May 30, 2007

The Honorable Thomas R. Carper
Chairman, Subcommittee on Federal Financial Management, Government Information, Federal Services, and International Security Committee on Homeland Security and Governmental Affairs United States Senate

Subject: Improper Payments: Responses to Posthearing Questions Related to Agencies’ Progress in Addressing Improper Payment and Recovery Auditing Requirements

Dear Mr. Chairman:

On March 29, 2007, we testified before your subcommittee at a hearing entitled, “Eliminating and Recovering Improper Payments.” At the hearing, we discussed federal agencies’ progress in addressing key requirements of the Improper Payments Information Act of 2002 (IPIA) and Section 831 of the National Defense Authorization Act for Fiscal Year 2002, commonly known as the Recovery Auditing Act. Our review and testimony focused on (1) trends in agencies’ reporting under IPIA from fiscal years 2004 through 2006, (2) challenges in reporting improper payment information and improving internal control, and (3) agencies’ reporting of recovery auditing efforts.

This letter responds to your April 18, 2007, request to provide answers to follow-up questions relating to our March 29, 2007, testimony. The responses are based on work associated with previously issued GAO products (see Related GAO Products at the end of this report) and data reported in agencies’ performance and accountability reports (PAR). Your questions, along with our responses, follow.

1. In your written testimony, you state that over half of the programs reporting improper payment estimates also had reported management challenges,

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Internal control is a major part of managing an organization. It comprises the plans, methods, and procedures used to meet missions, goals, and objectives that support performance-based management. Internal control serves as the first line of defense in safeguarding assets and preventing and detecting errors and fraud. Strong systems of internal control provide reasonable assurance that programs are operating as intended and are achieving expected outcomes. Generally, improper payments result from a lack of or an inadequate system of internal controls, but some result from program design issues.

For fiscal year 2006, agency auditors reported numerous internal control weaknesses that could increase the risk of improper payments. For example, at the National Science Foundation (NSF), agency auditors identified two reportable conditions during their examination of the effectiveness of NSF’s internal control over financial reporting. These reportable conditions related to oversight of grants and cooperative agreements and monitoring of contracts. For the first reportable condition, auditors found that NSF’s monitoring process to ensure that expenditures were allowable, allocable, and reasonable under the terms of the grant award or agreement lacked oversight reviews for 286, or about 84 percent, of high-risk awards, totaling approximately $2.7 billion for fiscal year 2006. As such, NSF could not ensure that federal funds were properly spent on allowable costs benefiting NSF’s research activities. The auditors recommended, among other things, that NSF management expand the coverage of review for its high-risk awards.

Regarding the second reportable condition, the auditors reported that NSF did not have a comprehensive, risk-based system, including detailed policies and procedures, in place to oversee and monitor its contract awards totaling about $550 million for fiscal year 2006. This lack of appropriate contract oversight was evident during the auditor’s review of NSF’s largest contractor responsible for acquiring, maintaining, and performing a physical inventory of NSF’s property, plant, and equipment (PP&E). The auditors reported that NSF did not perform any independent verification of the PP&E amounts reported by the contractor, and did not maintain copies of source documentation supporting the amounts included in the financial statements. The auditors recommended that NSF develop a more comprehensive, risk-based, internal management monitoring program to ensure that contractors use NSF funds consistent with the objectives of the contract, and that funds are protected from waste, fraud, or mismanagement.

NSF procedures require that awards are assessed as high, medium, or low risk based on objective factors. The procedures also require that institutions with high-risk awards receive a more detailed level of review such as site visits on a cyclical basis every 4 or 5 years.
There are two key resources available to agencies for implementing strong internal control and managing improper payments. First, our *Standards for Internal Control in the Federal Government* provides an overall framework for entities to establish control for all aspects of their operations and a basis against which entities’ control structures can be evaluated. Specifically, internal control provides reasonable assurance that an organization’s objectives are achieved through (1) effective and efficient operations, (2) reliable financial reporting, and (3) compliance with laws and regulations.

Second, our executive guide on strategies to manage improper payments focuses on internal control standards as they relate to reducing improper payments. The five components of internal control—control environment, risk assessment, control activities, information and communication, and monitoring—are defined in the executive guide in relation to improper payments as follows:

- Control environment—creating a culture of accountability by establishing a positive and supportive attitude toward improvement and the achievement of established program outcomes.
- Risk assessment—analyzing program operations to determine if risks exist and the nature and extent of the risks identified.
- Control activities—taking actions to address identified risk areas and help ensure that management’s decisions and plans are carried out and program objectives are met.
- Information and communication—using and sharing relevant, reliable, and timely financial and nonfinancial information in managing activities related to improper payments.
- Monitoring—tracking improvement initiatives over time, and identifying additional actions needed to further improve program efficiency and effectiveness.

2. *In your written testimony, you note that the Improper Payments Information Act does not include a requirement for auditors to assess agencies’ compliance with the Act. Would there be any value in making this a requirement of agency auditors?*

As we stated in our testimony, IPIA does not include a separate reporting requirement for auditors to assess agencies’ compliance with the act. However, where agencies’ auditors have elected to test specific compliance with IPIA, their assessments have provided a valuable independent validation of agencies’ efforts to implement the act. For example, we found that for the selected agencies we reviewed, some agencies’ auditors reported problems relating to agencies’ risk

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assessments, the definition of programs for IPIA purposes, sampling methodologies, lack of reporting for all risk-susceptible programs, and supporting documentation.

Identification of any deficiencies in implementing IPIA helps agencies determine if risks exist, what those risks are, and the potential or actual effect of those risks on program operations. Independent assessments of these estimates would also enhance an agency’s ability to identify sound performance measures, monitor progress against those measures, and help establish performance and results expectations. Finally, independent assessments of agencies’ improper payments estimates would enable agencies and others with oversight and monitoring responsibilities to measure progress over time and determine whether further action is needed to minimize future improper payments.

3. You have stated that certain methodologies used to estimate improper payments did not result in accurate estimates. Could you please explain what this means? What needs to be done to help ensure that amounts reported by agencies are accurate?

As we reported in our testimony, the $42 billion total improper payment estimate reported by agencies for fiscal year 2006 may not reflect the full magnitude of total improper payments. We noted that agencies employed different sampling methodologies to estimate improper payments, including statistical sampling, nonstatistical sampling, or a combination of the two. The advantage of using statistical sampling is that sample results can be generalized to the entire population from which the sample was taken. Thus, a properly designed statistical sampling methodology provides a more accurate representation of the extent to which improper payments exist within a given program or activity. On the other hand, results of a nongeneralizable, or judgmental, sample may not be extrapolated beyond the sample transactions tested. For fiscal year 2006, we found that seven agencies did not use statistical sampling to estimate improper payments for nine programs totaling about $202 million, with program outlays exceeding $88 billion. Because the results of nongeneralizable sample selections cannot be extrapolated beyond the sampled items, the improper payment estimate for these programs would likely have been much greater had statistically valid methods been used.

Agency statisticians should be engaged throughout the sampling process, from design of the sampling methodology to evaluation of the results. This is consistent with OMB’s revised IPIA implementation guidance, which provides general steps that agencies should follow to obtain a statistically valid improper payment estimate. Specifically, OMB guidance emphasizes that most agencies will need to consult with a

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7The Office of Management and Budget’s (OMB) implementing guidance requires that agencies generally use a statistical sample to estimate improper payments. Agencies may also use an alternative sampling approach provided they obtain OMB approval prior to implementation.

statistician to design an appropriate sample that considers payment universes with divergent dollar amounts, types of payments, or both, and samples that involve multiple stages of selection or stratification. Further, additional oversight of agencies’ sampling methodologies could help ensure that amounts reported by agencies are accurate and, in turn, enable agencies to measure progress over time and determine whether further action is needed to minimize future improper payments.

4. As you know, the Improper Payments Information Act requires agencies, with respect to any program or activity with estimated improper payments of more than $10 million, file a report along with their improper payments estimates that includes at least four things:

   a. a discussion of the causes of improper payments identified, actions taken to correct those causes, and results of the actions taken to address those causes;
   b. a statement of whether the agency has the information systems and other infrastructure it needs in order to reduce improper payments to minimal cost-effective levels;
   c. If the agency does not have such systems and infrastructure, a description of the resources the agency has requested in its budget submission to obtain the necessary information systems and infrastructure; and
   d. a description of the steps the agency has taken to ensure that agency managers (including the agency head) are held accountable for reducing improper payments.

Do you think these are the right things we should be asking agencies to report on? What, if anything, would you add or take away from the reporting requirements under the Act?

The current IPIA reporting requirements increase the visibility over the governmentwide improper payments problem and transparency of agencies’ efforts to address improper payments in their programs. Improper payments are a significant problem in the federal government and information on actions taken, and the results of those actions, is a critical element in the overall process of reducing improper payments. Prior to implementation of IPIA, we issued several reports on governmentwide improper payments. Our reviews showed that the type and amount of improper payment information reported were inconsistent across federal agencies, with few agencies publicly reporting the amounts of their improper payments or other information such as:

- barriers to identifying or reducing improper payments,
- targets and goals set for improvement, and
- progress in identifying, minimizing, and recovering improper payments.

The act’s reporting requirements coincide with our recommendations made prior to IPIA implementation that agencies take actions to estimate, reduce, and publicly report improper payments. Our prior recommendations and OMB’s IPIA

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9See the Related GAO Products list at the end of this report.
implementing guidance also provided that agencies (1) assign responsibility to a
senior official for establishing policies and procedures for assessing agency and
program risks of improper payments, and (2) establish improper payment goals or
targets and measure performance against those goals to determine progress made
and areas needing additional improvements.

However, two additional areas that could provide enhanced transparency in agencies’
improper payment reporting include (1) a reporting requirement concerning improper
payment estimates by type of error and (2) information on agencies’ efforts to
recover improper payments in their risk-susceptible programs and activities.
Currently, we found that only a few agencies report improper payment estimates by
type of error or provide information on the recovery of improper payments made to
program beneficiaries or grantees. Existing guidance to report recovery auditing
information solely focuses on contract overpayments made to vendors in accordance
with the Recovery Auditing Act. Agencies should consider performing cost-benefit
analyses of a recovery auditing program before implementation to provide a baseline
to help ensure that the cost of those activities to the organization is not greater than
the potential benefit and then measure results periodically.

Requiring the reporting of improper payment estimates by type of error would assist
in the identification of the source and progress made to reduce those errors. For
example, the Department of Housing and Urban Development (HUD) reports three
types of error rates for its public housing/rental assistance programs—errors due to
administrator subsidy determinations, tenant underreporting of income, and gross
billing errors. With this level of detail, HUD has the information available to readily
measure its progress in reducing improper payments related to these types of errors,
and thus is in a better position to target corrective actions. Other agencies
categorized errors as to cause, but did not report an estimate for each category. For
example, the Department of Transportation categorized its errors into various types—
such as data entry errors, unallowable charges, and materials received not in
accordance with contract terms—but did not report an estimate for each category.
We also realize that agencies may use other reporting methods to provide a detailed
breakout of their improper payment estimates. Although not included as part of its
PAR reporting, the Department of Health and Human Services (HHS) reports
improper payment estimates for its Medicare Fee-for-Service program by type of
error, individual contractor, and geographical region and makes this information
publicly available on its Web site.10

Another area that agencies could be required to report on as part of their IPIA
reporting includes the results of their efforts to recover improper payments in their
risk-susceptible programs and activities. Generally, agencies’ recovery auditing
efforts target contract overpayments as required by the Recovery Auditing Act. These
requirements are only applicable for agencies that enter into contracts with a total
value in excess of $500 million in a given fiscal year. Agencies currently have no

10See the Comprehensive Error Rate Testing (CERT) reports at www.cms.hhs.gov/CERT.
requirement under IPIA to report on any recovery efforts for improper payments made to program beneficiaries or grantees. Reporting this type of information would provide additional accountability mechanisms for agencies to recover taxpayer funds and provide Congress additional insight on challenges agencies face in recovering improperly paid funds.

5. As you know, there has been significant debate over OMB’s definition of the phrase “significant improper payments.” How this phrase is defined is important because it determines which programs and activities – all of which likely have some level of improper payment – actually report the payment errors they make. Do you think there is some way to define “significant improper payments” that gives us more transparency without imposing an unacceptable administrative burden on OMB and the agencies?

We reported\(^\text{11}\) in November 2006 that OMB’s implementation of IPIA’s general criteria to identify risk-susceptible programs limits the disclosure and transparency of governmentwide improper payments. This limitation does not further the objectives of IPIA, as programs that do not meet OMB’s criteria of exceeding $10 million and 2.5 percent of program payments are excluded from agencies’ improper payment reporting. For example, one agency identified three programs with estimated improper payments exceeding $10 million, but because the estimates did not exceed 2.5 percent of program outlays, they were not included in the governmentwide improper payments total. In that report, we recommended that Congress consider amending existing IPIA provisions to define specific criteria, such as a minimum dollar threshold, agencies should use to identify which programs and activities are susceptible to significant improper payments.

In response\(^\text{12}\) to posthearing questions related to our December 5, 2006, testimony,\(^\text{13}\) we included suggested language for amending IPIA for better transparency and disclosure of improper payments reporting. The suggested language would amend IPIA to define, for purposes of identifying what programs or activities are susceptible to improper payments, the term “significant” to mean “annual improper payments under a program or activity that exceed $10 million.” This amendment would be consistent with the threshold currently identified in IPIA that requires additional reporting for those agencies with estimates of more than $10 million.

6. As you know, current recovery audit requirements only apply to overpayments made to agencies’ contractors. I suspect that there are a number of other areas, however, that would benefit from this kind of audit work. Do you think it would


be appropriate and useful for Congress to require that a broader range of agency payments be subjected to recovery auditing?

Subjecting a broader range of agency payments to recovery auditing or collection procedures may provide useful information to Congress as part of its decision-making and oversight responsibilities. Currently, IPIA does not include a reporting requirement on agencies’ efforts to recover improper payments made to program beneficiaries or grantees. However, existing legislation, such as the Debt Collection Improvement Act of 1996 (DCIA)\(^{14}\) and program-specific legislation, provides mechanisms that agencies can utilize to recoup improper payments.

For example, the Social Security Administration (SSA) reported in its fiscal year 2006 PAR that it had collected $2.3 billion in program debt. SSA’s internal collection techniques include benefit withholding and billing to recipients with subsequent follow-up. In addition, SSA uses external collection techniques authorized by DCIA including the Treasury Offset Program,\(^{15}\) credit bureau reporting, and administrative wage garnishment\(^{16}\) to recoup improper payments. DCIA requires that agencies refer eligible debts that an agency has been unable to collect and remain delinquent more than 180 days to the Department of the Treasury for payment offset or for cross-servicing. Cross-servicing involves such actions as locating debtors, issuing demand letters, and referring debts to private collection agencies.

In another example, HHS under section 306 of the Medicare Prescription Drug, Improvement, and Modernization Act of 2003,\(^{17}\) was given authority to conduct a project to demonstrate the use of recovery audit contractors in identifying improper payments and recouping overpayments for Medicare in the Medicare Fee-for-Service program. HHS reported in its fiscal year 2006 PAR that it initiated this 3-year project in March 2005 in the three states with the highest Medicare utilization rates. HHS reported that it provided the recovery audit contractors about $167 billion of claims submitted between fiscal years 2002 and 2005 for review. Of the $167 billion, HHS reported that it is working on recovering $224 million in claims payments determined to be improper.

As we previously reported and testified before this subcommittee,\(^{18}\) recovery auditing is a method that agencies can use to recoup detected improper payments. While we support the use of recovery auditing and annual reporting of this information, effective internal control serves as the first line of defense in safeguarding assets and preventing and detecting errors and fraud. Given the large volume and complexity of


\(^{15}\)This program includes the offset of certain benefit payments, vendor payments, and tax refunds.

\(^{16}\)This is a process in which a federal agency orders an employer to withhold amounts each payday from an employee who owes a debt to the agency. In turn, the employer pays the withheld amount to the agency.


\(^{18}\)GAO-07-92 and GAO-07-635T.
federal payments and historically low recovery rates for certain programs, it is much more efficient to pay bills and provide benefits properly in the first place. Aside from minimizing overpayments, preventing improper payments increases public confidence in the administration of benefit programs and avoids the difficulties associated with the “pay and chase” aspects of recovering improper payments. Without strong preventive controls, agencies’ internal control activities over disbursements will not be effective in reducing the risk of improper payments.

7. You note in your written testimony that 18 agencies have reported on their recovery audit efforts and have used a variety of methods to do that auditing work. Some conducted in-house recovery audits, others contracted out their recovery audit services, and still others used both in-house and private sector auditors. Do you have any sense of whether contractor or in-house recovery is more effective?

Beginning with fiscal year 2004, OMB required that applicable agencies publicly report on their recovery auditing efforts as part of the PAR reporting of improper payment information. As we reported in our March 2007 testimony, the number of agencies reporting recovery auditing information, including the dollar amounts identified for recovery and actually recovered, had increased from fiscal year 2004 to 2006. We also reported that agencies conducted in-house recovery audits, contracted out their recovery audit services, or used a combination of the two methods. However, we have not analyzed the relative effectiveness of the different types of methods agencies used to recover overpayments.
We are sending a copy of this report to the Director of the Office of Management and Budget, and other interested parties. This report is also available on GAO’s home page at http://www.gao.gov. Should you have any questions on matters discussed in this report or need additional information, please contact me at (202) 512-9095 or at williamsml@gao.gov. Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this report. Major contributors to this report include Carla Lewis, Assistant Director; Francine DelVecchio; Christina Quattrociocchi; Heather Rasmussen; Donell Ries; and Viny Talwar.

Sincerely yours,

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