**22 VAC 40-325 – Fraud Reduction/Elimination Effort**
**State Board of Social Services**
June 10, 2004

The Department of Planning and Budget (DPB) has analyzed the economic impact of this proposed regulation in accordance with Section 2.2-4007.G of the Administrative Process Act and Executive Order Number 21 (02). Section 2.2-4007.G requires that such economic impact analyses include, but need not be limited to, the projected number of businesses or other entities to whom the regulation would apply, the identity of any localities and types of businesses or other entities particularly affected, the projected number of persons and employment positions to be affected, the projected costs to affected businesses or entities to implement or comply with the regulation, and the impact on the use and value of private property. The analysis presented below represents DPB's best estimate of these economic impacts.

## Summary of the Proposed Regulation

The proposed regulations will establish a methodology to reimburse the expenditures incurred by the dedicated fraud prevention units and establish performance expectations for the local departments of social services.

## Estimated Economic Impact

The proposed regulations contain rules for the Fraud Reduction/Elimination Effort (FREE) program administered by the Department of Social Services (DSS). This program is a statewide program in order to ensure that fraud prevention and investigation are pursued for Virginia's public assistance programs. Pursuant to section 63.2-526 of the Code of Virginia, each local department of social services is mandated to establish a fraud prevention and investigation unit only insofar as money is appropriated for their costs. Currently, DSS reimburses all the administrative costs and all of the 120 local departments have a fraud prevention and investigation unit employing about 93 full time equivalent positions.

The funding sources of the FREE program include the fraud recovery special fund, general fund, and federal funds. Even though the general fund had been a source of funding in the past, currently, no appropriation is provided for this purpose. Thus, the program relies mainly on the fraud recovery special fund for its state share of costs. This fund receives overpayment moneys (net of federal share) recovered by local departments primarily in the food stamp program and Temporary Assistance for Needy Families (TANF). In local fiscal year 2003, the state share of food stamp and TANF collections was about $1.4 million compared to $2.1 million administrative costs. Based on these figures, the state share of revenues the program generates is about 64% of the total costs the state reimburses localities. Since the program does not generate enough revenues, DSS is unable to reimburse for the full administrative costs of the local fraud units.

The proposed regulations will revise the reimbursement formula so that the local departments are allocated funds based on their state share of collections in a previous year. According to the proposed methodology, each local department's annual allocation will equal their state share of TANF, food stamp fraud and non-fraud related overpayment recoveries from the last fiscal year in which complete information is available[1] divided by the percentage of the state share of program costs. For example, a locality with $10,000 state share of collections two years ago will receive $19,417 if the state share of costs were 51.5%. In this example, $9,417 will be funded from federal sources while $10,000 would be funded from state sources.

Under the proposed changes, local departments may no longer be reimbursed for their full administrative costs if the collections are not sufficient. Their funding will be determined by their collections of the overpayments from two years ago. In 2003, the ratio of collections to expenditures was less than one for about 80 local departments. Because these local departments may no longer receive full funding for their expenses, they have the option to terminate their dedicated fraud prevention and investigation unit under the statue. If they do not have a dedicated fraud unit, they will continue to deposit overpayment recoveries to the fund, but they will not get reimbursed for their costs from the fund.

[1] Even though the current language stipulates "a designated previous local fiscal year," the conversations revealed that the intent to use is "the fiscal year two years prior to the budget year." It would be beneficial if the clarity of the base year improved in the proposed regulation.

Less than full funding of expenditures may cause some departments reduce the fraud unit staff, but it will be in their best interest to maintain dedicated fraud units as they will be allocated their share of collections. The local departments have an obligation to detect and pursue fraud. One option available for them outside the FREE program is designating some eligibility workers for pursuing fraud activity. The funding for eligibility workers is provided 50% from federal sources, 30% from state sources, and 20% from local sources. However, the continued participation in the FREE program is probably a better choice for a local department compared to designating some eligibility workers for pursuing fraud activity as this would take away from resources dedicated originally for eligibility determinations.

The proposed methodology will also provide incentives to increase recovery of overpayments. The recoveries collected this year will be used to determine the funding for two years later. Thus, if a locality increases overpayment recoveries this year, its funding will be higher two years later.

However, making funding contingent upon the recoveries of overpayments may discourage front-end fraud prevention efforts. Front-end fraud prevention activities are those that are directed at preventing fraud before it occurs. Under the proposed methodology, funding is determined by the overpayment recoveries. Since front-end efforts would prevent overpayments occurring in the first place, local departments will not be compensated for their front-end fraud prevention efforts. Additionally, the fraud collections are probably subject to some randomness and may fluctuate from year to year. Thus, if the collections are low in a year due to inherent uncertainty in the fraud activity and detection, a local department's fraud prevention funding two years later will be reduced, probably causing a reduction in their efforts in that year when the fraudulent activity may be particularly high.

These potential adverse incentives may be mitigated by making a portion of the funding fixed. For example, a portion of the funding may be determined based on the expenditures incurred by a local department and the rest of the funding may be determined based on available overpayment collections. The 2003 data indicates that the total overpayment collections were approximately 64% of the total administrative expenditures incurred by the local departments. For instance, if this ratio does not fall below 50% (or any other reasonable percentage for that matter), then it may be possible to reimburse one half of the administrative expenditures regardless of a local department's collections. The remaining funds (e.g. 14% based on 2003 data) may be allocated based on a local department's share of collections. Such a methodology would mitigate the likely adverse impact on the front-end and other fraud prevention efforts while still maintaining a reasonable incentive structure to increase recovery of overpayments.

The proposed regulations will also allow DSS to develop, implement, and monitor local fraud unit performance expectations. DSS indicates that local department performances are already evaluated internally. The proposed language will provide authority to make this internal procedure external. Since performance evaluations are already done internally, there does not seem to be any significant additional costs as a result of the proposed changes. However, the external performance reviews may allow DSS to withhold funding if the performance expectations are not met. Thus, the proposed changes will provide some incentives to fraud units to maintain high performance standards. In addition, if the funding is reduced because performance expectations are not met, a local department may choose to no longer participate in the FREE program.

## Businesses and Entities Affected

The proposed regulations apply to dedicated fraud units housed at 120 local departments of social services.

## Localities Particularly Affected

The proposed regulations apply throughout the Commonwealth. However, local departments whose overpayment collections are less than their fraud unit expenditures will be particularly affected. Based on 2003 data, overpayment collections of about 80 local departments were less than their fraud unit expenditures.

## Projected Impact on Employment

The proposed funding methodology may cause some local departments to reduce staffing dedicated to fraud units as they may not be reimbursed the full costs of their fraud related expenditures. Currently, local departments have approximately 93 full time equivalent positions involved in detection and pursing fraud. Thus, this change may reduce the demand for labor by an unknown amount.

## Effects on the Use and Value of Private Property

The proposed regulations are not expected to affect the use and value of private property.