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Testimony

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Financial Management, Committee on Government
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FINANCIAL
MANAGEMENT

Effective Implementation
of the Improper Payments
Information Act of 2002 Is
Key to Reducing the
Government's Improper
Payments

Statement of McCoy Williams
Director, Financial Management and Assurance





Highlights of [GAO-03-991T](#), a testimony before the Subcommittee on Government Efficiency and Financial Management, Committee on Government Reform, House of Representatives

Why GAO Did This Study

The Subcommittee asked GAO to testify on the implementation of the Improper Payments Information Act of 2002 (PL 107-300) and related Office of Management and Budget (OMB) guidance, and on GAO's strategies to reduce improper payments.

FINANCIAL MANAGEMENT

Effective Implementation of the Improper Payments Information Act of 2002 Is Key to Reducing the Government's Improper Payments

What GAO Found

Improper payments are a longstanding, widespread, and significant problem in the federal government. This past April, OMB estimated improper payments of about \$35 billion annually for major federal benefit programs that made payments in excess of \$1.2 trillion annually. Importantly, this estimate does not account for all federal programs and activities.

The Improper Payments Information Act of 2002 contains requirements in the areas of improper payment identification and reporting. It requires agency heads to annually review all programs and activities, identify those that may be susceptible to significant improper payments, estimate annual improper payments in the susceptible programs and activities, and report the results of their improper payment activities. The legislation also requires OMB to prescribe guidance for federal agency use in implementing the act. OMB issued the guidance in May 2003.

OMB's guidance addresses the specific reporting requirements called for in the act and lays out the general steps agencies are to perform to meet those requirements. The guidance defines key terms used in the law, such as *programs and activities*, and offers criterion that clarify the meaning of the term *significant improper payments*. It requires that agencies use statistical sampling when estimating improper payments and sets statistical sampling confidence and precision levels for estimation purposes. It also requires that agencies report the results of their improper payment activities in their annual Performance and Accountability Report. As with any legislation or implementing guidance, the act's ultimate success hinges on each agency's diligence and commitment to identify, estimate, determine the causes of, take corrective actions, and measure progress in reducing all improper payments.

Our prior work has demonstrated that attacking improper payment problems requires a strategy appropriate to the organization involved and its particular risks. We have found that entities using successful strategies to address their improper payment problems shared a common focus of improving the internal control system—the first line of defense in safeguarding assets and preventing and detecting errors and fraud. The components of the control system are:

- control environment—creating a culture of accountability,
- risk assessment—performing analyses of program operations to determine if risks exist,
- control activities—taking actions to address identified risk areas,
- information and communications—using and sharing relevant, reliable, and timely information, and
- monitoring—tracking improvement initiatives and identifying additional actions needed to further improve program efficiency and effectiveness.

www.gao.gov/cgi-bin/getrpt?GAO-03-991T.

To view the full report, including the scope and methodology, click on the link above. For more information, contact McCoy Williams at 202-512-6906 or williams1@gao.gov.

Mr. Chairman and Members of the Subcommittee:

I am pleased to be here today to discuss OMB's guidance¹ to federal agencies on the implementation of the Improper Payments Information Act of 2002 (Improper Payments Act) and some strategies that federal agencies should consider when planning and implementing actions to prevent improper payments.

Improper payments are a longstanding, widespread, and significant problem in the federal government and few would argue that the goal of reducing them is not a worthy one. As noted in our prior reports and testimonies on this topic, there is no clear picture of the extent of the problem. Historically, relatively few federal agencies and their components have publicly reported improper payment information such as improper payment rates, causes, and strategies for better managing their programs to reduce or eliminate these payments. This past April, OMB estimated improper payments to be about \$35 billion annually for major federal benefit programs that made payments in excess of \$1.2 trillion annually. Importantly, this estimate does not account for all federal programs and activities.

Further, the risk of improper payments and the government's ability to prevent them has important long-term implications. As the baby boom generation leaves the workforce, spending pressures will grow rapidly due to increased costs of programs such as Medicare, Medicaid, and Social Security. Other federal expenditures are also likely to increase. The increased size of federal programs and spending pressures, such as the implementation of new programs and changes in existing programs, all but guarantee that, absent improvement in internal controls and other proactive actions, the risk of even more improper payments will exist.

The Improper Payments Act, which this subcommittee sponsored, defines improper payments as any payment that should not have been made or that was made in an incorrect amount (including overpayments and underpayments) under statutory, contractual, administrative, or other legally applicable requirements. They include payments to ineligible recipients or payments for ineligible services. Improper payments also

¹OMB Memorandum M-03-13, *Improper Payments Information Act of 2002, Public Law 107-300* (May 21, 2003).

include duplicate payments, payments for services not received, and payments that do not appropriately reflect applicable discounts offered.

The act contains requirements in the areas of improper payment identification and reporting. It requires agency heads to annually review all programs and activities that they administer, identify those that may be susceptible to significant improper payments, and estimate annual improper payments for those programs and activities identified as susceptible to significant improper payments. Governmentwide implementation of these requirements will significantly increase the number of agencies analyzing their programs and activities for improper payments and coincides with our recommendation that the head of the CFO Act agencies assign responsibility to a senior official for establishing procedures for assessing agency and program risks of improper payments.

For programs for which estimated improper payments exceed \$10 million, agencies are to report certain information to the Congress including the causes of the improper payments, actions taken to correct those causes, and the results of those actions. This provision coincides with our recommendation that CFO Act agencies report to the Congress, OMB, and the agency head on the progress made in achieving improper payment reduction targets and future action plans for controlling improper payments.

OMB's Guidance on Addressing Improper Payments

The Improper Payments Act requires OMB to prescribe guidance for federal agency use in implementing the act. OMB issued this guidance in May 2003. As with any legislation or implementing guidance, the ultimate success of the Improper Payments Act hinges on each agency's diligence and its commitment to identify, estimate, determine the causes of, take corrective actions, and measure progress in reducing all improper payments.

OMB's guidance addresses the specific reporting requirements called for in the act and lays out the general steps agencies are to perform to meet those requirements. The guidance defines key terms used in the law. For example, it defines the term *programs and activities* to include "activities or sets of activities recognized as programs by the public, OMB, or the Congress as well as those that entail program management or policy direction." The guidance specifies that grants include competitive grant programs, regulatory activities, research and development activities, direct federal programs, all procurements including capital assets and service

acquisition, and credit programs. Also included are agency activities that support its programs.

As I noted earlier, the act requires agencies to identify programs and activities that are susceptible to significant improper payments. OMB's guidance defines *significant erroneous payments* as annual erroneous payments in the program exceeding both 2.5 percent of program payments and \$10 million. (GAO considers the terms improper payments and erroneous payments to be synonymous.) For those programs and activities susceptible to *significant erroneous payments*, the guidance instructs agencies to calculate annual improper payment estimates based on the gross total of both overpayments and underpayments, and to set statistical sampling confidence and precision levels for estimating those payments. It further requires agencies with estimated improper payments exceeding \$10 million in any program or activity to include, along with the estimated amount, a discussion of the amount of actual improper payments the agency expects to recover and how it will go about recovering them in the Management Discussion and Analysis section of their annual Performance and Accountability Report. These actions will help ensure transparency in reporting for those agencies with programs and activities with significant risks for improper payments.

According to the guidance, information on the results of improper payment-related efforts will generally be first reported in agency Performance and Accountability Reports for fiscal years ending on or after September 30, 2004. These reports should be available in November 2004. However, the guidance calls for those federal agencies already required by OMB Circular No. A-11, *Preparation and Submission of Budget Estimates*, to report improper payment information in their initial budget submissions to OMB to also include that improper payment information in their fiscal year 2003 Performance and Accountability Reports. This will result in publicly available information on improper payments for about 50 major federal programs, such as Medicare and Food Stamps, about one year earlier than the reporting date for all other federal programs and activities.

For years, we have recommended that OMB develop and issue guidance to federal executive agencies to assist them in developing and implementing a methodology for annually estimating and reporting improper payments, and for developing goals and strategies to address improper payments. This Improper Payments Act guidance is a good start in this area.

Strategies for Preventing Improper Payments

Because of the magnitude of improper payments and the actual and potential impact these payments can have on federal programs, it is essential that agencies develop appropriate methodologies for identifying and measuring improper payments, identifying cost-effective actions to correct them, implementing those actions, and periodically reporting improper payment-related information to agency managers, the Congress, and the public through publicly available documents. Our prior work has demonstrated that attacking improper payment problems requires a strategy appropriate to the organization involved and its particular risks, including a consideration of the legal requirements surrounding security and privacy issues.

In October 2001, we issued an executive guide² that provided information on strategies used successfully by public and private sector organizations to address their improper payment problems. We found that the federal, private sector, state, and foreign entities using these best practices shared a common focus of improving the internal control system over the program or activity that experienced improper payments. The components of this control system and a brief definition of each follows.

- Control environment—create a culture of accountability by establishing a positive and supportive attitude toward improvement and the achievement of established program outcomes.
- Risk assessment—perform comprehensive reviews and analyses of program operations to determine if risks exist and the nature and extent of the risks identified.
- Control activities—address identified risk areas and help ensure that management’s decisions and plans are carried out and program objectives are met.
- Information and communications—use and share relevant, reliable, and timely financial and nonfinancial information in managing improper payment-related activities.

²U.S. General Accounting Office, *Strategies to Manage Improper Payments: Learning From Public and Private Sector Organizations*, [GAO-02-69G](#) (Washington, D.C.: October 2001).

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- Monitoring—track improvement initiatives, over time, and identify additional actions needed to further improve program efficiency and effectiveness.

The entities that participated in our study found that they could effectively and efficiently manage improper payments by focusing on the components of internal controls and (1) changing their organizations' control environments or cultures, (2) performing risk assessments, (3) implementing activities to reduce fraud and errors, (4) providing relevant, reliable, and timely information and communication of results to management, and (5) monitoring performance over time. It is important to note that the implementation of the improvement process that addresses these internal control components will likely not be easy or quick. It will require strong support, not just in words but in actions, from the President, the Congress, top-level administration appointees, and agency managers. Once committed to a plan of action, they must remain steadfast supporters of the end goals and their support must be transparent to all.

Most recently, in a report issued last August,³ we pointed out that existing guidance did not require or offer agencies a comprehensive approach to measuring improper payments, developing and implementing corrective actions, or reporting on the results of the actions taken. As a result of our findings, we recommended, among other things, that the head of each CFO Act agency assign responsibility to a senior agency official for taking actions to minimize improper payments and that the Director of OMB work with agency officials to provide all reasonable assistance in implementing the corrective action plans developed to reduce improper payments. We also presented matters for congressional consideration to assist agencies in addressing barriers to actions to better manage efforts to reduce improper payments and to help them with improvement efforts.

As this subcommittee requested in May, we will issue a report later this year on the status of actions the CFO Act agencies and OMB have taken in designing and implementing programs to address our previous recommendations. As a result of preliminary information received from those agencies, we have found that they have begun to assign responsibility to lead and coordinate actions to reduce improper payments. Some

³U.S. General Accounting Office, *Financial Management: Coordinated Approach Needed to Address the Government's Improper Payments Problems*, [GAO-02-749](#) (Washington, D.C.: Aug. 9, 2002).

agencies have (1) developed detailed action plans to determine the nature and extent of improper payments, (2) set target goals for improper payment rates, and (3) reported progress in their annual accountability reports. For other agencies, methodologies for identifying risks, determining the nature and extent of improper payments, and developing corrective actions are in the early stages of implementation. As a part of our efforts, we will also discuss CFO Act agency progress in implementing the Improper Payments Act.

In closing, as the Congress and the American public have increased demands for accountability from corporations and their leaders, the federal government must demonstrate the same standards of accountability and responsibility expected from the private sector within its programs and activities. Areas vulnerable to fraud, waste, abuse, and mismanagement must be evaluated to ensure that scarce resources reach their intended beneficiaries and are not diverted for inappropriate, illegal, inefficient, or ineffective purposes.

We are seeing important leadership and action—both from the Congress and from the administration—to address the improper payment problem, but, as I mentioned earlier, the reduction or elimination of the government’s improper payments problems will not be quick or easy. I want to emphasize our commitment to continuing our work with the Congress, the administration, and federal agencies to ensure that improper payments are fully addressed governmentwide, and that actions are taken to reduce or eliminate the government’s vulnerabilities to the significant problem of improper payments.

Mr. Chairman, this completes my prepared statement. I would be happy to respond to any questions you or other Members of the Subcommittee may have at this time.

Contact and Acknowledgments

For information about this statement, please contact McCoy Williams, Director, Financial Management and Assurance, at (202) 512-6906 or at williamsm1@gao.gov. Individuals who made key contributions to this testimony include Tom Broderick, Bonnie McEwan, and Donell Ries. Numerous other individuals made contributions to the GAO reports cited in this testimony.

Related GAO Products

Financial Management: Challenges Remain in Addressing the Government's Improper Payments. [GAO-03-750T](#). Washington, D.C.: May 13, 2003.

Financial Management: Coordinated Approach Needed to Address the Government's Improper Payments Problems. [GAO-02-749](#). Washington, D.C.: August 9, 2002.

Financial Management: Improper Payments Reported in Fiscal Year 2000 Financial Statements. [GAO-02-131R](#). Washington, D.C.: November 2, 2001.

Strategies to Manage Improper Payments: Learning From Public and Private Sector Organizations. [GAO-02-69G](#). Washington, D.C.: October 2001.

Financial Management: Billions in Improper Payments Continue to Require Attention. [GAO-01-44](#). Washington, D.C.: October 27, 2000.

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