses that occur.

While we do not know how many individuals who applied for UI benefits have been disqualified, our 1998 audit identified 2,927 UI claims totaling over $3.2 million that were paid out to people using SSNs that were either not issued or belonged to deceased individuals. We selected a sample of 452 claims, were able to verify the legal status of 241 claimants, and found that 129 of those claimants (54 percent) were illegal aliens who improperly received $200,291 in benefits. Although we did not project nationwide the amount of UI benefits paid out to illegal aliens, we believed at the time that screening claimants' SSNs would prevent millions of dollars in misspent UI benefits. We recommended to the Department that it assist the states in developing and implementing methods of screening UI claimants for valid SSNs, and delaying or deferring benefit payments to those individuals without valid SSNs, among others. The Department agreed that significant improvements could be made in the areas we addressed in our report.

5. Have you done any work involving the abuse of Social Security Numbers (SSNs) in order to claim unemployment benefits? What have you found? Do you have any recommendations for us to consider in addressing such concerns?

As I mentioned in my full statement, identity theft for purposes of collecting benefits is one way fraud against the UI program is carried out. The number of investigations we have initiated in this area has increased markedly over the last 5 years, and indications are that this type of fraud will only increase. Unfortunately, fraud detection in these cases is complicated because any preliminary fraud screening that may be done would only disclose that the named employee actually exists.

In addition, as discussed in the previous question, the OIG's March 1998 audit report found 2,927 UI claims totaling over $3.2 million were paid to individuals who had filed for UI benefits under SSNs that had either not been issued or were issued to deceased individuals. We recommended the Employment and Training Administration (ETA) assist the states in developing and implementing means of screening UI claimants for valid SSNs, and delaying or deferring benefit payments to claimants without valid SSNs. We also recommended that ETA seek changes to immigration laws to allow states to delay payments to alien claimants where there are material discrepancies in alien information. ETA responded that significant improvements could be made in areas that our audit report addressed. However, ETA disagreed with our recommendation that UI benefits not be paid to individuals without valid SSNs, because ETA maintained the burden of policing the Social Security system does not reside with the states.

We plan to revisit the issues raised in our 1998 audit. In the meantime, we continue to recommend that ETA work with the states to develop more streamlined, effective means to validate claimants' work status and SSNs, and achieve a legislative or administrative solution that would allow states to delay payments to claimants with questionable status.

6. Earlier this year Congress passed and the President signed a law that provides for up to 13 additional weeks of unemployment benefits nationwide, and up to 13 weeks more in States with relatively high unemployment rates. That is a tremendously generous program, and we know that over a million Americans already have received these extended benefits. Do you have any reviews in place to make sure that those benefits are going to the right people?

We are not currently conducting any reviews of claimant eligibility under the Temporary Extended Unemployment Compensation Act of 2002 (TEUC). Eligibility for UI benefits, however, is examined as part of audits conducted in accordance with

the Single Audit Act (SAA), as amended. (The SAA requires that, instead of separate audits by each agency providing funds, a single audit be performed of all Federal funds that have been provided to a grantee.) My Office will be working with the Department and OMB in the coming months to develop guidance for SAA auditors to use in testing eligibility under the new TEUC program. Also, because SAA audits are the first line of defense for UI and other grant programs, we have initiated several studies to determine the reliability and usefulness of single audits for the Department's needs. We have identified some weaknesses in how DOL programs, including UI, are being audited, and we are continuing to work with the Department, OMB and the audit community to improve the reliability of such audits. These efforts will be to the benefit of the all DOL grant programs, including TEUC.

As discussed in my testimony, we are also in the process of examining the Benefit Accuracy Measurement (BAM) system funded by ETA and carried out by the states. BAM uses statistical sampling techniques to project total UI benefit overpayments made to claimants. This system will presumably cover TEUC payments.

As I mentioned in the hearing, preserving the integrity of the UI program has been a longstanding concern of my Office. We will continue to work with the Department and the Congress to ensure that weaknesses and vulnerabilities are adequately addressed. If you have any questions, or need assistance on this or any other matter, please do not hesitate to contact me at (202) 693–5100.

Sincerely,

Hon. Gordon S. Heddell
Inspector General

Illinois Department of Employment Security
Chicago, Illinois
June 21, 2002

Hon. Wally Herger,
Chairman Subcommittee on Human Resources
B–317 Rayburn House Office Building
Washington, DC 20515

Dear Chairman Herger:

Thank you for your letter of June 17, following up on my recent testimony on the Illinois Department of Employment Security's use of the State's New Hire Directory as an unemployment insurance integrity tool.

1. Your testimony indicates that Illinois is using the State Directory of New Hires to better ensure benefits are going only to those who have not already returned to work. What is the return on the dollar for States and taxpayers from this match with the State directory? How much might be saved if Illinois were allowed access to the National Directory of New Hires as the House-passed welfare bill would allow?

I offer the following figures in response to your question about the return on Illinois' investment in matching the Department's claimant data base against the State Directory. It cost approximately $64,000 to implement the cross-match function in 1997. We estimate the annual staff costs associated with the cross match—primarily, investigating and adjudicating the issues it raises—to be just over $1 million, including overhead.

To gauge the return on those costs, we focused on state fiscal year 2001, which is the last full fiscal year for which we have records, the period we examined to arrive at the average overpayment figures in my testimony and representative of our general experience. We assumed that, without the New Hire cross match, the overpayments in each of the cases it detected would have continued to accumulate, up to the average overpayment detected through the less timely wage record cross match. Multiplying the difference between the average overpayment detected through the New Hire cross match and the average overpayment detected through the wage record cross match by the total number of overpayments detected through the New Hire cross match, we estimate the New Hire cross match prevented almost $30 million in overpayments for the year.

Regarding the potential benefits of cross matches with the National New Hire Directory, we identified 12,044 overpayments, totaling $21 million, through the wage record cross match for state fiscal year 2001—overpayments the cross match with the State Directory did not catch. While we cannot offer any precise figures, with access to the National Directory, we would have had the potential to identify a number of those cases substantially earlier than we did.

2. What other tools, including those that may be unavailable to you due to Federal laws or regulations, would you like to have to help you improve the integrity of your unemployment program even more?

You also asked what other tools we would like to have to preserve benefit payment integrity. With greater emphasis on remote claims-taking, we need to be looking at cross matches with other Government agencies. We are currently working with the Social Security Administration.

(SSA) on a process for dealing with claimants who attempt to use Social Security numbers that do not belong to them and are, therefore, ineligible for unemployment benefits. We currently match our data base with some of SSA's records on a daily basis, and that agency is now exploring whether there are any barriers to cross matches with its file of deceased Social Security card holders. We will be happy to keep you informed of developments in this area if you desire.

3. Is there a higher level of public awareness in Illinois that it really is not a good idea to try to get unemployment benefits when you are not entitled to them? In other words, has your work to reduce fraud paid off so that you are seeing fewer incidences that need investigating?

Finally, as to whether our integrity efforts have resulted in fewer instances of people claiming benefits after returning to work, the statistics so far do not indicate they have. The amount of overpayments detected has actually increased since we instituted the New Hire cross match. We believe that is attributable to the fact the cross match is detecting substantial numbers of cases that otherwise would have remained undetected, instead of any change in claimant behavior. It is still our hope, however, that as word of the agency's enhanced detection capabilities spreads, we will see a decline in the amount of those overpayments.

Thank you again for the opportunity to discuss our experiences and views with the Subcommittee. Please do not hesitate to contact me if the Department can be of further assistance.

Sincerely,

Miles Paris
Deputy Director
Program Support Bureau

On Point Technology, Inc.
La Grange, IL 60525
October 18, 2002

Mr. Doug Sahmel
House Human Resources Subcommittee
B–317 Rayburn HOB
Washington, DC 20515

Dear Mr. Sahmel:

Thank you for following up with me on a response to Chairman Herger's letter of June 17, 2002. Please excuse my delay. In this letter I have restated Mr. Herger's questions followed by my response.

1. Can you provide some reasons why States are not taking more aggressive steps to combat fraud and abuse in the unemployment program? Are there any key impediments that could be addresses by Congressional action?

Response—Let me start by saying that you may have already provided the catalyst for change. I attended the UI Directors conference in Whitefish, Montana this week and in several presentations the planned new emphasis on fraud and abuse in the UI program was discussed.

In my opinion the primary reasons why combating fraud and abuse in the UI program has not been a priority are several. A central reason is that there was no incentive for the UI Director to solve this problem. The ETA had no motivating standards for the States to meet. The only Desired Level of Achievement (DLA) was that a State should collect 55% of the overpayments it identified. It was readily agreed that the best way to meet this standard was to identify fewer overpayments. This DLA has been recently dropped and a new standard based on figures developed from the Benefit Accuracy Program (BAM) is being proposed. This should make a big difference in emphasis.

Secondly, it costs administrative dollars to solve a problem that is repaid in trust fund dollars. In most states, until recently at least, trust funds were flush with money and administrative funds have been in short supply. Many administrators found that if no one was complaining, it was more convenient to spend the administrative dollars on problems that had a higher priority and/or more visibility. One

administrator said in a meeting when his BPC Manager proudly proclaimed that they were saving over $30 million with their fraud control efforts that the savings was small potatoes compared to their billion dollar trust fund.

Third, admitting that one has an overpayment problem is embarrassing to the Agency. If the Agency identifies and admits to the magnitude of the problem they will likely come under attack. It is easier to ignore the problem and hope that no one will bring up the issue—in fact agencies were rarely challenged.

My suggestions to Congress would be to require that fraud figures be overtly published, not covertly as they are now. Second would be to tie funds directly to the prevention of fraud. For over 20 years BAM and its predecessors BQC and Random Audit have been spending approximately $20 million per year to identify the problem yet no money has been directly allocated to solve the problem. Third and very importantly is to tie the new fraud prevention criteria to Tier 1 goals. Tier 1 goals are those DOL goals that states are required to meet in order to receive their funding. This would make fraud control a priority.

2. Do good antifraud efforts tend to be cost-effective in terms of paying for themselves over time? What produces the biggest return on the dollar?

Response—The answer to the first question is yes, absolutely. To really have an impact on fraud and abuse, two things need to happen. First is that more automated systems need to be put into place. Most fraud investigation activities, managed by the Benefit Payment Control (BPC) unit, are paper nightmares. Most of this paperwork can be made to disappear with the proper automation. We were able to help one state increase the number of overpayments processed by 600% with no increase in staff. It is my firm belief that most all states could make the same improvements.

The return on investment is very high. If one assumes the cost of new fraud detection, processing and collection software to be $1 million and the return to the trust fund to be $5 million annually the return on investment is extraordinary. These are my estimates but can be substantiated.

The second event that needs to happen is a change in culture in BPC. Many, probably most, BPC operations have a gumshoe attitude. Many BPC investigators think of themselves as detectives and treat their cases accordingly, even very simple redundant cases. Needless to say the throughput with this attitude is not very large. Paper is power and a large case load is a sign of high status. On the positive side, my experience shows that even though most BPC staff are very reluctant to embrace initial automation efforts, after a year or so they are very happy with it. They find that they deal with the truly interesting and complex cases while the system performs all of the mundane work.

The biggest return on the dollar is automated case management. This is where the paperwork is. This is where the process slows down. In excess of 85% of this process can be automated. You should be made aware that most states still use software that was developed a distributed by the DOL in 1974. Needless to say it is horribly out of date, and even with state enhancements automates only a small part of the process.

3. In your testimony, you note that effective computer systems can reduce fraud and abuse by getting the word out so it can no longer be tolerated. Can you give us a specific example of where this has happened?

Response—The State of Washington has conducted a test in the Winachi region of western Washington where they audited 100% of claimants that their software detected as having a likelihood of being overpaid, no matter how low that likelihood. They found that the year after that audit the fraud in this region was substantially lowered though it continued to increase over 4 years when it almost returned to the previous levels. This was a documented study. I do not have a copy of it at this time but will try to obtain a copy for you or you may contact Kathy Ramoska, Chief of Special Investigations at 360–486–3001.

Thank you again for the opportunity to respond to Congressman Herger's letter. If you have any questions regarding my response or if I may be of any further service, please do not hesitate to contact me.

Sincerely,

Michael Lorsbach
Principal

[A submission for the record follows:]

Statement of Tim Rogers, Revenue Plus, Vancouver, Washington

Summary Statement

We at Revenue Plus have been keenly aware of the amount of overpayments that each state has been trying to collect using their existing antiquated computer systems. Many states have asked us to demonstrate to them how the Revenue Plus software will them prioritize their collection efforts and to help them manage, track and report on their Overpayment of Benefits. We have conducted demonstrations for the Departments of Labor in WA, TN, LA, AL, AZ, GA, CA, and MD. Our software has helped other Government agencies increase their revenue up to 50% and the Overpayments Benefits group could take advantage of this technology.

Benefits of using Revenue Plus Collection Software for Overpayments

1. Data matching—automatically links debtor accounts based on matching demographic criteria or other matches.
2. Notes—provides complete account history of all account activity including charges, payments, correspondence, direct contacts & etc.
3. Tickler file—provides at-a-glance information on current collection activities for an account and prompts the collector about the next action to be taken.
4. Automated Reports—for managers and Federal Government requirements
5. Integration with other databases and systems
6. Tax Intercept—automated process for possible refund offset
7. Work queues'—provides a prioritized daily work list of accounts for each collector to work the accounts with the highest priority first

States using Revenue Plus Collection Software for collection of Overpayments and UI Taxes

1. Maryland Central Collections
2. Colorado Central Services
3. Ohio Attorney General's Office

About Revenue Plus

Revenue Plus, headquartered in Vancouver, WA is the Public Sector Division of Columbia Ultimate—makers of the #1 ranked collection software system for collection agencies in the United States. Since 1982 Columbia Ultimate has been addressing the unique software requirements of Government entities by integrating our vast private sector experience and technology into innovative public sector solutions. There are 58 Government agencies and over 500 companies in the private sector using Columbia Ultimate Collection software.

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