

## Employment Development Department

It Failed to Participate in a Federal Program That Would Have Allowed the State to Collect Hundreds of Millions of Dollars

Investigative Report I2012-0651

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March 13, 2014

Investigative Report I2012-0651

The Governor of California  
President pro Tempore of the Senate  
Speaker of the Assembly  
State Capitol  
Sacramento, California 95814

Dear Governor and Legislative Leaders:

Pursuant to the California Whistleblower Protection Act, the California State Auditor presents this investigative report concerning inefficiency at the Employment Development Department (EDD). EDD officials failed to take advantage of a federal program that would have allowed the State to collect hundreds of millions of dollars.

This report concludes that EDD failed to participate in a key aspect of the federal Treasury Offset Program (Offset Program) that would have allowed it to collect an estimated \$516 million owed to the State in unemployment benefit overpayments between February 2011 and September 2014. In January 2011 the U.S. Department of the Treasury adopted regulations that expanded the Offset Program and allowed states to use it to collect unemployment benefit overpayments by intercepting individuals' federal tax refunds and other federal payments. Although other states chose to participate in the expanded program from 2011 through 2013 with great success, EDD, acting on behalf of California, chose not to participate because it concluded that it did not have sufficient resources to make the information technology modifications necessary to participate in the program. EDD officials reached this conclusion even though in 2012 they initially estimated that they could make the modifications at a cost of a little more than \$322,800, compared to their own projection of recovering more than \$100 million during the first year of program participation.

After being contacted by our investigators regarding EDD's lack of participation in the expanded program, EDD officials developed a plan for participating in the Offset Program to collect unemployment benefit overpayments by May 2014. However, in February 2014, EDD reported that it would not complete the information technology modifications necessary to participate in the expanded program until September 2014.

Respectfully submitted,



ELAINE M. HOWLE, CPA  
State Auditor

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## Investigative Results

### Results in Brief

The Employment Development Department (EDD) failed to take advantage of a federal program that would have allowed it to collect an estimated \$516 million owed to the State in unemployment benefit overpayments made to claimants. In January 2011 the U.S. Department of the Treasury (U.S. Treasury) adopted regulations implementing federal legislation that expanded the federal Treasury Offset Program (Offset Program). This expansion of the Offset Program gave states the ability to collect money owed by unemployment insurance claimants who have received overpayments by intercepting federal payments the claimants are due to receive. Several states chose to participate in the Offset Program to collect unemployment benefit overpayments from 2011 through 2013 with great success. However, EDD, acting on behalf of California, declined to participate in this aspect of the Offset Program, and instead persisted with its existing collection efforts.

EDD officials concluded that in light of other projects they were working on, EDD did not have sufficient resources to make the information technology (IT) modifications necessary to participate in the program to collect unemployment benefit overpayments. They reached this conclusion even though in 2012 they initially estimated that they could make the modifications at a cost of a little more than \$322,800, compared to the projected benefit of recovering more than \$100 million during the first year of program participation. By deciding to forego participation in the Offset Program to collect unemployment benefit overpayments, EDD acted inefficiently and therefore lost an opportunity to recoup an estimated \$516 million from February 2011 through September 2014, the month in which EDD now projects it will start collecting unemployment benefit overpayments through the Offset Program.

### Background

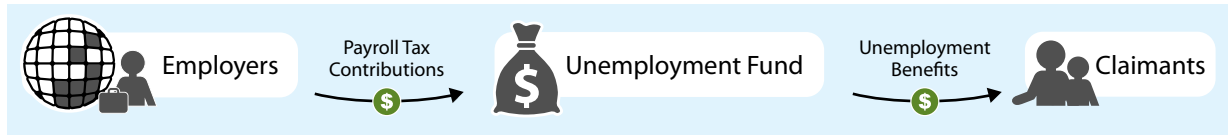
As part of its responsibility for carrying out various employment and workforce functions within California, EDD administers the State's unemployment benefits program. As Figure 1 on the following page depicts, the State maintains the Unemployment Fund, which is financed by a payroll tax imposed on employers, to provide benefits to eligible unemployed workers in the form of weekly payments. These payments are intended to provide partial replacement of the earnings workers have lost due to losing their jobs. EDD is responsible for collecting the employer payroll tax contributions and distributing the benefits to eligible claimants.

### Investigative Highlights . . .

*Our investigation at the Employment Development Department (EDD) substantiated the following:*

- » *EDD officials failed to act efficiently to participate in the federal Treasury Offset Program (Offset Program) that would have allowed the State to collect an estimated \$516 million in unemployment benefit overpayments.*
- » *EDD decided to forego participation even though it estimated it would cost \$322,800 for modifications, compared to the projected benefit of recovering more than \$100 million in the first year.*
- » *After our investigation began, EDD officials developed a plan for participating in the Offset Program.*

**Figure 1**  
**The State's Process for Paying Unemployment Benefits**



Source: California State Auditor's analysis of the California Unemployment Insurance Code.

Occasionally, in distributing benefits to claimants, EDD makes overpayments from the Unemployment Fund. The vast majority of these overpayments result from claimants committing fraud, including misreporting the dates on which they return to work. Other overpayments occur due to EDD errors or delayed determination of ineligibility. When overpayments occur, EDD is responsible for

collecting the money from claimants. As the text box indicates, EDD uses a number of methods to attempt to collect these overpayments. EDD deposits the overpayments it is able to collect, along with penalties and interest assessed on overpayments due to fraud, into two accounts. Penalties and interest go into a special account called the Benefit Audit Fund.<sup>1</sup> The money held in this account is particularly significant because the Legislature can appropriate it to pay EDD's administrative costs or transfer it to the State's General Fund to address other state needs. EDD deposits the remainder of what it collects into the Unemployment Fund. As of October 2013 EDD was owed overpayments of more than \$1.4 billion.

**The State's methods for collecting overpayments of unemployment benefits:**

- Repayment plans
- Wage garnishments
- Interceptions of state tax refunds
- Interceptions of lottery winnings
- Interceptions of future unemployment benefits

Source: Employment Development Department staff.

The ability of EDD to collect benefit overpayments always has been important, but it took on heightened significance after January 2009, when the Unemployment Fund became insolvent because benefit payments exceeded the fund's available balance. Since then, California has borrowed about \$10 billion from the federal government to cover the deficit and paid hundreds of millions of dollars in interest on the money it has borrowed.

***The Offset Program***

California is not unique in needing to collect unemployment benefit overpayments and other debts owed by individuals. To enhance the ability of states and various entities within the federal government

<sup>1</sup> Because of a change in state law, when EDD collects penalties that it assessed on or after October 22, 2013, rather than depositing 100 percent of those penalties into the Benefit Audit Fund, it deposits 50 percent into the Benefit Audit Fund and 50 percent into the Unemployment Fund.



to collect debts owed by individuals, the U.S. Treasury established the Offset Program in 1996. Under this program, state and federal agencies may collect delinquent debts by intercepting federal payments, primarily federal tax refunds, directed to persons who owe money to government entities. Since its inception, the Offset Program has been effective in collecting a variety of debts owed by individuals to government entities, including delinquent child support payments and unpaid state taxes. For example, California's Franchise Tax Board used the program to collect more than \$71 million in outstanding state taxes during fiscal year 2012–13.

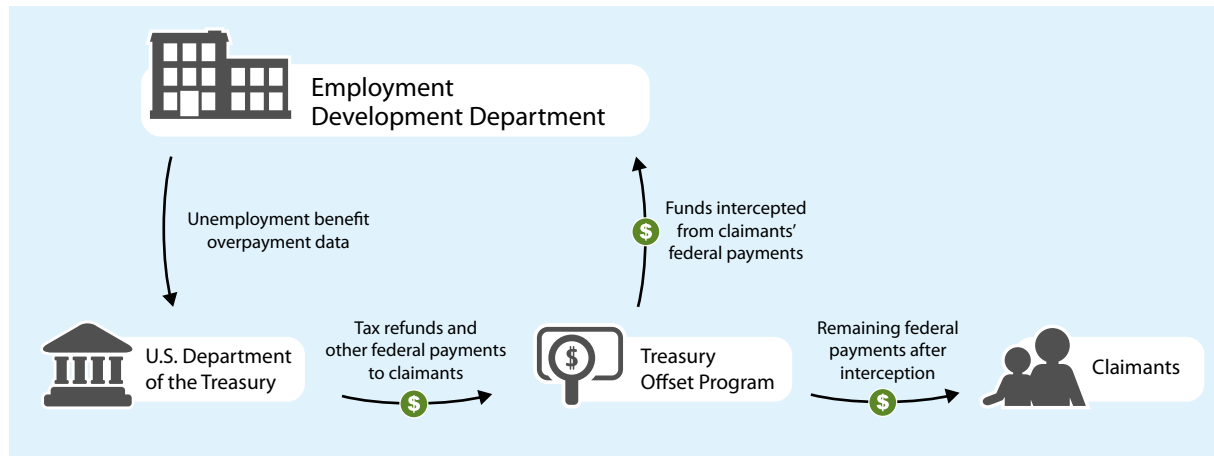
Starting in 2004 EDD began participating in the Offset Program to collect certain kinds of debts owed to the State in connection with particular benefit programs it administers. EDD uses the Offset Program to collect outstanding personal income taxes and state disability insurance contributions that employers withheld from their employees' paychecks but failed to remit to EDD.

Until 2011 the Offset Program was not available as a mechanism for collecting unemployment benefit overpayments. However, in 2010 and 2011, changes to federal law expanded the Offset Program to allow states to use it for that purpose. To participate in the Offset Program, states must be able to transmit electronically to the U.S. Treasury specified information about the debt, including the amount owed and the name and taxpayer identification number of the debtor. States must transmit the information in a particular computer format so the U.S. Treasury can upload the information to its computer system to compare the name and taxpayer identification number of the debtor with the names and taxpayer identification numbers of persons about to receive payments from the federal government. If there is a match, the U.S. Treasury *offsets* the payment the debtor is about to receive by deducting from the payment whatever amount the debtor owes, up to the total amount of the payment. The U.S. Treasury then transmits the offset amount to the state to which the debtor owes money and directs to the debtor whatever remains of the payment after it has deducted the offset amount. Figure 2 on the following page illustrates how California could use the Offset Program to collect unemployment benefit overpayments.

Because a state's participation in the Offset Program for the purposes of collecting unemployment benefit overpayments depends on its ability to transmit to the U.S. Treasury information about debts in a particular format, a number of states have found that being able to transmit the information in the required format is an obstacle to participating in this aspect of the program. Some states, including California, maintain their unemployment benefit debt information in an older computer system that provides the required information in an incompatible format.

*In 2010 and 2011, changes to federal law expanded the Offset Program to allow states to use it for collecting unemployment benefit overpayments.*

**Figure 2**  
The Process by Which the Employment Development Department Could Use the Treasury Offset Program to Collect the State's Unemployment Benefit Overpayments



Source: California State Auditor's analysis of information on the U.S. Department of the Treasury's Web site.

Therefore, to transmit the information in the required format, the state must translate the information prior to sending it to the U.S. Treasury. Due to the complexity of computer programming, especially when dealing with older computer systems, translating the information can be a labor-intensive and costly undertaking. However, because of the financial benefits they may derive from participating in the Offset Program to collect unemployment benefit overpayments, many states have undertaken that task.

As a result of a whistleblower complaint, the California State Auditor's Office (state auditor's office) learned that EDD had put off participation in the Offset Program to collect unemployment benefit overpayments in spite of the program's potential for collecting millions of dollars of unemployment benefit overpayments owed to the State. We were told that EDD made this decision because it did not want to devote the relatively small amount of resources needed to make the required modifications to its IT system. Although state agencies have broad discretion in deciding how to use their resources to fulfill their respective missions, Government Code section 8547.2 provides that any action by a state agency that is economically wasteful or involves inefficiency is an improper governmental activity. We therefore launched an investigation into EDD's choice not to participate in the Offset Program to collect unemployment benefit overpayments.

## Facts and Analysis

Our investigation revealed that over nearly three years, EDD received a stream of information about the Offset Program's potential to improve California's ability to collect unemployment benefit overpayments and even had advocates for entering the program among its staff. However, despite the projected effectiveness of the Offset Program and its proven success in other states, EDD senior officials failed to act efficiently to take advantage of this program and therefore missed an opportunity to collect an estimated \$516 million in benefit overpayments from February 2011 through September 2014.

### **When the Federal Government Advised EDD of the Approaching Opportunity to Participate in the Offset Program to Collect Unemployment Benefit Overpayments, EDD Officials Did Little to Explore or Prepare for Participation in the Program**

In June 2010 EDD officials received a detailed letter from the U.S. Department of Labor (Labor Department), directed to state employment offices throughout the country, advising them that the Offset Program was expanding to allow states to collect unemployment benefit overpayments through this program. Acting in partnership with the U.S. Treasury to promote participation in the Offset Program by state employment offices, the Labor Department informed EDD and employment offices in other states that although the U.S. Treasury still needed to adopt certain implementing regulations before states could participate in the Offset Program to collect unemployment benefit overpayments, it anticipated these regulations would be adopted soon. The Labor Department therefore provided instructions on what states should do immediately—particularly regarding the formatting of required data—so that they could collect unemployment benefit overpayments using the Offset Program as soon as the implementing regulations were enacted.

During 2010 some states, including New York, began preparing in earnest to participate in the Offset Program to collect unemployment benefit overpayments and made significant progress toward having their data properly formatted so they could enter the program as soon as it became available. In contrast, EDD took no significant actions to prepare for participation in this aspect of the Offset Program, even though California's Unemployment Fund had been insolvent for more than a year. The only action that EDD took in response to the letter it received about the expansion of the Offset Program was to send three employees to an informational webinar about the program in July 2010. After this webinar, the employees were enthusiastic about the prospect of having EDD participate in

*EDD took no significant actions to prepare for participation in this aspect of the Offset Program, even though California's Unemployment Fund had been insolvent for more than a year.*

the Offset Program as a means of drastically improving EDD's ability to collect outstanding unemployment benefit overpayments. Despite this enthusiasm, other than some lower-level management employees discussing the idea of participating in the Offset Program to collect unemployment benefit overpayments, EDD took no further action to prepare for entering the expanded Offset Program.

We interviewed Official A, an EDD official with responsibilities related to EDD's collection efforts, about EDD's actions during this period when the Offset Program was about to expand. Official A, who now is retired, recalled that he thought collecting unemployment benefit overpayments through the Offset Program would be a good way for EDD to collect more revenue for the State. Accordingly, he believed EDD should take advantage of the opportunity to participate in the expanded program. He further recalled that modifying EDD's IT system to participate in the program appeared to require only minimal work and resources. He surmised that implementation of another major IT project could have lowered the priority of preparing for participation in the Offset Program to collect unemployment benefit overpayments, but he could not explain why he had not explored participation in the program further.

A high-ranking EDD official (Official B), also now retired, recalled what was occurring at this time somewhat differently. She recalled that the Offset Program was not "on the radar" when the U.S. Treasury was about to expand the program for use in collecting unemployment benefit overpayments. She explained that the Offset Program did not receive any attention because EDD's resources already were strained due to numerous other IT projects being undertaken.

In any event, neither Official A nor Official B took action to prepare EDD to participate in the Offset Program to collect unemployment benefit overpayments once it became available for states to use for that purpose. Although it may have been working on other important IT projects at this time, EDD did not perform even a basic analysis to determine the resources required to prepare for participation in the Offset Program to collect unemployment benefit overpayments. EDD officials merely made assumptions about the resources needed and ultimately did not take any significant steps toward participation because they decided EDD could not spare the resources to do so at that time.

***EDD did not perform even a basic analysis to determine the resources required for participation in the Offset Program to collect unemployment benefit overpayments.***

### **While Other States Began Participating in the Offset Program to Collect Unemployment Benefit Overpayments, EDD Took No Significant Steps Toward Participation**

The U.S. Treasury adopted regulations in January 2011 to implement expansion of the Offset Program to allow states to use the program to collect unemployment benefit overpayments. Three states immediately joined the program and started collecting delinquent overpayments, and within the year, other states stepped up their preparations for participating in the program. Meanwhile, officials at EDD failed to take any action to move EDD toward participation in the program to collect unemployment benefit overpayments.

In April 2011 Official A left his position to work in a different branch of EDD, and Official C transitioned into his position.<sup>2</sup> According to both Official A and Official C, Official A did not discuss the Offset Program with Official C to any extent during the transition. Official C stated that as a result, she was unfamiliar with the changes to the Offset Program until she had been in her new position for nearly a year. Consequently, between April 2011 and March 2012, Official C did not direct any action be taken to move EDD toward participation in the Offset Program to collect unemployment benefit overpayments, even as other states began participating.

In the midst of this one-year period, however, EDD's staff initiated a study to evaluate the feasibility of replacing the computer system that EDD was using to operate its benefit overpayment collection program. As part of the feasibility study, one of the things staff performing the study began to examine was how a new computer system might facilitate EDD's participation in the Offset Program to collect unemployment benefit overpayments. To advance that part of the feasibility study, four employees attended a webinar about the Offset Program in August 2011. Subsequently, the feasibility study continued without making much progress toward identifying a suitable replacement for the collection program's computer system or advancing EDD's ability to participate in the Offset Program to collect unemployment benefit overpayments.

### **Even After EDD Officials Learned of Other States' Successful Use of the Offset Program to Collect Unemployment Benefit Overpayments, EDD Still Took No Meaningful Actions Toward Participating**

In March 2012, about a year after some states began participating in the Offset Program to collect unemployment benefit overpayments, EDD started receiving newsletters from the U.S. Treasury describing

*Between April 2011 and March 2012, Official C did not direct any action be taken to move EDD toward participation in the Offset Program to collect unemployment benefit overpayments, even as other states began participating.*

<sup>2</sup> Official C was acting in this position from May 2011 through December 2011. EDD officially appointed her to the position in January 2012.

other states' success in collecting such overpayments through the Offset Program. Specifically, states participating in the program in 2011 collected an average of 12 percent of the total overpayment debts they submitted to the Offset Program. New York, one of the first states to join the expanded Offset Program, and a state with a large population like California, collected 19 percent of the total amount of the overpayment debts it submitted in 2011. Further, even before submitting the debts to the Offset Program, some states were successful in collecting a substantial amount in overpayments simply by sending debtors letters informing them that unless they paid the overpayment debts they owed, their federal tax refunds would be intercepted to secure payment. According to a New York official, debtors in New York voluntarily repaid \$4 million after receiving such letters.

In the same month that EDD began receiving newsletters touting the success of other states in collecting unemployment benefit overpayments through participation in the Offset Program, Official C became aware of these other states' success and directed EDD's collections and IT staff to look into the program further. Specifically, she asked them for an estimate of the revenue EDD would derive from participating in the expanded program and an estimate of the cost EDD would incur to participate. In May 2012 EDD's collections staff estimated conservatively that the State could collect more than \$100 million from benefit overpayment debtors during just its first year of participation in the Offset Program. In June 2012 EDD's IT staff estimated that EDD would need to spend about \$322,800 to complete the computer programming necessary to translate information about claimants' benefit overpayment debts into the format required by the U.S. Treasury for states to participate in the Offset Program to collect overpayments.

***EDD's staff estimated that the State could collect more than \$100 million from benefit overpayment debtors during its first year in the Offset Program at a cost of significantly less than 1 percent of that amount.***

Armed with the revenue and cost estimates prepared by staff, in July 2012 Official C met with other high-level EDD officials, including Official B, to advocate that EDD dedicate the resources needed to participate in the Offset Program to collect unemployment benefit overpayments. She argued that committing the needed resources constituted a good deal for the State because it could reap an estimated \$100 million in additional revenue during just its first year of participation in the program at a cost of significantly less than 1 percent of that amount.

According to Official C, some officials at the meeting saw the value of participating in the Offset Program to collect unemployment benefit overpayments but were opposed to dedicating the resources needed to participate because of the strain they believed it would place on staff resources. In the end, Official B, who had authority to approve the proposal, agreed with those opposed to dedicating resources to join the Offset Program to collect unemployment benefit overpayments. Official B stated that although participating in this aspect of the Offset Program seemed like a "no-brainer," she believed that due to other ongoing projects, EDD simply did not have enough staff resources to

undertake the IT work necessary to participate in the program to collect unemployment benefit overpayments. Official B claimed that because EDD's computer system used for collections was so antiquated, and the programming language it used was so outdated, only a few EDD employees and contractors possessed the technical knowledge necessary to create a program for converting EDD's collection information into a different format, and all of those people were occupied with other EDD projects.

However, certain IT personnel at EDD told us that although the number of IT professionals possessing the technical expertise needed to work with EDD's old computer system may have been somewhat scarce, EDD always has been able to locate and hire qualified contractors to perform work on the old computer system. EDD did not even attempt to hire any contractors to perform the work, so Official B's conclusion that EDD could not hire anyone with appropriate skills to perform the work was pure speculation at best.

As a result of Official B's refusal to devote resources to bringing EDD into the expanded Offset Program in 2012, the only effort EDD made to position itself for participation in the program was to continue with the feasibility study for replacing its collection program's computer system. However, because the Offset Program was not the main focus of the feasibility study, while EDD may have made some progress in late 2012 toward identifying a replacement for its collections computer system, it made no progress toward participation in the Offset Program to collect unemployment benefit overpayments. As a result, while other states collected millions of dollars in benefit overpayments through the expanded Offset Program in 2012 and later in 2013, EDD gave up this opportunity.

### **After Being Contacted by the State Auditor's Office, EDD Committed to Participating in the Offset Program to Collect Unemployment Benefit Overpayments**

By early 2013 a total of 31 states were participating in the Offset Program to collect unemployment benefit overpayments, but EDD still had not joined them and did not have a plan for doing so.<sup>3</sup> Official C, who was promoted in January 2013 to a higher position, instructed staff to continue working on the feasibility study regarding the replacement of the computer system that EDD was using for its collection program and, as part of that effort, to explore how this

*Although a total of 31 states were participating in the Offset Program by early 2013, EDD still did not have a plan to participate.*

<sup>3</sup> In 2013 California began participating in the Offset Program to collect a different kind of unemployment debt, the debt owed by employers. The employers' combined debt was much smaller than the amount of debt owed by overpaid claimants. EDD maintains the employer debt information in a different computer system that allows it to submit the debt information to the U.S. Treasury far more easily than it can transmit claimant debt information.

*Soon after we had started our investigation concerning EDD's lack of participation in the Offset Program to collect unemployment benefit overpayments, EDD established a schedule to begin its participation.*

system could facilitate participation in the Offset Program to collect unemployment benefit overpayments. However, no one at EDD was working on translating EDD's benefit overpayment debt information into a format that could be transmitted to the U.S. Treasury, and EDD had no plans to join the Offset Program to collect unemployment benefit overpayments.

This situation substantially changed just a few months later when in May 2013 we began interviewing EDD officials about EDD's lack of participation in the Offset Program to collect unemployment benefit overpayments. Soon afterward, Official C advised us that EDD had established a schedule to participate in this aspect of the Offset Program. Official C told us that she and other EDD officials had determined the feasibility study was not progressing in a timely manner and realized that EDD needed to perform the IT work required to participate in the Offset Program to collect unemployment benefit overpayments independent of the outcome of the feasibility study. Official C therefore recommended to Official B that EDD commit to devoting the resources necessary to participate in this aspect of the Offset Program as soon as possible. Official B agreed to Official C's recommendation and in August 2013 EDD implemented a plan to begin its participation by the end of May 2014 at an estimated cost of about \$657,000. However, in February 2014, EDD revised its estimate and now projects that it will not begin participating in the Offset Program to collect unemployment benefit overpayments until September 2014 at a projected cost of a little more than \$1 million.

### **Had EDD Chosen to Participate in the Offset Program to Collect Unemployment Benefit Overpayments Earlier, the State Could Have Collected an Estimated \$516 Million**

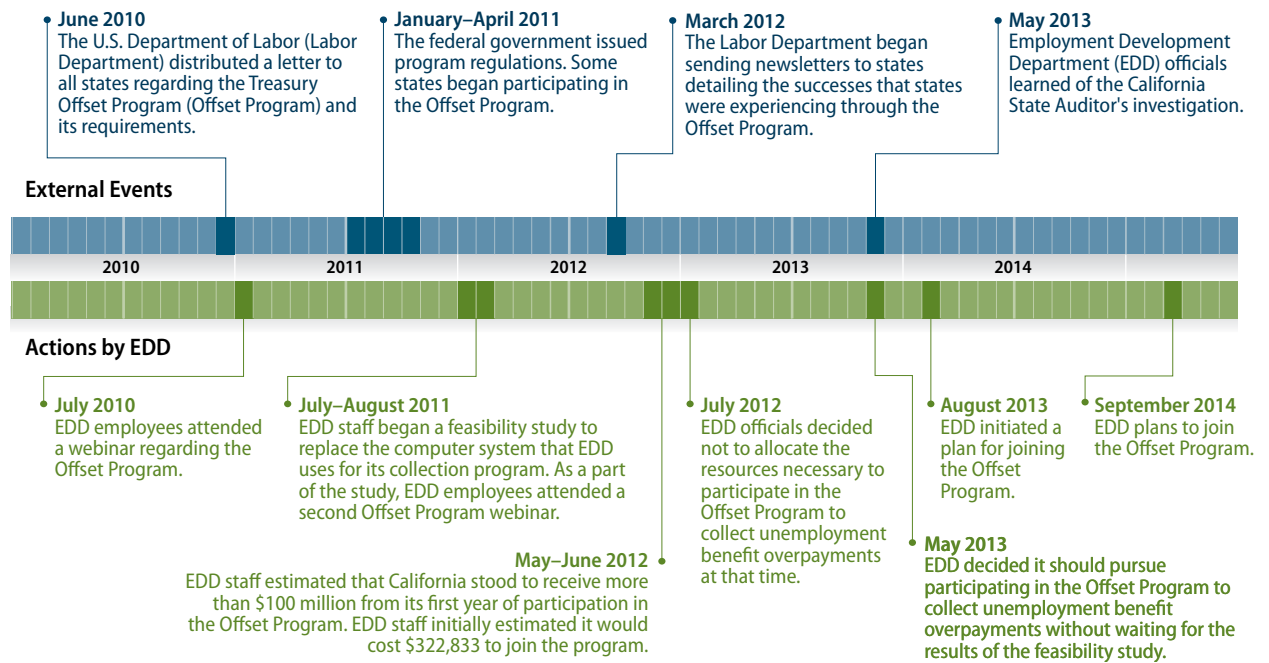
Figure 3 details the events that occurred between 2010, when EDD first learned of the opportunity to participate in the Offset Program to collect unemployment benefit overpayments, and 2014, when EDD finally committed to participating in the program.

While we applaud EDD's decision to participate in the Offset Program and thereby greatly enhance the State's ability to collect millions of dollars in unemployment benefit overpayments, EDD's delay in arriving at this decision has been costly to the State. Between 2011 and 2013, this delay deprived the State of fleeting opportunities to collect overpayments from the stream of federal payments directed to overpayment debtors. In addition, by further delaying its start date to participate in this aspect of the Offset Program until September of this year, EDD will miss most of its opportunity in 2014 to collect overpayment debts through the Offset Program. This lost opportunity will occur because the Internal Revenue Service (IRS) distributes approximately 90 percent of federal tax refunds during the months



of January through May of each year. Therefore, by the time its participation in the program is scheduled to begin in September, EDD already will have missed the opportunity to collect more than 90 percent of the unemployment benefit overpayments it could have collected through the Offset Program in 2014.

**Figure 3**  
**Time Line of Events Leading to the Employment Development Department’s Planned Participation in the Treasury Offset Program to Collect Unemployment Benefit Overpayments**



Sources: U.S. Department of the Treasury records, Labor Department records, and EDD records and staff.

As shown in Table 1 on the following page, we estimate that if EDD had participated in the expanded Offset Program when it first became available to the states, California could have collected \$516 million in overpayment debts from February 2011 through September 2014. To arrive at that estimate, we calculated the collection rates states achieved in each of their first, second, and third years of participation in the Offset Program to collect unemployment benefit overpayments by dividing the amount of money successfully offset and redirected to the states by the total amount of debt that all participating states submitted to the U.S. Treasury. We then applied each first-, second-, and third-year collection rate to the total amount of collectable benefit overpayment debt owed to California in 2011, 2012, and 2013, respectively, that EDD could have submitted to the Offset Program. For 2014 we assumed that the collection rate would be the same as the third-year rate, but we discounted the rate by 10 percent because

California is not expected to participate in the Offset Program to collect unemployment benefit overpayments until after the IRS has issued 90 percent of federal tax refunds for the year. We applied this rate to the amount owed to EDD as of October 31, 2013. We also reduced the amounts owed to EDD for years 2012 through 2014 by the amount of unemployment benefit overpayments we estimated EDD would have collected through the Offset Program during the previous year(s).

**Table 1**  
**Estimated Amounts the Employment Development Department Could Have Collected by Participating in the Treasury Offset Program to Collect Unemployment Benefit Overpayments**

	2011	2012	2013	2014	TOTAL
Overpayments the Employment Development Department (EDD) could have submitted	\$894,171,474	\$929,987,886	\$920,488,448	\$892,991,625	
Estimated collection rate	15.11%	18.54%	12.09%	10.88%	
Estimated amount EDD could have collected	\$135,109,310	\$172,419,754	\$111,287,053	\$97,157,489	\$515,973,606

Sources: California State Auditor's analysis of data from EDD and the U.S. Department of the Treasury.

Furthermore, if it had collected the estimated \$516 million, EDD likely would have been able to use a substantial amount to pay for its administrative costs. As discussed in the Background section of this report, EDD deposits the portion of funds that it collects attributable to penalties and interest assessed on fraudulent claims into the Benefit Audit Fund. To determine this amount, we looked at the annual amount of unemployment benefit overpayments that EDD was able to collect through its other collection efforts during 2011, 2012, and 2013, and calculated the percentage of each of these amounts attributable to penalties and interest. We then multiplied those percentages by the amounts of unemployment benefit overpayments we estimated that EDD could have collected through the Offset Program during those years. For 2014 we used the percentage of EDD's actual collections attributable to penalties and interest during the previous three years combined. As Table 2 describes, EDD could have deposited an estimated 19 percent of the \$516 million, or \$99 million, into the Benefit Audit Fund. Those funds are particularly significant because the Legislature could have appropriated them to pay EDD's administrative costs or transferred them to the General Fund to address other state needs. The remaining \$417 million would have been deposited in the Unemployment Fund, which could have helped reduce the \$10 billion debt that California owes to the federal government.<sup>4</sup>

<sup>4</sup> State law requires EDD to return collected overpayments to the source that originally funded them. In past years, many Californians received extended or augmented unemployment benefits funded by federal sources. Therefore, EDD would have been required to return collections on federally funded overpayments to the federal source from which they originated.

**Table 2**  
**Estimated Amounts the Employment Development Department Could Have Deposited Into the Benefit Audit Fund to Pay Its Administrative Expenses**

	2011	2012	2013	2014	TOTALS
Estimated amount the Employment Development Department (EDD) could have collected through the Treasury Offset Program	\$135,109,310	\$172,419,754	\$111,287,053	\$97,157,489	\$515,973,606
Estimated percentage of collected funds that EDD could have deposited in the Benefit Audit Fund	18.06%	19.94%	19.55%	19.23%	
Estimated amount not deposited in the Benefit Audit Fund	\$24,400,741	\$34,380,499	\$21,756,619	\$18,683,385	\$99,221,244

Sources: California State Auditor's analysis of data from EDD and the U.S. Department of the Treasury.

Once EDD begins participating in the Offset Program to collect unemployment benefit overpayments, it will be able to use the program to intercept future federal payments to claimants who owe the State for these overpayments, allowing EDD to collect such overpayments more effectively and efficiently. However, by delaying its decision to participate in this aspect of the Offset Program, EDD failed to maximize the benefits of the program and missed opportunities to collect millions of dollars in unemployment benefit overpayments. Some of these funds could have paid for EDD's administrative costs, and the remainder could have reduced California's debt to the federal government for unemployment benefit costs. However, its inefficient actions forced EDD to cover these administrative costs by using funds from other sources and prevented California from reducing its debt.

**Recommendations**

To remedy the effects of the improper governmental activity described in this report and to prevent it from recurring, we make the following recommendations:

- To ensure that EDD collects unemployment benefit overpayments as efficiently as possible, we recommend EDD adhere to its commitment to begin participating in the Offset Program to collect unemployment benefit overpayments by no later than September 2014.
- To ensure that EDD efficiently acts to take advantage of future collection opportunities, we recommend EDD institute a routine process for staff to identify and thoroughly evaluate ideas for improving EDD's ability to collect overpayments. This process should require staff to bring promising ideas to the

attention of EDD's senior management so it can give prompt, informed consideration to these ideas and document in detail the substance of that consideration.

Respectfully submitted,



ELAINE M. HOWLE, CPA  
State Auditor

Date: March 13, 2014

Steven Benito Russo, JD, Chief of Investigations

Legal Counsel: Julie Jacob, JD

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Lane Hendricks, CFE

For questions regarding the contents of this report, please contact Margarita Fernández, Chief of Public Affairs, at 916.445.0255.

## Summary of Agency Response and California State Auditor's Comments

After reviewing our draft report, the Employment Development Department (EDD) provided comments and additional information regarding its efforts to join the federal Treasury Offset Program (Offset Program) to collect unemployment benefit overpayments. Regarding our estimate that EDD could have collected \$135.1 million in 2011 through the Offset Program, EDD commented that it believes this amount was overstated. EDD argued that because the U.S. Department of the Treasury did not release the federal regulations governing the expanded Offset Program until January 28, 2011, it did not have adequate time to begin participating in the expanded program before the federal government began processing tax refunds in early 2011. However, as noted in our report, in June 2010 the U.S. Department of Labor provided EDD with the information it needed to begin preparations immediately for participating in the Offset Program once the regulations were issued. In response to this notification, other states undertook the necessary preparations and were able to begin participating in the Offset Program as early as February 2011. Thus, we believe that EDD could have participated in the Offset Program in 2011 because, as demonstrated by the success of these other states, EDD was given sufficient warning and information about the expansion of the Offset Program to permit its participation in early 2011. Further, we arrived at an estimate of \$135.1 million using an estimated collection rate based on the successes of the other states that participated in the Offset Program in 2011. Therefore, we do not believe that this estimate is overstated.

EDD also commented that our draft report did not provide sufficient information about the different ways that it has participated in the Offset Program since 2004 to collect other types of debts owed to the State. To address EDD's comment, we included additional information in the Background section of our report about the other ways in which EDD participates in the Offset Program, including using the program to collect outstanding personal income taxes and disability insurance contributions that employers withheld from employees' paychecks but failed to remit to EDD. However, considering EDD's extensive familiarity with the effectiveness of the Offset Program as a collection mechanism over the past decade, we find its delay in using the program to collect unemployment benefit overpayments to be even more appalling.

EDD also expressed concern that our draft report did not adequately acknowledge its efforts during 2012 and 2013 to pursue a feasibility study to replace the computer system EDD uses for its collection program. Although one of the goals of installing a

new computer system was to facilitate EDD's participation in the Offset Program, it was not the primary objective of the project, and tying participation in the expanded Offset Program to installing a new computer system only served to hinder joining the program. Further, even after recognizing early on that the study and subsequent work would not be completed in time to participate in the Offset Program in January 2013, EDD still did not pursue participating in the Offset Program other than to continue treating it as a potential byproduct of someday installing a new computer system. Ultimately, EDD's efforts to pursue the feasibility study did not result in advancing its participation in the Offset Program and left it to make the necessary changes to its existing computer system later anyway—a decision that EDD could have made much earlier and thereby yielded substantial returns.

In addition, EDD provided further details regarding the factors that it claimed led to its decision to delay participation in the Offset Program to collect unemployment benefit overpayments. It stated that between 2011 and 2013, its information technology (IT) project portfolio included a total of eight projects costing more than \$572 million. Some of these projects had legislatively set deadlines and required securing vendors through the competitive bidding process and dedicating EDD's IT and program staff resources. EDD also stated that in 2010 it notified the Legislature that it would have to suspend work on several IT projects because it had overcommitted its staff resources. However, this notification did not highlight that EDD was forgoing an opportunity to collect hundreds of millions of dollars owed to the State by not participating in the Offset Program to collect unemployment benefit overpayments. Further, EDD did not request additional resources from the Legislature to avoid suspending work on these projects or to enable it to participate in the expanded Offset Program. Although we do not dispute that EDD had allocated its resources toward other IT projects, we still find it difficult to understand why it did not attempt to find a way to dedicate a relatively small amount of resources to a project that was projected to bring such large returns.

To address our first recommendation, EDD reported that it is working actively to perform the IT work necessary to participate in the Offset Program to collect unemployment benefit overpayments. EDD had planned to begin participating in the Offset Program by May 2014, and in our draft report to EDD, we made a recommendation urging the department to begin participating in the program by that planned date. However, EDD explained that the work had proved to be more complex than originally anticipated, delaying its participation schedule and increasing its costs. As noted in the report, EDD now plans to participate in the Offset Program beginning in September 2014, at an increased cost totaling roughly \$1 million. We hope EDD succeeds in complying with this

revised date for beginning to participate in the Offset Program to avoid missing additional opportunities to collect unemployment benefit overpayments.

To address our second recommendation, EDD stated that since 2000, its collections division has a structured process in place to solicit ideas from staff for greater efficiencies and revenue opportunities. Its business results planning process includes a monthly meeting between staff and managers where the participants share information and communicate operational changes. In the meetings, managers encourage staff to provide input and make suggestions for improvement. The managers then share these ideas with senior-level management for consideration and implementation. EDD reported that through this process, it has implemented many ideas that have improved the effectiveness of its operations. However, because this process was in place between 2010 and 2012, a time when some EDD employees openly favored participating in the expanded Offset Program yet the program still received little or no attention from EDD, we are left to conclude that the process was ineffective at raising the expanded Offset Program to the awareness of EDD's senior officials. Therefore, EDD needs to improve its process to implement our recommendation fully.

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## Appendix

### THE INVESTIGATIONS PROGRAM

The California Whistleblower Protection Act (Whistleblower Act) contained in the California Government Code, beginning with Section 8547, authorizes the California State Auditor (state auditor) to investigate allegations of improper governmental activities by agencies and employees of the State. Under the Whistleblower Act, an improper governmental activity, as defined by Government Code section 8547.2, subdivision (c), includes any action by a state agency, or by a state employee in connection with his or her employment, that violates a state or federal law; violates an executive order of the governor, a California Rule of Court, or a policy or procedure mandated by the *State Administrative Manual* or *State Contracting Manual*; is economically wasteful; or involves gross misconduct, incompetence, or inefficiency. To enable state employees and the public to report suspected improper governmental activities, the state auditor maintains a toll-free Whistleblower Hotline: (800) 952-5665. The state auditor also accepts reports of improper governmental activities by mail and over the Internet at [www.auditor.ca.gov](http://www.auditor.ca.gov).

Although the California State Auditor's Office conducts investigations, it does not have enforcement powers. When it substantiates an improper governmental activity, the state auditor reports confidentially the details to the head of the state agency or to the appointing authority responsible for taking corrective action. The Whistleblower Act requires the agency or appointing authority to notify the state auditor of any corrective action taken, including disciplinary action, no later than 60 days after transmittal of the confidential investigative report and monthly thereafter until the corrective action concludes. The Whistleblower Act authorizes the state auditor to report publicly on substantiated allegations of improper governmental activities as necessary to serve the State's interests. The state auditor may also report improper governmental activities to other authorities, such as law enforcement agencies, when appropriate.