KANSAS LEGISLATIVE
DIVISION of POST AUDIT

A Performance Audit Report Presented to the Legislative Post Audit Committee

Evaluating the Kansas Department of Labor's Response to COVID-19 Unemployment Claims (Part 1).

February 2021

Report Number: R-21-003

Introduction

The Legislative Post Audit Committee requested this audit and authorized it at its September 2, 2020 committee meeting.

Objectives, Scope, & Methodology

The audit request included three questions. For reporting purposes, we divided those three questions into two separate audit reports. This audit report answers the following question:

1. What types of unemployment claims fraud schemes is the Kansas Department of Labor aware of and how are they being addressed?

To answer this question we spoke to officials with the Kansas Department of Labor (KDOL), the U.S. Department of Labor's Inspector General, the Federal Bureau of Investigation, and the National Association of State Workforce Agencies to understand the types of fraud schemes that occurred nationally and in Kansas in 2020. We also interviewed KDOL officials and surveyed KDOL fraud staff to understand their process to detect fraudulent unemployment claims. We reviewed KDOL weekly reports and information they provided on fraudulent claims identified in Kansas to estimate how much unemployment fraud occurred in Kansas in 2020.

There was very limited information on the amount of fraud that occurred both in Kansas and nationally in 2020. That's because states and the federal government were still assessing the extent of fraud that occurred in 2020. We worked with KDOL officials to estimate how much fraud occurred in Kansas in 2020. However, our estimate is only intended to provide a general scale of the fraud that likely occurred in Kansas.

Several members of this audit team were either victims of unemployment fraud or knew someone that was a victim. We concluded these events did not constitute an actual impairment to the team's independence or ability to objectively complete this audit.

More specific details about the scope of our work and the methods we used are included throughout the report as appropriate.

Important Disclosures

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. Overall, we believe the evidence obtained provides a reasonable basis for our findings and conclusions based on those audit objectives.

The Kansas Department of Labor's fraud detection process was not designed to detect the large-scale, nationwide fraud campaign that occurred during the COVID-19 pandemic.

Unemployment Insurance Program Background

The Regular Unemployment Insurance program is administered by the Kansas Department of Labor (KDOL) and gives financial aid to unemployed individuals.

- The Regular Unemployment Insurance program is a joint program between federal and state governments. Although there are broad federal guidelines over the program, states establish their own criteria for who is eligible for Regular Unemployment insurance. States also decide the amount and duration of Regular Unemployment benefits.

- In Kansas, individuals must meet several criteria to qualify for Regular Unemployment benefits. For example, individuals must have met a minimum duration of employment and left work through no fault of their own (e.g., medical emergency, hostile workplace, layoffs, etc.).

- Generally, Regular Unemployment Insurance benefits are funded entirely by employer contributions in each state. Kansas employers contribute to the state's unemployment insurance trust fund, which is used to pay weekly benefits to unemployed individuals for 16 to 26 weeks depending on the state's unemployment rates. Based on state law, employers fall into two general categories:

    - A contributing entity is a private company or public employer that pays KDOL a quarterly unemployment tax before claims are made. This tax helps fund Kansas' unemployment trust fund. Contributing entities receive an annual statement summarizing their past year's charges. Charges occur when a company's former employee receives Regular Unemployment benefits. A company's future tax rate is based in part on their past charges. For example, a company with high prior-year charges could also see higher future taxes rates.

    - A reimbursing entity is a public employer, not-for-profit, or tribal entity that pays KDOL after claims are paid. They do this instead of paying a quarterly tax. Reimbursing entities are charged quarterly for any unemployment funds used. Typically, these entities are responsible for paying 100% of funds used. However, under the CARES Act, half of these employers' unemployment costs are reimbursed with federal funding. This is a temporary arrangement under the CARES Act, set to expire March 14, 2021.

- Kansas employees do not contribute any money to the trust fund.

In 2020, the federal government created three temporary unemployment insurance programs to help individuals who lost their jobs due to COVID-19.

- The COVID-19 pandemic significantly increased the unemployment rate nationally and in Kansas. Before the pandemic, the national unemployment rate was about 4% in January 2020 (about 3% in Kansas). By April 2020, the national unemployment rate rose to about 15% (about 12% in Kansas).

- In March 2020, Congress passed the CARES Act to help individuals negatively affected by the pandemic. The act included funding for three new unemployment insurance programs.

- The new programs differed from Regular Unemployment Insurance in a few ways. For example, the new programs were funded entirely with federal funds. Additionally, all the new programs were temporary and have either expired or are scheduled to expire in 2021.

- The new programs expanded unemployment benefits to include more people who lost their jobs due to COVID-19. For example, the Pandemic Unemployment Assistance program extended benefits to several new classes of workers. This included the self-employed (e.g., independent contractors) and gig workers (e.g., Uber drivers). Under this program, individuals not eligible for Regular Unemployment Insurance could receive up to about $500 per week for 39 weeks (a maximum of about $19,500) under the terms of the original CARES Act in 2020. The Federal Pandemic Unemployment Compensation (FPUC) program also gave an extra $600 per week to anyone already receiving unemployment benefits, for a period from late March through late July 2020. FPUC was renewed at a level of $300 per week in late December 2020 and will now run through Mid-March, 2021

- Benefits paid out for the temporary federal unemployment programs are paid with federal money and do not come from the state's unemployment trust fund.

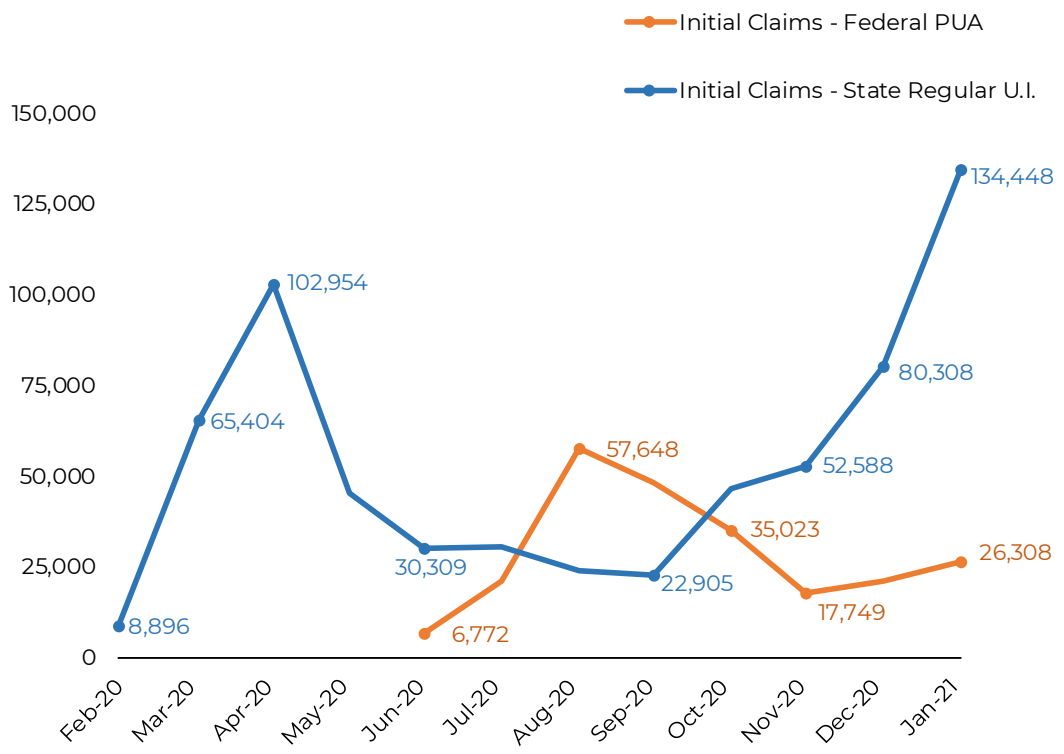
There were two main types of unemployment fraud alleged nationally and in Kansas during the pandemic.

- We reviewed claims reports from KDOL for both the state's Regular Unemployment program and the federal Pandemic Unemployment Assistance (PUA) program. That's because these programs have been specifically targeted by fraudsters during the past year. **Figure 1** shows claims filed from February 2020 through January 2021.

- COVID-19 created a massive spike in PUA claims in the summer 2020. As **Figure 1** shows, PUA claims spiked during the summer of 2020 but have steadily decreased since September 2020. It is possible the federal program saw an initial spike as individuals who needed PUA benefits applied for them for the first time. The PUA program has also been the focus of unemployment

fraud nationally and in Kansas. It is likely some portion of these claims reflect that fraud. PUA fraud is discussed in more detail in the following section.

Figure 1
Initial claims for the Regular Unemployment Program increased again in late 2020. (a)



(a) Monthly totals for initial claims only. This figure does not include continuing claims filed by claimants already receiving benefits.
Source: 2020 and 2021 KDOL Weekly Claims Reports (Unaudited).

- COVID-19 also created a massive spike in Regular Unemployment initial claims during the spring of 2020. As **Figure 1** shows, claims for the state's Regular Unemployment program increased from about 8,900 initial claims in February 2020 to about 103,00 initial claims in April. That's roughly a 1,060% increase.

- Regular Unemployment claims have spiked again in January 2021. KDOL officials told us that's because fraudsters began targeting the state's Regular Unemployment program in late 2020. Regular Unemployment fraud is discussed in more detail later in the report. It is possible that legitimate seasonal unemployment claims also contributed to this increase.

Federal Unemployment Program Fraud

Nationally, fraudsters targeted the new Pandemic Unemployment Assistance (PUA) program because of weaknesses in its application process.

- We spoke to officials with KDOL, the Federal Bureau of Investigation, the U.S. Department of Labor's Office of Inspector General, and the National Association of State Workforce Agencies. We spoke to these officials to understand what fraud schemes occurred nationally and in Kansas during the COVID-19 pandemic. According to those officials, fraudsters used a large-scale identity theft campaign to target the Pandemic Unemployment Assistance (PUA) program specifically.

- Because of how it was set up federally, fraudsters could easily falsify claims to get approved for PUA. Individuals must file a claim with KDOL to apply for and potentially receive unemployment benefits.

    - Fraudsters recognized they could apply for PUA benefits as "self-employed." Self-employed individuals were eligible for benefits under the new PUA program. Because there is no employer, states are limited in what they can do to verify the claim. This created an incentive for fraudsters to apply for PUA benefits.

    - Fraudsters could apply for PUA benefits without submitting supporting documents. To apply for PUA benefits, individuals must self-report their personal information and prior earned income. Generally, the PUA application process did not require applicants submit proof of prior income (e.g., pay stub, W2, invoices, etc.) to receive benefits. Because no documents were required, it was easy for fraudsters to file as self-employed.

- Fraudsters relied on large-scale identify theft to exploit weaknesses in PUA's application process. Fraudsters likely obtained stolen personal information from past large-scale data breaches. This could include the 2014 eBay data breach and the 2017 Equifax data breach, for example. In both cases, criminals stole the identities of over one hundred million people (e.g., names, addresses, social security numbers, etc.). Using this data, fraudsters could apply for PUA benefits in other peoples' names, usually in mass quantities.

- Unemployment funds are typically disbursed on debit cards or sent via direct deposit, making them easy to convert into cash. Like other unemployment programs, PUA benefits could be loaded on debit cards or deposited through direct deposit Fraudsters could use stolen names and social security numbers to apply but have the debit cards mailed to an address they specified. They could also have the funds deposited directly to an account of their choosing. Once they had access to the benefits it became difficult for government agencies to track or recover those funds.

- Once eligible for PUA, fraudsters could also receive additional benefits under the Federal Pandemic Unemployment Compensation program or the Lost Wages Assistance program.

Many of KDOL's existing processes were not effective to identify PUA fraud because of how the program was structured by the federal government.

- Before the pandemic, KDOL's fraud detection process was focused on the Regular Unemployment Insurance program. That program is used by employees who have an employer (e.g., not self-employed individuals). KDOL largely relied on a visual review of claims data and public assistance to identify fraud. Prior to benefits being paid, KDOL officials told us they reviewed state and federal wage reports to confirm claimants were recently employed. Claim notices were also sent to former employers, giving them a chance to contest the claim as potentially fraudulent. KDOL told us they also reviewed claims data for trends that might indicate fraud, including suspicious log-in credentials and duplicated fields. Claims were approved for payment if no red flags were raised during this process.

- Because of how the program was federally structured, the PUA program made it possible for fraudsters to circumvent KDOL's existing process for verifying potentially fraudulent claims with employers.

- Moreover, many of KDOL's other fraud detection methods were manual and not effective against the high number of claims filed during the pandemic. Unemployment claims for both Regular Unemployment and PUA increased dramatically during the pandemic in 2020. KDOL officials told us their fraud staff at the time were overwhelmed and did not have time to do a detailed review (e.g., comparing claims to wage reports or new-hire reports) on all claims during this time.

- During the pandemic, KDOL implemented two anti-fraud measures in addition to their existing processes.

    - In July 2020, KDOL put a 72-hour hold on all PUA claims before benefits could be paid out. They told us that KDOL staff reviewed PUA claims data during this time to identify suspicious information that could indicate fraud. KDOL staff put holds on any suspicious PUA claims, preventing payment.

    - KDOL also started a public campaign in August 2020 to ask individuals to report cases of identity theft and unemployment fraud. KDOL staff could then stop payment associated with those claims.

- KDOL officials told us that as of December 2020, about 157,000 claims were identified or reported as fraudulent. That's about 24% of the roughly 650,000 claims filed during that time. It wasn't clear to KDOL at the time of the audit how many of the fraudulent claims were related to the Regular

Unemployment program and how many were related to the temporary federal unemployment programs.

KDOL officials told us they are in the process of upgrading their fraud detection process to better identify PUA and other unemployment fraud.

- In December 2020, KDOL officials told us they partnered with a private company to improve its data analytic capabilities. KDOL officials hope this arrangement will give them access to new automated tools. These include programs that automatically flag claims data as suspicious, machine learning to identify new fraud trends, and a consistent way to score a claim's risk for fraud. These new automated tools could help make KDOL's fraud detection process more effective and efficient. KDOL officials hope to have these tools in place by early 2021.

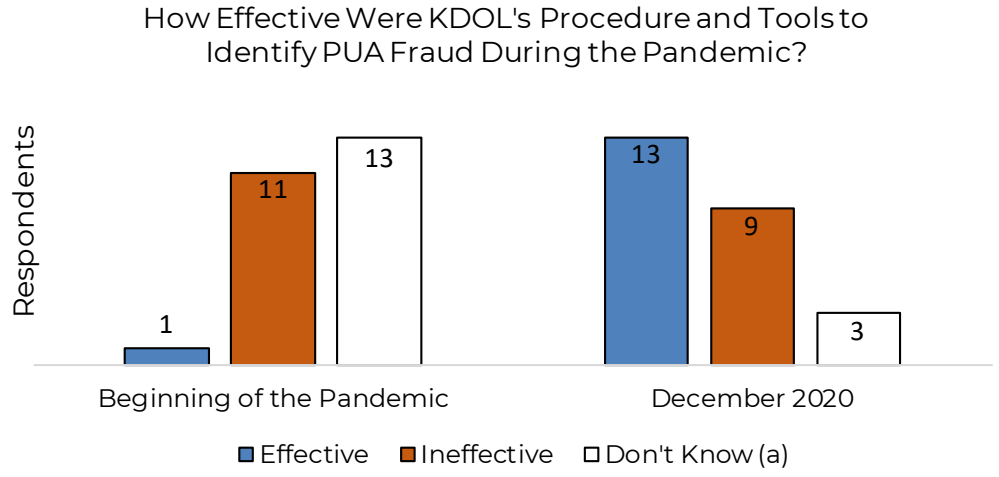
- In January 2021, KDOL implemented an identity verification system that could help combat cases of identity theft and unemployment fraud. Under the new system, all claimants are sent to a third-party site and asked to answer a series of questions to help verify their identify. The system uses a claimant's credit history to generate questions that only they should know. The claimant must successfully answer the questions in order to apply for benefits. This system could help reduce identify theft and fraudulent claims in Kansas.

- KDOL officials hope staff will have broader access to multi-state checks by February 2021. During the pandemic KDOL gained access to a data integrity hub that allows states to cross-check their unemployment claims data to better identify suspicious claims. However, IT limitations prevented all KDOL staff from having access to these tools in 2020.

- KDOL officials plan to document these and other new fraud detection procedures in the near future. Prior to the pandemic KDOL officials did not have a documented policy for their fraud detection process. A lack of a documented process could lead to inconsistencies in how KDOL staff look for fraud. KDOL officials understand the need to document their process and told us they plan to do so after they finish upgrading their process.

- KDOL fraud staff reported mixed reviews of KDOL's fraud detection measures. We surveyed all 36 KDOL fraud staff for their opinion on issues related to KDOL's fraud detection process. **Figure 2** shows the results of the survey. As the figure shows, of the 25 staff that responded (69% response rate) only one respondent said KDOL's process was effective to identify PUA fraud at the beginning of the pandemic. 13 respondents said KDOL's process to detect PUA fraud was effective as of December 2020. However, 9 staff still said the fraud detection process was ineffective in December 2020.

Figure 2
KDOL staff had mixed opinions on the effectiveness of KDOL's fraud detection process



(a) 13 respondents said they did not know how effective KDOL's procedures or tools were at the beginning of the pandemic. KDOL hired additional fraud staff as the pandemic continued. It is possible these staff were not employed or just recently employed at the beginning of the pandemic.
Source: LPA survey of KDOL fraud staff.

State Unemployment Fraud

Fraudsters targeted the state's Regular Unemployment program beginning in late 2020.

- According to KDOL officials, around November 2020 there was a rise in reported fraud cases targeting the state' Regular Unemployment program.

- KDOL officials could not tell us how many of the Regular Unemployment claims filed during this time were fraudulent, or how this fraud occurred. They speculate that fraudsters filed for Regular Unemployment in mass quantities to try and overwhelm the state's system. It is unclear at this time to what extent Regular Unemployment systems in other states were also targeted.

- KDOL officials told us they were still looking into how exactly fraudsters penetrated the state's Regular Unemployment system. KDOL officials speculated fraudsters attempts to overload the unemployment system could have impeded employers' ability to report fraudulent notices. Employers have 10 days to contest a claim from the time they receive a claim notice. Claims are processed for payment if not contested by an employer within 10 days. We were unable to determine whether these claims were sent timely as part of this audit.

- Additionally, KDOL's fraud detection process was fairly manual. It is possible overloading the system with claims made it difficult for KDOL staff to review claims for fraud.

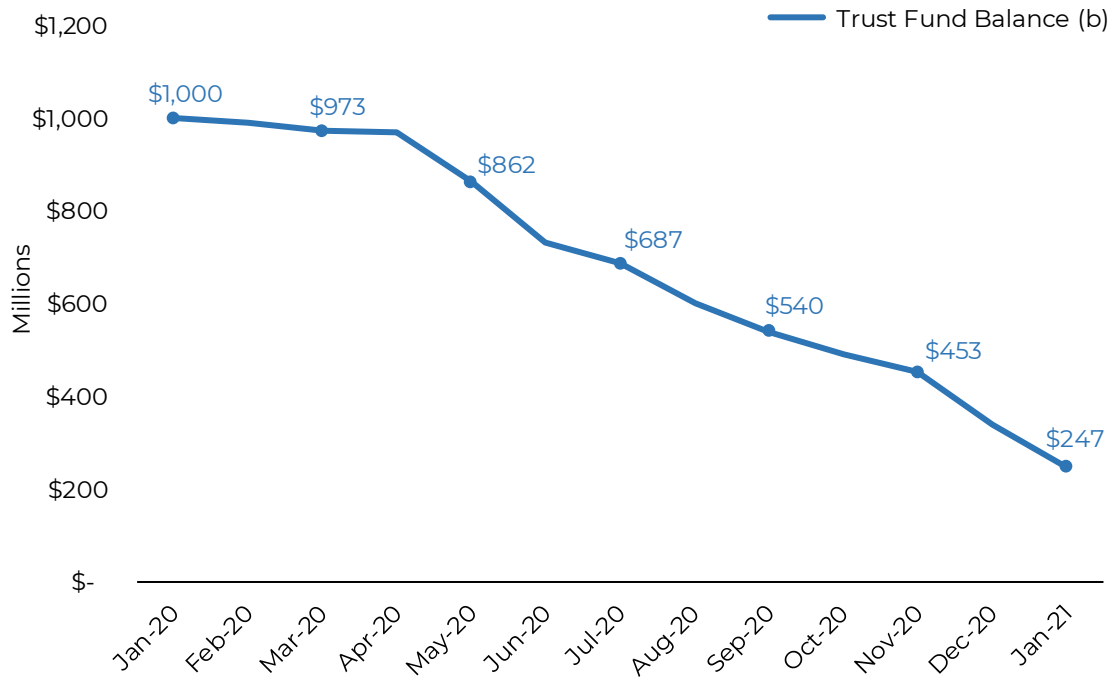
The state's unemployment trust fund balance has declined 75% in one year.

- The state's unemployment trust fund is used to pay Regular Unemployment claims. Most companies and public organizations pay KDOL a quarterly unemployment payroll tax to support the fund. Other public entities reimburse the trust fund for unemployment funds used to pay claims for their employees. Benefits paid out for the temporary federal unemployment programs do not come from the state's unemployment trust fund.

- **Figure 3** summarizes the monthly balance of the state's unemployment trust fund. As the figure shows, the balance of the state's unemployment trust fund dropped from about $1 billion in January 2020 to about $247 million as of January 25, 2021. That's about a 75% decrease. This is largely because January 2020 was the last month the fund had a positive net contribution. This means unemployment benefits paid out of the fund have exceeded tax contributions into the fund since February 2020.

Figure 3

The state's unemployment trust fund has declined 75% in one about one year (a).



(a) Trust fund balances through January 25, 2021.

(b) Trust fund balances are month-end balance.

Source: KDOL regular unemployment trust fund data. 2020 and 2021. (Unaudited)

- It was unclear at the time of this audit how much of this decrease was related to fraudulent claims. Both legitimate and fraudulent unemployment claims could be depleting the state's unemployment trust fund. As **Figure 1** showed, there were a significant number of claims filed for the Regular Unemployment program, both early in the pandemic and beginning again in November 2020. Both legitimate and fraudulent benefits would negatively affect the balance of the state's trust fund.

- Employer tax rates were adjusted to help replenish the state's unemployment trust fund. According to KDOL officials, employer tax rates are based in part on the state's unemployment trust fund balance. Historically, employers' tax rates were discounted up to 0.5% when the fund was in a surplus. This discount effectively reduced some companies' contribution rates to zero. However, KDOL officials told us they had to remove this discount per state law as the trust fund diminished last year. It is possible that alternative funding solutions may be needed to help replenish the state's trust fund.

Estimated Unemployment Fraud

Of the roughly $2.6 billion in state and federal unemployment benefits paid in Kansas in 2020, we estimated about $600 million (24%) could have been fraudulent.

- There was little information on how much fraud occurred in Kansas in 2020. Each year the U.S. Department of Labor reviews a sample of unemployment claims in each state to determine an estimated fraud rate. However, the U.S. Department of Labor did not have a complete 2020 fraud rate available at the time of this audit. KDOL officials reported about 157,000 potentially fraudulent claims were reported or identified from March 2020 (when the pandemic began) through the end of November 2020. However, KDOL officials had not yet assigned a dollar value to those claims at the time of this audit.

- As a result, we developed a preliminary estimate of how much fraud could have occurred in Kansas in 2020. We determined the 157,000 potentially fraudulent claims were about 24% of the roughly 650,000 initial claims filed from March through November 2020. We applied this estimated fraud rate to the total state and federal benefits paid out in 2020. This is meant to be a preliminary estimate only. We will use KDOL claims data to provide a more precise fraud estimate in part two of this audit.

- We estimated about $600 million in state and federal funds paid out in Kansas in 2020 could have been fraudulent. In total, KDOL reported expending about $2.6 billion on state and federal unemployment funds. That's comprised of about $970 million in state funds and $1.6 billion in federal funds. Applying our 24% fraud rate, we estimated

- about $200 million in fraud in state funds
- about $400 million in fraud in federal funds

- In its response, KDOL estimated about $300 million in unemployment benefits were paid on claims they identified as potentially fraudulent in 2020. Our analysis in part two of this audit will include a similar analysis. In addition, we also hope to use KDOL claims data to estimate how much in unemployment benefits were paid that KDOL did not identify as potentially fraudulent. For that reason, our estimate will likely exceed KDOL's initial estimate of $300 million.

Our fraud estimate is subject to some key assumptions and limitations.

- We included unemployment funds expended through Kansas' and the federal unemployment programs in 2020. Although it appeared PUA, and federal programs tied to PUA, were targeted during the pandemic, it is likely the state's Regular Unemployment program was also attacked to some degree in 2020. During our fieldwork, KDOL could not estimate how many of the 157,000 fraudulent claims it identified were related to the state's unemployment program versus the federal unemployment programs. Given this uncertainty, we applied our 24% fraud rate evenly between state and federal funds expended in 2020.

- Our estimate was based on the 157,000 total claims KDOL identified as potentially fraudulent. It is likely that more fraudulent claims occurred that KDOL did not catch. This would understate our estimate. For that reason, it is possible the actual amount of fraud that occurred in Kansas in 2020 was much higher.

- Not all of the 157,000 cases KDOL identified as potential fraud will be fraudulent. These claims were flagged and stopped by KDOL staff as suspicious but need to be investigated by KDOL law enforcement to determine fraud. It is likely not all 157,000 cases will end up being fraud. This would overstate our estimate.

- Our estimate included some Regular Unemployment benefits that were paid in January and February 2020, which could be considered pre-pandemic. However, given the relatively low number of claims filed during this time it is unlikely to significantly affect our estimate.

Impacts on Kansas Employees and Employers

If not reported to or stopped by KDOL, Kansas employees could owe taxes on benefits they never filed or received because of fraudulent claims.

- According to KDOL, benefits received under both the state's Regular Unemployment program and the temporary federal programs are considered taxable income. Claimants that received benefits in tax year 2020 will receive a

1099-G form from KDOL showing taxable benefits. Claimants need to include those benefits when filing their income taxes, which will likely increase their tax liability.

- Victims of unemployment fraud may receive 1099-G forms for unemployment benefits they never received. KDOL officials told us they attempted to flag, amend, and prevent 1099-G forms tied to known fraud cases from ever being mailed out. However, individuals still received 1099-G's for unemployment benefits they did not file or receive.

- KDOL officials were not able to provide the number of 1099-G forms that were sent in error. KDOL officials told us some forms were sent before the claim was identified as fraud. In other cases, the form may be tied to a fraudulent claim that KDOL never identified.

- KDOL officials told us anyone who received a 1099-G in error should contact them to amend it. If the individual does not report the fraud to KDOL, those individuals could be responsible for paying taxes on the fraudulent benefits. Individuals need to file an unsworn statement with KDOL attesting the form was sent in error. This should eliminate any taxes owed related to fraud. KDOL officials urge anyone who received a 1099-G form in error to contact the department's Tax Call Center at **785-575-1461** or by calling toll-free at **1-888-499-0063** to fill out this form. Individuals can also complete the form online by visiting www.UIAssistance.GetKansasBenefits.gov. There is no deadline for protesting a fraudulent 1099-G.

If not appealed or stopped by KDOL, private and public employers could be financially responsible for fraudulent claims filed under the state's Regular Unemployment program.

- Generally, an employer either pays for unemployment funds as a contributing entity or a reimbursing entity. Employers either contribute payroll taxes to the fund before claims are made (contributing) or pay no tax upfront but reimburse the fund after claims are made (reimbursing). Employer tax rates are based on a number of things including how long the employer has been in business, the employer's industry type, and their past payment experience.

- If not appealed in time, contributing and reimbursing entities could be financially responsible for fraudulent claims tied to the state's Regular Unemployment program.

    - Because contributing entities' tax rates are based on past charges, fraudulent charges against their account could increase their future tax rates.

    - Because reimbursing entities are responsible for paying KDOL back for benefits paid out, these organizations could be responsible for paying KDOL back for fraudulent claims. However, under the CARES Act, the

federal government repays reimbursing entities half of their unemployment costs. This could help reduce the employer costs associated with fraudulent claims by 50%. This provision of the CARES Act is set to expire March 14, 2021.

- Contributing entities receive "charge statements" annually and reimbursing entities receive them quarterly. These statements could alert them to fraudulent behavior. KDOL officials told us any private or public organization needs to contact KDOL to protest fraudulent charges. Depending on the circumstance, KDOL told us employers have 15 to 20 days to protest a statement once mailed. Otherwise, they could be responsible for the financial impact of the fraud. It is important to note that annual charge statements for contributing agencies are based on fiscal years. As such, fraud that occurred between July 1, 2020 and June 30, 2021 won't be reflected until 2021's statements. Those statements won't be mailed until October 2021.

- KDOL officials were unable to determine how much private and public organizations were charged due to fraud. KDOL officials told us they attempted to stop statements associated with claims flagged as fraud. However, it is possible some statements went out before the claim was flagged. Other statements might be associated with fraudulent claims KDOL never identified. For these reasons, KDOL officials told us they could not determine how much organizations were charged due to fraud.

- It is important to note this issue only applies to fraud within the state's Regular Unemployment program. Public and private employers would not be affected by fraud within the temporary federal unemployment programs, such as PUA.

KDOL reported potentially fraudulent cases to federal agencies for investigation but focused its investigative resources on stopping fraudulent claims during the pandemic.

- KDOL's special investigations unit is responsible for the criminal investigation of potentially fraudulent claims. At the time of this audit, the unit consisted of five licensed law enforcement officers and one special investigator.

- KDOL officials told us they prioritized stopping fraudulent claims over pursuing criminal charges. Officials told us the special investigations unit was reassigned during the pandemic to help identify and stop potentially fraudulent claims.

- KDOL officials told us they are in the process of working with federal agencies to investigate potentially fraudulent claims. These agencies include the Federal Bureau of Investigation and the U.S. Department of Labor's Office of Inspector General for investigation. It is possible that out-of-state or out-of-country cases could be turned over to those offices for investigation.

Conclusion

The COVID-19 pandemic created a unique opportunity for fraudsters across the nation. It resulted in a massive spike in unemployment claims that would challenge even the most adept unemployment systems. It also resulted in a new federal Pandemic Unemployment Assistance program with far fewer verification requirements than the state's program. Kansas was clearly not well prepared to address either situation. The combined effect has been significant fraud within the federal program and some fraud almost certain to affect the state's program.

Recent trends suggest that the state's unemployment system is now being targeted by fraudsters. This could have significant consequences for some Kansas employers, especially nonprofits, government entities, and tribal organizations that chose to reimburse the state instead of making unemployment contributions. That is because these employers are currently responsible for covering the costs of these claims unless they can successfully appeal them. Moreover, Kansas taxpayers are hurt by fraud at both the federal and state level. Not only because their identities have been stolen, but because they may face a tax liability if they don't report fraudulent benefits they never received.

Recommendations

We did not have any recommendations for part 1 of this audit but will be considering recommendations for part 2.

Agency Response

On February 16, 2021 we provided the draft audit report to the Kansas Department of Labor. The Department raised a number of concerns with the report findings and our fraud estimate. The agency's full response is below. We carefully reviewed the information agency officials provided, but ended up only making minor changes to our findings.

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Amber Shultz, Acting Secretary

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February 19, 2021 **CONFIDENTIAL**

Matt Etzel
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RE: Audit Objective 3 of the Kansas Department of Labor's COVID-19 Unemployment Claim Response

Dear Mr. Etzel:

On behalf of the Kansas Department of Labor (KDOL), I welcome the opportunity to respond to the above-referenced audit (the Audit). While KDOL recognizes Kansas Legislative Division of Post Audit's (LPA's) cooperation in exchanging data for the Audit, KDOL is disappointed that the data was not used to provide a credible estimate of the extent of unemployment insurance fraud in Kansas.

LPA's estimate of $600 million in potential fraud is flawed in both its underlying assumptions and methodologies, and for the reasons laid out below, KDOL requests LPA withdraw this estimate as insufficiently supported. Critically, KDOL believes LPA misunderstands how fraud is distinct between the new federal unemployment insurance programs and the existing state unemployment insurance system. Addressing unemployment insurance fraud is of paramount importance to the state of Kansas and the nation. We hope this response clears up some confusion that may have adversely affected the Audit's findings.

Since the passage of the CARES Act, international and domestic fraudsters have acted in a highly coordinated effort to defraud state unemployment trust funds across the nation and the federal Pandemic Unemployment Assistance program. According to conservative estimates from the United States Department of Labor (USDOL), this fraud totals at least $360 billion. Sources further indicate that this is an issue being faced by all 50 states, Washington D.C., and United States territories.

Executive Summary:

The Audit suffers from three major flaws, which have permeated the entire audit. First, LPA's estimate of fraud at the state and federal level has not been reliably generated. There are errors in the underlying assumptions. KDOL's chief concern is the completely unsupported assumption that there was a uniform fraud rate between the state and federal unemployment programs. Even LPA acknowledges the limitations of its assumptions, including the uniform fraud rate. This estimate should be withdrawn because it is not sufficiently supported. Second, LPA misunderstands important distinctions between the new federal pandemic unemployment insurance programs and the existing state unemployment insurance program. For example, LPA fails to understand the consequences surrounding USDOL's guidance on the Pandemic Unemployment Assistance (PUA) program that states are prohibited from asking claimants to provide documentation to prove eligibility and the impact it has on KDOL's ability to combat fraud. This issue was even publicly debated between USDOL's internal watchdog, the Office of Inspector General (OIG), and Employment and Training Administration (ETA), but ETA doubled-down that PUA claimants were not required to provide documentation to prove eligibility. Congress resolved this vulnerability in the PUA program and amended the law on December 27, 2020. Third, LPA misunderstands KDOL's measures to combat fraud. KDOL's fraud detection processes comply with federal guidance, and if LPA had examined the efficacy of these processes, LPA would have recognized that many of them—even if automated—would not have rapidly and proactively prevented, detected, and investigated fraudulent activity in the PUA program.

I. The estimate of $600 million in potential fraud is flawed and should be withdrawn.

LPA estimated the level of potential fraud by taking the number of claims KDOL identified as fraudulent (157,000), dividing by the total number of initial claims filed between March through November of 2020 (650,000), to arrive at an estimated fraud rate of 24%. LPA then applied this fraud rate to the total paid out in federal and state benefits ($2.6 billion) to arrive at an estimate of $600 million.

There are several issues with this analysis, which LPA acknowledges as limitations when discussing its assumptions. First, not all of the 157,000 identified potential fraud claims paid out. This number represents those claims that were flagged as potential fraud, and in many cases stopped before funds were paid on the claim. LPA notes this limitation on page 11, and states that this issue would <u>overstate</u> LPA's estimate. Further, LPA notes that the 157,000 potentially fraudulent claims are just those identified by KDOL, and that the actual number may be higher for the potentially fraudulent claims KDOL did not catch. Thus, LPA acknowledges there is both potential to overestimate and underestimate, but LPA does not, nor would it be prudent to do so, suggest the potential overestimate and underestimate

counterbalance such that there is an appreciable degree of confidence in the overall estimate.

The second issue with LPA's methodology is that it used a uniform fraud rate of 24% in estimating potential fraud in both state and federal programs. As discussed in more detail below, the PUA program, one of the new temporary federal programs, was rife with fraud because of how the federal legislation was drafted and because it was an entirely new unemployment insurance system for which traditional anti-fraud measures used in the state unemployment insurance system were not readily adaptable.

LPA acknowledged this limitation in the audit, but referred to it as an "uncertainty" on page 11; despite this uncertainty, LPA forged forward to provide estimates of potential state and federal fraud. Additionally, LPA **did not use** the data provided by KDOL to develop an estimate rooted in more realistic data. For example, LPA could have taken the list of claimants with fraud codes placed and cross-referenced that with the list of payments made. That relatively simple analysis, similar to what KDOL is performing and finalizing internally, would have produced numbers with at least some basis in reality, such as the below (which was developed with exactly the data provided to LPA by KDOL):

	Amount Paid to Claimants with Fraud Codes, by Program
EB	$ 689,587.00
PEUC	$ 5,056,403.00
PUA	$ 42,040,362.00
UI REGULAR	$ 137,401,838.00
FPUC	$ 105,537,476.00

Unfortunately, the impact of the uncertainty on LPA's estimates with the methodology utilized in the audit cannot be ignored and has not been quantified. KDOL respectfully requests these estimates be withdrawn as insufficiently supported and encourages LPA to use the data provided to develop more realistic estimates.

II. LPA oversimplifies, neglects, and misstates the laws and requirements regarding state unemployment insurance.

The state unemployment insurance program is a joint program between federal and state governments. However, there is more to the state unemployment insurance program than LPA's simplification of "broad federal guidelines" as described on page 2. State unemployment insurance programs are governed in part by Sec. 303 of the Social Security Act (SSA).[1] Sec. 303 of the SSA specifies what states must include in their unemployment insurance laws. This entails, just to name a few of the federal requirements, how the state can use money from their state unemployment insurance trust fund and what information claimants are required to disclose.[2]

And while the states do establish criteria for who is eligible for state unemployment insurance, they do not have free reign to do whatever they want. States have limited flexibilities for establishing their own eligibility criteria subject to compliance with federally-mandated eligibility requirements.

LPA misunderstands certain unemployment insurance eligibility requirements when it stated that Kansas employees must meet "a minimum duration of employment." State law requires individuals to be monetarily entitled to receive unemployment insurance, meaning they must have received wages from insured employment in two or more quarters of their base period, and have total base period wages equaling at least 30 times their calculated weekly benefit amount.[3]

LPA misstates the law once again and says funding of the Kansas' unemployment insurance program falls exclusively on Kansas employers. LPA's generalization is not only overly simplistic, but it is also misleading. There are several funding mechanisms that contribute to administering the entire state unemployment insurance program, such as federal government grants and public employment services programs.[4]

What LPA should have clarified is that the state unemployment insurance trust fund that pays unemployment insurance benefits to claimants is funded by employer contributions. Employers are charged only for state unemployment insurance benefits paid to claimants who are eligible and qualified. As LPA pointed out, the state unemployment insurance program is a joint program between federal and state governments, meaning the federal government helps fund the administration of a state's unemployment insurance laws and Kansas employers fund the state unemployment insurance trust fund.

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[1] 42 U.S.C. 503, et seq.
[2] 42 U.S.C. 503, et seq.
[3] K.S.A. 44-705(e).
[4] See 20 C.F.R. 601.6.

To be clear, none of the employers described below will be charged for benefits paid out under any of the federal unemployment insurance programs created in response to the COVID-19 pandemic.

- **A Contributing Employer** is any employer other than a reimbursing employer.[5] A contributing employer is required to report total wages paid each employee during each quarter, but pays taxes based upon a taxable wage base as defined in K.S.A. 44-703(o)(1). The quarterly tax funds the Kansas unemployment trust fund. Contributing entities receive an annual statement of their pro rata share of unemployment benefits which were charged to their account. The benefit charges will be used in the computation of the annual contribution experience rate.[6]

  Contributing employers will not be charged if KDOL finds that one of their employees (1) was discharged for misconduct, (2) left work voluntarily, or (3) was discharged from an employer directly impacted by COVID-19.[7] **Contributing employers will not be charged for claims KDOL determines are fraudulent.**

- **A Reimbursing Employer** is only available to nonprofit 501(c)(3) organizations, governmental entities, or tribal entities.[8] With this option, the employer reports total wages paid each employee each quarter, but pays no tax at the time. Instead, the law requires the employer to reimburse the fund 100 percent for any benefits paid to their former employees with quarterly statements.[9]

  LPA is correct that under the CARES Act, the federal government allowed KDOL to reduce reimbursing employer's contributions by 50%.[10] Congress had many opportunities to amend the CARES Act and allow the states to reduce reimbursing employer's contributions by 100%, but decided to leave it at 50%. **Reimbursing employers will not be charged for claims KDOL determines are fraudulent.**

- **A Rated Governmental Employer** may elect to make payments to the Unemployment Insurance Trust Fund as a contributing employer, reimbursing employer, or a rated governmental employer.[11] If a rated governmental employer choses to make payments as such, then they report and make benefit cost payments based upon total wages paid during each calendar quarter. Rated governmental employers eligible for a contribution rate make quarterly payments at a calendar

[5] K.S.A. 44-703(y).
[6] See K.S.A. 44-710(b).
[7] K.S.A. 44-710(c)(2)(A).
[8] K.S.A. 44-710(e).
[9] K.S.A. 44-710(e)(2).
[10] Sec. 2103(b) of the CARES Act, as amended by the Protecting Nonprofits from Catastrophic Cash Flow Strain Act of 2020, Pub. L. 116-151, as amended by Sec. 202 of the Continued Assistance for Unemployed Workers Act of 2020.
[11] K.S.A. 44-710d.

year rate determined by the experience of all rated governmental employers and the individual employer's experience.

Rated governmental employers are not charged if KDOL finds that one of their employees was discharged for misconduct, left work voluntarily, or were discharged from an employer directly impacted by COVID-19. [12] **Rated governmental employers will not be charged for claims KDOL determines are fraudulent.**

III. LPA oversimplifies, neglects, and misstates the laws and requirements regarding the federal unemployment insurance programs Congress has created in response to the COVID-19 pandemic.

A. LPA fails to understand the consequences surrounding the PUA program's requirement that claimants do not need to provide documentation to prove eligibility and the impact it has on KDOL's ability to combat fraud.

LPA briefly mentioned that fraudsters have targeted the PUA program because they do not have to submit supporting documentation to prove eligibility. However, LPA ends the analysis there. What LPA fails to recognize is that requiring claimants to provide documentation is an anti-fraud tool. KDOL was prohibited from requiring claimants to provide documentation to establish their eligibility because of federal law and guidance, until recently.

As explained in further detail below, PUA is a federal unemployment benefit program created on March 27, 2020 under the Coronavirus Aid, Relief, and Economic Security (CARES) Act of 2020 that provides benefits to individuals who are either ineligible or have exhausted all their rights to regular unemployment insurance, PEUC, and other federal and state unemployment insurance programs. USDOL has referred to PUA as a "benefit of last resort."[13] To be eligible for PUA, claimants only have to self-certify that they are otherwise able and available to work within the meaning of state unemployment insurance law, except that they are unemployed, partially unemployed, or unable or unavailable to work due to one of the COVID-19 related reasons identified in the CARES Act.[14]

Due to an influx of questions from the states on implementing this brand new program, USDOL issued additional guidance to address the states' questions on April 27, 2020.[15] In this new guidance, **USDOL stated that PUA claimants do not need to provide "proof of employment**

[12] K.S.A. 44-710(c)(2)(A).
[13] UIPL 16-20, Change 1, Attachment I, I-8 Q 33.
[14] Sec. 2102(a)(3)(A)(ii)(I) of the CARES Act.
[15] UIPL 16-20, Change 1, *Coronavirus Aid, Relief, and Economic Security (CARES) Act of 2020 – Pandemic Unemployment Assistance (PUA) Program Reporting and Instructions and Questions and Answers, available at* https://wdr.doleta.gov/directives/attach/UIPL/UIPL_16-20_Change_1.pdf.

or self-employment to qualify for PUA, nor does PUA take into account the individual's principal source of income as part of the self-certification process."[16]

Kansas was very concerned with this guidance, as proof of employment and wages are two key tools that states use to combat fraud. This guidance even prompted USDOL-OIG to publicly voice its concerns to USDOL-ETA on May 26, 2020 that, "state's reliance on self-certifications alone to ensure eligibility for PUA will lead to increased improper payments and fraud."[17] For example, USDOL-OIG stated that, "An individual could continue to receive an average of $775 per week based solely on an initial undocumented self-certification statement that one of the COVID-19 related reasons were met; and by acknowledging any intentional misrepresentation to obtain PUA benefits constitutes fraud."[18] Applying the FPUC program to USDOL-OIG's scenario, this hypothetical payment could be increased to $1,375 per week. USDOL-OIG provided USDOL-ETA with its interpretation and argued that states have the authority to require claimants to submit documentation to substantiate employment and wages, so that only legitimate claimants would receive PUA funds.

USDOL-ETA agreed with USDOL-OIG that the way the CARES Act is "statutorily construct[ed] may introduce a degree of risk of fraud" in its response on June 5, 2020.[19] However, USDOL-ETA noted that it is sole arbiter of policy pronouncements and legal interpretations, and is "singularly charged with providing guidance to the states for administering the self-certification eligibility process under the PUA statute."[20] USDOL-ETA doubled-down on its guidance prohibiting states from requiring PUA claimants to submit any documentation as a condition of eligibility to substantiate (1) employment or self-employment, (2) why they are unemployed due to COVID-19, or (3) wages. The only instance where PUA claimants are required to provide documentation is if they want a weekly benefit amount (WBA)

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[16] UIPL 16-20, Change 1, Attachment I, I-1.

[17] Memorandum (i.e. OIG Alert Memorandum) from Elliot P. Lewis, Assistant Inspector General Office of Audit, OIG-USDOL, for John P. Pallasch, Assistant Secretary of ETA, Subject: *Alert Memorandum: The Pandemic Unemployment Assistance Program Needs Proactive Measures to Detect and Prevent Improper Payments and Fraud Report Number: 19-20-002-03-315*, page 1, issued May 26, 2020, *available at* https://www.oversight.gov/sites/default/files/oig-reports/Alert%20Memorandum%20The%20Pandemic%20Unemployment%20Assistance%20Program%20Needs%20Proactive%20Measures%20to%20Detect%20and%20Prevent%20Improper%20Payments%20and%20Fraud.pdf.

[18] OIG Alert Memorandum, page 1.

[19] Memorandum (i.e. ETA Response Memorandum) from Kate O'Scannlain, Solicitor, ETA-USDOL and John Pallasch, Assistant Secretary of ETA, for Scott S. Dahl, Inspector General OIG-USDOL, Subject: *Response to the Office of Inspector General's (OIG) Alert Memorandum: The Pandemic Unemployment Assistance Program Needs Proactive Measures to Detect and Prevent Improper Payments and Fraud, Report Number: 19-20-002-03-315*, page 3, issued June 5, 2020, *available at* https://www morganlewis.com/-/media/files/document/2020/covid-19/Response-to-Office-of-Inspector-Generals-Alert-Memorandum.pdf.

[20] ETA Response Memorandum, page 2. If not, States do not know if they can continue to follow the guidance ETA provides on all federal-state unemployment insurance program and requirements.

greater than the minimum.[21] Thus, even if claimants fail to provide documentation to substantiate a higher WBA, a claimant remains eligible for PUA.

Recognizing that states were hampered to combat PUA fraud, **Congress amended the law on December 27, 2020. The law now requires claimants to provide documentation to substantiate their employment or self-employment to be eligible to receive PUA.**[22] KDOL now requires all PUA claimants, those who previously received PUA payments and those who will file new PUA claims, to provide employment/self-employment documentation. Failure of claimants to do so will result in them being ineligible for PUA and possible overpayments.

B. LPA misunderstands the number of federal unemployment insurance programs that were created under the CARES Act, when they were created, and how they were created.

First, LPA states that the CARES Act "created funding for six new unemployment insurance programs." The CARES Act did not create six new unemployment insurance programs. The CARES Act created three:

1. **Pandemic Unemployment Insurance (PUA)** provided up to 39 weeks of unemployment insurance benefits to individuals who have either exhausted their entitlement to regular UC or are not eligible or qualify for regular UC (i.e. individuals who are self-employed, have limited recent work history, certain gig economy workers, clergy and those working for religious organizations).[23] To be eligible for PUA, individuals must also be otherwise able and available for work within the meaning of state unemployment insurance law, except that they are unemployed, partially unemployed, or unable or unavailable to work due to a specific COVID-19 related reason identified in the CARES Act.[24] The individual must self-certify to the specific reason why they are unable or unavailable to work due to COVID-19.[25] Under Sec. 201(b) of the Continued Assistance for Unemployed Workers Act of 2020 (CAA), which was signed into law on December 27, 2020, PUA was expanded to provide claimants up to 50 weeks of unemployment insurance benefits to these individuals.

2. **Pandemic Emergency Unemployment Insurance (PEUC)** provided unemployment insurance benefits to claimants in the amount of 13 times their calculated weekly benefit amount if they have exhausted all their rights to regular

[21] ETA Response Memorandum, page 7.
[22] See Sec. 241 of the CAA.
[23] See Sec. 2102 of the CARES Act (Pub. L.) 116-136.
[24] Sec. 2102(a)(3)(A)(ii)(I) of the CARES Act.
[25] Sec. 2102(a)(3)(A)(ii) of the CARES Act.

unemployment insurance under state or federal law.[26] Claimants must otherwise be able to work, available to work, and actively seeking work similar to regular unemployment insurance claimants.[27] Under Sec. 206(b) of the CAA, PEUC was expanded to provide claimants with benefits in the amount of 24 times their calculated weekly benefit amount.

3. **Federal Pandemic Unemployment Insurance (FPUC)** provided an additional $600 per week to individuals who are collecting at least $1 of unemployment insurance from either state or federal programs.[28] The first week this additional $600 was payable was the week ending April 4, 2020.[29] The FPUC program expired on July 31, 2020.[30] Under the CAA, the FPUC program was reactivated, but now provides an additional $300 per week to individuals collecting at least $1 of unemployment insurance from either state or federal programs. FPUC at $300 is set to expire the week ending March 13, 2021.

These three programs were the only new federal unemployment insurance programs created by the CARES Act. Although LPA is correct that these programs are federally funded, LPA neglects to inform in its Audit that employers will not be charged for benefits paid under any of these programs.

What LPA should have clarified is that after FPUC expired, the President established the **Lost Wage Assistance Program (LWA)** through a Presidential Memorandum, and was a program administered by the Federal Emergency Management Agency (FEMA).[31] LWA provided claimants who were receiving at least $100 of unemployment insurance from state or federal programs up to $400 of wage assistance per week, with a $300 federal contribution. The remaining $100 had to be contributed by the state. Kansas chose to meet its $100 contribution per claimant with the payments KDOL makes for regular unemployment insurance benefits to claimants that met the requirement to be unemployed or partially unemployed as a result of COVID-19.[32] LWA claimants also had to self-certify that they were unemployed or partially unemployed because their work or workplace was directly impacted by the COVID-19

[26] See Sec. 2107 of the CARES Act.
[27] See Sec. 2107 of the CARES Act.
[28] Sec. 2104 of the CARES Act.
[29] UIPL No. 15-20, *Coronavirus Aid, Relief, and Economic Security (CARES) Act of 2020 - Federal Pandemic Unemployment Compensation (FPUC) Program Operating, Financial, and Reporting Instructions*, page 3, issued April 4, 2020, *available at* https://wdr.doleta.gov/directives/corr_doc.cfm?DOCN=9297.
[30] Sec. 2104(e)(2) of the CARES Act.
[31] Authorizing the Other Needs Assistance Program for Major Disaster Declarations Related to Coronavirus Disease 2019, August 8, 2020.
[32] UIPL 27-20, *Presidential Memorandum on Authorizing the Other Needs Assistance Program for Major Disaster Declarations Related to Coronavirus Disease 2019 (COVID-19)-Unemployment Insurance (UI)-Related Technical Assistance for States Administering Lost Wages Assistance (LWA)*, page 4, issued August 12, 2020, *available at* https://wdr.doleta.gov/directives/attach/UIPL/UIPL_27-20.pdf.

pandemic. LWA was only available for the weeks ending August 1, 2020 through September 5, 2020 and is funded by FEMA.

The other program that LPA may be referring to is the **Federal-State Unemployment Insurance Extended Benefits (EB) Program**. Kansas' EB program can be found in K.S.A. 44-704a and K.S.A. 44-704b and provides claimants either 13 weeks or 20 weeks of unemployment insurance benefits, depending on the state unemployment rate, to individuals who have exhausted regular unemployment insurance and PEUC. [33] Contributing employers and rated governmental employers are not charged for any EB benefits paid.[34] Furthermore, as authorized by Sec. 2103 of the CARES Act, KDOL is permitted to reduce the amount of EB benefits charged to a reimbursing employer by 50%.

IV. LPA misunderstands that anti-fraud tools used in the state unemployment insurance program do not adequately address: (A) fraud prevention in the federal PUA program as the PUA program did not require individuals to provide proof of self-employment until Congress created this eligibility requirement through the recently enacted CAA in late December of 2020; and (B) prevention and detection of imposter claims resulting from identity theft.

In its Audit, LPA concludes that "[m]any of KDOL's existing processes were manual and not effective to identify PUA fraud." To support its conclusion, LPA appears to be blindly relying on their KDOL staff emailed survey rather than doing an in-depth analysis of the federally-recommended anti-fraud tools that KDOL had in place at the time LPA conducted the Audit.

A. PUA Fraud

In making this statement, LPA first suggests these fraud-detection processes would have been effective in identifying PUA fraud had KDOL's implementation of these processes been automated rather than manual. KDOL disagrees.

Recognizing the historic amount of fraud all the states were experiencing, USDOL issued guidance on program integrity and listed mandatory and strongly recommended tools the states should use to combat fraud.[35] KDOL's fraud detection processes complies with

[33] UIPL 24-20, *Temporary Changes to the Federal-State Extended Benefits (EB) Program in Response to the Economic Impacts of the Coronavirus Disease 2019 (COVID-19) Pandemic Emergency*, page 3, *available at* https://wdr.doleta.gov/directives/attach/UIPL/UIPL_24-20.pdf.
[34] K.S.A. 44-710(c)(2)(C).
[35] UIPL 23-20, *Program Integrity for the Unemployment Insurance (UI) Program and the UI Programs Authorized by the Coronavirus Aid, Relief, and Economic Security (CARES) Act of 2020 – Federal Pandemic Unemployment Compensation (FPUC), Pandemic Unemployment Assistance (PUA), and Pandemic Emergency Unemployment Compensation (PEUC) Programs*, *available at* https://wdr.doleta.gov/directives/attach/UIPL/UIPL_23-20.pdf.

USDOL's guidance, and if LPA had examined the efficacy of these processes, LPA would have recognized that many of them—even if automated—would not have rapidly and proactively prevented, detected, and investigated fraudulent activity in the PUA program.

- For example, **the new hires cross-matching** is a fraud detection process used to compare new hires in the national and state directory of new hires databases to claimants who continue to file for unemployment insurance benefits after the hire date is submitted by their employers. Basically, the reports from employers of recent hires are cross-matched against claimants to see if claimants may have found new work that they are not reporting on their claims for benefits. However, because PUA benefits are provided mostly to self-employed claimants, their information would not appear in these national and state new hires databases. This means that the federally-recommended fraud detection process of new hires cross-matching, itself, is not an effective tool to identify a majority of PUA fraud.

- Similarly, **the quarterly wage cross-matching** is a process used to compare employer quarterly wage reports to claimants who continue to file for unemployment insurance benefits while receiving wages. Under state law, this report is due at the end of each calendar quarter. This report reveals claimants that are employed by certain employers, not self-employed, which means that the federally-recommended fraud detection process of quarterly wage cross-matching, once again, is not an effective tool to identify a majority of PUA fraud.

- Likewise, **the state information data exchange system (SIDES)** is a database where employers and third party administrators supply information. It is unlikely that self-employed individuals are reporting their job separation and earnings verification information to SIDES. Therefore, the use of this federally-recommended fraud detection process, once again, is not an effective tool to identify a majority of PUA fraud.

In its Audit, LPA also overlooked the difficulties in maintaining program integrity when the law surrounding the PUA program made the program vulnerable to fraud. As described in Section III A. of this response, this issue was brought up and challenged by USDOL-OIG against USDOL-ETA regarding USDOL-ETA's guidance limiting states' authority to substantiate PUA claimant eligibility with documentation. In overlooking this controversial issue between USDOL-OIG and USDOL-ETA, LPA failed to recognize Congress' recent addition of a new eligibility requirement to the PUA program in the CAA that essentially combats fraud by requiring individuals to now submit documentation to substantiate employment or self-employment, or planned commencement of employment or self-employment within a certain period from the date of application to be eligible for PUA benefits.

B. Identity Theft

Second, LPA often mistakenly applies the strategies of fraud detection to the strategies for prevention of imposter claims resulting from identity theft. **This overlooks the reality that many traditional fraud management tools and resources are ineffective in preventing imposter claims resulting from identity theft.** For instance, identify verification tools, such as the Social Security Administration Cross-Match do not prevent or detect imposter claims resulting from identity theft when fraudsters use valid social security numbers and valid names—obtained through large nationwide data breaches like Target, Equifax, or the U.S. Office of Personnel Management—to file for unemployment insurance benefits. Fraudsters using valid names connected with valid social security numbers allows them to bypass the checks put in place through fraud-combatting tools, such as the Social Security Administration Cross-Match.

Unfortunately, the FBI notes that identity theft in unemployment claims is a nationwide problem.[36] The Audit needs to provide the national context for this issue, and the Audit should not suggest that KDOL was "clearly not well prepared to address" the spike in unemployment claims because it suggests some state was. A more apt description is that KDOL was not sufficiently resourced to be in a position to respond to the demands of the new federal programs, which are now acknowledged to have been originally drafted with serious vulnerabilities for exploitation and fraud.

USDOL recognized the need to release additional guidance to assist states in the prevention and detection of **imposter claims from identity theft** when it issued additional guidance on August 31, 2020.[37] This guidance came approximately 5 months after the CARES Act was signed. USDOL reminded states to follow identity verification measures, including data analytics that identified shared characteristics among claims that displayed indicators of suspicious claims activity.

LPA does not make any findings of what preparedness measures KDOL should have taken in addition to its existing tools and KDOL's additional anti-fraud measures (72-hour holds, public assistance, and data analytic tools). As identified by LPA in its Audit, KDOL has implemented data analytics tools by initially reviewing claims for trends of suspicious log-

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[36] *FBI Sees Spike in Fraudulent Unemployment Insurance Claims Filed Using Stolen Identified*, FBI National Press Office, July 6, 2020, *available at* https://www fbi.gov/news/pressrel/press-releases/fbi-sees-spike-in-fraudulent-unemployment-insurance-claims-filed-using-stolen-identities.

[37] UIPL 28-20, *Addressing Fraud in the Unemployment Insurance (UI) System and Providing States with Funding to Assist with Efforts to Prevent and Detect Fraud and Identity Theft and Recover Fraud Overpayments in the Pandemic Unemployment Assistance (PUA) and Pandemic Emergency Unemployment Compensation (PEUC) Programs*, *available at* https://wdr.doleta.gov/directives/attach/UIPL/UIPL_28-20.pdf.

in credentials and duplicated fields to currently using tools that automatically flag claims data through machine learning that identifies new fraud trends.

V. LPA's Audit is rife with additional factual errors.

KDOL points out other areas in which LPA's Audit contains additional factual errors:

- **Figure 1, pp. 3 to 4.** LPA's selected numbers in Figure 1 are misleading, and it is unclear what source LPA used to support their analysis. All the regular unemployment insurance claim numbers do not reflect KDOL's recent revisions submitted to USDOL-ETA. PUA claims began in May 2020, not June 2020. The numbers displayed do not represent monthly totals.

- **Figure 2, pp. 7 to 8.** LPA's analysis from its emailed survey identifies, but fails to highlight, that many of the respondents opined on KDOL's performance in the beginning of the pandemic when not employed by KDOL at the beginning of the pandemic. LPA did not interview any respondents. Rather, LPA relied solely on its one-time responses from newly-hired staff.

- **Last bullet, p. 4.** Contrary to LPA's conclusion that the increase of regular unemployment claims in January 2021 was due solely to fraudsters, KDOL officials have explained that the recent increase is likely related to multiple factors. There is usually a seasonal increase in claims for industries like construction, and manufacturing will sometimes see temporary layoffs around the holidays. There was also an increase in accommodation and food services, which could be related to increased community spread of coronavirus. The education industry, particularly support staff, may have been impacted by the move to remote learning. Although it is still likely that fraudulent claims are included in these files, KDOL has done its best to filter those out, but they can only be removed if they were identified as fraud at the time the claim was filed. The new identity verification process that was implemented at the beginning of February 2021 should help with this issue by identifying fraud before the claim is even filed.

- **Header, p. 4.** LPA should clarify that the fraudsters targeted the new PUA program because of the weaknesses relating to the federal requirements surrounding the PUA application process, which prohibited Kansas from requiring documentation to substantiate employment or self-employment, self-certification to why a claimant was unemployed due to COVID-19, and income.

- **First bullet, p. 5.** LPA should clarify that fraudsters used a large-scale identity theft campaign to target the PUA program in all 50 states, Washington D.C., and United States territories.

- **Last bullet, p. 5.** LPA's description that unemployment funds are disbursed mostly by debit cards is incorrect. Unemployment insurance benefit payments are distributed by prepaid debit card and direct deposit. Since the onset of the pandemic, the majority of claimants have selected to receive their payments via direct deposit. Fraudsters have used both methods to fraudulently receive funds. KDOL is working with federal and state law enforcement agencies and banks on recovering such funds.

VI. KDOL does not choose to raise payroll taxes.

The tax rates and solvency adjustments are defined in K.S.A. 44-710a, and they are a function of the unemployment insurance trust fund's balance. For calendar years 2019 and 2020, during a period of low unemployment, employers' tax rates were decreased by up to 0.5 percentage points when the fund was in a surplus. However, as the pandemic resulted in a near-overnight spike in unemployment, the trust fund diminished in 2020, and KDOL was required per statute and legislation to remove this tax decrease.

The Audit correctly notes that "benefits paid out for the temporary federal unemployment programs do not come from the state's unemployment trust fund." So the Audit should clarify in its subsequent statement that "both legitimate and fraudulent benefits would negatively affect the balance of the state's trust" does not include any legitimate or fraudulent claims in the federal programs like PUA.

VII. LPA misstates the impact that fraudulent claims will have on Kansas employees and employers.

A. Tax Form 1099-G

KDOL has expended considerable time and resources to assist identity theft victims who may have or will receive a tax form 1099-G for unemployment insurance benefits fraudulently obtained using a stolen identity. This includes not only proactively seeking guidance from the Internal Revenue Service (IRS) and the Kansas Department of Revenue (KDOR), but also dedicating significant resources in setting up a processes for claimant communication about the issue and for issuing corrected 1099-G forms and allocating resources dedicated to those processes. In fact, Kansas was one of the first states to raise this issue to the IRS.

Despite continued delays from the IRS in issuing guidance on how KDOL should address 1099-G forms in cases of fraud, KDOL developed criteria to substantially limit the number of 1099-G forms that would be sent to the victims of identity theft. KDOL proactively did an audit of the first 1099-G mailing and identified identity theft victims that should not have been included in the initial mailing. KDOL then sent out corrected 1099-G forms to these identity theft victims,

and the IRS, instructing them that they needed to take no further actions. Those corrected 1099-Gs went out the week beginning February 14, 2021.

Due to the volume of claims and fraudulent attempts in tax year 2020, not all fraudulent 1099-Gs were stopped. However, KDOL did stop many 1099-G forms from going out that KDOL knew were due to identity theft. KDOL also created a process for claimants to dispute inaccurate 1099s, began issuing corrected 1099-Gs, and stood up a call center to answer questions related to the 1099-G process.

It is worth noting that officials in most if not all states have had significant challenges with the 1099-G process because of the tsunami of fraud in the unemployment system in 2020. For example, in Vermont significant errors with the 1099-G process resulted in the state's Department of Labor recalling all 1099-Gs that were sent out in the state.[38] Additionally, every state has had issues with identify theft victims receiving 1099Gs for benefits they did not apply for or receive.

B. LPA misstates Kansas employers' financial responsibility for fraudulent claims.

LPA incorrectly stated the impact that fraudulent unemployment insurance payments will have on employers. KDOL's procedures regarding fraudulent claims and employer charges remain the same. **Employers will not be charged if KDOL identifies a state unemployment insurance claim as fraudulent**. Claims that have been identified as fraudulent, including reported identity theft claims, will not be displayed on any employer's statement. This applies to all employers regardless of their classification.

If an employer identifies any charges that were the result of a fraudulent claim, then they are able to bring these to KDOL's attention so that they can be removed. As such, KDOL has removed all charges from employers it is aware of that are related to fraud.

VIII. KDOL is criminally investigating potentially fraudulent claims.

The Audit says KDOL's Special Investigations unit had not started criminal investigations into the 157,000 potentially fraudulent claims it reported. LPA is incorrect. During the summer of 2020, KDOL referred tens of thousands of potentially fraudulent accounts to the USDOL-OIG for comparison with other similar data collected from other states labor departments. This included IP addresses/passwords and email addresses. The IP addresses spanned throughout the south and southeast United States. In addition to the USDOL-OIG, KDOL has referred potentially fraudulent claims to the FBI and the Secret Service and

[38] *Labor Department issues recall of all 1099s because of mailing error,* Vermont Business Magazine, Feb. 2, 2021, 6:39pm, *available at* https://vermontbiz.com/news/2021/february/01/labor-department-issues-recall-all-1099s-because-mailing-error.

continues to do so. Federal law strongly encourages states to work with federal law enforcement, including USDOL-OIG because of jurisdictional issues.

LPA also failed to recognize the distinction between civil fraud and crimes associated with identity theft and unlawfully receiving unemployment insurance benefits. Not every potentially fraudulent claim warrants criminal prosecution. Identifying select cases for criminal investigation and prosecution is a matter involving evaluation by the KDOL law enforcement officers as well as input from prosecuting authorities.

The Audit does not mention that KDOL has expended considerable time and resources responding to two large subpoenas from USDOL-OIG, for the stated purpose of collecting data from each state on claims in the various programs in an effort to detect nationwide fraud patterns and schemes. This is in addition to a data-sharing Memorandum of Agreement KDOL entered into with USDOL-OIG at the beginning of the pandemic to share data with them to combat fraud. KDOL has also been working the FBI on similar data-sharing arrangements.

Thank you again for your staff's work on this report.

Respectfully,

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Appendix A – Cited References

This appendix lists the major publications we relied on for this report.

1. Kansas Department of Labor Weekly Unemployment Claims Reports (December, 2020). Kansas Department of Labor.

2. COVID-19: States Cite Vulnerabilities in Detecting Fraud While Complying with the CARES ACT UI Program Self-Certification Requirement (October 2020.). The U.S. Department of Labor Office of the Inspector General.