Office of the Washington State Auditor
Pat McCarthy

Fraud Investigation Report

Employment Security Department

For the investigation period January 1, 2020 through December 31, 2020

Published April 13, 2021

Report No. 1028164

A note about data involved in this audit

In January 2021, the State Auditor's Office was alerted to a potential cybersecurity incident involving its third-party file transfer service. Among the files that may have been compromised was a set of data files provided by ESD containing personal information of people who received unemployment benefits in the 2017 to 2020 time period. The data files were provided as part of our series of audits of the Unemployment Insurance program. We worked collaboratively with ESD to assess the information included in the files so we could notify those people whose personal information may have been compromised. The effort to address the cybersecurity incident involving the data files was handled separately from the audits themselves, and it did not affect the findings, conclusions or recommendations of any of the audits.

Office of the Washington State Auditor
Pat McCarthy

April 13, 2021

Commissioner
Employment Security Department
Olympia, Washington

Report on Fraud Investigation

Attached is the official report on a misappropriation at the Employment Security Department. In May 2020, our Office became aware of false unemployment claims being made in the names of some of our employees. We contacted the Department about a potential loss of public funds. Through additional discussions, the ESD shared information about the potential losses they were experiencing.

This report contains the results of our investigation of the illegitimate unemployment claims and payments at the Department from January 1, 2020 through December 31, 2020. The purpose of our investigation was to determine if a misappropriation had occurred and to provide the Department with recommendations to improve internal controls.

We performed our investigation under the authority of state law (RCW 43.09.290) and included procedures we considered necessary under the circumstances.

If you have questions about this report, please contact Director of Communications Kathleen Cooper at (564) 999-0800.

Pat McCarthy

State Auditor

Olympia, WA

cc: Kari Summerour, External Audit Manager

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FRAUD INVESTIGATION REPORT

Investigation Summary

In April 2020, the Employment Security Department (Department) became aware that an increasing number of the unemployment insurance benefit claims it received, and in many cases had paid, were initiated by someone other than a legitimate claimant. Imposters, posing as unemployed Washingtonians, used personal information widely available on the "dark web" to file false claims in record numbers. The Department initiated an investigation, which is still ongoing. The Department is working with the U.S. Department of Justice and the Federal Bureau of Investigation, which are also investigating.

In May 2020, our Office became aware of false unemployment claims being made in the names of some of our employees. We contacted the Department about a potential loss of public funds. During our investigation, we worked with the Department to obtain information to conduct our investigation into the loss.

Limitation on investigation scope

One of our investigation objectives was to quantify the extent and scope of illegitimate activity. This includes quantifying the number and associated dollar amount of illegitimate claims filed with the Department in 2020, including those the Department stopped before payment, as well as those actually paid. Throughout our investigation, we consistently adjusted our timelines, as we acknowledged the Department was having difficulty getting us information. However, even though the Department made multiple attempts to get us information throughout our investigation, they could not provide us with enough information timely to fully achieve this objective.

The Department originally provided a report showing claimant-level detail for a large portion of the loss; however, during the course of our investigation, we determined the report did not encompass the entirety of the loss. For example, the report showed the "net" amount of loss, not "gross." As such, we requested a revision to the report; however, we determined the revised report unexpectedly omitted data that was included on the original report.

The Department provided us with a final, revised report; however, the Department did not include a date field. Without the date field, we could not tell if the Department captured the entire population of claims during the investigation period.

Lastly, the Department's data can change at any point as new claimant data is entered in the Department's system. This means each revised report included different data. Since this information is not closely monitored by the Department, revision requests added to the complexity of confirming that all information provided for this investigation was accurate and complete.

Finally, Washingtonians continue to notify the both Department and our Office that unemployment claims were filed with their stolen personal information. This indicates the actual extent of misappropriation is greater than the Department has been able to capture so far.

Background

The Department's usual operating budget before the pandemic was about $400 million. The Department administers programs authorized under the Workforce Innovation and Opportunity Act, paid family medical leave program and Unemployment Insurance program. The Department's Office of Special Investigations and Financial Services Division are tasked with reviewing any potentially illegitimate claims. In 2020, the Department paid out more than $13.6 billion in unemployment benefits.

Soon after the coronavirus pandemic was declared a national emergency on March 13, 2020, the federal government took action. On March 18, 2020, the Families First Coronavirus Response Act (FFCRA) was signed into law, which provided additional flexibility for state unemployment insurance agencies. On March 27, the Coronavirus Aid, Relief, and Economic Security (CARES) Act was signed into law. The CARES Act in turn created the Pandemic Unemployment Assistance (PUA) program. This program offers unemployment assistance to classes of workers, such as those who are self-employed or working part time, not normally eligible for regular unemployment compensation. PUA allows eligibility for these people if they are not considered able and available for work for reasons related to the coronavirus pandemic, without the typical verifications required for regular unemployment benefits.

The CARES Act also created the Federal Pandemic Unemployment Compensation (FPUC) program, which allowed people receiving regular unemployment or PUA benefits to have their weekly benefit amount increased by $600. The Pandemic Emergency Unemployment Compensation (PEUC) program allowed people who had exhausted their unemployment benefits to claim benefits for an additional 13 weeks.

In spring 2020, the Department received record numbers of unemployment claims as a result of the pandemic and the state's efforts to manage its spread, such as the Governor's "Stay Home, Stay Healthy" order. In late April, an investigator in the Department's fraud detection unit learned from staff at a federal agency that unemployment claims had been made in the names of people currently employed. Over the next few days, the same federal contact reached out to the Department with further instances. The Department received an increasing number of reports over the following weeks from citizens, federal and Washington state agency sources. On May 14, the U.S. Secret Service released an informational alert about "imposter fraud" targeting unemployment programs in Washington and other states. That same day, the Department announced that it was suspending payments for two days to help "validate claims as authentic," and provided information on how people should report illegitimate claims made in their name.

Investigation results

The widespread unemployment misappropriation was carried out through multiple schemes. The reduced verification requirements for Pandemic Unemployment Assistance (PUA) benefits may have been the largest contributing factor in allowing each type of misappropriation to occur.

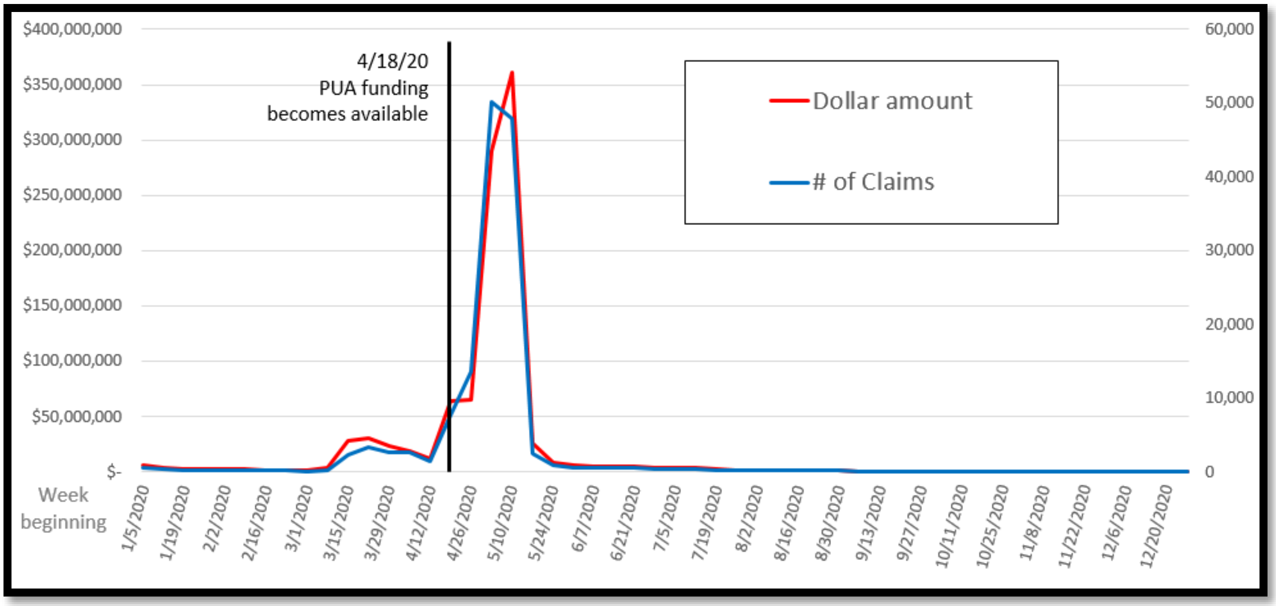
Reduced verification requirements for PUA

The new PUA program expanded unemployment benefits to new classes of workers not previously eligible, such as self-employed workers and gig workers. PUA allowed eligibility for these people if they were not considered able and available for work for reasons related to the coronavirus pandemic. The program did not apply the typical verifications required for regular unemployment benefits. For example, when applying for other unemployment funding, claimants are typically required to provide verification of prior employment, such as a pay stub or W-2. The Department also verified the claimant's employment with the prior employer. These verification steps are not required to receive PUA funding.

The U.S. Department of Labor's Employment and Training Administration instructed states not to require people applying for PUA to provide documentation to support their employment, but rather to accept an applicant's self-certification. On May 26, 2020, the Office of the Inspector General (OIG) issued an alert memorandum highlighting the increased risk for fraud due to the sole reliance on self-certification for claimant eligibility. On June 5, the Department of Labor responded, maintaining its position that the PUA program does not require proof of employment, but requires only that applicants self-certify their employment status.

The PUA eligibility form asks claimants a list of questions. They only need to check a box to be eligible for benefits. This simple certification made it easier for ineligible people and imposters with stolen information to submit illegitimate claims.

Within a week of PUA funding availability, the number in potentially illegitimate claims began to increase sharply, reaching a peak in the week starting May 10. This chart illustrates the number of claims and associated benefit payments that the Department either confirmed as misappropriation or flagged as potential misappropriation; the latter is still under investigation by the Department.



Misappropriation schemes

We've classified the schemes used to conduct the widespread unemployment misappropriation at the Department into three categories. While the largest portion is attributed to external bad actors who used stolen personal information to file claims, other schemes were also successful.

Imposter scheme: Bad actors using stolen personal information

The largest scheme in terms of both dollar amount and number of claims was conducted by bad actors using stolen personal information to file illegitimate claims.

Our investigation did not attempt to determine the exact source of personal information used in this scheme. However, personal information for potentially millions of Americans is available for sale on the dark web. Cybercriminals have obtained this information through various means, including a series of large-scale data breaches. The Equifax breach alone exposed more than 145 million consumers' personal information in 2017.

With stolen identities in hand, the bad actors created user accounts for each identity and filed claims. They primarily applied for PUA benefits, given the program's lax eligibility and verification requirements. For a more in depth discussion of this scheme, please refer our Office's related performance audit, Washington's Unemployment Benefit Programs in 2020.

Claimant scheme: People claiming benefits when they are ineligible

Another category of loss was carried out by people who filed claims under their own valid identities but were not actually eligible for benefits.

This scheme involves the intentional misreporting or withholding of information in order to receive benefits, such as:

- Knowingly submitting false information
- Knowingly continuing to collect benefits when ineligible
- Certifying for benefits under state law despite not being able and available to work

The scheme is not new to the Department. The agency's fraud detection strategy prior to 2020 was designed mostly to detect claims made under this scheme. For example, the Department verified wages and employment status with employers to verify eligibility. However, the introduction of PUA funding made it easier for people to claim benefits they were not eligible for. For example, the Department may not be able to verify employment for claimants certifying they are self-employed.

Potential misappropriation by department employees

We are conducting an ongoing investigation into this matter, and will issue a separate report upon its completion.

Quantifying the misappropriation

The Department categorizes known and potentially illegitimate claims into various categories as the Department initially flags the claim for review and subsequently investigates it. As one example, in a nightly process referred to as "Discovery," the Department's software system evaluates unemployment claims against a series of metrics in a variety of categories that have been shown to correlate with fraud. Claims that contain a combination of certain risk elements are flagged for review by the Department's Office of Special Investigations.

We have categorized claims flagged for review by Special Investigations, but not yet investigated, as questionable, because the Department cannot yet know whether these claims represent misappropriation.

Dollar amount	Imposter claims	People claiming benefits when they are not eligible	Total
Misappropriation	$642,954,417	$3,863,955	**$646,818,372**
Questionable	$458,112,292	$2,390,732	**$460,503,024**
Total	**$1,101,066,709**	**$6,254,687**	**$1,107,321,396**

Number of claims	Imposter claims	People claiming benefits when they are not eligible	Total
Misappropriation	191,634*	2,157	**193,791**
Questionable	51,340	799	**52,139**
Total	**242,974**	**2,956**	**245,930**

**Includes illegitimate claims filed, but stopped by the Department before making payment.*

Not every misappropriated dollar makes it into the hands of bad actors

Even though the Department suffered a loss of over $646 million, those dollars did not necessary make it to the bad actors. Portions of the benefit payment can be withheld and redirected. For example, the Department may deduct child support garnishments or federal taxes and redirect that money to the Department of Social and Health Services or Internal Revenue Service respectively.

State versus federal dollars

Members of the public and lawmakers have expressed interest in knowing in the dollar value of the loss that was an actual loss to the state, but determining this would require calculating what portion of the misappropriated funds was comprised of state tax dollars. The Department did not provide this data in the format we needed for our analysis before we issued this report. Management at the Department explained that the Unemployment Tax and Benefit (UTAB) system was not designed to draw the data we asked for because no federal or state laws require the agency to report data in that way. Developing the requested data requires the Department to change how financial information is stored in the UTAB system; the Department is currently working on doing so.

Control Weaknesses

Internal controls at the Department were inadequate to safeguard public resources. Some control weaknesses were information technology (IT) related. Because public distribution of information about tests performed and the related results could increase the risk to the Department, distribution of recommendations related to IT will be limited to management and the governing body of the Department. In addition to the IT control weaknesses, we found the following additional weaknesses allowed the misappropriation to occur:

The Department was primarily reactive

The Department's pre-pandemic fraud detection and prevention structure was not prepared for the massive influx of claims during the pandemic, or for the shift in illegitamate claims from those made by ineligble residents to those made by bad actors using stolen identities.

Some of the tools in the Department's fraud prevention portfolio were not working early in 2020. For example, the Department ran certain Discovery tools a day after claims were processed and, potentially, paid. This was an intentional choice due to a key component of Discovery that required additional time to run. Prior to March 2020, this choice may not have had the same consequences. In accordance with state law, claimants were not paid during the first week of unemployment eligibility, which gave the Department time to run Discovery tools. However, when the governor authorized the Department to waive the one-week waiting period in March, many payments went out before the Discovery process ran.

In March 2016, we released an Accountability Audit showing that some incarcerated people received unemployment benefits. Incarcarated people are typically not able and available to work, and are therefore ineligible for benefits. To prevent improper payments, we recommended the Legislature allow the Department to use jail information to perform a cross-match with unemployment insurance payments and incarceration records. We also recommended the Department continue to identify and investigate improper payments to incarcerated people.

In 2018, the Department discontinued its cross-match between people filing for unemployment benefits and people in jails and prisons. The Department ran this cross-check in prior years, but discontinued it when the Department of Corrections changed the format of its data, which then caused problems with Department's cross-checking software. The Department ran a cross-match late in 2020, analyzing the first three quarters of the year, and flagged 1,500 potentially ineligible claims made by incaracarated people.

Separately, although the Department runs the Discovery process to flag potential illegitimate claims, the Department will continue to pay claims flagged with eligibility issues until Special Investigations has determined they are either valid or illegitimate – as long as the claimant continues to file weekly, and the initial payment was made.

The Department's identity verification process may not be sufficient

When claims are flagged for any number of reasons, Department staff try to verify the claimant's identity. We examined a selection of claimant accounts along with the documents that claimants submitted to verify their identity. While many claimants provided reasonable and appropriate proof of their identity, we also found instances of some questionable documents. With the massive influx of flagged claims, at the end of 2020, Special Investigation's has accumulated a backlog of roughly 56,000 claims, just relating to possible cases of imposters filing with stolen personal information.

The Department requires management oversight of their key activities

Department and Special Investigations staff make important decisions for claims they work with, and can approve payment on large dollar-amount claims, especially if the claimant has back-dated claims. However, the Department does not require a secondary review of the decisions staff make about the claim's legitimacy, even for large claims. This heightens the Department's risk of illegitimate claims being erroneously cleared and paid. Further, this lack of secondary review creates an opportunity for Department staff to abuse their positions by possibly approving ineligible claims for friends or family, or even submitting and approving ineligble claims for personal benefit. These risks were exacerbated during the pandemic, as the Department hired 417 additional people to help process claims. These new staff were given access to the claims system with minimal training.

Furthermore, the Department lacks adequate procedures to monitor the overall extent of loss, including the development of accurate and complete reports to capture loss activity.

Early in our investigation, we asked the Department for detailed records concerning the complete population of misappropriation by claim, illegitimate claims filed but caught before payment, and other information on subsets and categories of loss. While the Department was able to give us information, the agency's IT staff had to build new reports based on our requests. This indicates the Department does not have this information readily available for its own analysis and management of loss. Additionally, the Department indicated it verified the data provide to us; however, we identified discrepancies, such as claims included on one report but unexpectedly omitted from another.

Recommendations

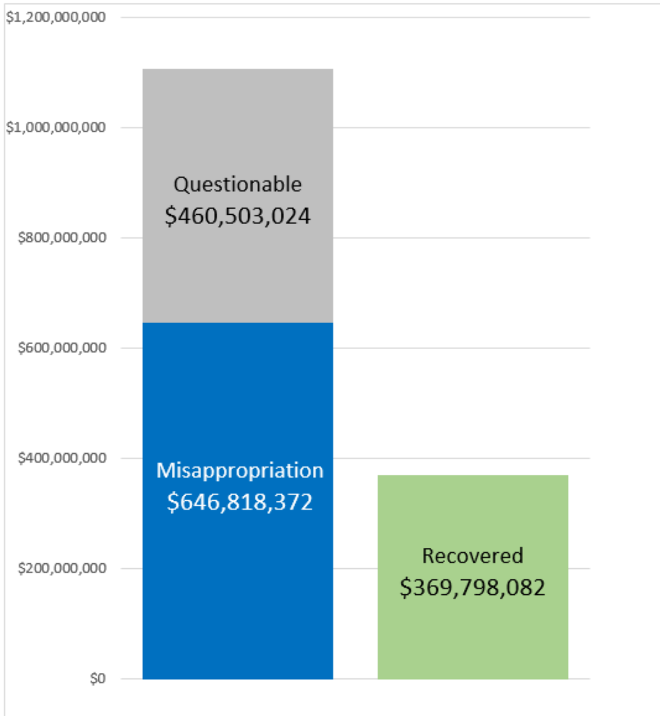
Internal controls

The Department said it has taken steps to improve its control structure. We recommend the following to supplement those actions:

- Develop an agency plan to adequately respond to any future surges in Unemployment Insurance claims.
- Continue to improve the fraud prevention portfolio, including the Discovery process, to identify known or potentially illegitimate claims accurately and promptly.
- Ensure the cross-match between claimants and incarcerated people is performed consistently.
- Dedicate resources as needed to clear the backlog of flagged claims.
- Improve the identity verification processes to ensure claimants provide sufficient, valid proof of their identities.
- Improve monitoring over employees to include approval levels for certain dollar thresholds of benefit payments, and frequent spot checks of other activity.
- Improve Department oversight to evaluate the extent and population of the entire loss, including improved reporting mechanisms.
- We also recommend the Department implement recommendations we will provide in a separate communication about IT systems.

Recovering misappropriated funds

The Department has worked with federal agencies and banking institutions to recoup some of the lost funds. As of March 2021, the Department reports it has recovered $369,798,082 of the loss:



We recommend the Department continue seek recovery of the remaining loss.

Department's Response

The Department deeply appreciates the role of the State Auditor's Office (SAO), and welcomes any new insights that will bolster the progress the Department has already made to reduce the risk of fraud.

It must be made clear that, although there are aspects of the Accountability Audit the Department agrees with, there are also deep flaws, numerous pieces of incorrect information and overall, the characterization of the total amount of possible imposter fraud paid in 2020 is false.

This audit stands in stark contrast to the SAO's Performance Audit, which is both thorough and followed processes that allowed the Department the opportunity for technical review of a draft report to provide corrections and clarification where needed.

The heart of any state agency's challenge when providing essential benefits to Washingtonians is in balancing service delivery and the safeguarding of public funds. As noted in the SAO's Performance Audit:

> *ESD has already taken steps to restructure and expand its fraud program and to hire additional staff to address concerns about customer service. We make no additional formal recommendations, but strongly encourage ESD to continue its efforts to address these issues.*

The Department remains wholly committed to our ongoing efforts to strike this balance between service delivery and fraud prevention, and will continue to be transparent about our successes, challenges and lessons learned. We also will continue to be a dedicated partner to the SAO, and share the desire to identify and address the strengths and weaknesses of our agency's response in this historic crisis.

Background

When the COVID-19 pandemic hit in the spring of 2020, the Washington State Employment Security Department (Department) was one of the first state workforce agencies to implement the new unemployment benefit programs created under the Coronavirus Aid, Relief, and Economic Security Act (CARES Act), including the Pandemic Unemployment Assistance program (PUA). The prompt rollout of these essential benefits, along with our state having one of the highest weekly benefit amounts in the nation, made Washington an early target of an unprecedented nationwide imposter fraud attack.

The Department's swift action to halt the attack was highly effective in stopping further fraud, and even using the SAO's figures for misappropriation, resulted in less than 5 percent of total benefits paid to imposters during 2020. For context, the U.S. Department of Labor's Office of Inspector General assumed a baseline 10 percent CARES Act benefit improper payment rate, with a significant portion due to fraud, as nationwide the state UI program improper payment rate is typically above the 10 percent acceptable threshold set in federal statute and implementing federal guidance.

It is always a priority of the Department to keep losses as low as possible, and pre-pandemic levels of loss due to fraud were about 3.4 percent. Moreover, we are currently below the 10 percent baseline assumption for improper payments even as other states have struggled with much higher losses due to fraud.

Data provided by the Department to the SAO

In the spirit of partnership, the Department has spent hundreds of staff hours gathering the required information and developing new reports requested by the SAO when they were not already available. The development of these reports often takes complex technical programing, which siphons hours otherwise spent in implementing benefit extensions or customer service *improvements. The aggressive timelines set by the SAO, and their revisions to data requests, complicated these efforts. It is worth noting that since this audit work began in December 2020, the Department has implemented two rounds of significant extensions of the federal CARES Act benefits and developed an entirely new direct benefit at the state level.*

Contrary to the published report, the Department provided the SAO the data requested within their parameters. While the SAO argues that they couldn't complete the depth of the work (or had a "limitation on scope") to answer their questions about fraud, the data the Department provided the SAO was timely and in the format investigators requested, as they confirmed during meetings with Department staff. The only exception was one report, that breaks the losses out by federal and state dollars, which isn't relevant to the total amount of loss. The Department discussed this report in advance and agreed to a later delivery date. The Department continues its willingness to provide the SAO with the information they requested to meet their objectives. However, the SAO has imposed their own deadlines and communicated they will not accept additional information offered by the Department for the purposes of their report.

Also contrary to the SAO report, the Department has sufficient tools in place to analyze and manage potential fraud and losses, and has a robust monitoring system in place. The data provided is "living data" that naturally changes daily as new information comes in about individual claims and claimants. The Department is constantly monitoring this data for fraud trends and adjusting our controls to improve efficiencies and limit false positive ratios. The Department's Financial Unit also constantly monitors data to ensure the Department is not making payments to claims identified as fraudulent.

No opportunity to provide technical review of the audit

As a ready partner in safeguarding public assets, the Department was disappointed it was not given a draft report in order to provide technical review of the work in this audit. This opportunity to provide technical review and corrections has been afforded with every other audit conducted so far. As such, much of the information in the report has not been validated by the Department and there is information included that is inaccurate. A notable example is the mischaracterization of the total potential fraud loss. There are also inaccuracies in the report about various processes and methods of information verification that we would have appreciated the opportunity to correct. The lack of transparency and opportunity to provide technical review directly resulted in gross inaccuracies throughout the SAO's report.

Key points of clarification

- ***Inaccuracy in reported fraud amounts:*** *Since the novel imposter fraud attack that occurred, primarily in May 2020, the Department has been very open about the estimated loss of between \$550-\$650 million – although roughly \$370 million has already been recovered by the Department. The total likely imposter fraud reported by the SAO — which was validated in three of the SAO's audits of the unemployment benefit programs and* *conducted under Governmental Auditing Standards — was about $647 million and falls within the Department's initial estimates.*

In this audit however, the SAO has reported a possible total of more than $1.1 billion in imposter fraud. Taken at face value, this is widely variant from the Department's numbers reported and those validated in other SAO audits. It must be made clear that this total represents a gross mischaracterization of possible fraud loss.

There are two primary reasons this total inflates what the Department has reported:

1. *The SAO's inclusion of "Questionable" claims.*
2. *The SAO included additional types of fraud not part of the novel imposter fraud attack.*

***The SAO's inclusion of "Questionable" claims** falsely and dramatically inflates the possible total imposter fraud. There are three key reasons for this.*

First, this category constitutes a population of claims flagged for review that are in no way connected to the novel imposter fraud attack last May. This population is highly transitory and will change daily as claims are flagged for review, investigated, and resolved. Including this category creates a perception that there are hundreds of millions of possible dollars paid to imposters that the Department has not disclosed. This is simply not true. Imposter fraud has been almost entirely stopped as a result of the actions the Department took following the May 2020 attack, as noted in the SAO's own Performance Audit – conducted at the same time as this investigation – in which the SAO stated "ESD did not make significant payments to fraudsters after [the May 2020 attack] despite high demand for unemployment assistance throughout 2020." (See the Appendix for further details.)

As such, the "Questionable" category includes claims that are not imposter fraud. For example, legitimate claimants that had an identity issue flagged and who failed to provide necessary documentation to the Department in time, resulting in presumptive denial of benefits, are included in this category. Another example is claimants the Department is waiting to hear back from after contacting them.

To further illustrate the transitory nature of this population, the data run on March 6, 2021, produced the $458 million in "Questionable" imposter fraud in the SAO's report. The exact same data set run on April 8, 2021, updates that figure to approximately $222 million. In one month, what the SAO deems as "Questionable" imposter fraud decreased by $236 million. This is because the SAO is reporting claims flagged that need review but that ultimately are not found to be imposter fraud. What hasn't changed is the roughly $643 million in confirmed and probable imposter fraud, which remains within the range the Department first reported and is reaffirmed in this and other SAO reports. Again, it is *worth noting the Department has already recovered roughly $370 million and continues to pursue further recoveries.*

Second, it is inappropriate to label as "imposter fraud" claims that remain under investigation. In fact, the SAO defines that to be the entirety of the "Questionable" population, which the SAO says is "claims flagged for review by Special Investigations, but not yet investigated." The SAO's Performance Audit identified a loss of $647 million, a figure the Department largely agrees with, indicating this "Questionable" category cannot be verified as imposter fraud and should not be considered in the total for this report.

Third, the SAO inflates the number of claims that remain under investigation. The SAO's definition of "Questionable" as awaiting investigation is not aligned with the data they use. In the data provided on which the SAO relies for its table on page 7 of the report, many of the claims were and are not awaiting investigation but had been denied or presumptively denied. And those claims are not imposter fraud, because the claims that have been determined and rise to the level of confirmed or probable fraud appear in the SAO's data as misappropriation.

For all of these reasons, the "Questionable" fields are unreliable and should have no place in this report.

The SAO included additional types of fraud not part of the novel imposter fraud attack *(see below for more). The estimates that have been given by the Department in previous statements and presentations were in reference to the imposter fraud attack only.*

- ***Additional types of fraud:*** *The Department is not clear as to why two additional types of fraud were included within the scope of this audit:*

    - ***Claimant fraud****: People claiming benefits when they are ineligible is an ongoing risk for the Unemployment Insurance system throughout the nation. As the SAO noted, the Department developed its fraud detection strategy to primarily address this type of fraud and our controls are highly effective in combatting it. Additionally, there are claims the SAO categorizes as "claimant fraud" that have been investigated and cleared and yet are still inaccurately included in the "People claiming benefits when they are not eligible – Questionable" category. As such, the SAO's numbers are inaccurate.*

    - ***Potential internal fraud:*** *The Department is committed to protecting public dollars from all types of fraud. The SAO highlights the potential for fraud committed by internal employees. This is not currently, nor has it ever been, a systemic issue. In 2020, the Department detected and reported two cases of suspected employee fraud to the SAO. Only one of these is likely to be a confirmed isolated case of individual fraud, although it is still under investigation by law enforcement and is immaterial* *to the overall losses due to fraud in 2020. The other case was found to not be fraudulent.*

- ***Inaccuracies in processes:*** *There are several inaccuracies related to processes or verifications published in this report. Examples include:*

    - ***Confusing eligibility fraud with imposter fraud****. Claims flagged as potential imposter fraud are not paid while the investigation is pending. The SAO identified a control weakness that the Department is continuing to pay claims with certain eligibility issues, when in fact the Department must do this per state and federal requirements, as has been the case for decades. When that eligibility issue is imposter fraud, however, those claims do not continue to pay out and the SAO's inclusion of this issue represents a deep misunderstanding of the Department's rules and has the potential to create confusion in a report that is intended to focus on imposter fraud.*

    - ***Misunderstanding of the Discovery process.*** *This report inaccurately describes the Discovery process as an eligibility control, when it is instead about identity verification. Tying the Discovery process to claims paid with eligibility issues is inaccurate. We do not continue to pay claims flagged by the Discovery process because, since last May, we stop payment on claims flagged with identity issues until we have received sufficient information to verify the claimant's identity.*

    - ***Inaccurate characterization of PUA.*** *While the SAO correctly identifies aspects of PUA as ripe for fraud, the Department implemented the program – including allowing claimants to self-certify eligibility – as prescribed in the CARES Act and affirmed in U.S. Department of Labor guidance. The Department does not have discretion in how it implements this federal program. Moreover, there are inaccuracies that raise fundamental questions as to whether SAO understands how unemployment programs work. For example, the SAO fails to note that claimants must first be denied regular unemployment benefits before being afforded the opportunity to apply for PUA (a claimant cannot just apply directly for PUA). They also state that regular unemployment claimants are typically required to provide verification of prior employment such as a paystub or W-2 – this is not true. Individual wage information is reported by employers, and individuals only provide it when their employers have failed to report as required by law.*

- ***False reporting of the backlog of 56,000 claims.*** *There was not a backlog of 56,000 claims relating to possible imposter fraud. Of that 56,000, about 19,000 claims with new issues were awaiting initial review by an investigator. The rest of these claims had been investigated and determinations on them had been made.*

- ***Payments to incarcerated individuals remains a low risk issue**: Contrary to the report, the Department does conduct crossmatching on claims made by incarcerated individuals. Although one type of crossmatch was temporarily inoperable because of the way the data was provided to the Department, the agency has continued crossmatching. As such, fraud by incarcerated individuals is a low risk.*

  > *For example: Out of the roughly 1,500 incarcerated individuals that applied for unemployment benefits, only 67 were newly identified claimants that were determined to be committing fraud (totaling $83,950). The rest had already been flagged, were legitimate claimants or otherwise found to be not fraudulent.*

Many recommendations are already implemented or underway

Since the imposter fraud attack last May, the Department has set in place a continuous process to improve its fraud prevention portfolio and strengthen internal controls within the Department as a whole. In the course of these ongoing improvements, many of the SAO's recommendations in this audit have already been put in place, and it is unfortunate the Department did not get the opportunity to provide this information for inclusion. Some of the many activities include:

- *Creating and fully staffing a unit headed by a Chief Fraud Officer. This unit is dedicated to combating all types of fraud and is already underway in developing a response strategy for any surge in fraud that may occur in the future.*
- *Hiring an Internal Control Officer to review agency internal control systems.*
- *Conducting a comprehensive review of the Department's employee-based internal controls with a focus on monitoring activities and approval levels. This review is critical to the balance the Department must strike between timely benefit payments and protection of public funds.*
- *Building a formal management structure specific to data analytics and fraud detection.*
- *Establishing a specialized team in August 2020, dedicated to reviewing new claims for fraud schemes.*
- *Partnering with other state industries and financial institutions to implement industry fraud prevention best practices and recovery of funds. We have already successfully recovered $370 million – a number we expect to continue to rise as the recovery is ongoing.*
- *Continuing to implement and refine a suite of identity verification tools.*

All of these and other controls implemented are proving to be effective, as there has been a dramatic reduction in fraudulent claim attempts since June 2, 2020.

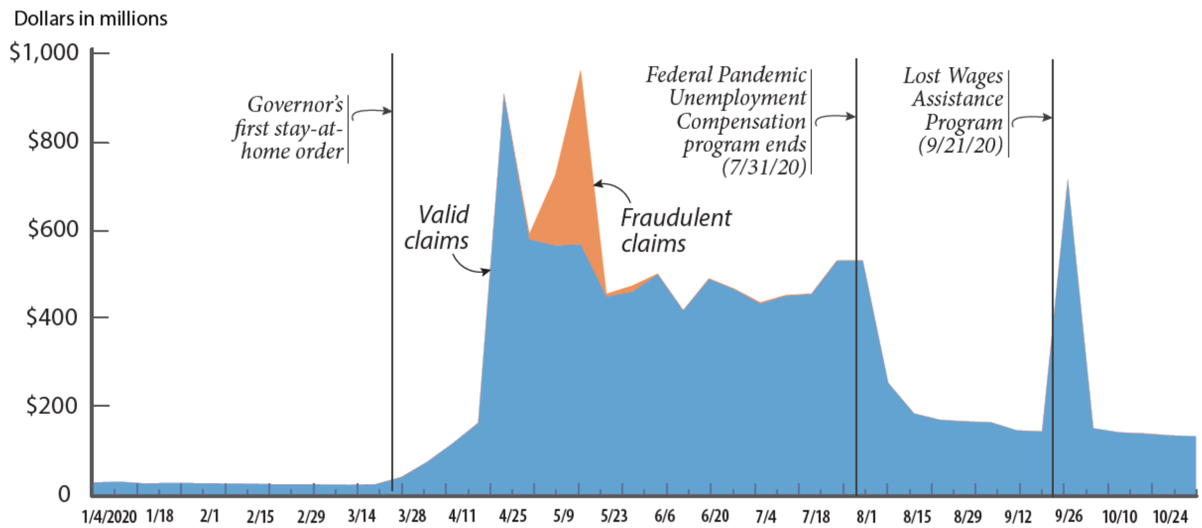
Closing

Assessing the lessons learned from this crisis is an ongoing effort by the Department. All aid in that effort is welcome, including the audits from the SAO. No single narrative can capture the complexity of what happened over the past year, and yet with the benefit of hindsight the Department and its partners may continue to learn and adapt to this new reality. As always, this assessment serves the critical pursuit of balancing rapid service delivery to eligible claimants, and prevention of fraud from those who seek to do harm.

Appendix

*From the SAO's Performance Audit, April 2021: "**Exhibit 3** shows that the wave of fraudulent payments were made when ESD was already struggling to manage the first wave of pandemic-related claims. The graph also shows that ESD did not make significant payments to fraudsters after that time despite high demand for unemployment assistance throughout 2020."*

Exhibit 3 – Total payments on Unemployment Insurance claims compared to payments on fraudulent claims



Source: Data provided by Employment Security Department.

Auditor's Remarks

This report, along with the accountability audit report and the performance audit report, seek to establish the extent and scope of illegitimate claims activity, and to understand the reasons behind the payments. The audits work together to explain what happened during the pandemic-related unemployment surge and its effect on the state's administration of benefits. Each audit and report serves important objectives. The fraud investigation provided a detailed analysis of all unemployment-related fraud, and examined known and potential losses from all misappropriation methods or schemes. This analysis necessarily included more than just the imposter fraud, because our responsibility is to explore and report on all aspects of any loss of public funds. The performance audit focused on the significant "imposter fraud" and customer service issues at the

Department, and put those issues in a national context. The performance audit relied on numbers from this fraud investigation.

Each audit report references and properly contextualizes the misappropriated amount of $646,818,372. The fraud report includes the questionable amount of $460,503,024 as is appropriate for its objective. Each report explains how the figures were determined, and each report explains why the total loss of public funds is likely higher than what has been previously described publicly. Finally, each report acknowledges improvements at the Department while describing weaknesses in internal controls that existed at the time of the misappropriation.

The Office of the Washington State Auditor stands behind its work and re-affirms its findings. We will continue to audit the Department and verify the amount of known and suspected misappropriation related to pandemic-era unemployment benefits.

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We work with state agencies, local governments and the public to achieve our vision of increasing trust in government by helping governments work better and deliver higher value.

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