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Report to the Chairman of the Committee on Governmental Affairs, U.S. Senate

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FINANCIAL MANAGEMENT

Increased Attention Needed to Prevent Billions in Improper Payments

G A O
Accountability * Integrity * Reliability

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Contents

Abbreviations

ACF	Administration for Children and Families
AFDC	Aid to Families with Dependent Children
AID	Agency for International Development
C&P	Compensation and Pension Program
CFO	Chief Financial Officer
CRP	Conservation Reserve Program
CSRS	Civil Service Retirement System
DCIA	Debt Collection Improvement Act
DFAS	Defense Finance and Accounting Service
DI	Disability Insurance
DOD	Department of Defense
DOL	Department of Labor
ED	Department of Education
EITC	Earned Income Tax Credit
FASAB	Federal Accounting Standards Advisory Board
FCIC	Federal Crop Insurance Corporation
FECA	Federal Employees' Compensation Act
FEGLI	Federal Employees' Group Life Insurance
FEHBP	Federal Employees' Health Benefits Program
FEMA	Federal Emergency Management Agency
FERS	Federal Employees' Retirement System
FFMSR	Federal Financial Management System Requirements
FICA	Federal Insurance Contributions Act
FNS	Food and Nutrition Service
FSP	Food Stamp Program
GAO	General Accounting Office
GMRA	Government Management Reform Act
HCFA	Health Care Financing Administration
HHS	Department of Health and Human Services
HUD	Department of Housing and Urban Development
IG	Inspector General
IRS	Internal Revenue Service
JFMIP	Joint Financial Management Improvement Program
NRCS	Natural Resources Conservation Service
OASI	Old Age and Survivors Insurance
OIG	office of inspector general
OMB	Office of Management and Budget
OPM	Office of Personnel Management
PCIE	President's Council on Integrity and Efficiency
PHA	Public Housing Authority

SECA	Self-Employment Contributions Act
SSA	Social Security Administration
SSI	Supplemental Security Income
STAR	Systematic Technical Accuracy Review
TANF	Temporary Assistance for Needy Families
USDA	United States Department of Agriculture
VA	Department of Veterans Affairs
VBA	Veterans Benefits Administration

United States General Accounting Office
Washington, D.C. 20548

Accounting and Information Management Division

B-282920

October 29, 1999

The Honorable Fred Thompson
Chairman, Committee on Governmental Affairs
United States Senate

Dear Mr. Chairman:

The federal government—the largest and most complex organization in the world—annually expends hundreds of billions of dollars for a variety of grants, transfer payments, and procurement of goods and services. As the steward of taxpayer dollars, the federal government is accountable for how it spends those funds and is responsible for safeguarding against improper payments—that is, payments made for unauthorized purposes or excessive amounts, such as overpayments to program recipients or contractors and vendors. Reported estimates of improper payments total billions of dollars annually. Viewed in the simplest context, improper payments are an inefficient use of taxpayers' funds. Specifically, for programs with legislative or regulatory eligibility criteria, improper payments indicate that agencies are spending more than necessary to meet program goals. Conversely, for programs with fixed funds, any waste of federal funds translates into serving fewer recipients or accomplishing less programmatically than could be expected.

Because of concerns regarding improper payments in light of the projected future growth of federal expenditures, you asked us to (1) quantify, where possible, amounts reported by agencies as improper payments in their fiscal year 1998 financial statements prepared pursuant to the Chief Financial Officers Act of 1990 (CFO Act),[1] (2) identify additional types of federal programs at risk of disbursing improper payments, (3) determine reported causes of improper payments prevalent across government, and (4) assess the extent to which agencies are addressing improper payments in their performance plans under the Government Performance and Results

[1]The CFO Act, as expanded by the Government Management Reform Act of 1994 (GMRA), requires 24 major departments/agencies to prepare and have audited agencywide financial statements. See appendix I for a list of the 24 CFO Act agencies.

Act of 1993 (Results Act).[2] We also considered the impact of potential Year 2000 computing problems on improper payments.

Results in Brief

In their fiscal year 1998 financial statement reports, nine agencies collectively reported improper payment estimates of $19.1 billion.[3] These improper payment estimates relate to 17 major programs[4] that expended approximately $870 billion.[5] The programs and related improper payment estimates include:

- Medicare Fee-for-Service ($12.6 billion),
- Supplemental Security Income ($1,648 million),
- Food Stamps ($1,425 million),
- Old Age and Survivors Insurance ($1,154 million),
- Disability Insurance ($941 million),
- Housing subsidies ($857 million), and
- Veterans Benefits, Unemployment Insurance, and others ($514 million).

Also included are the Agency for International Development (AID), Medicaid, and the Federal Crop Insurance Corporation. AID and the agencies administering these programs acknowledged making improper payments in their fiscal year 1998 financial statements, but did not disclose specific dollar amounts.

While financial statement disclosures draw attention to the need to address this problem, the full extent of the government's improper payments is not known. Improper payments are much greater than have been disclosed thus far in agency financial statement reports, as shown by our prior audits and those of agency inspectors general (IG). These audit reports identified additional agencies that made improper payments, such as the departments

[2]The Results Act requires agencies to prepare annual performance plans that include performance goals and measures, strategies, and resources required to achieve performance goals, and procedures to verify and validate performance information.

[3]This includes $14.9 billion in improperly paid expenses and an additional $4.2 billion of receivables that these agencies expect to collect.

[4]For purposes of this report, major programs include those that disburse $1 billion or more annually. Loan programs were not included in the scope of this review. See appendix II for a description of these agencies or their programs.

[5]This amount primarily consists of programs' fiscal year 1998 net outlays.

of Defense (DOD) and Education (ED) and the Internal Revenue Service (IRS). For example, audits have disclosed that between fiscal years 1994 and 1998, DOD contractors returned to the government $984 million that had been erroneously paid to them.

Agencies are not performing comprehensive quality control reviews—internal studies or reviews—for certain programs to determine the propriety of program expenditures. As a result, the full extent of the problem—and possible solutions to it—is unknown. Comprehensive quality control reviews could also identify the causes of improper payments, which range from inadvertent errors to fraud and abuse. Improper payments can result from incomplete or inaccurate data used to make payment decisions, insufficient monitoring and oversight, or other deficiencies in agency information systems and weaknesses in internal control. This risk is inherently increased in programs involving (1) complex program regulations, (2) an emphasis on expediting payments, and (3) a significant volume of transactions. Audit reports note that other federal programs and activities for which agencies did not report improper payments experience the same kinds of problems as agencies that have acknowledged improper payments—problems that are major causes leading to improper payments. Thus, these programs also risk making improper payments.

Working with the Office of Management and Budget (OMB), some agencies are taking steps to mitigate this risk by focusing attention on identifying, reporting, and reducing improper payments through the discipline of annual audited financial statements and the development of performance goals[6]—management reforms created by the Congress in the CFO Act and the Results Act. For example, the Department of Health and Human Services (HHS) has identified, reported in its financial statements, and substantially reduced improper payments in its $177 billion Medicare Fee-for-Service program. For fiscal year 1996, through the process of preparing audited financial statements, HHS estimated $23.2 billion in improper payments—its first such estimate of the extent of this long-standing serious problem. HHS' analysis of improper Medicare payments helped lead to the implementation of several initiatives to identify and reduce such payments. For fiscal year 1998, its estimate was significantly less—$12.6 billion. Future annual estimates of improper payments will provide further

[6]Performance goals are presented in agency performance plans, which are the vehicles agencies use to define their expected results for the fiscal year.

information on the nature of the problem and the progress of these initiatives.

In another case, the Department of Housing and Urban Development (HUD) has also identified improper payments in its housing subsidy programs. For fiscal year 1998, HUD reported $857 million in improper payments. Similarly, the Department of Agriculture (USDA) disclosed $1.4 billion in food stamp overissuances. USDA, HUD and HHS estimated improper payments by implementing methodologies that use statistical sampling. For certain other programs—particularly programs whose administration varies state-by-state—implementing a statistically valid methodology will not be easy. Without a baseline measurement of the extent of improper payments, agencies lack the information needed to address improper payments. By analyzing the characteristics of cases identified as having improper payments, agencies can then identify the circumstances and root causes leading to improper payments. This provides a foundation for developing sound strategies to mitigate improper payments in their programs.

However, agencies responsible for 13 of the 17 programs having made improper payments—many of which we identified in our High-Risk and Performance and Accountability series issued earlier this year[7]—did not include specific performance goals or strategies to comprehensively address these payments in their fiscal year 2000 performance plans under the Results Act. This may indicate inadequate attention to developing mechanisms to comprehensively address this serious problem. Thus, some agencies have not fully demonstrated the accountability Congress called for in the CFO and Results Acts. Without a systematic measurement of the extent of the problem, the establishment of expected results, and the periodic measurement and reporting on these results, agency management lacks the means to determine (1) whether the problem is significant enough to require corrective action or (2) the success of efforts implemented to reduce improper payments.

As the federal budget grows, more taxpayer dollars are placed at risk, thus increasing the urgency for identifying and preventing these types of

[7] *High-Risk Series: An Update* (GAO/HR-99-1, January 1999) and *Performance and Accountability Series: Major Management Challenges and Program Risks* (GAO/OCG-99-22SET, January 1999). These 2 series of reports outline actions needed to improve the performance and accountability of, and manage the risk relating to, our national government.

payments and providing complete accountability to taxpayers. Finally, unless corrected, potential Year 2000 computing problems could have a costly, widespread impact on these programs—including the extent to which improper payments are made.

We are making recommendations to the Director of OMB directed at developing and implementing a methodology for annually estimating and reporting improper payments and for addressing improper payments in agencies' annual performance and strategic plans and performance reports. In commenting on a draft of this report, OMB agreed that its focus on improper payments should be expanded.

Background

Annually, the federal government expends hundreds of billions of dollars for a variety of grants, transfer payments, and procurement of goods and services. Because of its size, complexity, weak control environment, and insufficient preventive controls, the federal government risks disbursing improper payments. Agency-specific studies and audits have indicated that improper payments are a widespread and significant problem. They occur in a variety of programs and activities including those involving contract management, financial assistance benefits—such as Food Stamps and Veterans Benefits—and tax refunds. However, some overpayments, by their nature, are not considered improper payments, such as routine contract price adjustments.[8]

Legislative efforts have focused on improving the federal government's control environment. For example, under the Federal Managers' Financial Integrity Act of 1982 and the Federal Financial Management Improvement Act of 1996, agency managers are responsible for ensuring that adequate systems of internal controls are developed and implemented. An adequate system of internal controls, as defined by the Comptroller General's internal control standards, which are issued pursuant to the Financial Integrity Act, should provide reasonable assurance that an agency is effectively and efficiently using resources, producing reliable financial

[8]For example, a routine contract price adjustment allows for the payment of an expense at a provisional rate until the actual cost information is available and audited. When the actual cost is lower than that provisionally paid, an overpayment has occurred. These amounts may be offset in future payments or returned directly to the government. This type of overpayment is not considered an improper payment.

reports, and complying with applicable laws and regulations.[9] Accordingly, cost-effective internal controls should be designed to provide reasonable assurance regarding prevention of or prompt detection of unauthorized acquisition, use, or disposition of an agency's assets.

Recent legislation has provided an impetus for agencies to systematically measure and reduce the extent of improper payments. For example, with the advent of the CFO Act, GMRA, and the Results Act, agencies are challenged to increase attention on identifying and addressing improper payments. The CFO Act, as expanded by GMRA, requires 24 major departments/agencies to prepare and have audited agencywide financial statements, which are intended to report an agency's stewardship over its financial resources—including how it expended available funds. The Office of Management and Budget's Bulletin 97-01, *Form and Content of Agency Financial Statements*, provides implementing guidance on these CFO Act requirements. In addition, the CFO Act sets expectations for agencies to routinely produce sound cost and operating performance information. Effective implementation of this requirement would enable managers to have timely information for day-to-day management decisions. The CFO Act also requires OMB to prepare and annually revise a governmentwide 5-year financial management plan and status report that discusses the activities the executive branch plans to and has undertaken to improve financial management in the federal government. Additionally, each agency CFO is responsible for developing annual plans to support the governmentwide 5-year financial management plan.

The Results Act seeks to improve the effectiveness and efficiency of the federal government by requiring that agencies develop strategic and annual performance goals and report on their progress in achieving these goals. Agency strategic plans are required to include the agency's mission statement; identify long-term general goals, including outcome-related goals and objectives; and describe how the agency intends to achieve these goals. Agencies are required to consult with the Congress when developing their strategic plans and consider the views of other interested parties. In their annual performance plans, agencies are required to set annual goals, covering each program activity in an agency's budget, with measurable target levels of performance. Agencies are also required to issue annual performance reports that compare actual performance to the annual goals.

[9] *Standards for Internal Control in the Federal Government, Exposure Draft* (GAO/AIMD-99-21.3.1, May 1999).

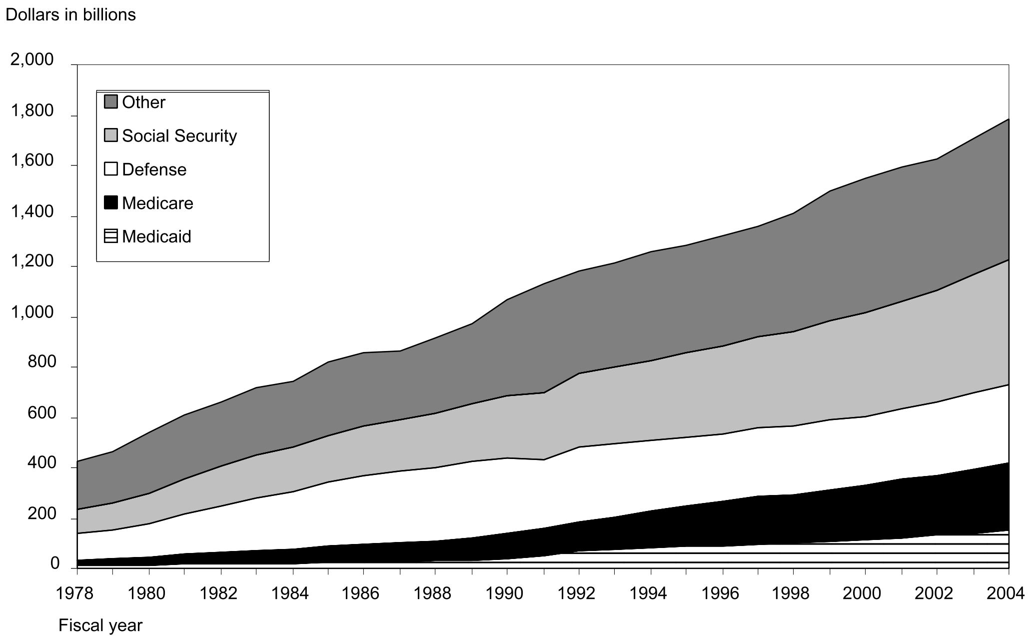
Together, these plans and reports are the basis for the federal government to manage for results. The Results Act is supported by the development of federal cost accounting standards under the CFO Act, which require agencies to identify the costs of government activities.[10] These standards can lead to and support linking costs with achieving performance levels. This can give managers information for assessing the full costs of goods, services, and benefits compared to program outputs and results. Such information can provide the basis for agencies to develop performance goals to monitor and track improper payments as well as strategies for preventing such future disbursements.

The risk of improper payments and the government's ability to prevent them will continue to be of concern in the future. Under current federal budget policies, as the baby boom generation leaves the workforce, spending pressures will grow rapidly due to increased costs of Medicare, Medicaid, and Social Security.[11] Other federal expenditures are also likely to increase. Thus, absent improvements over internal controls, the potential for additional or larger volumes of improper payments will be present. Figure 1 illustrates the reported and projected trends in federal expenditures, excluding interest on the public debt, for fiscal years 1978 through 2004.

[10] Statement of Federal Financial Accounting Standards No. 4, *Managerial Cost Accounting Standards; Managerial Cost Accounting System Requirements, Federal Financial Management System Requirements* (FFMSR) 8, Joint Financial Management Improvement Program (JFMIP), February 1998; *The Managerial Cost Accounting Implementation Guide*, Chief Financial Officers Council and JFMIP, February 1998.

[11] *Federal Debt: Answers to Frequently Asked Questions—An Update* (GAO/OCG-99-27, May 28, 1999) and *Medicare and Budget Surpluses: GAO's Perspective on the President's Proposal and the Need for Reform* (GAO/T-AIMD/HEHS-99-113, March 10, 1999).

Figure 1: Trends in Certain Federal Expenditures: Fiscal Years 1978 Through 2004



Note: Expenditures for fiscal years 1999-2004 are projections.

Source: *Budget of the United States Government, Fiscal Year 2000*, “Historical Tables.”

Historically, the recovery rates for certain programs identified as having improper payments have been low. Therefore, it is critical that adequate attention be directed to strengthen controls to prevent improper payments.

Scope and Methodology

This report is based on our reviews of available major agencies’ fiscal year 1998 financial statement reports prepared under the CFO Act, as expanded by GMRA. We reviewed these reports to identify amounts of reported improper payments. We also identified and reviewed recent GAO reports to identify additional types of programs at risk. We supplemented our review with IG reports from CFO Act agencies and other information obtained from a variety of sources, such as agency studies. In addition, we reviewed these data sources to discern the causes of improper payments. For the nine agencies that reported improper payments in their financial statement reports, we reviewed the agencies’ Results Act performance plans for fiscal year 2000 to determine the extent to which the plans addressed improper payments. We relied on recent GAO reports and guidance to consider any impact from potential Year 2000 computing problems on improper payments. In selected cases, we interviewed agency CFO and IG personnel. Because of the nature of improper payments, our review would not capture all reported instances of such payments.[12] As requested, relevant GAO reports covering our work in these areas for the past 4 fiscal years are listed at the end of this report.

To gather information on existing financial statement and performance reporting criteria, we reviewed relevant professional literature, including the American Institute of Certified Public Accountants' *Codification of Statements on Auditing Standards* and the Federal Accounting Standards Advisory Board's (FASAB) *Statements of Federal Financial Accounting Concepts and Standards.* In addition, we reviewed OMB Bulletin 97-01, *Form and Content of Agency Financial Statements* and OMB Circular A-11, Part 2, *Preparation and Submission of Strategic Plans, Annual Performance Plans, and Annual Program Performance Reports.*

We performed our work from June 1998 through August 1999. Our work was conducted in accordance with generally accepted government auditing standards. We provided a draft of this report for comment to the Director of the Office of Management and Budget (OMB). These comments are presented and evaluated in the "OMB Comments and Our Evaluation" section and reprinted in appendix IV.

[12]For example, to the extent that individuals who owe the federal government for certain programs and/or activities receive other federal benefits and payments, such amounts constitute missed opportunities for collection. If outstanding amounts are owed to the government for one type of program or activity, these amounts could be collected through either offsetting or levying other federal benefits and payments. Along these lines, the Debt Collection Improvement Act (DCIA) of 1996 calls for the centralization and aggressive pursuit of delinquent nontax federal receivables, including delinquent loans and other forms of payment owed the federal government. The Department of the Treasury is developing a mechanism to pursue collection of outstanding federal receivables as mandated by DCIA, including the ability to offset tax refunds and levy federal benefits and payments to recover other amounts owed the federal government. However, it was beyond the scope of this report to consider the magnitude of payments that might otherwise be offset or levied to recover other delinquent amounts owed or to review Treasury's efforts to implement DCIA. See *Unpaid Payroll Taxes: Billions in Delinquent Taxes and Penalty Assessments Are Owed* (GAO/AIMD/GGD-99-211, August 2, 1999).

Improper Payments Are Widespread Across Government, but the Full Extent Is Unknown

Agency-specific studies performed by GAO, IGs, and others indicate that improper payments are a widespread and significant problem. However, efforts by agencies to develop comprehensive estimates have varied. Nine agencies have taken the initiative to disclose improper payments for 17 of their programs in their financial statement reports, which has resulted in the disclosure of important information for oversight and decision-making. At the same time, the methodologies used by some agencies to estimate improper payments do not always result in complete estimates, and many other agencies have not even attempted to identify or estimate improper payments. As a result, the full extent of improper payments governmentwide is largely unknown, which hampers efforts to reduce such payments. Ascertaining the full extent of improper payments governmentwide is critical to determining related causes. Obtaining these data would give agencies baseline information for making cost-effective decisions about enhancing controls to minimize improper use of federal resources.

Nine Agencies Reported Improper Payments, but Estimates Are Incomplete

Nine of the CFO Act agencies that had issued their fiscal year 1998 audited financial statements as of the end of our field work,[13] acknowledged making improper payments. For fiscal year 1998, HHS,[14] USDA, and HUD collectively reported improper payments of $14.9 billion as part of their program expenses in their financial statement reports. HHS' estimated improper Medicare benefit payments constitute $12.6 billion of this amount, which represents 7.1 percent of the $177 billion in Fee-for-Service payments processed in fiscal year 1998. USDA disclosed $1.4 billion in food stamp overissuances or approximately 7 percent of its annual program cost of $20.4 billion. HUD's excess housing subsidy payments totaled $857 million, or 4.6 percent of its rental assistance payments for this $18.6 billion program. These agencies have made significant progress in estimating and reporting improper payments for these programs by implementing methodologies that use statistical sampling. However, implementing a statistically valid methodology will pose challenges to agencies for certain programs.

[13]Four of the 24 CFO Act agencies—the departments of Education and State, the Environmental Protection Agency, and the Small Business Administration had not issued audited financial statements for fiscal year 1998 as of the end of our field work.

[14]HHS also reported $6.5 million in improper payments for its Administration for Children and Families programs that spent $32 billion in fiscal year 1998.

The disclosure methods used by HHS, USDA, HUD, and the other six agencies varied. Some agencies, such as the Social Security Administration (SSA), reported known improper payments as receivables and provided explanatory disclosures in the notes accompanying their financial statements. Other agencies disclosed explanatory information in other sections of their financial statement reports, such as in management's discussion and analysis or in supplemental data sections. In addition, reporting within agencies for different programs also varied. For example, USDA disclosed improper payments of $1.4 billion for the Food Stamp Program, but only acknowledged making improper payments without providing a specific amount for its Federal Crop Insurance Corporation (FCIC).

Three of the nine agencies reported improper payments as expenses for 4 programs, while five agencies reported them as accounts receivable for 10 programs. Three agencies acknowledged making improper payments, but did not quantify the dollar amounts for three programs. Eleven of the CFO Act agencies did not report any information related to improper payments in their financial statement reports. Such inconsistent financial reporting makes it difficult to quantify the extent of the problem governmentwide and indicates a need for more guidance. To address this issue, OMB is contemplating revising its guidance to provide uniform reporting and disclosure of improper payments by management. In addition, OMB has made error reduction in the distribution of benefits a Priority Management Objective,[15] which is monitored by the OMB Director. OMB works with agencies on an individual basis to address these issues in ways most appropriate to the individual programs. For example, OMB is working with ED and the Department of the Treasury to examine ways to implement new statutory authorization for IRS verification of income of student aid applicants, in accordance with existing tax and privacy laws.

Table 1 lists the nine agencies and the manner in which they reported improper payments in their fiscal year 1998 financial statement reports for the 17 programs identified. See appendix II for a description of these agencies and/or their programs.

[15]Priority Management Objectives focus the administration's efforts to meet some of the government's biggest management challenges. They are specific management initiatives covering a wide range of concerns—ranging from meeting the Year 2000 computer challenge to implementing the restructuring of IRS.

Table 1: Agencies and Programs that Reported Improper Payments

Department or Agency	Program	Reported in financial statements: As a fiscal year 1998 expense	As part of multiyear accounts receivable	Other[a]
Agency for International Development (AID)	Not specifically identified[b]			X
Department of Agriculture	Federal Crop Insurance Corporation			X
	Food Stamp Program	X		
Department of Health and Human Services	Various Programs under the Administration for Children and Families	X		
	Medicare Fee-for-Service	X		
	Medicaid			X
Department of Housing and Urban Development	Housing Subsidy Programs	X		
Department of Labor (DOL)	Federal Employees' Compensation Act		X	
	Unemployment Insurance		X	
Office of Personnel Management (OPM)	Federal Employees' Group Life Insurance		X	
	Federal Employees' Health Benefits		X	
	Retirement		X	
Social Security Administration	Disability Insurance		X	
	Old Age and Survivors Insurance		X	
	Supplemental Security Income		X	
Department of the Treasury – Customs	Drawbacks and Refunds		X	
Department of Veterans Affairs (VA)	Veterans Benefits		X	

[a]Acknowledged within the financial statement report, but no amount specifically included.

[b]This represents a combination of programs at AID for which improper payments were not separately reported.

Source: GAO analysis based on a review of the CFO Act agencies' fiscal year 1998 financial statement reports.

The extent of the problem for certain of these agencies' programs is unknown because agencies are not performing comprehensive quality control reviews to estimate the range and/or identify rates of improper payments. For example:

- SSA reported $2.5 billion in gross receivables as overpayments related to its Supplemental Security Income (SSI) program—a $27 billion program annually providing cash assistance to about 7 million financially needy individuals who are aged, blind, or disabled. These receivables consist of amounts specifically identified over multiple years based on SSA's discussions with recipients and the results of its efforts in matching data provided by recipients with information from other federal and state agencies, such as IRS 1099 information, VA benefits data, and state-maintained earnings and employment data. SSA reports a statistically based accuracy rate for new SSI awards of 92.5 percent.[16] However, this accuracy rate does not consider the medical eligibility of recipients. Since the majority of SSI program dollars are historically directed to recipients with medical disabilities, refining the methodology to factor in any questions concerning medical risk is critical to determining improper payments within this program. According to SSA's year 2000 performance plan, SSA is developing a comprehensive mechanism for quantifying dollar errors related to SSI disability benefit payments. However, no timing for implementation has yet been determined.
- Although HHS reported $12.6 billion in improper payments for its $177 billion Medicare Fee-for-Service program based on a statistically valid sample, it has not attempted to estimate improper payments for the $98 billion Medicaid program. The HHS IG reported[17] that the Health Care Financing Administration (HCFA)—the HHS agency responsible for overseeing the Medicaid program—has no comprehensive quality assurance program or other methodology in place for estimating improper Medicaid payments. Administered by state agencies, Medicaid provided health care services to approximately 33 million low-income

[16]This represents the fiscal year 1997 initial payment accuracy rate as reported in SSA's fiscal year 1998 Accountability Report.

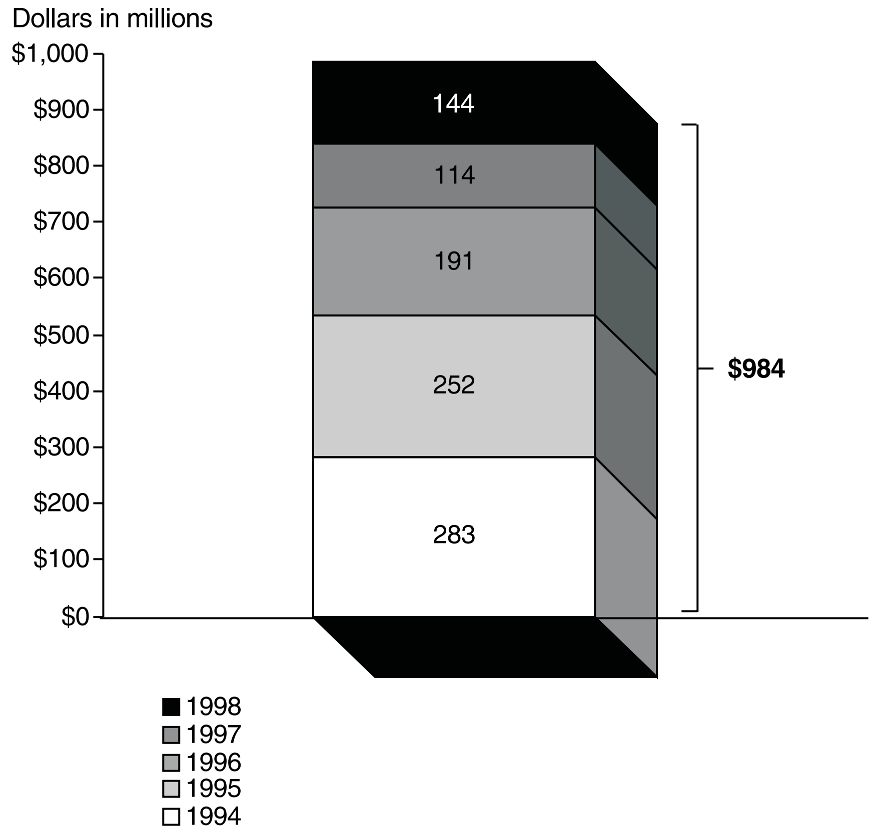
[17]*Report on the Financial Statement Audit of the Health Care Financing Administration for Fiscal Year 1998* (Department of Health and Human Services' Office of Inspector General Audit Report, CIN A-17-98-00098, February 26, 1999).

individuals. The IG recommended that HCFA work with the states to develop a methodology to determine the range of improper payments in the Medicaid program. However, developing a statistically valid methodology to estimate Medicaid improper payments poses a challenge. Other state-administered or intergovernmental programs also face difficulties in developing estimates due to the variable nature of the programs and the need to gain the cooperation of state and local government officials nationwide. HCFA has recently drafted a strategy for discussing this issue with states.

Other Programs and Activities Have Improper Payments or Are at Risk

Previous audits conducted by GAO and IGs have identified several other agencies, such as DOD, ED, and IRS that had improper payments. As illustrated in figure 2, between fiscal years 1994 and 1998, DOD contractors voluntarily returned $984 million that DOD's Defense Finance and Accounting Service (DFAS) erroneously paid them—resulting from inadvertent errors, such as paying the same invoice twice or misreading invoice amounts. As a result, the contractors, as opposed to DOD, were determining the existence and amount of erroneous payments. As part of its stewardship duties, DOD is responsible for making these determinations. However, DOD has not yet made a comprehensive estimate of improper payments to its contractors, and there are likely more overpayments that have yet to be identified and returned. With an annual budget of over $130 billion in purchases involving contractors, DOD would benefit from estimating the magnitude of improper payments.

Figure 2: Improper Payments Returned to DFAS by DOD Contractors for Fiscal Years 1994 Through 1998



Source: *DOD Contract Management: Greater Attention Needed to Identify and Recover Overpayments* (GAO/NSIAD-99-131, July 19, 1999).

ED is another agency with improper payments. ED's student financial assistance programs have been designated as high risk[18] since our governmentwide assessment of vulnerable federal programs began in 1990. ED provides over $8 billion in grants to assist over 4 million students in obtaining postsecondary education. As discussed in our January 1999

[18] *High-Risk Series: An Update* (GAO/HR-99-1, January 1999).

Performance and Accountability Series,[19] ED-administered student financial aid programs have a number of features that make them inherently risky. They provide grants to a population composed largely of students who would not otherwise have access to the funds necessary for higher education. ED estimates[20] that $78.9 million, or 1 percent, was misspent by grantees in fiscal year 1997; however, an ED IG report[21] indicates that this estimate may be incomplete. A more complete estimate would allow ED to identify areas of greater risk and target corrective actions.

Also, the Earned Income Tax Credit (EITC) program—a refundable tax credit available to low income, working taxpayers—has historically been vulnerable to high rates of invalid claims. During fiscal year 1998, IRS reported that it processed EITC claims totaling over $29 billion, including over $23 billion (79 percent) in refunds.[22,23] Of the 290,000 EITC tax returns with indications of errors or irregularities that IRS examiners reviewed, $448 million (68 percent of the $662 million claimed) was found to be invalid during fiscal year 1998. The IRS has not disclosed any estimated improper payments in its financial statement reports. IRS examinations of tax returns claiming EITC are important control mechanisms for detecting questionable claims and providing a deterrent to future invalid claims. However, because examinations are often performed after any related refunds are disbursed, they are less efficient and effective than preventive controls designed to identify invalid claims before refunds are made. OMB has worked with IRS to start a 5-year compliance initiative to minimize losses in this area. This initiative is intended to increase taxpayer awareness, strengthen enforcement of EITC requirements, and research sources of EITC noncompliance. EITC compliance efforts include a significant focus on pre-refund fraud/error prevention and detection. For

[19] *Major Management Challenges and Program Risks: Department of Education* (GAO/OCG-99-5, January 1999).

[20] *Fiscal Year 1997 Department of Education Financial Statement Audit* (Department of Education OIG Audit Report ACN 17-70002, June 15, 1998).

[21] *Accuracy of Student Aid Awards Can Be Improved By Obtaining Income Data From the Internal Revenue Service* (Department of Education OIG Audit Report ACN 11-50001, January 29, 1997).

[22] EITC claims do not always result in refunds. They may also reduce tax assessments.

[23] *Financial Audit: IRS' Fiscal Year 1998 Financial Statements* (GAO/AIMD-99-75, March 1, 1999).

example, the EITC compliance initiative includes recalculation of erroneous overclaims, identification of questionable returns, and initiation of many EITC audits, all of which should occur prior to issuing refunds. However, our work has shown that even in cases where IRS has identified potentially erroneous claims, it released refunds prior to completing the reviews.

Other types of federal programs and activities that undergo audits also risk making improper payments. Internal control deficiencies and other problems similar to those prevalent in programs that have acknowledged improper payments suggest that additional federal financial assistance programs, contract management activities, and other miscellaneous programs may also be particularly vulnerable to disbursing improper payments. For example, USDA's IG reported[24] that the Natural Resources Conservation Service (NRCS) exhibited significant control weaknesses when determining if farmers qualified for annual payments under the Conservation Reserve Program (CRP). CRP, which disbursed $1.7 billion in fiscal year 1998, provides incentives and financial assistance to farmers and ranchers to retire environmentally sensitive land from production. Due to these control weaknesses, the USDA IG noted that CRP risked making incorrect decisions. These incorrect decisions could result in USDA disbursing improper payments. Without a measurement of the extent of improper payments, it is difficult to assess the appropriate level of management attention needed to mitigate these program risks.

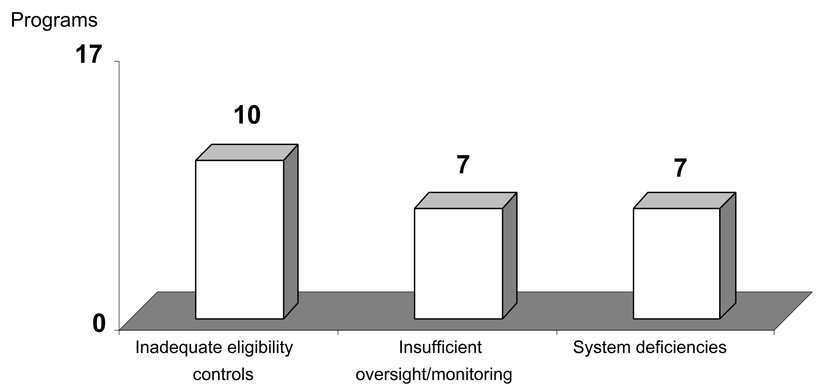
Once agencies have implemented methodologies to estimate the amount of improper payments, they can use this information to develop error rates. Agencies may find it useful to compute the dollar amount of errors as a percentage of program outlays, and the number of transaction errors as a percentage of the total number of transactions processed. Management could then use these error rates to evaluate whether further action is needed to address improper payments.

[24] *United States Department of Agriculture Office of Inspector General's Semi-Annual Report*, October 1 – March 31, 1998.

Internal Control Weaknesses Cause Improper Payments

Pervasive deficiencies in internal control across the federal government result in the payment of federal funds for purposes other than those originally intended. For example, several agencies face challenges in ensuring adequate controls for assessing beneficiaries' initial and continued eligibility due to ineffective data sharing and sources of information. Also, some agencies have insufficient oversight and monitoring mechanisms, such as site visits and reviews of appropriate documentation, to ensure the validity of payments—particularly for federal financial assistance programs. Systems deficiencies also contribute to improper payments when accurate or timely data are not always available for payment decisions. Figure 3 illustrates our categorization of internal control weaknesses that contribute to improper payments within the 17 programs where agencies reported improper payments.

Figure 3: Internal Control Weaknesses Cause Improper Payments for 17 Programs



Note: Six of the17 programs have two or more internal control weaknesses reported in this chart.

Source: GAO analysis based on prior IG and GAO reports.

Internal Controls Over Eligibility Determinations Are Often Inadequate

As highlighted in our reviews of GAO and IG reports, ensuring adequate controls over determining beneficiaries' eligibility often proves difficult for many agencies. Initial and/or continued eligibility determination problems were noted for 10 of the 17 programs that reported improper payments. For instance, initial eligibility for HUD's Section 8 and Public Housing programs—providing $18.6 billion in rental assistance for lower income families in fiscal year 1998—is primarily based on an applicant's selfreported income. According to HUD's IG,[25] HUD regulations require owners and housing authorities to verify the information provided, but this process often lacks effective controls to ensure that verifications are adequately performed. In addition, the IG reported that recipients do not always report complete or accurate information. Consequently, improper payments have occurred. To improve HUD's procedures for verifying participant's income and correct this long-standing problem, the HUD IG recommended the following actions: (1) on-site reviews to assess first hand the housing subsidy administrator's control environment, (2) confirmations with third parties, and (3) computerized income verification matching to IRS and SSA records. As discussed in our January 1999 Performance and Accountability Series,[26] HUD unveiled a multifaceted plan to identify households' unreported and/or underreported income in fiscal year 1998. The plan includes steps to (1) further expand HUD's computer matching efforts, (2) strengthen recertification policies and procedures, (3) ensure that HUD's information systems have accurate and complete data on tenants, (4) institute penalties, and (5) perform monitoring and oversight functions. OMB is also working with HUD in reducing payment errors in rental assistance due to recipient underreporting of income.

In another example, the DOL is challenged to correctly identify eligible recipients for its Unemployment Insurance (UI) program, which in fiscal year 1998 provided over 7 million unemployed workers with about $20 billion in temporary financial support to facilitate re-employment. The DOL IG reported[27] that state-administered claims offices, responsible for determining eligibility requirements, have ineffective controls to verify information provided by claimants. Claimants declaring themselves to be U.S. citizens are not screened for immigration legal status, which in some cases has resulted in improper payments. For example, ineligible individuals, including illegal aliens, were paid millions of dollars over an approximate 2-year time frame because states did not perform up-front verification of social security numbers provided by claimants. OMB has

[25] *Fiscal Year 1998 Department of Housing and Urban Development Financial Statement Audit* (Department of Housing and Urban Development Office of Inspector General Audit Report 99-FO-177-0003, March 29, 1999).

[26] *Major Management Challenges and Program Risks: Department of Housing and Urban Development* (GAO/OCG-99-8, January 1999).

[27] *Verification of Social Security Numbers Could Prevent Unemployment Insurance Payments to Illegal Aliens* (U. S. Department of Labor Office of Inspector General Final Audit Report No. 04-98-001-03-315, March 2, 1998).

worked with DOL to secure a congressional authorization for an integrity initiative focused on reducing benefit overpayments and improving UI tax compliance.

Our analysis of GAO and IG reports also showed that, as with initial eligibility determinations, agencies' controls are insufficient to ensure the continuing eligibility of beneficiaries for 8 of the 10 programs with eligibility determination problems. For example, SSA is mandated to perform reviews for continued eligibility for program benefits to aid in preventing fraud, waste, and abuse in the Disability Insurance (DI) program—a program to provide a continuing income base for more than 6 million disabled workers and eligible members of their families. However, acknowledged delays in performing these continuing disability reviews have undermined the effectiveness of this control.[28] Because SSA disburses approximately $50 billion in disability benefit payments annually, it is critical that these reviews be performed promptly; otherwise, beneficiaries who are no longer eligible for this program may inappropriately receive benefits. SSA has a multiyear plan to become current with all disability reviews by 2002.[29]

Since 1996, the HUD IG has reported[30] that HUD's housing subsidy programs experience improper payments when beneficiaries' income status changes and they do not notify housing authorities to adjust their benefits. Various legal, technical, and administrative obstacles impede housing authorities from ensuring that tenants report all income sources during the periodic determination to assess continuing eligibility. HUD has encouraged housing authorities to computer match with state agencies to detect unreported income, since housing authorities lack the legislative

[28] *Fiscal Year 1998 Social Security Administration Financial Statement Audit* (Social Security Administration Office of Inspector General Report Number A-13-98-51036, November 20, 1998) and *Fiscal Year 1997 Social Security Administration Financial Statement Audit* (Social Security Administration Office of Inspector General Report Number A-13-97-51012, November 21, 1997).

[29] *Social Security Disability: SSA Making Progress in Conducting Continuing Disability Reviews* (GAO/HEHS-98-198, September 18, 1998).

[30] *Housing and Urban Development Audit of Fiscal Year 1998 Financial Statements* (Housing and Urban Development OIG Audit Report 99-FO-177-0003, March 29, 1999); *Housing and Urban Development Audit of Fiscal Year 1997 Financial Statements* (Housing and Urban Development OIG Audit Report 98-FO-177-0004, March 20, 1998); and *Housing and Urban Development Audit of Fiscal Year 1995 Financial Statements* (Housing and Urban Development OIG Audit Report 96-FO-177-0003, August 16, 1996).

authority to access IRS and SSA data. However, little progress has been made in this area, since most housing authorities do not have the systems expertise to effectively implement this technique.

In May 1998, the President's Council on Integrity and Efficiency (PCIE)[31] issued a report[32] to highlight the need for increased cooperation among federal agencies in sharing income/financial resource information about federal program beneficiaries in an effort to improve controls over eligibility verification. For example, the report indicated that the DOL IG's ability to ensure eligibility of Unemployment Insurance Program recipients could be enhanced by verifying employment status of those recipients with IRS or SSA wage records. Currently, DOL's IG must coordinate with states, requiring subpoena authority in some cases, to obtain this information from states. Also, governmentwide, there is no omnibus authority for efficiently and effectively obtaining access to some data. We have work ongoing on this issue and will report at a later date.

Oversight and Monitoring Controls Are Insufficient

Our analysis of GAO and IG reports showed that insufficient federal monitoring and oversight of program expenditures exist in 7 of the 17 programs where agencies reported improper payments. Effective federal monitoring assesses the quality of performance over time. It includes regular management and supervisory activities, such as periodic comparisons of expected and actual results and reconciliation of data to its source. Generally, activities such as site visits, reviews of progress and financial reports filed by contractors and grantees, and reviews of contracts and grant agreements are techniques often used by federal officials to oversee and monitor programs.

The lack of sufficient oversight and monitoring controls can lead to improper payments by fostering an atmosphere that invites fraud. For

[31]The PCIE is comprised of all presidentially appointed IGs and members from OMB, the Federal Bureau of Investigation, the Office of Special Counsel, and the Office of Government Ethics.

[32]*Eligibility Verification Needed to Deter and Detect Fraud in Federal Government Benefit and Credit Programs*, PCIE, May 1998.

instance, both we and the HHS IG have reported[33] that HCFA's insufficient oversight of the Medicare program hampered it from preventing improper Medicare payments. To fulfill its primary mission of providing health care coverage for approximately 39 million aged individuals, Medicare pays contractors to process claims for health care services. These contractors are responsible for all aspects of claims administration and serve as HCFA's front line of defense against fraud and abuse. Yet, vulnerabilities in contractors' procedures for paying Medicare claims have provided a lax environment. This environment permitted unscrupulous providers opportunities to obtain additional unjustified payments.[34] These activities include billing for services never rendered, misrepresenting the nature of services provided, duplicate billing, and providing services that were not medically necessary. Although HCFA's most recent estimate of improper payments in its $177 billion Medicare Fee-for-Service program amounted to $12.6 billion, this estimate did not consider improper payments made as part of another $33 billion Medicare Managed Care program.[35] Therefore, the impact of insufficient monitoring and oversight on improper payments could be more extensive than current estimates indicate. To enhance HCFA's oversight function, the HHS IG recommended that HCFA perform risk assessments of contractor functions to identify those functions that significantly affect the improper payment of claims. This would enable HCFA to target areas and strengthen related controls.

The Agency for International Development (AID), which spent $5.2 billion in fiscal year 1998 to provide assistance to developing countries, also

[33]*Medicare Contractors: Despite Its Efforts, HCFA Cannot Ensure Their Effectiveness or Integrity* (GAO/HEHS-99-115, July 14, 1999); *Medicare: Improprieties by Contractors Compromised Medicare Program Integrity* (GAO/OSI-99-7, July 14, 1999); and *Department of Health and Human Services' Office of Inspector General Semi-Annual Report to the Congress: April 1, 1998 – September 30, 1998*.

[34]*Department of Health and Human Services: Management Challenges and Opportunities* (GAO/T-HEHS-97-98, March 18, 1997); *Report on the Financial Statement Audit of the Health Care Financing Administration for Fiscal Year 1998* (Department of Health and Human Services' Office of Inspector General Audit Report Common Identification Number (CIN): A-17-98-00098, February 26, 1999); and *Improper Fiscal Year 1998 Medicare Fee-for-Service Payments* (Department of Health and Human Services' Office of Inspector General Audit Report CIN: A-17-99-00099, February 9, 1999).

[35]Medicare beneficiaries have the option of enrolling in prepaid health care plans (typically health maintenance organizations) that are commonly referred to as managed care plans.

suffers from insufficient monitoring and oversight. We reported[36] that AID does not have accurate information to ensure that its operations and programs are being managed cost-effectively and efficiently. In addition, AID's IG reported[37] weaknesses in monitoring relief and rehabilitation activities. For example, mission employees in Rwanda, who were asked to monitor relief and rehabilitation activities, did not have basic documentation they needed to monitor relief efforts, such as copies of grant agreements, progress reports, and financial status reports. The impact of this control deficiency on improper payments was not quantified.

Based on previous GAO[38] and IG reports, insufficient oversight and monitoring is also present in other programs that have improper payments but did not report them. For example, according to the ED IG,[39] audits performed under the Single Audit Act are ED's principal control for ensuring that student financial assistance funds were being disbursed to eligible students in proper amounts. However, the IG noted that ED did not (1) ensure that all audit reports were received, (2) follow-up on problems identified, or (3) have a systematic process in place to measure trends in the misspending by grantees. The IG recommended that the department (1) complete the development of an ongoing process to identify missing/delinquent audit reports, (2) take corrective actions against delinquent audit report filers, and (3) develop a systematic methodology to quantify costs to measure the effectiveness of monitoring efforts and trends among institutions. The IG also recommended that the department use a risk management model to determine how to effectively deploy limited monitoring resources. Without this type of information, the department is unable to make cost-benefit decisions to determine whether to strengthen preventive internal controls.

[36]*Major Management Challenges and Program Risks: Agency for International Development* (GAO/OCG-99-16, January 1999).

[37]*Agency for International Development's Office of Inspector General Semi-Annual Report to the Congress: April 1, 1997 – September 30, 1997.*

[38]For example, *Defense Health Care: DOD Needs to Improve Its Monitoring of Claims Processing Activities* (GAO/T-HEHS-99-78, March 10, 1999), and *Medicare HMO Institutional Payments: Improved HCFA Oversight, More Recent Cost Data Could Reduce Overpayments* (GAO/HEHS-98-153, September 9, 1998).

[39]See footnote 19.

Systems Deficiencies Exist

Deficiencies in agencies' automated systems, or the lack of systems, prevent personnel from accessing reliable and timely information, which is integral to making disbursement decisions. As a result, improper payments frequently occur because agency personnel lack needed information, rely on inaccurate data, and/or do not have timely information. Agency systems deficiencies have been identified in prior GAO and IG reports for 7 of the 17 programs reporting improper payments. For example, we reported[40] that interstate duplicate participation in the Food Stamp Program goes undetected because there is no national system to identify participation in more than one state. While states may currently learn of some duplicate participation from SSA or through their own matching efforts with neighboring states, they rely primarily on applicants and clients to truthfully identify who resides in their households. USDA's Food and Nutrition Service (FNS) manages the Food Stamp Program through agreements with state agencies. Because USDA's most current annual estimate[41] indicates that food stamp overissuances account for over 7 percent of the program's $20 billion in annual benefit expenses, it is critical that action be taken to strengthen systems and related controls. FNS is considering whether to establish a central system to help ensure that individuals participating in the Food Stamp Program are not being improperly included in more than one state.

System deficiencies are also a factor for agency programs that did not disclose improper payments. For example, DOD's payment process suffers from nonintegrated computer systems that require data to be entered more than once in different systems, sometimes manually, which increases the possibility of erroneous or incomplete data. Also, DOD contracts may have from 1 to over 1,000 accounting classification reference numbers which involve extensive data entry, also increasing the chance for errors. As previously discussed, DOD contractors returned about $984 million between fiscal years 1994 and 1998 to the DFAS in Columbus, Ohio, as a

[40] *Food Stamp Overpayments: Households in Different States Collect Benefits for the Same Individuals* (GAO/RCED-98-228, August 6, 1998).

[41] *USDA Food and Nutrition Service's Fiscal Year 1998 Financial Statements* (USDA OIG Audit Report No. 27401-14-HY, February 1999).

result of duplicate and erroneous payments.[42] We also reported[43] that pervasive weaknesses in access controls in the Air Force vendor payment system application including inadequate separation of duties and other internal control deficiencies resulted in fraudulent payments and left DOD vulnerable to abuse. While no internal control system at DOD, or any other agency, can guarantee the elimination of improper payments and the prevention of fraud, resolving DOD's systems problems and designing effective solutions to reduce related risks are of critical importance, particularly since DOD expenditures comprise nearly half of the federal government's discretionary spending. We made several recommendations to resolve these deficiencies, such as suggesting that DOD limit vendor payment system access levels to those appropriate for the user's assigned duties. DOD has a number of initiatives underway to help ensure that payments are proper—including the development of a standard core system for procurement. However, the new system is not scheduled to be fully implemented for several years.

Similar to DOD, ED also lacks a fully functional integrated database to administer over $7 billion in federal student financial aid programs.[44] As a result, it remains vulnerable to losses because the department and schools often do not have accurate, complete, and timely information on program participants needed to effectively and efficiently operate and manage its programs. We have reported[45] that a lack of common identifiers for students and institutions makes it difficult to track them across systems. Because each system uses different combinations of data fields to uniquely identify, access, and update student records, duplicate student records have been identified in key systems. Many of ED's student financial aid systems were developed independently over time by multiple contractors. Consequently, ED relies on various contractors to operate its numerous systems using different hardware and software. We recommended[46] that

[42] *DOD Contract Management: Greater Attention Needed to Identify and Recover Overpayments* (GAO/NSIAD-99-131, July 19, 1999).

[43] *Financial Management: Improvements Needed in Air Force Vendor Payment Systems and Control*s (GAO/AIMD-98-274, September 28, 1998).

[44] See footnote 19.

[45] *Department of Education: Multiple, Nonintegrated Systems Hamper Management of Student Financial Aid Programs* (GAO/T-HEHS/AIMD-97-132, May 15, 1997).

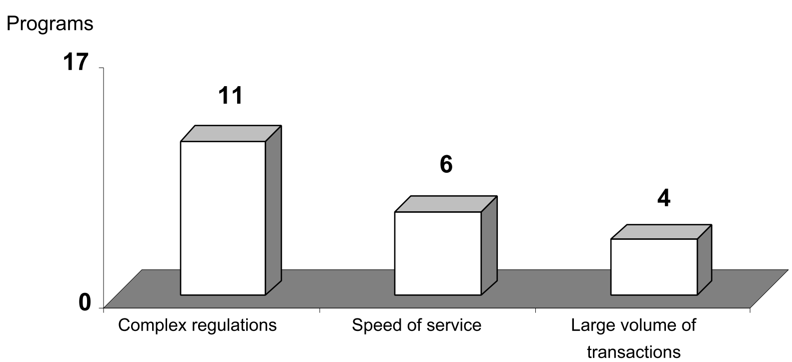
[46] *Student Financial Aid Information: Systems Architecture Needed to Improve Programs' Efficiency* (GAO/AIMD-97-122, July 29, 1997).

ED (1) develop and enforce a departmentwide systems architecture and (2) ensure that the developed systems architecture addresses systems integration, common identifiers, and data standards. The Office of Student Financial Assistance has developed its Modernization Blueprint to guide the development of an integrated financial aid delivery system, which ED officials stated depicts the first 3 years of a continuing process of modernizing its system.

Program Design Issues Contribute to Improper Payments

Often, the nature of a program can contribute to the disbursement of improper payments. Many programs have complex program regulations, and several emphasize expediting payments or have high volumes of transactions to process. These program design issues inherently increase the potential for improper payments, yet such payments are virtually impossible to eliminate. However, strengthening business practices and developing targets or goals for reducing improper payments can mitigate the risk of improper payments occurring. Also, measuring progress in relation to such targets or goals may serve as a measure of the effectiveness of an agency's improper payment reduction program. According to our analysis of GAO and IG reports, program design issues were present in programs with improper payments as illustrated in figure 4.

Figure 4: Program Design Issues for the Agencies Reporting Improper Payments for 17 Programs



Note: Five of the 17 programs have 2 or more program design issues.

Source: GAO analysis based on prior work performed on these programs.

Some agencies currently have programs that use targets or goals to aid in reducing improper payments. One example is the Medicaid program, wherein states are responsible for determining the eligibility of beneficiaries and disbursing related federal funds. According to HHS regulations,[47] states must have a payment error rate no greater than 3 percent due to errors in eligibility determinations or HHS may disallow medical assistance payments. Another example is the Food Stamp Program administered by state agencies under USDA regulations. In this program, USDA may pay 50 percent of each state's cost of administering the program. To encourage states to reduce their payment error rates, the program includes an incentive. This incentive allows USDA to increase the 50 percent reimbursement for administrative costs, by as much as 10 percent, to a total of 60 percent based on reductions in states' error rates below 6 percent and on other conditions. State agencies also may be required to make payments to USDA if their payment error rate exceeds USDA's national performance measure.[48] State agencies may be required to invest in improving their administration of the program rather than making refunds.

Complex Program Regulations Increase Risk of Improper Payments

Program complexity inherently increases the risk of improper payments. Previous GAO and IG reports disclosed this condition for 11 of the 17 programs with reported improper payments. For example, the complexity of state Medicaid programs provide challenges for federal oversight because of the variations in managing these programs on a state-by-state basis. Medicaid—the primary source of health care for 12 percent of the U.S. population—provides matching grants to states based on formulas encompassing states' per capita income. States have a variety of options for program administration. They can elect to administer the program at the state or county level. Also, they can operate a fee-for-service program, a managed care program, or some combination of the two. States may also elect to operate their claims processing systems directly or contract with private vendors. Because of the size of this program—it disbursed nearly $98 billion in federal funds during fiscal year 1998—it is critical that HCFA comprehensively estimate its improper payments to assess its risk and determine appropriate actions to strengthen oversight controls. Such

[47] 42 C.F.R. § 431.865(c).

[48] 7 U.S.C. § 2025(c); and 7 C.F.R. § 275.1.

actions would help to ensure that HCFA is fulfilling its stewardship responsibilities for this program.

Block grants present unique challenges to providing adequate accountability for federal funds. Block grants give states flexibility to adapt funded activities to fit state and local needs and devolve major responsibilities to the states themselves to oversee these programs.[49] Under the Temporary Assistance for Needy Families (TANF) block grant, states are authorized to collectively spend up to $16.5 billion annually to provide assistance to needy families and promote work activities. To implement TANF, states and localities determine the range of services and eligibility criteria.

Many states manage the TANF, Food Stamp, and Medicaid programs through local offices, and depending upon the state, the same staff may be determining eligibility and benefit levels for all three programs. These programs' eligibility rules and income tests are complex and differ from one another; thus, although all three programs consider assets and household income and size, the extent to which they do so varies. A requirement that recipients notify the staff when their income changes further complicates eligibility determinations—staff must use three sets of eligibility criteria to recalculate benefit levels. Given the complexity and diversity of eligibility rules among these three programs, it is a challenge at all levels of government to adequately oversee these programs, and improper payments are sometimes made.[50]

Speed of Service Issues, Coupled With Resource Constraints, Impact Improper Payments

Many programs' missions emphasize speed of service. As a result, errors are more likely to occur, resulting in improper payments. We considered this condition to exist for 6 of the 17 programs with reported improper payments. It is also present in agencies that had improper payments but did not report them. For example, IRS' ability to successfully meet the financial management challenges it faces must be balanced with the competing demands placed on its resources by its customer service and tax law compliance responsibilities. IRS is mandated to process tax refunds within 45 days of receipt of a tax return. If the refund is not processed within this

[49] *Block Grants: Issues in Designing Accountability Provisions* (GAO/AIMD-95-226, September 1, 1995).

[50] *Welfare Benefits: Potential to Recover Hundreds of Millions More in Overpayments* (GAO/HEHS-95-111, July 20, 1995).

time, IRS must remit interest payments to the taxpayer. However, IRS' systems were not designed to handle this volume of information within these time frames. Further, we reported[51] that IRS lacks critical preventive controls, such as comparing the information on tax returns to third-party data such as W-2s (Wage and Tax Statements) in a timely manner. As a result, the agency is unable to identify and correct discrepancies between these documents that allow duplicate refunds to be issued. Although IRS has detective (post-refund) controls in place, they often occur months after the returns are submitted and processed. Insufficient preventive controls expose the government to potentially significant losses due to inappropriate disbursement of refunds. According to IRS records, IRS' investigators identified over $17 million in alleged fraudulent refunds that had been disbursed during the first 9 months of calendar year 1998. However, the full magnitude of improper payments disbursed by IRS is unknown.

The Federal Emergency Management Agency's (FEMA) Disaster Relief program is another example of how providing service—in this case, providing assistance to disaster victims—as quickly as possible increases the risk of improper payments being made. FEMA provided over $2.2 billion in disaster relief in fiscal year 1998 to assist individuals, families, communities, and states in responding to and recovering from disasters, such as floods, hurricanes, and tornadoes. FEMA has set demanding performance goals for its disaster assistance activities, from acting within 12 hours on requests to supply disaster victims with water, food, and shelter, to processing disaster housing applications from eligible individuals within an average of 8 days.[52] The IG has noted that achieving these goals will require FEMA to streamline operations and apply new technology to reduce waste and duplication of benefits. In past years, the IG has identified specific cases of individuals filing false claims to obtain FEMA disaster assistance; however, the full extent of this problem has not been quantified.

We recognize that delivering services expeditiously while ensuring that the right amount is paid to the right person poses a significant challenge for many agencies. Without state-of-the-art information management systems

[51]See footnote 22.

[52]*Annual Performance Plan Fiscal Year 2000* (Federal Emergency Management Agency, February 23, 1999).

and appropriate sharing of data, agency personnel cannot readily access needed information for payment decisions and thus are hampered from preventing improper payments. Due to the diverse nature of programs, consulting with congressional oversight bodies would assist agencies when establishing targets and goals to reduce improper payments without impairing service delivery and be an important means of obtaining agreement with the Congress as to expected results for each program.

Large Volumes of Transactions Increase Risk of Improper Payments

A significant volume of claims or payments is also a factor that contributes to improper payments, especially when compounded with resource constraints. Large volumes of claims were identified in 4 of the 17 programs with reported improper payments. For example, in a single year, Medicare contractors process over 800 million claims with limited time for processing. IRS is another agency with large volumes of activity. For instance, in fiscal year 1998, it processed 1.4 billion tax and information returns, with 88 million involving refunds. Given the high volume of transactions, inadvertent clerical errors are more likely and they could result in improper payments.

Potential Year 2000 Problem Increases the Need for Effective Internal Controls

While implementing effective internal controls is and will be an ongoing concern, the Year 2000 problem[53] presents a unique challenge to ensuring effective payments controls. Many of the federal government's computer systems were originally designed and developed 20 to 25 years ago, are poorly documented, and use a wide variety of computer languages, many of which are obsolete. Some applications include thousands, tens of thousands, and even millions of lines of code, each of which must be examined for date-format problems. Moreover, federal programs are also vulnerable to Year 2000 risks stemming from items outside of their control, such as the Year 2000 compliance of critical business partners. Unless corrected, Year 2000 failures may have a costly, widespread impact on federal, state, and local governments—including the extent to which improper payments are made.

[53]The Year 2000 problem is rooted in how dates are recorded and computed. For the past several decades, computer systems typically used two digits to represent the year, such as "99" for 1999, in order to conserve electronic data storage and reduce operating costs. In this format, however, 2000 is indistinguishable from 1900 because both are represented as "00." As a result, if not modified, systems or applications that use dates or perform date- or time-sensitive calculations may generate incorrect results beyond 1999.

These many risks increase the possibility that Year 2000 induced failures could result in increased number and amounts of improper payments as agencies attempt to sustain their core business functions. Further, nonexistent or ineffective internal controls, as previously discussed, increase this risk. Accordingly, the federal government could potentially distribute additional improper payments.

While the Year 2000 problem increases the risk of improper payments, as we reported[54] earlier this year, it also provides the opportunity to institutionalize valuable lessons, such as the importance of reliable processes and reasonable controls. Our Year 2000 enterprise readiness guide[55] calls on agencies to develop and implement policies, guidelines, and procedures in such critical areas as configuration management,[56] quality assurance, risk management, project scheduling and tracking, and performance metrics. To address the Year 2000 problem, several agencies have implemented such policies. For example, HCFA has implemented policies and procedures related to configuration management, quality assurance, risk management, project scheduling and tracking, and performance metrics for its internal systems.

Most Agency Performance Plans Do Not Comprehensively Address Improper Payments

As previously discussed, nine agencies acknowledged making improper payments in 17 programs for fiscal year 1998. These agencies' fiscal year 2000 performance plans, under the Results Act, included performance goals and strategies that address key internal control weaknesses in four programs. For nine programs, the respective agencies did not comprehensively address improper payments in their plans. Improper payments were not addressed at all for the remaining four programs. Appendix III contains our assessment of the extent to which each agency reporting improper payments addressed them in its performance plan. For these and other agencies at risk, the first step in addressing improper payments is to identify the magnitude of these payments. Agencies can then analyze the characteristics of these cases to identify the

[54] *Year 2000 Computing Crisis: Defense Has Made Progress, but Additional Management Controls Are Needed* (GAO/T-AIMD-99-101, March 2, 1999).

[55] *Year 2000 Computing Crisis: An Assessment Guide* (GAO/AIMD-10.1.14, September 1997).

[56] Configuration management is the continuous control of changes made to a system's hardware, software, and documentation throughout the development and operational life of the system.

circumstances and root causes leading to the improper payments. Using this analysis, agencies can make cost-benefit decisions on systems and other internal control improvements to mitigate the risk of improper payments and implement performance goals to manage for results.

The use of appropriate performance goals relating to improper payments can focus management attention on reducing such payments. For example, HHS has reported a national estimate of improper payments in its Medicare Fee-for-Service benefits since fiscal year 1996. For fiscal year 1998, HHS reported estimated improper payments of $12.6 billion, or more than 7 percent, in Medicare Fee-for-Service benefits—down from about $20 billion, or 11 percent, reported for fiscal year 1997 and $23.2 billion, or 14 percent, for fiscal year 1996. As discussed earlier, HCFA would also benefit from identifying improper payments and establishing related performance goals for its $98 billion Medicaid program.

Analysis of improper Medicare payments, as part of the financial statement preparation and audit process, helped lead to the implementation of several initiatives intended to identify and reduce improper payments. These initiatives included prepayment reviews of selected claims, an increase in the overall level of prepay and postpay claims reviews, and medical reviews of providers identified as having nonstandard billing practices. Annual estimates of improper payments in future audited financial statements will provide information on the progress of these initiatives.

Without a systematic measurement of the extent of the problem, management cannot determine (1) if the problem is significant enough to require corrective action, (2) how much to invest in internal controls or (3) the success of efforts implemented to reduce improper payments. In fiscal year 1998, VA piloted a new measurement system to determine the accuracy of veterans' benefit payments—the Systematic Technical Accuracy Review (STAR) system. Using the STAR system, the Veterans Benefits Administration (VBA)—a component of VA—determined that its regional offices were accurate only 64 percent of the time when making initial benefit decisions. This measure indicated that VBA should focus additional attention on ensuring that correct decisions are made the first time. Using the 64 percent as a baseline, VBA established a goal of achieving a 93 percent accuracy rate by fiscal year 2004. Although it is too early to determine whether VBA's efforts to meet its accuracy improvement goal will be successful, the new STAR system represents an important step forward by VBA in identifying and correcting the causes of errors and having a baseline against which to measure results and progress.

Currently, there is no governmentwide guidance on how to develop mechanisms for identifying and estimating improper payments, which would help agencies to identify whether a need exists to address improper payments in their annual strategic and performance planning processes. Developing such mechanisms would enable each agency's management to better understand the full extent of its problem. With these mechanisms in place, appropriate cost-beneficial corrective actions could be designed and implemented.

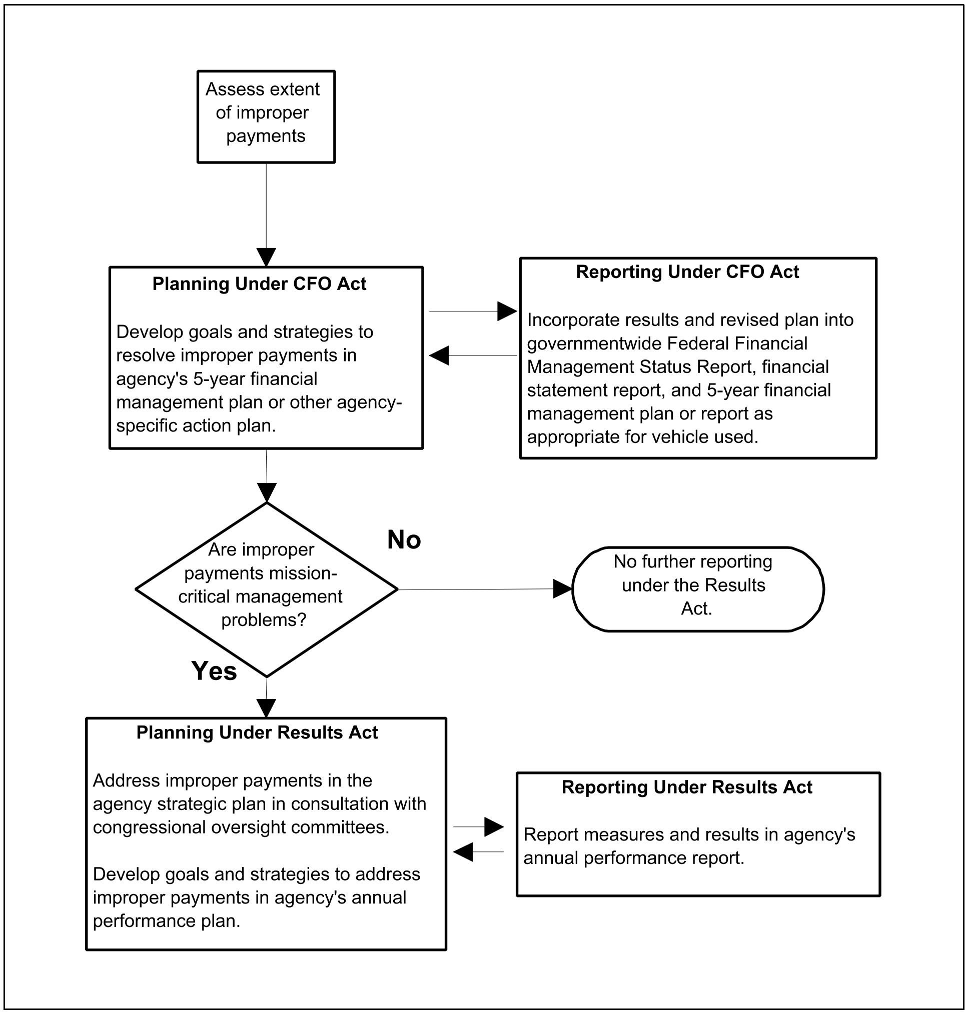
Although no governmentwide guidance exists for identifying and estimating improper payments, the CFO and Results Acts provide a framework for OMB and agencies to report on efforts to minimize improper payments. Under the CFO Act, OMB is required to prepare and annually revise a governmentwide 5-year financial management plan and status report that discusses the activities the executive branch has undertaken to improve financial management in the federal government. Each agency CFO is responsible for developing annual agency-specific plans to support the governmentwide 5-year financial management plan. The CFO Act also requires OMB to provide the governmentwide 5-year plan and status report to appropriate congressional committees. This reporting process keeps the appropriate congressional committees informed of agencies' efforts to improve accountability and stewardship over federal funds.

As discussed earlier, under the Results Act, agencies are required to prepare strategic plans that identify goals and objectives at least every 3 years. Complementing the strategic plans are annual performance plans that set annual goals with measurable target levels of performance, and annual performance reports that compare actual performance to the annual goals. The Results Act also requires that OMB annually prepare a governmentwide performance plan as a part of the President's budget. The agency performance plans are the foundation for OMB's governmentwide plan.

The framework afforded by the CFO and Results Acts suggests that agencies have a variety of mechanisms for reporting on improper payments, depending upon the magnitude or significance of those payments. OMB calls[57] for mission-critical management problems—those which prospectively and realistically threaten achievement of major program goals—to be discussed in agencies' strategic plans and also in their annual performance plans under the Results Act. In our view, improper payments can reasonably be considered mission-critical problems for certain programs, including the 17 programs with reported improper payments discussed in this report. For example, for programs providing financial assistance benefits, such as the Food Stamp Program, maintaining integrity and accuracy in the payment of benefits is critical to the missions of the programs. For those agencies where these payments are not deemed mission critical, an appropriate vehicle for managing improper payments would be agency 5-year financial management plans developed under the auspices of the CFO Act, or other vehicles such as action plans. Figure 5 shows how the CFO and Results Acts provide a broad structure under which agencies can report the status of their efforts to reduce improper payments.

[57] *Preparation and Submission of Strategic Plans, Annual Performance Plans and Annual Program Performance Reports*, OMB Circular A-11 Part 2, OMB/Executive Office of the President (Washington, D.C., July 1999).

Figure 5: Reporting Improper Payments Within the Framework of the CFO and Results Acts

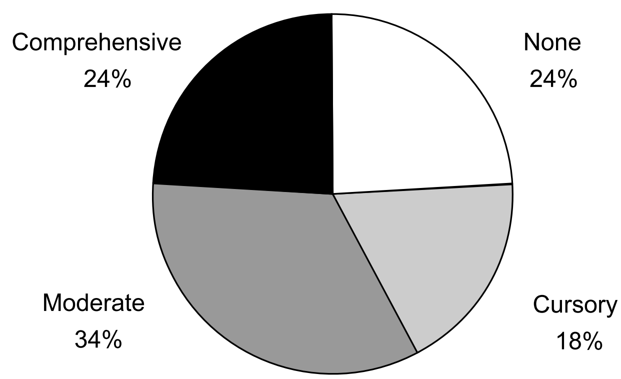


Note: The planning and reporting stages become iterative as management assesses the relative success of internal controls employed to minimize improper payments.

Source: GAO analysis of Results Act and CFO Act reporting requirements.

We evaluated the extent to which agencies that reported improper payments in their financial statement reports also addressed improper payments in their fiscal year 2000 performance plans. HHS, SSA, VA, and OPM are four agencies that comprehensively addressed improper payments using this framework. These agencies' performance plans included both performance goals and strategies for minimizing improper payments for the Medicare Fee-for-Service, Old Age and Survivors Insurance, Veterans Benefits, and Federal Employees' Life Insurance programs. As shown in figure 6, these programs represent 24 percent of those that reported improper payments or 61 percent of the total program dollars for the 17 programs. In contrast, 7 of the 17 programs (42 percent) did not or only cursorily addressed improper payments in their performance plans, and 34 percent addressed them in a moderate (i.e., less than comprehensive) manner. Some of the nine agencies we reviewed may have addressed these issues in their 5-year financial management, component, or other agency action plans. However, only HHS' performance plan contained a reference or "pointer" to another plan that addressed improper payments. Because some agencies do not appear to be addressing improper payments in their performance plans, they may not consider the prevention of improper payments a priority or focus adequate attention on this issue.

Figure 6: Degree to Which 17 Programs Addressed Improper Payments



Source: GAO analysis based on review of agency fiscal year 2000 performance plans.

Legend:

None: Agency performance plan does not address the issue of improper payments for this program.

Cursory: Agency performance plan addresses the need to minimize improper payments but does not provide any substantive performance goals or strategies to minimize improper payments in this program.

Moderate: Agency performance plan has either performance goals to address improper payments or strategies to minimize improper payments in this program, but not both, or lacks a comprehensive approach.

Comprehensive: Agency performance plan has performance goals and strategies that address key internal control weaknesses to minimize improper payments in this program.

OMB Circular A-11, Part 2, which serves as implementing guidance for agencies in preparing and submitting Results Act strategic and performance plans, states that agency plans should include goals for resolving mission-critical management problems. Circular A-11 also directs agencies to describe actions taken to address and resolve these issues in their performance plans by developing performance goals and discussing strategies. We have also advocated[58] that agencies address mission-critical management problems, in their performance plans, by developing performance goals and discussing strategies.

Our analysis indicates that additional guidance on improper payments may be helpful to agency managers. Without an appropriate methodology in place for estimating and reporting improper payments, the Congress, agency managers, and the public are not aware of the full extent of this problem. As a result, agency managers cannot effectively use performance goals for managing improper payments.

Conclusions

Although reported amounts of improper payments totaled $19.1 billion in fiscal year 1998, many agencies are not identifying, estimating, and reporting the nature and extent of improper payments. As a result, the magnitude is largely unknown. Based on previous audit reports, inadequate internal control and program design issues are the primary causes of improper payments for numerous federal programs. Compounding this problem, some agencies have not recognized the need to address and resolve mission-critical improper payment problems by discussing steps taken in their strategic plans and incorporating appropriate goals into their performance plans.

Economic and demographic projections indicate that federal expenditures in certain programs will grow significantly. With billions of dollars at risk, agencies will need to continually and closely safeguard those resources entrusted to them and assign a high priority to reducing fraud, waste, and abuse. A first step for some agencies will involve developing mechanisms to identify, estimate, and report the nature and extent of improper payments annually. Without this fundamental knowledge, agencies cannot be fully informed about the magnitude, trends, and types of payment errors occurring within their programs. As a result, most agencies cannot make

[58] *Agency Performance Plans: Examples of Practices That Can Improve Usefulness to Decisionmakers* (GAO/GGD/AIMD-99-69, February 26, 1999).

informed cost-benefit decisions about strengthening their internal controls to minimize future improper payments or effectively develop goals and strategies to reduce them. Consulting with congressional oversight committees on the development of these goals and strategies is also important to obtaining consensus on how to address this multibillion dollar problem.

Recommendations

To assist agencies in estimating and managing improper payments, we recommend that the Director of the Office of Management and Budget, through the Deputy Director for Management and OMB's Office of Federal Financial Management, within the framework of the CFO and Results Acts:

- Develop and issue guidance to executive agencies to assist them in (1) developing and implementing a methodology for annually estimating and reporting improper payments for major federal programs and (2) developing goals and strategies to address improper payments in their annual performance plans.
- Require agencies to (1) include a description of steps being taken to address improper payments in their strategic and annual performance plans when the level of improper payments is mission critical and (2) consult with congressional oversight committees, as appropriate, on the projected target levels and goals for estimating and reducing improper payments, as presented in the agencies' annual performance plan.

OMB Comments and Our Evaluation

In commenting on a draft of this report, OMB agreed that its focus on improper payments should be expanded. OMB agreed with our first recommendation calling for guidance to assist agencies in developing and implementing a methodology for annually estimating and reporting improper payments for major federal programs and developing goals and strategies to address improper payments in their annual performance plans.

Regarding the first element of our second recommendation, OMB expressed concern that it may be inappropriate for agency strategic plans to always include a general goal or objective for reducing improper payments. OMB said it would expect agencies to include goals or objectives in their strategic plans if the level of improper payments was determined to be mission critical. We agree. As stated in our report, it was not our intention that goals or objectives for reducing improper payments be universally included in agency strategic plans. Specifically, within the framework of the CFO and Results Acts, and as shown in figure 5, judgment needs to be exercised so that only mission-critical management problems are addressed in agency strategic and performance plans. To avoid any misconception regarding this issue, we have clarified our recommendation accordingly.

With regard to our recommendation to consult with the Congress on specific goals and targets for improper payments, OMB noted that congressional consultation is required by the Results Act and said that agencies interact with the Congress throughout the year as part of the normal appropriations and oversight processes. OMB stated that this level of interaction provides the opportunity for both the agency and the Congress to raise and discuss improper payment issues and should be adequate. In this regard, it will be important that these interactions take place. As discussed in our report, several agencies have not reported improper payments in their performance plans even when they could reasonably be considered mission critical. OMB's comments are reprinted in appendix IV. OMB also provided informal technical comments, which we have incorporated as appropriate.

As agreed with your office, unless you publicly announce contents of this report earlier, we will not distribute it until 30 days from its date. Then, we will send copies to Senator Joseph Lieberman, Ranking Minority Member, Senate Committee on Governmental Affairs; Representative Dan Burton, Chairman, and Representative Henry A. Waxman, Ranking Minority Member, House Committee on Government Reform; Senator Pete V. Domenici, Chairman, and Senator Frank R. Lautenberg, Ranking Minority Member, Senate Committee on the Budget; Representative John R. Kasich, Chairman, and Representative John M. Spratt, Jr., Ranking Minority Member, House Committee on the Budget. We will also send copies to the Honorable Jacob J. Lew, Director of the Office of Management and Budget; the heads of the 24 CFO agencies; and respective agency CFOs and Inspectors General. Copies will also be made available to others upon request.

This report was prepared under the direction of Gloria L. Jarmon, Director, Health, Education, and Human Services Accounting and Financial Management, who may be reached at (202) 512-4476 or by e-mail at jarmong.aimd@gao.gov if you or your staff have any questions. Staff contacts and other key contributors to this letter are listed in appendix V.

Sincerely yours,

Jeffrey C. Steinhoff
Acting Assistant Comptroller General
Accounting and Information Management Division

Executive Departments and Agencies Covered by the CFO Act

Department of Agriculture
Department of Commerce
Department of Defense
Department of Education
Department of Energy
Department of Health and Human Services
Department of Housing and Urban Development
Department of the Interior
Department of Justice
Department of Labor
Department of State
Department of Transportation
Department of the Treasury
Department of Veterans Affairs
Agency for International Development
Environmental Protection Agency
Federal Emergency Management Agency
General Services Administration
National Aeronautics and Space Administration
National Science Foundation
Nuclear Regulatory Commission
Office of Personnel Management
Small Business Administration
Social Security Administration

Agencies/Programs/Activities With Reported Improper Payments Included in the Agencies' Fiscal Year 1998 Financial Statements

Agency for International Development

The U.S. Agency for International Development (AID) was established in 1961 pursuant to the Foreign Assistance Act of 1961. AID manages U.S. foreign economic and humanitarian assistance programs and helps countries recover from disaster, escape poverty, and become more democratic. AID's mission is to contribute to U.S. national interests by supporting the people of developing and transitional countries in their efforts to achieve enduring economic and social progress and to participate more fully in resolving the problems of their countries and the world. In fiscal year 1998, AID's total outlays for its various programs were $5.2 billion.

Department of Agriculture

Federal Crop Insurance Corporation

The Federal Crop Insurance Program was established in 1938 by the Federal Crop Insurance Act to protect crop farmers from unavoidable risks associated with adverse weather, plant diseases, and insect infestations. The USDA Risk Management Agency administers the Federal Crop Insurance Program through the Federal Crop Insurance Corporation (FCIC), a government-owned corporation. The federal government retains a portion of the insurance risk for all policies and pays private insurance companies a fee that is intended to reimburse them for the reasonable expenses associated with selling and servicing crop insurance to farmers. In fiscal year 1998, FCIC had over 1 million crop insurance policies in force, with total premiums of $1.9 billion.

Food Stamp Program

The Food Stamp Program (FSP), enacted by the Food Stamp Act of 1964, is the nation's principal food assistance program. FSP enables low-income households to obtain a more nutritious diet by issuing monthly allotments of coupons or electronic benefits redeemable for food at retail stores. Eligibility and allotment amounts are based on household size and income as well as on assets, housing costs, work requirements, and other factors. In fiscal year 1998, 19.8 million individuals per month were provided food stamps for total annual program costs of $20.4 billion.

Department of Health and Human Services – Administration for Children and Families

The Administration for Children and Families (ACF), a division of the Department of Health and Human Services, is responsible for almost 50 programs that promote the economic and social well being of families, children, individuals, and communities. Three programs do most of ACF's spending: TANF, Foster Care, and Head Start.

TANF

Temporary Assistance for Needy Families (TANF) block grants were created by the Personal Responsibility and Work Opportunity Reconciliation Act of 1996 to replace the Aid to Families with Dependent Children (AFDC) Program. Specified goals of TANF include providing assistance to needy families and ending the dependence of needy parents on government benefits by promoting job preparation, work, and marriage. Over $16 billion in federal assistance is available to states each year through 2002 to fund the TANF program. While states have flexibility over the design and implementation of their welfare programs, they must impose several federal requirements, including work requirements and time limits on aid.

Foster Care

Foster Care was originally created in 1961 under title IV of the Social Security Act. The Foster Care Program is a permanently authorized entitlement program that provides matching funds to states for maintenance of eligible children in foster care homes, private nonprofit child care facilities, or public child care institutions. In fiscal year 1998, over half a million children were supported by the Foster Care Program with total federal outlays of $4.5 billion.

Head Start

The Head Start Program was created in 1965 as part of the war on poverty to improve the social competence of children in low-income families. To support the social competence goal, Head Start programs deliver a broad range of services to children. These services include educational, medical, nutritional, mental health, dental, and social services. Head Start regulations require that at least 90 percent of the children enrolled in each program be from low-income families. ACF awards Head Start grants directly to local grantees who operate programs in all 50 states, the District of Columbia, Puerto Rico, and the U.S. territories. In fiscal year 1998, over 800,000 children participated in Head Start programs, and federal outlays totaled $3.3 billion.

Department of Health and Human Services – Health Care Financing Administration

Medicaid

Medicaid, established in 1965 by Title XIX of the Social Security Act, is a federal-state matching entitlement program that pays for medical assistance for certain vulnerable and needy individuals and families with low incomes and resources. In 1998, it provided health care assistance to 33 million persons, at a cost of about $98 billion to the federal government. The Health Care Financing Administration (HCFA) is responsible for the overall management of Medicaid; however, each state is responsible for managing its own program. Within broad federal statutory and regulatory guidelines, each state: (1) establishes its own eligibility standards, (2) determines the types and range of services, (3) sets the rate of payment for services, and (4) administers its own program.

Medicare Fee-for-Service

Authorized by Title XVIII of the Social Security Act in 1965, Medicare is the nation's largest health insurance program, covering an estimated 39.6 million elderly and disabled at a cost of about $210 billion annually. The Medicare Program is administered by HCFA. While some beneficiaries participate in Medicare's $33 billion Managed Care program, most receive their health care from the $177 billion Fee-for-Service portion of Medicare. HCFA contracts with over 40 insurance companies to process fee-for-service claims. Although contractors are the program's front line of defense against fraud, abuse, and erroneous payments, HCFA is responsible for overseeing these contractors and for assuring that claims are paid accurately and efficiently.

Department of Housing and Urban Development

Housing Subsidy Programs

Housing and Urban Development's (HUD) Public Housing and Section 8 programs were established by the U.S. Housing Act of 1937 and the Housing and Community Development Act of 1974 (revising Section 8 of the U.S. Housing Act of 1937), respectively. These programs help eligible low-income families obtain decent, safe, and sanitary housing by paying a portion of their rent.

HUD's Public Housing Program is operated by approximately 3,200 public housing authorities (PHA), which operate under state and local laws and are funded by HUD. Public housing provides affordable shelter for low-income families comprised of citizens or eligible immigrants. Through the operating subsidy program, HUD provides an annual subsidy to help PHAs pay some of the cost of operating and maintaining public housing units. In fiscal year 1998, more than 1.2 million public housing units were under management, with a net cost of about $3.1 billion.

The Section 8 programs assist low-income families. Residents in subsidized units generally pay 30 percent of their income for rent, and HUD pays the balance. Section 8 has two assistance programs: project-based and tenant-based assistance. Tenant-based assistance is linked to specific individuals; the project-based assistance is linked to housing units. In fiscal year 1998, the Section 8 programs assisted approximately 3 million households and had net costs of $15.5 billion.

Department of Labor

Federal Employees' Compensation Act

Enacted in 1916, the Federal Employees' Compensation Act (FECA) provides workers' compensation coverage to federal employees for work-related injuries or disease. FECA, administered by the U.S. Department of Labor, authorizes the government to compensate federal employees when they are temporarily or permanently disabled due to injury or disease sustained while performing their duties. In fiscal year 1998, the Department of Labor received 165,000 federal injury reports and issued benefit payments of more than $1.9 billion.

Unemployment Insurance

Unemployment Insurance, enacted by Title IX of the Social Security Act of 1935, as amended, is the nation's response to the adverse effects of unemployment. The program's mission is to provide unemployed workers with temporary income support and to facilitate re-employment. By doing so, the program helps stabilize the economy. In fiscal year 1998, over 7 million unemployed workers received approximately $20 billion from the program.

The program is administered by the states through a network of local claims offices and central offices in each state. These offices also are responsible for the collection of taxes from all subject employers. The program is financed through collections of taxes from employers by both the federal and state governments. In addition, each state is responsible for determining eligibility requirements and levels of compensation, including the length of time benefits are paid.

Office of Personnel Management

Federal Employees' Health Benefits Program

The Federal Employees' Health Benefits Program (FEHBP) was established by the Federal Employees Health Benefits Act of 1959 for the purpose of making basic hospital and medical protection available to active federal employees, annuitants, and their families through plans offered by carriers participating in the FEHBP. In fiscal year 1998, there were 2.3 million federal civilian employees and 1.8 million annuitants enrolled in the FEHBP. In total, FEHBP covers about 9 million individuals. Annual premiums are over $16.3 billion, with the government paying up to 75 percent of the premiums and employees paying the remaining portion.

Federal Employees' Group Life Insurance Program

The Federal Employees' Group Life Insurance (FEGLI) Program was established in 1954 by the Federal Employees' Group Life Insurance Act to provide federal employees and annuitants with group term life insurance. The program is administered pursuant to a contract with a life insurance company. In fiscal year 1998, FEGLI covered 90 percent of eligible employees and annuitants, as well as many of their family members, and had $1.6 billion in net outlays.

Retirement Program

The Retirement Program is a defined benefit retirement plan and includes two components: (1) the Civil Service Retirement System (CSRS), created in 1920 by the Civil Service Retirement Act and (2) the Federal Employees' Retirement System (FERS), established in 1986 by the Federal Employees' Retirement System Act. CSRS is a stand-alone retirement plan intended to pay benefits for long-service federal employees. CSRS covers most federal employees hired before 1984 and is closed to new members. FERS covers most employees first hired after December 31, 1983, and provides benefits to the survivors of deceased FERS annuitants and employees. Using Social Security as a base, FERS provides an additional defined benefit and a voluntary thrift savings plan. OPM administers only the defined benefit component of FERS. In fiscal year 1998, OPM had over $43 billion in outlays, with over 2 million annuitants in CSRS, and approximately 100,000 in FERS.

Social Security Administration

Old Age and Survivors Insurance

In 1935, the Social Security Act established a program to help protect aged Americans against the loss of income due to retirement. The 1939 amendments added protection for survivors of deceased retirees by creating the Old Age and Survivors Insurance (OASI) Program. Employee and employer payroll tax contributions under the Federal Insurance Contributions Act (FICA) and the Self-Employment Contributions Act (SECA) finance this program. Administration of the program lies with the Social Security Administration (SSA). In fiscal year 1998, SSA directly disbursed $324 billion to approximately 38 million beneficiaries under this program.

Disability Insurance

In 1956, the Social Security Act was amended to protect disabled workers against loss of income due to disability through creation of the Disability Insurance (DI) Program. In 1958, amendments to the act expanded benefits to include dependents of disabled workers. As a result, the DI Program provides a continuing income base for eligible workers who have qualifying disabilities and for eligible members of their families before those workers reach retirement age. As authorized by the act, workers are considered disabled if they have severe physical or mental conditions that prevent them from engaging in substantial gainful activity. The condition must be expected to last for a continuous period of at least 12 months or to result in death. Once DI beneficiaries reach age 65, they and their families are converted to the OASI Program. The DI Program is financed by employee and employer payroll tax contributions under FICA and SECA. SSA, using assistance from 54 state Disability Determination Services to make required medical and vocational decisions, is responsible for administering the DI Program. In fiscal year 1998, SSA disbursed approximately $48 billion in monthly cash payments to about 6 million beneficiaries.

Supplemental Security Income

In 1972, amendments to the Social Security Act established the Supplemental Security Income (SSI) Program. SSI provides cash assistance to financially needy individuals who are aged, blind, or disabled. General tax revenues finance this program. Many states supplement the federal SSI payment, choosing either to have SSA administer the supplement or to pay it directly. In fiscal year 1998, SSA disbursed approximately $27 billion in federal SSI payments to about 7 million recipients. Also, SSA disbursed approximately $3 billion in state supplemental payments during fiscal year 1998.

Department of the Treasury

Customs Drawbacks/Refunds

Refunds are payments made to importers/exporters for overpayments or duplicate payments of duties, taxes, and fees when goods are originally imported into the United States. A drawback is a refund of duties and/or excise taxes already paid to Customs on imported goods which were either (1) never entered into the commerce of the United States because they were either re-exported or destroyed under Customs' supervision, or (2) used (or substituted) in a process to manufacture articles which were exported from the United States or destroyed under Customs' supervision without being used.

The Congress initially passed legislation authorizing drawbacks in 1789, citing the need to facilitate American commerce and manufacturing. Drawback privileges are provided by the Tariff Act of 1930. The rationale for drawbacks has always been to encourage American commerce or manufacturing, or both. It permits the American manufacturer to compete in foreign markets without the handicap of including in the costs, and consequently in the sales price, the duty paid on imported merchandise. Drawbacks are generally processed in Customs' port offices across the nation. In fiscal year 1998, net outlays related to drawbacks and refunds were over $1.3 billion.

Department of Veterans Affairs

In 1930, the Congress consolidated and coordinated various veterans' programs with the establishment of the Veterans Administration. The Department of Veterans Affairs (VA) was established as a Cabinet level department in March 1989. VA's mission is to administer the laws providing benefits and other services to veterans and their dependents and the beneficiaries of veterans. The Veterans Benefits Administration (VBA) administers VA's nonmedical programs, which provide financial and other assistance to veterans, their dependents, and survivors. The compensation and pension (C&P) program is VBA's largest, and in fiscal year 1998, VA paid approximately $20 billion in C&P benefits to more than 3 million veterans and their survivors.

Assessment of Performance Plans for Those Agencies Reporting Improper Payments

Department/agency	Activity/program	Degree to which the performance plan addresses improper payments			
		None	Cursory	Moderate	Comprehensive
Agency for International Development	Not specifically identified	X			
Department of Agriculture	Federal Crop Insurance Corporation			X	
Department of Agriculture	Food Stamp Program			X	
Department of Health and Human Services	Administration for Children and Families	X			
Department of Health and Human Services	Medicaid	X			
Department of Health and Human Services	Medicare Fee-for-Service				X
Department of Housing and Urban Development	Housing Subsidies		X		
Department of Labor	Federal Employees' Compensation Act			X	
Department of Labor	Unemployment Insurance		X		
Office of Personnel Management	Federal Employees' Health Benefits		X		
Office of Personnel Management	Federal Employees' Group Life Insurance				X[a]
Office of Personnel Management	Retirement			X	
Social Security Administration	Disability Insurance			X	
Social Security Administration	Old Age Survivors Insurance				X[a]
Social Security Administration	Supplementary Security Income			X	
Department of the Treasury	Customs Drawbacks and Refunds	X			
Department of Veterans Affairs	Veterans' Benefits				X

[a]Although the agency performance plans did not include strategies for these programs, we assessed them as comprehensive because the related payment accuracy rates were 99.8 percent for both the Old Age Survivors Insurance and Life Insurance programs. Therefore, it may not be cost-beneficial for these agencies to design and implement additional strategies to mitigate improper payments.

Source: GAO analysis based on a review of fiscal year 2000 agency performance plans.

Legend:

None: Agency performance plan does not address the issue of improper payments for this program.

Cursory: Agency performance plan addresses the need to minimize improper payments but does not provide any substantive performance goals or strategies to minimize improper payments in this program.

Moderate: Agency performance plan has either performance goals to address improper payments or strategies to minimize improper payments in this program, but not both, or lacks a comprehensive approach.

Comprehensive: Agency performance plan has performance goals and strategies that address key internal controls to minimize improper payments in this program.

Comments From the Office of Management and Budget

EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

October 20, 1999

Mr. Jeffrey C. Steinhoff
Acting Assistant Comptroller General
United States General Accounting Office
Washington, DC 20548

Dear Mr. Steinhoff:

This letter is in response to your request to the Director of OMB for comments on a draft report entitled, "Financial Management -- Increased Attention Needed to Prevent Billions in Improper Payments." We appreciate GAO's recognition of the Administration's focus on addressing the problem of improper payments at major payment agencies such as the Department of Health and Human Services and the Department of Housing and Urban Development. We agree that our focus on this area should be expanded.

The Administration is committed to ensuring that federal payments are made properly. The Office of Management and Budget (OMB) has identified payment error reduction as one of 24 Priority Management Objectives (PMOs), which are closely monitored by senior OMB officials. Our goal is to make all payments correctly and on time. When we pay correctly, we prevent errors and eliminate the need and expense of collection. The Administration will continue to make modernizing payment systems a high priority. This priority is reflected in the "1999 Financial Management Status Report and Five-Year Plan," which was recently transmitted to Congress.

We agree with your first recommendation that OMB guidance would assist agencies in developing and implementing a methodology for annually estimating and reporting improper payments for major payment programs. As recognized in the GAO report, the annual financial statement audit process has been extremely useful in estimating the size and nature of program payment problems, as evidenced by our efforts in the Medicare fee-for-service program administered by the Department of Health and Human Services and the subsidized housing programs administered by the Department of Housing and Urban Development. This approach to estimating and reporting error rates merits expansion to other programs through the annual financial statement preparation and audit process.

With regard to your second recommendation that agency strategic plans, required by the Government Performance and Results Act (GPRA) of 1993, should always include reduction of

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improper payments as a general goal or objective, we agree including such a goal may be appropriate in some cases, but dictating that such a goal appear for all agencies would distort the purpose of the goals and objectives. The strategic plan's goals and objectives are derived from the agency's mission statement, and describe how the agency will carry out its mission. Agencies define and choose goals consistent with their mission. For those problems that are mission critical by impairing the ability to carry out the mission, we would expect agencies to include goals that address these problems.

A second group of plans required by GPRA -- the agency annual performance plans -- can be used to set goals and target levels for reducing improper payments. By covering every agency program and activity, the annual plans are more extensive in scope than strategic plans. OMB's guidance for preparing the annual performance plan is set out in Circular No. A-11. This guidance allows agencies to address significant management problems in two ways: by setting a measurable performance goal; and/or describing the actions being taken to address a specific management problem Agencies may also use their financial management plans or their annual accountability reports to indicate what they are doing to resolve problems such as improper payment levels.

The GAO report also recommends that agencies consult with Congress on specific goals and target levels for reducing improper payments. GPRA requires agencies to consult with Congress when preparing their strategic plans. Consultation on the goals and specific target levels in the annual performance plan occurs during congressional review of the agency budget request. Through the appropriations process, oversight hearings, and consideration of substantive legislation, every agency interacts on a regular basis with its authorizers and appropriators throughout the year. This interaction provides the opportunity for both the agency and Congress to raise and discuss improper payments issues, and should be adequate for consideration of these issues by all parties.

OMB staff has made numerous technical suggestions to your staff on the report. We appreciate the opportunity to review and comment on this draft report.

Sincerely,

Deidre A. Lee
Acting Deputy Director
for Management

GAO Contact and Staff Acknowledgements

GAO Contact

Debra Sebastian, (202) 512-9385

Acknowledgements

Staff making key contributions to this report are Kwabena Ansong, Kay Daly, Margaret Davis, Marie Kinney, Meg Mills, and Ruth Sessions as well many other staff throughout GAO who contributed to selected sections of this report.

Related GAO Products

The following lists prior GAO products dealing with improper payments, or overpayments dating back to fiscal year 1996, as requested by the Chairman.

Crop Insurance: USDA Needs a Better Estimate of Improper Payments to Strengthen Controls Over Claims (GAO/RCED-99-266, September 22, 1999).

Medicare: HCFA Oversight Allows Contractor Improprieties to Continue Undetected (GAO/T-HEHS/OSI-99-174, September 9, 1999).

Food Assistance: Efforts to Control Fraud and Abuse in the WIC Program Can Be Strengthened (GAO/RCED-99-224, August 30, 1999).

DOD Information Security: Serious Weaknesses Continue to Place Defense Operations at Risk (GAO/AIMD-99-107, August 26, 1999).

Defense Health Care: Claims Processing Improvements Are Under Way but Further Enhancements Are Needed (GAO/HEHS-99-128, August 23, 1999).

Medicare Fraud and Abuse: DOJ's Implementation of False Claims Act Guidance in National Initiatives Varies (GAO/HEHS-99-170, August 6, 1999).

Defense Health Care: Improvements Needed to Reduce Vulnerability to Fraud and Abuse (GAO/HEHS-99-142, July 30, 1999).

Medicare Contractors: Despite Its Efforts, HCFA Cannot Ensure Their Effectiveness or Integrity (GAO/HEHS-99-115, July 14, 1999).

Medicare: HCFA Should Exercise Greater Oversight of Claims Administration Contractors (GAO/T-HEHS/OSI-99-167, July 14, 1999).

Department of Energy: Need to Address Longstanding Management Weaknesses (GAO/T-RCED-99-255, July 13, 1999).

Food Stamp Program: Households Collect Benefits for Persons Disqualified for Intentional Program Violations (GAO/RCED-99-180, July 8, 1999).

Recovery Auditing: Reducing Overpayments, Achieving Accountability, and the Government Waste Corrections Act of 1999 (GAO/T-NSIAD-99-213, June 29, 1999).

Food Stamp Program: Relatively Few Improper Benefits Provided to Individuals in Long-Term Care Facilities (GAO/RCED-99-151, June 4, 1999).

Medicare Subvention Demonstration: DOD Data Limitations May Require Adjustments and Raise Broader Concerns (GAO/HEHS-99-39, May 28, 1999).

Medicare: Early Evidence of Compliance Program Effectiveness Is Inconclusive (GAO/HEHS-99-59, April 15, 1999).

Auditing the Nation's Finances: Fiscal Year 1998 Results Highlight Major Issues Needing Resolution (GAO-T-AIMD-99-131, March 31, 1999).

Financial Audit: Fiscal Year 1998 Financial Report of the U.S. Government (GAO/AIMD-99-130, March 31, 1999).

Contract Management: DOD is Examining Opportunities to Further Use Recovery Auditing (GAO/NSIAD-99-78, March 17, 1999).

Veterans' Benefits Claims: Further Improvements Needed in Claims-Processing Accuracy (GAO/HEHS-99-35, March 1, 1999).

Medicare Managed Care: Better Risk Adjustment Expected to Reduce Excess Payments Overall While Making Them Fairer to Individual Plans (GAO/T-HEHS-99-72, February 25, 1999).

Direct Student Loans: Overpayments During the Department of Education's Conversion to a New Payment System (GAO/HEHS-99-44R, February 17, 1999).

HCFA Management: Agency Faces Multiple Challenges in Managing Its Transition to the 21st Century (GAO/T-HEHS-99-58, February 11, 1999).

Social Security: What the President's Proposal Does and Does Not Do (GAO/T-AIMD/HEHS-99-76, February 9, 1999).

Supplemental Security Income: Long-Standing Issues Require More Active Management and Program Oversight (GAO/T-HEHS-99-51, February 3, 1999).

Medicare Home Health Agencies: Role of Surety Bonds in Increasing Scrutiny and Reducing Overpayments (GAO/HEHS-99-23, January 29, 1999).

Financial Management: Problems in Accounting for Navy Transactions Impair Funds Control and Financial Reporting (GAO/AIMD-99-19, January 19, 1999).

Supplemental Security Income: Increased Receipt and Reporting of Child Support Could Reduce Payments (GAO/HEHS-99-11, January 12, 1999).

Internal Controls: Reporting Air Force Vendor Payment System Weaknesses Under the Federal Managers' Financial Integrity Act (GAO/AIMD-99-33R, December 21, 1998).

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