

September 28, 2007

MEMORANDUM FOR: EMILY STOVER DeROCCO
Assistant Secretary for Employment
and Training



FROM: ELLIOT P. LEWIS
Assistant Inspector General
for Audit

SUBJECT: Insufficient Controls Over Hurricane-issued Debit
Cards Created Opportunities for Fraud
Management Letter No. 06-07-002-03-315

INTRODUCTION

This Office of Inspector General (OIG) Management Letter is being issued as part of OIG's audit in response to the 2005 Gulf Coast hurricanes. The complete results of the audit will be summarized in a roll-up report.

We are recommending ETA take corrective actions to ensure the Louisiana Department of Labor (LDOL) has adequate controls in place to safeguard Unemployment Compensation (UC) and Disaster Unemployment Assistance (DUA) benefits paid to its claimants by debit cards, and to recover any federally funded benefits paid under the DUA grants that have not been claimed by or paid to its claimants.

BACKGROUND

Following Hurricanes Katrina and Rita, many residents from the Gulf Coast region were displaced and forced to relocate to other parts of the country. Not only were these individuals without a home, many had lost their means to earn an income and provide basic necessities for their families. As a result, an unprecedented number of individuals in Louisiana were eligible and did apply for assistance under one of two unemployment benefits programs. The first, State UC, provides benefits to eligible workers who are unemployed through no fault of their own, and meet eligibility requirements established by their states. UC benefits are state-funded except for former federal employees. The second, DUA, provides financial assistance to individuals whose employment or self-employment has been lost or interrupted as a direct result of a major disaster declared by the President of the United States. Before an individual can be

determined eligible for DUA, it must be established that the individual is not eligible for regular UC benefits.

DUA is federally funded by the Federal Emergency Management Agency (FEMA) through transfer of funding to ETA for allocation of funds to State Workforce Agencies, such as LDOL. Immediately after all payment activity has been concluded for a disaster—up to 26 weeks after its declaration—funding should be closed out and unexpended funds returned to FEMA, via ETA.

To expedite the delivery of benefits, LDOL implemented a new payment method using debit cards¹. LDOL contracted with JPMorgan Chase to establish debit card accounts for claimants, and transferred pertinent information to the company--name, address, full social security number (SSN), and birth date. JPMorgan Chase contracted with Oberthur Card Services (Oberthur) to produce and distribute these debit cards.

Debit cards were sent to claimants based on addresses provided when they initiated their claims. Because so many claimants subsequently relocated, debit cards were returned undelivered to LDOL, as well as Oberthur. Undelivered cards were reissued only when claimants contacted LDOL or JPMorgan Chase to update their new address.

Claimants who did receive their debit cards were instructed to call a toll-free number and use JPMorgan Chase's Interactive Voice Response system to activate their account and create a personal identification number (PIN) by entering their SSN and birth date. The PIN was a security measure to ensure that only the person who activated the account could gain access to the unemployment benefits paid on the card.

OBJECTIVES, SCOPE, AND METHODOLOGY

Our objectives were to determine if:

1. LDOL had adequate controls in place to ensure claimants eligible for Hurricanes Katrina- and Rita-related UC and DUA received benefits paid on debit cards;
2. LDOL retrieved from JPMorgan Chase UC and DUA benefits paid on inactive debit cards; and
3. LDOL had sufficient evidence to support the amount of reimbursements requested from ETA's DUA grants.

¹ Debit cards allow authorized users 24-hour online or ATM access to their accounts with the convenience, flexibility and spending power of a Visa® Check Card or MasterCard Banking Card.

We accomplished these objectives by:

1. Reviewing the processes LDOL, JPMorgan Chase, and Oberthur used to manage and distribute debit cards to determine the sufficiency of controls in place to ensure claimants received the benefits to which they were entitled.

To assess the controls Oberthur had in place, we reviewed its Statement on Auditing Standards (SAS) 70 report², *Independent Service Auditor's Report on Controls Placed in Operation and Tests of Operational Effectiveness*, for the period of December 1, 2005 – May 31, 2006.

2. Matching LDOL payment records, as of October 23, 2006, against a data file JPMorgan Chase provided to OIG that identified unactivated and undelivered debit card accounts, as of November 14, 2006 (no new debit cards were issued for hurricane-related claims after October 23, 2006), to determine the amount of benefits that remained on these accounts 60 or more days after the deposits were made.

To achieve our objectives, we relied on computer-processed data contained in LDOL's payment records. We assessed the reliability of this data and found it to be adequate except for a discrepancy that resulted from a backlog in LDOL's processing of an unprecedented number of transactions. We believe this discrepancy will be resolved once LDOL eliminates the claims backlog. Therefore, we feel that the data reported in LDOL's payment records are complete with the exception of these unprocessed transactions.

We also relied on computer-processed data contained in the JPMorgan Chase Data File. We did not establish the reliability of this data because we had no means to assess the reliability of the reported transactions. As a result, additional investigations are needed to confirm whether the lack of controls affected legitimate claimants receiving benefits to which they were entitled.

3. Comparing the total DUA benefits LDOL recorded as having paid for both Hurricanes Katrina and Rita to its accounting records, as well as the drawdowns it made from the ETA grants, to test the integrity of LDOL's payment file and ensure the information we used in our analysis was

² SAS 70 reports are used to examine control activities for service organizations and providers to demonstrate whether adequate controls and safeguards are in place when they host or process their client's data. A SAS-70 report was not available to cover the period when the debit cards were first sent to LDOL's claimants--September 15, 2005, through November 30, 2005.

complete and accurate.

4. Reviewing the results of the LDOL Audit Division's review, performed April 1 – May 21, 2006, over the security of debit cards returned to LDOL's offices. No additional procedures were performed to support the reliability of LDOL's findings.

JPMorgan Chase investigates reports of fraud or misuse of debit cards in accordance with Regulation E³, but denied our request to review pending or closed cases as they relate to debit cards issued to LDOL's claimants. Therefore, we cannot quantify the financial impact the control deficiencies identified in this management letter has had if someone other than the intended claimant obtained unauthorized unemployment benefits.

Our audit period was based on benefits paid for the weeks ending September 10, 2005, through June 3, 2006.⁴ We conducted fieldwork at LDOL's central administrative offices in Baton Rouge, Louisiana, and analyzed LDOL's electronic claims files in our Denver Office, from January 2006 to February 2007.

RESULTS

LDOL and JPMorgan Chase used procedures to administer debit cards that created opportunities for ineligible persons to gain access to benefits to which there were not entitled.

Section 303(a)(1) of the Social Security Act requires that each state establish a system for paying unemployment benefits to qualified individuals who become unemployed through no fault of their own:

The Secretary of Labor shall make no...payment to any State unless he finds that the law of such State...includes provision for such methods of administration...to insure full payment of unemployment compensation when due.

Therefore, it is LDOL's responsibility to establish sufficient controls over its disbursement of UC and DUA funds to ensure benefits are received by the intended qualified claimants.

³ Regulation E, monitored and enforced by the Federal Reserve System, addresses Electronic Fund Transfers. It establishes the rights, liabilities, and responsibilities of parties in electronic funds transfers, and protects consumers when they use such systems.

⁴ Hurricane Katrina benefits were payable through the week ending June 3, 2006. Hurricane Rita benefits were payable through the week ending June 24, 2006.

Controls over claimant security data

LDOL and JPMorgan Chase circumvented controls they had in place to ensure that debit card activation and benefit access was limited to authorized claimants. LDOL granted JPMorgan Chase customer service representatives (CSRs) access to claimant security data, such as birthdates, SSNs, and addresses. CSRs had the capability to either reveal to claimants, or change, the birthdates recorded in claimants' accounts, in order to facilitate the activation of their debit cards. Further, CSRs also had the capability to change the addresses to which re-issued debit cards were mailed.⁵

JPMorgan Chase's Interactive Voice Response system required claimants to confirm birthdates and SSNs in order to establish a PIN for and activate their debit cards. Claims entered into DOL's system contained inaccurate security data, resulting in claimants encountering problems with the activation process and contacting the CSRs for assistance. Instead of LDOL requiring the CSRs to refer claimants to its offices to confirm other security data in LDOL's claims system—past employers, employment dates, wages, etc.—to establish the claimants' identity before changing birthdates and addresses, LDOL allowed the CSRs to unilaterally change them. LDOL also allowed CSRs access to claimants' full SSNs instead of just partial SSNs (i.e. the last four digits.) These actions created opportunities for ineligible persons, including the CSRs, to gain access to benefits to which they were not entitled.

Controls over returned debit cards

LDOL had implemented an inadequate policy for handling debit cards returned to its offices. While this policy instructed employees to immediately destroy returned debit cards, it did not include controls to ensure accountability over these cards, such as limiting who could receive them, or recording their receipt and destruction.

While at LDOL's offices, we learned that debit cards had been returned as undelivered from the U.S. Postal Service, as well as directly from claimants⁶. LDOL's Audit Division informed us of its subsequent review of returned cards to evaluate the adequacy of physical controls over cards, as well as to determine whether staff was in compliance with LDOL's established policies. As a result of the review, the LDOL's Audit Division issued an internal memorandum to LDOL management on June 1, 2006, outlining the following findings:

⁵ Claimants needed to provide CSRs with the SSN on an account to learn or change the associated birth date, and had to provide the SSN and original address on the account to effect an address change.

⁶ Some claimants who were not entitled to unemployment benefits or did not want this assistance returned the debit cards they had received to LDOL.

1. A tray of unsecured debit cards was found outside the offices of the LDOL Accounting Division. Some cards were still intact and had not been destroyed in accordance with LDOL policy.
2. LDOL employees were neither following, nor aware of, the established policy for handling returned debit cards.
3. 30 debit card accounts were identified during the review as having questionable social security numbers.

The controls LDOL had in place were not sufficient to properly handle and account for debit cards returned to its offices, creating an opportunity for LDOL employees--who have access to the LDOL claims system containing information needed to activate debit cards--to activate the returned debit cards and illegally gain access to unemployment benefits.

LDOL paid, and had not retrieved, approximately \$1.2 million in hurricane-related benefits on 1,570 debit card accounts that were never activated.

The State of Louisiana paid, and had not retrieved, \$1,193,379 in Hurricanes Katrina- and Rita-related UC and DUA benefits applied to 1,570 debit cards accounts that were never activated by the claimants. Of this amount, \$354,070 was paid from the DUA grants.

Employment and Training Handbook, No. 356, Chapter IX, Closeout, states, in part:

Once payment activity has ceased or the end of the disaster assistance period, it is important to close out the disaster as soon as possible. This is necessary because disaster funds are no-year funds and any unused state funds will be reobligated by FEMA for future disasters.

Further, LDOL's Debit Card Business Rules require that UC and DUA funds paid on debit card accounts with no activity within 60 days be returned to the agency.

Delays in entering paid claims created a \$2.7 million discrepancy in LDOL's records.

As of October 23, 2006, LDOL had drawn down \$2,622,229 and \$118,496 more from the DUA grants for Hurricanes Katrina- and Rita- related claims, respectively, than it had evidence to support were paid by its claims system. LDOL officials claimed that these differences in DUA totals between the accounting and claims systems were the result of backlogged transactions they estimated would be completed and entered into the claims system within a year.

Regulations over the administration of DUA grants, Employment and Training Handbook No. 356, Chapter IX, Closeout, Financial Monitoring, require that “Regions . . . monitor each DUA project to ensure that excess funds are not being maintained by the State. . . .”

RECOMMENDATIONS

We recommend that the Assistant Secretary for Employment and Training:

1. Work with the LDOL to ensure adequate controls are in place, internally as well as with contracted service organizations, to safeguard debit cards and protect confidential information belonging to claimants. These procedures should be evaluated to ensure the intended objectives are achieved and effective in mitigating the risk of fraud;
2. Ensure that LDOL takes action to adequately address the results of its Audit Division’s internal review;
3. Work with LDOL to retrieve approximately \$1.2 million from JPMorgan Chase for UC and DUA benefits paid on inactive debit card accounts. In addition, \$354,070 of this amount should immediately be returned to ETA for benefits paid under the DUA grants; and
4. Monitor LDOL’s processing of its backlogged claims to facilitate the reconciliation of discrepancies between its accounting and claims systems. Upon completion, collect any funds LDOL has drawn down in excess of claims paid.

AGENCY RESPONSE

In response to the draft Management Letter, the Assistant Secretary for Employment and Training stated that LDOL has negotiated a new contract with JP Morgan Chase to safeguard debit cards and protect confidential information belonging to claimants. Under the new contract, no funds will be deposited into an account until the debit card is activated, and the bank will provide LDOL a daily list of inactive cards. LDOL has also retrieved approximately \$38-40 million from JP Morgan Chase for benefits paid on inactive accounts. Further, it has completed an investigation of all findings reported by its Audit Division, and has established overpayments for State employees who were found to have received improper benefits. ETA regional staff will monitor LDOL’s collection efforts as well as its reconciliation of discrepancies between its accounting and claims system and, further, will ensure that, where applicable, the DUA portion of funds is returned to the proper DUA grant. The Assistant Secretary’s response is included in its entirety as an Attachment.

OIG CONCLUSION

Based on the Assistant Secretary's response, we consider the recommendations resolved. They will be closed upon receipt of documentation to support LDOL's and ETA regional staff's actions taken to address the recommendations, as described in the response.

This final Management Letter is submitted for appropriate action. We request a response within 60 days documenting actions taken in response to the recommendations.

If you have any questions concerning this Management Letter, please contact David Williams, Regional Inspector General for Audit, in Dallas at (972) 850-4005.

Attachment

cc: Howard Radzely
Acting Deputy Secretary

Phyllis Newby
ETA Audit Liaison

U.S. Department of Labor

Assistant Secretary for
Employment and Training
Washington, D.C. 20210

SEP 28 2007

MEMORANDUM FOR ELLIOT P. LEWIS

FROM: EMILY STOVER DeROCCO *Emily Stover DeRocco*

SUBJECT: Insufficient Controls Over Hurricane-Issued Debit Cards
Created Opportunities for Fraud
Draft Management Letter No. 06-07-002-03-315

This response addresses recommendations for the Employment and Training Administration (ETA) contained in the Office of Inspector General (OIG), Draft Management Letter No. 06-07-002-03-315. During an audit, in response to the 2005 Gulf Coast Hurricanes, the OIG determined that there were insufficient controls in place by the Louisiana Department of Labor (LDOL) to safeguard Unemployment Compensation (UC) and Disaster Unemployment Assistance (DUA) paid to its claimants by debit cards.

Our response to each recommendation is provided below:

Work with the LDOL to ensure adequate controls are in place, internally as well as with contracted service organizations, to safeguard debit cards and protect confidential information belonging to claimants. These procedures should be evaluated to ensure the intended objectives are achieved and effective in mitigating the risk of fraud.

LDOL negotiated a new contract with JP Morgan Chase to safeguard debit cards and protect confidential information belonging to claimants. The new contract will provide that no funds will be deposited into an account until the debit card is activated, and the bank will provide LDOL a daily list of inactive cards. We believe that the State has taken appropriate action to establish sufficient controls in its procedures to administer debit cards. We also believe that Louisiana is actively recovering improper payments and inactive accounts. The ETA Regional Office will continue to monitor these efforts.

Ensure that LDOL takes action to adequately address the results of its Audit Division's internal review.

LDOL has completed an investigation of all findings reported by its Audit Division. An overpayment has been established for each state employee who was investigated and found to have received improper UC benefits. Collection of the overpayments has been referred to the Louisiana Attorney General.

Work with LDOL to retrieve approximately \$1.2 million from JPMorgan Chase for UC and DUA benefits paid on inactive debit card accounts. In addition, \$354,070 of this amount should immediately be returned to ETA for benefits paid under the DUA grants.

LDOL has retrieved approximately \$38-40 million from JP Morgan Chase for UC and DUA benefits paid on inactive debit card accounts. ETA Regional staff will ensure that the DUA portion of these funds is returned to the proper DUA grant when each grant is closed.

Monitor LDOL's processing of its backlogged claims to facilitate the reconciliation of discrepancies between its accounting and claims systems. Upon completion, collect any funds LDOL has drawn down in excess of claims paid.

ETA Regional staff will monitor LDOL's reconciliation of discrepancies between its accounting and claims systems. Upon completion, the ETA Regional Office will ensure that all funds drawn in excess of claims paid are posted to the proper UC and DUA accounts and ensure the DUA funds are not retained by LDOL.