



## Testimony

Before the Subcommittee on Federal Financial Management, Government Information, and International Security, Committee on Homeland Security and Governmental Affairs, U.S. Senate

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# IMPROPER PAYMENTS

## Incomplete Reporting under the Improper Payments Information Act Masks the Extent of the Problem

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Comptroller General of the United States





Highlights of [GAO-07-254T](#), a testimony before the Subcommittee on Federal Financial Management, Government Information, and International Security, Committee on Homeland Security and Governmental Affairs, U.S. Senate

## Why GAO Did This Study

Fiscal year 2005 marked the second year that executive agencies were required to report improper payment information under the Improper Payments Information Act of 2002 (IPIA). The ultimate goal is to minimize such payments because, as a practical matter, they cannot be entirely eliminated. GAO's testimony is primarily based on its recently issued report, [GAO-07-92](#), which included a review of improper payment information reported by 35 agencies in their fiscal year 2005 performance and accountability or annual reports. This statement focuses on the progress agencies have made in their improper payment reporting, the challenges that remain, and the total amount of improper payments recouped through recovery auditing.

## What GAO Recommends

In its related report, GAO suggested that the Congress consider amending IPIA to define specific criteria agencies should use to ensure that the full extent of improper payments is captured. GAO also made recommendations to the Office of Management and Budget (OMB) to help ensure accurate and complete improper payment and recovery auditing reporting. OMB generally agreed with GAO's recommendations and outlined actions planned and under way for continued progress. However, in a subsequent letter to GAO, OMB's Controller raised concerns about the report, including the timing of issuance.

[www.gao.gov/cgi-bin/getrpt?GAO-07-254T](http://www.gao.gov/cgi-bin/getrpt?GAO-07-254T).

To view the full product, including the scope and methodology, click on the link above. For more information, contact McCoy Williams at (202) 512-9095 or [williamsm1@gao.gov](mailto:williamsm1@gao.gov).

# IMPROPER PAYMENTS

## Incomplete Reporting under the Improper Payments Information Act Masks the Extent of the Problem

### What GAO Found

While agencies are making progress, their fiscal year 2005 reporting under IPIA does not yet reflect the full scope of improper payments across executive branch agencies. Major challenges remain in meeting the goals of the act and ultimately improving the integrity of payments. GAO found that three challenges in particular continue to hinder full reporting of improper payment information:

- **Existing reporting incomplete.** Although 18 agencies collectively identified and estimated improper payments for 57 programs and activities totaling \$38 billion, some agencies still had not instituted systematic methods of reviewing all programs, resulting in their identification of none or only a few programs as susceptible to significant improper payments. In many cases, these same agencies had well-known and well-documented financial management weaknesses as well as fraudulent, improper, and questionable payments. Further, improper payments estimates totaling about \$389 million for 9 programs were not based on a valid statistical sampling methodology as required. Materially higher estimates would have been expected had the correct methods been used, given that total outlays for these 9 programs exceeded \$58.2 billion.
- **Large programs still not included.** Estimates of improper payments for 10 risk-susceptible programs with outlays totaling over \$234 billion still have not been provided. Most of these programs were subject to OMB reporting requirements that preceded IPIA.
- **Threshold criteria limit reporting.** The act includes broad criteria to identify risk-susceptible programs. OMB's implementing guidance includes more specific criteria that limit the disclosure and transparency of agencies' improper payments.

GAO's preliminary review of fiscal year 2006 data indicates that while additional progress is being made, agencies continue to face many of the significant challenges noted in GAO's report on fiscal year 2005 reporting.

With regard to agencies' recovery audit efforts, GAO found that the data reported may present an overly optimistic view of these efforts. While 21 agencies were required to report on their recovery audit efforts, GAO identified discrepancies in several agencies' information and found limited reviews over contract payments. For example, for fiscal year 2005, the National Aeronautics and Space Administration (NASA) reported that it had identified and recovered \$617,442 in contract payments, a 100 percent recovery rate. Yet, the NASA Office of Inspector General reported it had identified over \$515 million in questioned contract costs during fiscal year 2005, of which NASA management decided to pursue recovery of \$51 million. Had this amount been compared to the \$617,442 NASA actually recovered, its recovery rate would drop from the reported 100 percent to 1.2 percent.

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Mr. Chairman and Members of the Subcommittee:

Thank you for the opportunity to be here today to discuss the governmentwide problem of improper payments in federal programs and activities. My testimony today is based on our November 2006 report<sup>1</sup> as well as on our previous testimonies<sup>2</sup> on this topic issued earlier this year. We focused on agencies' fiscal year 2005 reporting under the Improper Payments Information Act of 2002 (IPIA),<sup>3</sup> the most recent data available at the time we started this body of work. As agencies recently reported their fiscal year 2006 data, my testimony today also includes some preliminary observations on this information. IPIA has increased visibility over improper payments<sup>4</sup> by requiring executive agency heads, based on guidance from the Office of Management and Budget (OMB),<sup>5</sup> to identify programs and activities susceptible to significant improper payments,<sup>6</sup> estimate amounts improperly paid, and report on the amounts of improper payments and their actions to reduce them. As the steward of taxpayer dollars, the federal government is accountable for how its agencies and grantees spend hundreds of billions of taxpayer dollars and is responsible for safeguarding those funds against improper payments. However, although the ultimate goal is to identify and minimize these payments

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<sup>1</sup>GAO, *Improper Payments: Agencies' Fiscal Year 2005 Reporting under the Improper Payments Information Act Remains Incomplete*, [GAO-07-92](#) (Washington, D.C.: Nov. 14, 2006).

<sup>2</sup>GAO, *Financial Management: Challenges Remain in Meeting Requirements of the Improper Payments Information Act*, [GAO-06-482T](#) (Washington, D.C.: Mar. 9, 2006), and *Financial Management: Challenges Continue in Meeting Requirements of the Improper Payments Information Act*, [GAO-06-581T](#) (Washington, D.C.: Apr. 5, 2006).

<sup>3</sup>Pub. L. No. 107-300, 116 Stat. 2350 (Nov. 26, 2002).

<sup>4</sup>IPIA defines improper payments as any payment that should not have been made or that was made in an incorrect amount (including overpayments and underpayments) under statutory, contractual, administrative, or other legally applicable requirements. It includes any payment to an ineligible recipient, any payment for an ineligible service, any duplicate payment, payments for services not received, and any payment that does not account for credit for applicable discounts.

<sup>5</sup>OMB Memorandum M-03-13, "Improper Payments Information Act of 2002 (Public Law 107-300)" May 21, 2003, and OMB Circular No. A-136, *Financial Reporting Requirements*, § II.5.6 (July 24, 2006). OMB recently issued revised guidance for fiscal year 2006 reporting in OMB Memorandum M-06-23, "Issuance of Appendix C to OMB Circular No. A-123" (Aug. 10, 2006).

<sup>6</sup>OMB's guidance defines significant improper payments as those in any particular program that exceed both 2.5 percent of program payments and \$10 million annually.

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through a variety of strategies, it is important to recognize that, given the complexity, diversity, and magnitude of federal payments across the executive branch, such improper payments will never be completely eliminated.

Today, my testimony will focus on the following key points:

- trends in agencies' reporting under IPIA from fiscal year 2004 through fiscal year 2006,
- several major challenges that continue to hinder full reporting of improper payment information,
- agencies' reporting of recovery auditing efforts to recoup improper payments, and
- our proposals for continued progress in capturing the full extent of improper payments.

This testimony is primarily based on our recent review, which included the 35 federal agencies that the Department of the Treasury (Treasury) determined to be significant to the U.S. government's consolidated financial statements. We reviewed improper payment information reported by the 35 agencies in their fiscal year 2005 performance and accountability reports (PAR) or annual reports. We also performed a preliminary review of agencies' fiscal year 2006 PARs or annual reports. We reviewed OMB guidance on implementation of IPIA and its report<sup>7</sup> on the results of agency-specific reports, significant findings, agency accomplishments, and remaining challenges. We did not independently validate the data that agencies reported in their PARs or annual reports or the data that OMB reported. However, we are providing agency-reported data as descriptive information that will inform interested parties about the magnitude of governmentwide improper payments and other improper payment-related information. We believe the data to be sufficiently reliable for this purpose. We conducted our work from April 2006 through September 2006 in accordance with generally accepted government auditing standards. Our November 2006 report contains additional details on our scope and methodology.

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## Summary

Under OMB's leadership, progress has been made in the first 3 years of IPIA implementation. Agencies' reporting under the act's provisions

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<sup>7</sup>Office of Management and Budget, *Improving the Accuracy and Integrity of Federal Payments* (Washington, D.C.: Feb. 2, 2006).

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though, does not yet reflect the full scope of improper payments across executive branch agencies. For fiscal years 2004 and 2005, we concluded that the magnitude of the governmentwide improper payments problem was still unknown because agencies had not yet prepared improper payment estimates for all of their programs. Our preliminary review of fiscal year 2006 reporting indicates that while additional progress is being made, several challenges noted in our report on fiscal year 2005 reporting continue to hinder full reporting of improper payment information. Similar to our previous results, we found that some agencies have not annually reviewed all programs and activities, have not estimated improper payments for their risk-susceptible programs, or only estimated improper payments for one component of the program. For example, we noted that the total improper payment estimate for fiscal year 2006 still does not include 9 risk-susceptible federal programs, including Medicaid with total program outlays of about \$183 billion for fiscal year 2006. In addition, federal agency auditors continue to identify weaknesses in agencies' compliance with the requirements of IPFA.

Our review of agencies' fiscal year 2005 reporting of selected improper payment information identified three key challenges to fully addressing improper payments reporting requirements.

- First, we found that agencies' reporting of improper payment information was incomplete and the extent and level of detail of agencies' improper payment information varied. Although 18 agencies collectively identified and estimated improper payments for 57 programs and activities totaling \$38 billion, some agencies still had not instituted systematic methods of reviewing all programs, resulting in their identification of none or only a few programs as susceptible to significant improper payments. In many cases, these same agencies had well-known and well-documented financial management weaknesses as well as fraudulent, improper, and questionable payments. A lack of detailed guidance may be a contributing factor to agencies' inability to adequately assess their programs for risks. Specifically, we found that OMB's implementing guidance does not include a description of the common types of risk factors agencies should consider when annually reviewing their programs, such as program complexity, operational changes, findings from investigative reports, and financial statement and performance audit reports. Further, improper payments estimates totaling about \$389 million for 9 programs were not based on a valid statistical sampling methodology as required. Higher estimates would have been expected had statistically valid methods been used, given that total outlays for these 9 programs exceeded \$58.2 billion in fiscal year 2005.

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- Second, the total improper payment estimate does not include several large, risk-susceptible federal programs. Agencies have not estimated improper payments for 10 risk-susceptible programs with outlays totaling over \$234 billion, even though most of these programs had such reporting requirements predating IPIA.<sup>8</sup> Further, although the total improper payment estimate of about \$38 billion represents almost a \$7 billion, or 16 percent, decrease from the \$45 billion of improper payments reported by agencies in fiscal year 2004, the reported reduction may not reflect improved accountability or strengthened internal controls. As we previously reported in March and April 2006, this estimate reduction is primarily attributable to a decrease in the Department of Health and Human Services' (HHS) Medicare program improper payment estimate. This decrease mainly resulted from a change to Medicare's estimating methodology rather than from improved payment controls. We noted that HHS's Office of Inspector General (OIG) continued to cite the integrity of Medicare payments as a top management challenge in HHS's fiscal year 2005 PAR.
  - Third, OMB's implementation of the act's broad criteria to identify risk-susceptible programs limit the disclosure and transparency of governmentwide improper payments. This limitation does not further the objectives of IPIA, as programs that do not meet OMB's criteria—improper payments exceeding \$10 million and 2.5 percent of program payments—are excluded from agencies' improper payment reporting. For example, one agency identified three programs with estimated improper payments exceeding \$10 million, but because the estimates did not exceed 2.5 percent of program outlays, they were not included in the governmentwide improper payment total.

In addition, we noted that the definition of improper payments under IPIA excludes certain types of payments required to be made under constitutional, statutory, or judicial requirements, even if those payments are subsequently determined to be incorrect. These include payments that an agency must make pursuant to a statute or court order that later are determined to be overpayments. Yet, because agencies are not required to

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<sup>8</sup>Prior to the executive branch-wide IPIA reporting requirements, beginning with fiscal year 2004, former section 57 of OMB Circular No. A-11 required certain agencies to submit similar information, including estimated improper payment target rates, target rates for future reductions in these payments, the types and causes of these payments, and variances from targets and goals established. In addition, these agencies were to provide a description and assessment of the current methods for measuring the rate of improper payments and the quality of data resulting from these methods.

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track, monitor, and report on these types of overpayments, the governmentwide magnitude of this issue is unknown.

With regard to agencies' recovery auditing efforts, a mechanism used to detect and recoup improper payments, we found that the data reported may not present an accurate view of the extent or success of these efforts. While 21 agencies were required to report on their recovery audit efforts, we identified discrepancies in several agencies' information and found limited reviews over contract payments. For example, for fiscal year 2005, the National Aeronautics and Space Administration (NASA) reported that it had identified and recovered \$617,442 in contract payments, a reported 100 percent recovery rate. Yet, the NASA OIG reported it had identified over \$515 million in questioned contract costs during fiscal year 2005, of which NASA management decided to pursue recovery of \$51 million. Had the \$51 million amount been compared to the \$617,442 NASA actually recovered, its recovery rate would drop from the reported 100 percent to 1.2 percent. In addition, we noted that 5 of the 21 agencies did not review all of their agency components as part of their recovery audit efforts while 2 agencies reported that recovery auditing was not cost beneficial without reporting any details to support this determination.

Our November 2006 report included one matter for congressional consideration and four recommendations for executive action. Specifically, to ensure that the full extent of improper payments is being captured, we believe the Congress should consider amending existing IPPIA provisions to add more specific criteria, such as a dollar threshold agencies should use to identify which programs and activities are susceptible to significant improper payments, thereby triggering improper payment estimating and reporting requirements. In addition, to facilitate agencies' progress in ensuring accurate and complete improper payments and recovery auditing reporting, we recommended that OMB take several actions regarding (1) risk assessment methodologies and the level of detail necessary to meet the annual improper payment reporting requirements, (2) statistically valid estimates, (3) extent of payments agencies make under statute or judicial determinations that later are determined to be overpayments, and (4) agencies' rationale that recovery auditing is not cost beneficial. In written comments on the draft of our report, OMB agreed with our assessment of the challenges that remain in meeting the goals of IPPIA. OMB generally agreed with our recommendations and highlighted progress made in the second year of governmentwide improper payments reporting, as well as initiatives under way to measure improper payments in selected programs susceptible to significant improper payments. However, in a subsequent letter to GAO, OMB's

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Controller raised concerns about the report, including the timing of our analysis and report issuance, which we discuss later in this testimony.

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## Significant Trends in IPIA Reporting

I would now like to focus on the progress that has been made in the first 3 years of IPIA implementation. Regarding the first year reporting under IPIA, as we reported in March 2005,<sup>9</sup> the improper payment estimate of \$45 billion reported by 17 agencies did not include any amounts for some of the highest risk programs, such as Medicaid with outlays in excess of \$175 billion for fiscal year 2004. Further, we noted that some agencies still had not instituted systematic methods of reviewing all programs and activities or had not identified all programs susceptible to significant improper payments. We concluded that the magnitude of the governmentwide improper payments problem was still unknown because agencies had not yet prepared improper payment estimates for all of their programs. In that report, we made three recommendations to OMB to help ensure successful implementation of IPIA requirements. OMB commented that its management emphasis and inspector general oversight offer sufficient incentives to ensure agencies meet IPIA requirements.

Regarding the second year of IPIA reporting, we recently reported in November 2006<sup>10</sup> that while making progress, agencies' fiscal year 2005 reporting under IPIA does not yet reflect the full scope of improper payments across executive branch agencies. For fiscal year 2005, 18 agencies reported improper payment estimates totaling in excess of \$38 billion,<sup>11</sup> which is \$7 billion less than the \$45 billion reported for fiscal year 2004.<sup>12</sup> All indications are that the estimate should be markedly higher because the total improper payment estimate did not include certain factors that if included, would increase the estimate. For example,

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<sup>9</sup>GAO, *Financial Management: Challenges in Meeting Requirements of the Improper Payments Information Act*, [GAO-05-417](#) (Washington, D.C.: Mar. 31, 2005).

<sup>10</sup>[GAO-07-92](#).

<sup>11</sup>Included in this estimate were 10 agencies reporting for the first time improper payment estimates of almost \$1.2 billion for 17 programs. Also, the governmentwide estimate includes both over- and underpayments. OMB's implementing guidance requires agencies to report the gross versus net total of both over- and underpayments.

<sup>12</sup>In their fiscal year 2005 PARs, several agencies updated their fiscal year 2004 improper payment estimates to reflect changes since issuance of their fiscal year 2004 PARs. These updates increased the governmentwide improper payment estimate for fiscal year 2004 from \$45 billion to \$46 billion.



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agencies had not estimated improper payments for 10 risk-susceptible programs with outlays totaling over \$234 billion, even though most of these programs had such reporting requirements predating IPIA.<sup>13</sup> In addition, we found that improper payment estimates totaling about \$389 million for 9 programs were not based on a statistical sampling methodology.<sup>14</sup> Given that total outlays for these 9 programs exceeded \$58.2 billion in fiscal year 2005, estimates for these programs would likely have been much greater had statistically valid methods been used. Further, we reported that agencies identified a number of statutory or regulatory barriers that limited their corrective actions in reducing improper payments. I will discuss these matters in greater detail later in my statement. We concluded that major challenges remain in meeting the goals of the act and ultimately improving the integrity of payments.

Based on our preliminary review<sup>15</sup> of available information for fiscal year 2006, 18 agencies estimated improper payments totaling about \$42 billion, a net increase of about \$4 billion, or 11 percent, from the prior year improper payment estimate of \$38 billion.<sup>16</sup> This increase was attributable to 10 newly reported programs with improper payment estimates totaling about \$2.3 billion and federal agencies reporting an increase in estimates for programs that had previously reported.

Our preliminary review of federal agencies' fiscal year 2006 reporting of selected improper payment information identified that while progress is being made, improvements are still needed to fully address improper payments reporting requirements. Similar to our previous results, we found that some agencies have not yet annually reviewed all programs and activities, have not yet estimated improper payments for their risk-

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<sup>13</sup>See footnote 8.

<sup>14</sup>Agency-reported estimates were primarily based on known cases identified through Office of Inspector General audits and other isolated instances. However, one agency reported using a combination of statistical and nonstatistical methodologies, but did not identify what portion of the estimate was calculated using statistical sampling. Any agency that reported using nonstatistical sampling methodologies to calculate its programs' improper payment estimates was included in this analysis.

<sup>15</sup>We plan to report further details of agencies' fiscal year 2006 improper payment reporting in 2007.

<sup>16</sup>In their fiscal year 2006 PARs, selected federal agencies updated their fiscal year 2005 improper payment estimates to reflect changes since issuance of their fiscal year 2005 PARs. These updates increased the governmentwide improper payment estimate for fiscal year 2005 from \$38 billion to \$39 billion.

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susceptible programs, or only estimated improper payments for one component of the program. For example, we noted that the fiscal year 2006 total improper payment estimate of \$42 billion still does not include 9 risk-susceptible federal programs, including Medicaid with total program outlays of about \$183 billion for fiscal year 2006. In addition, some federal agency auditors continue to identify weaknesses in agencies' compliance with the requirements of IPIA. Five agency auditors that tested compliance with IPIA cited agencies that were either in noncompliance with the act or had not fully complied with certain aspects of the act requirements, such as not estimating for all risk-susceptible programs, excluding certain types of payments from reviews, and estimating improper payments using samples that were not statistically derived. In addition to the noncompliance issues, many federal agencies' OIGs again reported on major management challenges, including reducing improper payments in programs and payment activities. For example, one agency's OIG reported that ineffective oversight and monitoring of policies, programs, and its program participants has hindered the agency's ability to identify and correct improper payments. Another agency's OIG reported that improving acquisition and contract management is needed to reduce cost and eliminate improper payments.

I would also like to address certain concerns recently raised by OMB's Controller in a letter to us dated November 28, 2006. In that letter, the Controller stated that our report issued on November 14, 2006, contained out-of-date information because it was based on agencies' fiscal year 2005 reporting. We had a number of reasons for the timing of our analysis and report issuance. First, it is important to note that we first stated our findings related to fiscal year 2005 improper payments less than 4 months after agencies reported their fiscal year 2005 information. On March 9, 2006, and again on April 5, 2006, we testified<sup>17</sup> before the Senate and House Government Reform subcommittees on agencies' progress in meeting IPIA reporting requirements for fiscal year 2005. In those testimony statements, we focused on selected reporting requirements, and our objectives included (1) the extent to which agencies performed risk assessments of all programs and activities, (2) the annual amount of improper payments estimated by reporting agencies, and (3) the amount of improper payments recouped through recovery audits. For our November 14 report, the objectives were similar but broader, and focused on additional improper payment reporting requirements as well as on the definition and the types

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<sup>17</sup>GAO-06-581T and GAO-06-482T.

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of improper payments included in IPIA and OMB's implementing guidance. The latter issues, it should be noted, are unrelated to specific fiscal year reporting. Thus, the issuance of our report was timely, given the body of work we issued prior to November 14—the two testimonies mentioned above, another related report on improper payments in state-administered programs,<sup>18</sup> and our responses to posthearing questions.<sup>19</sup>

Second, the issuance of our report was in accordance with the congressional schedule this fall, which included a lengthy recess for mid-term elections. Third, the information in our November 14 report provides a sound framework for documenting the issues that affected agencies and OMB in fiscal year 2005 and which they continue to face. Most of the findings discussed in our report continue to be relevant for the fiscal year 2006 improper payment reporting. Specifically, our November 14 report highlighted incomplete reporting of improper payment information related to agencies' risk assessments and improper payment estimates, as well as risk-susceptible programs that still are unable to report improper payment estimates. As discussed previously, based on our preliminary review of the fiscal year 2006 PARs, these issues continue to exist.

Finally, let me add that we provided a draft of our report to OMB prior to publication for its review and comment. The Controller sent detailed written comments in a letter dated October 26, 2006, which are reprinted in full in our final report. These comments make no mention of any concerns with the timeliness of the data included in our report. Indeed, the official comments state that OMB generally agreed with our assessment that challenges remain in meeting the goals of IPIA.

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<sup>18</sup>GAO, *Improper Payments: Federal and State Coordination Needed to Report National Improper Payment Estimates on Federal Programs*, [GAO-06-347](#) (Washington, D.C.: Apr. 14, 2006).

<sup>19</sup>GAO, *Improper Payments: Posthearing Questions Related to Agencies Meeting the Requirements of the Improper Payments Information Act of 2002*, [GAO-06-1067R](#) (Washington, D.C.: Sept. 6, 2006).

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## Challenges That Hinder Full Reporting of Improper Payment Information

While showing progress, agencies' fiscal year 2005 reporting under IPFA does not yet reflect the full scope of improper payments across executive branch agencies. Major challenges remain in meeting the goals of the act and ultimately improving the integrity of payments. We found that the following challenges continue to hinder full reporting of improper payment information: existing reporting remains incomplete, large programs are still not included, and OMB's threshold criteria limit complete reporting.

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## Improvements Needed in Agencies' Reporting of Improper Payment Information

Of the 35 agencies whose fiscal year 2005 agency PARs or annual reports were included in our review, 23, the same number of agencies that reported having risk assessments in our prior year review, reported they had performed risk assessments of all of their programs and activities. The remaining 12 agencies either did not report this information in their PARs or annual reports, or included some improper payment details in their PARs but did not report assessing for the risk of improper payments for all of their programs and activities.

Although OMB's guidance identifies the scope of payments agencies are to review, such as federal awards made by recipients and subrecipients subject to the Single Audit Act, as amended,<sup>20</sup> it does not provide agencies detailed information on how to conduct a risk assessment in order to adequately carry out their responsibilities to meet the requirements of the act. Specifically, we found that OMB's guidance lacks a description of the common types of risk factors agencies should consider when annually reviewing their programs, such as program complexity; operational changes; and findings from investigative, financial statement, and performance audit reports. Developing such a framework would begin the process to effectively identify and target high-risk areas within a program and better position agencies as they determine which control activities to implement to reduce risks and ultimately reduce fraud and errors.

Although 23 agencies reported meeting this requirement for all of their programs and activities, other readily available information suggests to us

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<sup>20</sup>31 U.S.C. §§ 7501-7507. Under the Single Audit Act, as amended, and implementing guidance, independent auditors audit state and local governments and nonprofit organizations that expend federal awards to assess, among other things, compliance with laws, regulations, and the provisions of contracts or grant agreements material to the entities' major federal programs. Organizations are required to have single audits if they annually expend \$500,000 or more in federal funds.

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that the adequacy of agencies' risk assessments was questionable. For example, auditors for the Department of Justice (DOJ) and the Department of Homeland Security (DHS) cited agency noncompliance with IPFA in their fiscal year 2005 annual audit reports, primarily caused by inadequate risk assessments. The DOJ auditors stated that one agency component had not established a program to assess, identify, and track improper payments. The DHS auditors reported that the department did not institute a systematic method of reviewing all programs and identifying those it believed were susceptible to significant erroneous payments. This was the second consecutive year that the auditors reported IPFA noncompliance for DHS. Although the auditors identified the agency's risk assessment methodology as inadequate, DHS again reported in its PAR that it had assessed all of its programs for risk and found none susceptible to significant improper payments.

However, existing significant financial management weaknesses at these agencies highlight visible, well-known risks for improper payments. For example, DHS continues to face significant financial management weaknesses as illustrated by previous reviews of the Federal Emergency Management Agency's (FEMA)—a DHS component—Individuals and Households Program (IHP). The DHS OIG has also cited disaster response and recovery as one of DHS's major management challenges for fiscal year 2005.

In May 2005, the DHS OIG reported<sup>21</sup> weaknesses in DHS's IHP, including inspection and verification of losses reported by individuals related to the 2004 hurricane season as well as eligibility issues. Subsequently, in July 2005, the Senate Committee on Homeland Security and Governmental Affairs released its investigation results of FEMA's response to the 2004 Florida hurricanes, in particular, Hurricane Frances, and found similar weaknesses in FEMA's IHP. In discussing its risk assessment methodology, DHS reported that FEMA's IHP might be at high risk for issuing improper payments as a result of the weaknesses identified in the DHS OIG report and performed a second round of testing of its fiscal year 2004 disbursements. From its test results, DHS concluded that its estimate of improper payments for IHP did not meet OMB's criteria of exceeding \$10 million and 2.5 percent of program payments. DHS reported that IHP

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<sup>21</sup>Department of Homeland Security, Office of Inspector General, *Audit of FEMA's Individuals and Households Program in Miami-Dade County, Florida, for Hurricane Frances*, OIG-05-20 (Washington, D.C.: May 2005).

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would receive closer scrutiny and undergo an independent payment review in fiscal year 2006, but that its sample payment testing did not show the program to be at high risk for improper payments.

Our recent review of FEMA's IHP shows a dramatically different result. In our June 2006 report,<sup>22</sup> we estimated improper payments related to FEMA's IHP of about \$1 billion as of February 2006, related to individual assistance payments in response to hurricanes Katrina and Rita that occurred in 2005. This amount represents 16 percent of the IHP payments. For example, we determined that millions of dollars in expedited and housing assistance payments went to registrants who provided the names and Social Security numbers of individuals incarcerated in federal and state prisons during the hurricanes. In addition, FEMA improperly paid individuals twice for their lodging—paying both hotels and rental assistance. Also, FEMA could not confirm that 750 debit cards worth \$1.5 million went to Hurricane Katrina victims.

In addition to these problems with agency risk assessments, we found that only a limited number of agencies were estimating improper payments and several of those that were did not base their estimates on a valid statistical sampling methodology as required. Of the 35 agencies, 18 agencies accounting for 57 programs reported improper payment estimates totaling in excess of \$38 billion<sup>23</sup> for some or all of their high-risk programs. (See [GAO-07-92](#), app. II, for further details.) This represents approximately 2 percent of the total fiscal year 2005 government outlays of \$2.5 trillion. For the remaining 17 agencies that did not report estimates, 8 said they did not have any programs susceptible to significant improper payments, 8 were silent about whether they had programs susceptible to significant improper payments, and the remaining agency identified programs susceptible to significant improper payments and said it planned to report an estimate by fiscal year 2007. (See [GAO-07-92](#), table 2, for further details.)

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<sup>22</sup>GAO, *Hurricanes Katrina and Rita Disaster Relief: Improper and Potentially Fraudulent Individual Assistance Payments Estimated to Be Between \$600 Million and \$1.4 Billion*, [GAO-06-844T](#) (Washington, D.C.: June 14, 2006).

<sup>23</sup>Included in this estimate were 17 newly reported programs in 10 agencies, totaling about \$1.2 billion for fiscal year 2005.

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Unless previously approved by OMB, the improper payments estimates must be based on a statistically valid sampling methodology<sup>24</sup> and should include a gross total of both over- and underpayments. In its Circular No. A-136, OMB encourages agencies to break out over- and underpayments as part of improper payment reporting, if available. (For more details related to over- and underpayment estimates, see [GAO-07-92](#), app. III.) With statistical sampling, sample results can be generalized to the entire population from which the sample was taken. From our review, we found six agencies that did not use statistical sampling as a basis for reporting improper payments totaling approximately \$389 million for nine programs with outlays exceeding \$58 billion.

For example, the Department of Labor (Labor) analyzed fiscal year 2003 single audits to identify questioned costs for its Workforce Investment Act<sup>25</sup> program, which, in turn, were used as a proxy for reporting its improper payment estimate. Specifically, the improper payment rate was determined by calculating the projected questioned costs and dividing this total amount by the corresponding outlays. We do not believe this is a reasonable proxy for improper payment levels because single audits, by themselves, may lack the level of detail necessary for achieving IPIA compliance. Specifically, single audits generally focus on the largest dollars in an auditee's portfolio. Thus, all programs identified as susceptible to improper payments at the federal level may not receive extensive coverage under a single audit. Consequently, both the depth and level of detail of single audit results are, generally, insufficient to identify improper payments, estimate improper payments, or both.

We also found instances where agencies estimated improper payments for only one component of the risk-susceptible program. For example, HHS's Medicare program is the largest program constituting the total improper payment estimate, with an estimate of \$12.1 billion for fiscal year 2005. However, this estimate represents payment errors only for its fee-for-service program component. HHS has not yet begun to estimate improper payments for its managed care component, with outlays totaling about \$52 billion, or 15 percent of Medicare program outlays. In its fiscal year 2005 financial report, HHS's Centers for Medicare and Medicaid Services (CMS) identified bringing the Medicare managed care component into

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<sup>24</sup>OMB requires that agencies' statistical sampling methodologies be designed to yield estimates with a 90 percent confidence interval of plus or minus 2.5 percent.

<sup>25</sup>Pub. L. No. 105-220, 112 Stat. 936 (Aug. 7, 1998).

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## Statutory or Regulatory Barriers That May Hinder Agency Reporting and Corrective Actions

compliance with IPIA as a key challenge in the coming years. In addition, CMS's external auditors identified Medicare's managed care benefits payment cycle as a material weakness in its report on internal controls. Specifically, the auditors found that existing CMS policies and procedures are not sufficient to adequately reduce the risk of material benefit payment errors from occurring or not being detected and corrected in a timely manner.

A key element that agencies are required to address as part of their improper payment reporting includes a description of any statutory or regulatory barrier that may limit the agencies' corrective actions in reducing improper payments. Reporting this type of information gives the Congress the ability to use its authorization, appropriation, and oversight responsibility to help agencies meet performance goals. Citing specific statutory or regulatory barriers as part of its improper payments reporting allows the Congress to determine whether the public's needs are adequately served by federal programs, and thus can take corrective action through legislative changes. It should be recognized that this type and other barriers exist as a result of decisions to ensure beneficiary privacy and other data safeguards and the inherent nature of some federal programs. As a result, it may be difficult to eliminate or mitigate these barriers to the point where they no longer restrict agency actions in certain areas to better manage their improper payment problems.

During our review of agencies' fiscal year 2005 PARs, we found that nine agencies identified statutory or regulatory barriers that may limit corrective actions to reduce improper payments.<sup>26</sup> Agencies cited various barriers that restrict their ability to manage their programs against improper payments, including three agencies that cited barriers related to data matching.<sup>27</sup> Data matching and other computer-related techniques play a significant role not only in identifying improper payments, but also in providing data on why these payments were made and, in turn, highlighting areas that need strengthened prevention controls. The adoption of these techniques allows agencies to have effective detection methods to quickly identify and recover improper payments. These powerful internal control tools provide more useful and timely access to information. The use of these techniques can achieve potentially

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<sup>26</sup>We did not independently verify the validity of these agency assertions.

<sup>27</sup>Data matching is the process in which information from one source is compared with information from another to identify any inconsistencies.



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significant savings by identifying client-related reporting errors and misinformation during the eligibility determination process—before payments are made—or by detecting improper payments that have been made. Therefore, it will be critical for the Congress, federal agencies, and the administration to carefully consider the information reported on statutory barriers to ensure that agencies can take advantage of such tools to the greatest extent possible.

For example, Education reported that requirements in the Internal Revenue Code precluded data matching, but that a database match with the Internal Revenue Service (IRS) would likely improve the accuracy of Pell Grant awards. In addition, it would eliminate the need for schools to rely on paper copies of tax returns submitted by applicants, which are used to verify applicants' adjusted gross income and taxes paid. Currently, the schools have limited assurance that the tax returns submitted by the applicants contain the same information that is filed with IRS. However, Education's proposal to amend the Internal Revenue Code to permit a 100 percent database match has not yet been enacted, and Education is uncertain whether or when such legislation may be enacted. As a further illustration, Labor reported that for its Federal Employees' Compensation Act (FECA) program,<sup>28</sup> legislation does not currently permit FECA to verify employment earnings with the Social Security Administration (SSA) without the claimant's written permission. Compensation benefits may be overpaid if an employee has unreported earnings and does not grant Labor permission to verify earnings with SSA.

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### Improper Payments Estimate Does Not Include Several Large, Risk-Susceptible Programs

The fiscal year 2005 governmentwide improper payments estimate of \$38 billion did not include any amounts for 10 programs, with fiscal year 2005 outlays totaling over \$234 billion. OMB had specifically required 7 of these programs to report selected improper payment information for several years before IPIA reporting requirements became effective. After passage of IPIA, OMB's implementing guidance required that these programs continue to report improper payment information under IPIA. The remaining 3 risk-susceptible programs, with no previous reporting requirement, provided target dates for estimating improper payments. As shown in table 1, the fiscal year 2005 improper payment estimate does not include one of the largest federal programs determined to be susceptible

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<sup>28</sup>This act was repealed and parts of it are now codified in code sections of Titles 1, 5, and 18 of the United States Code.

to risk, HHS's Medicaid program, with outlays exceeding \$181 billion annually.

**Table 1: Susceptible Programs That Did Not Report Improper Payment Estimates and Target Dates for Estimates**

Dollars in billions

Agency/program	Fiscal year 2005 outlays	Target date for improper payment estimates	Previously required to estimate
Department of Agriculture—School Programs	\$8.2	2007	X
Federal Communications Commission—Universal Service Fund's Schools and Libraries	1.7	2007	
Federal Communications Commission—High Cost Support Program	3.8	2007	
Department of Health and Human Services—State Children's Insurance Program	5.1	2008	X
Department of Agriculture—Women, Infants, and Children	4.8	2008	X
Department of Health and Human Services—Medicaid	181.7	2008	X
Department of Agriculture—Child and Adult Care Food Program	2.1	2010	
Department of Health and Human Services—Child Care and Development Fund	4.9	Did not report target date	X
Department of Health and Human Services—Temporary Assistance for Needy Families	17.4	Did not report target date	X
Department of Housing and Urban Development—Community Development Block Grant	5.0	Did not report target date	X
<b>Total</b>	<b>\$234.7</b>		<b>7</b>

Sources: OMB and cited agencies' fiscal year 2005 PARs.

OMB reported that some of the agencies were unable to determine the rate or amount of improper payments because of measurement challenges or time and resource constraints, which OMB expects to be resolved in future reporting years. For example, since fiscal year 2002, HHS has conducted pilots at the state level to further its progress toward reporting a national improper payments estimate for its Medicaid program. Each state is responsible for designing and overseeing its own Medicaid program within the federal government structure. This type of program structure presents challenges for implementing a methodology to estimate improper payments as HHS must work with states to obtain applicable documentation used in the calculation. An additional challenge HHS and other agencies with state-administered programs say they face is the ability to hold states accountable for meeting targets to reduce and recover improper payments in the absence of specific statutory authority.

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Of the three programs that did not report a target date for estimating, the Department of Housing and Urban Development's (HUD) Community Development Block Grant (CDBG) program was the only one that did not report any actions under way to begin estimating improper payments. In its fiscal year 2005 PAR, HUD reported that based on completed testing of fiscal year 2003 payments, this program is below OMB's threshold criteria—exceeding \$10 million and 2.5 percent of program payments—for significant improper payments and, therefore, was removed from HUD's at-risk inventory. HUD stated that this program was not subject to retesting unless there was a significant change in the nature of activity or internal control structure.

We have several problems with HUD's position. The CDBG program was subject to the previous OMB Circular No. A-11 requirements and thus was required by OMB's guidance to continue to report improper payment information under IPFA, regardless of the agency-determined risk level, which based on other known information may not reflect actual risk. During a June 2006 hearing<sup>29</sup> on the CDBG program, HUD's OIG reported on numerous instances of fraudulent, improper, and abusive use of program funds identified over a 2-½-year period based on 35 audits. The HUD OIG reported that its office has recovered over \$120 million in program funds, identified over \$100 million in questioned costs, indicted 159 individuals, initiated administrative actions against 143 individuals, and took 5 civil actions and 39 personnel actions. As evidenced by the HUD OIG reviews, the CDBG program may be at risk of significant improper payments.

Further, we noted that the total improper payment estimate of about \$38 billion represents almost a \$7 billion, or 16 percent, decrease from the \$45 billion of improper payments reported by agencies in fiscal year 2004.<sup>30</sup> On the surface, this would suggest that significant progress has been

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<sup>29</sup> June 29, 2006, hearing before the Senate Subcommittee on Federal Financial Management, Government Information, and International Security, Committee on Homeland Security and Governmental Affairs.

<sup>30</sup> In their fiscal year 2005 PARs, several agencies updated their fiscal year 2004 improper payment estimates to reflect changes since issuance of their fiscal year 2004 PARs. These updates increased the governmentwide improper payment estimate for fiscal year 2004 from \$45 billion to \$46 billion.

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made. However, the reported \$7 billion decrease in the governmentwide estimate is primarily attributable to a decrease in Medicare's estimate.<sup>31</sup>

Based on our review, the Medicare improper payment estimate decrease was principally caused by increased efforts to educate health care providers about its Medicare error rate testing program and the importance of responding to its requests for medical records to perform detailed statistical reviews of Medicare payments. HHS reported that these more intensive efforts had dramatically reduced the number of "no documentation" errors in its medical reviews. HHS reported marked reductions in its error rate attributable to fewer cases of (1) nonresponses to requests for medical records and (2) insufficient documentation submitted by the provider. We noted that these improvements partially resulted from HHS extending the time that providers have for responding to documentation requests from 55 days to 90 days.

These changes primarily affected HHS's processes related to its efforts to perform detailed statistical reviews for the purposes of calculating an annual improper payment estimate for the Medicare program. While this may represent a refinement in the program's improper payment estimate, the reported reduction may not reflect improved accountability over program dollars. Therefore, the federal government's progress in reducing improper payments may be exaggerated because the reported improper payments decrease in the Medicare program accounts for the bulk of the overall reduction in the governmentwide improper payments estimate.

Our work did not include an overall assessment of HHS's estimating methodology. However, we noted that the changes made for the fiscal year 2005 estimate were not related to improvements in prepayment validation processes, and we did not find any evidence that HHS had significantly enhanced its preventive controls in the Medicare payment process to prevent future improper payments. Further, we also found that HHS's OIG continues to cite the integrity of Medicare payments as a top management challenge. In addition, health care fraud schemes continue to hamper HHS's efforts to improve accountability. For example, in May 2006, DOJ

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<sup>31</sup>We determined that the decrease was primarily caused by a \$9.6 billion reduction in the HHS Medicare program improper payment estimate, which was partially offset by more programs reporting estimates of improper payments, resulting in a net decrease of \$7 billion. The \$9.6 billion reduction is the difference between the fiscal year 2004 estimate of \$21.7 billion and the fiscal year 2005 estimate of \$12.1 billion.

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reported<sup>32</sup> that a businessman pleaded guilty to conspiracy to defraud Medicare of \$40 million in fraudulent billings over a 16-month period. The fraud scheme included billing Medicare for motorized wheelchairs that were either not required by the Medicare beneficiary, not delivered, or both.

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## Threshold Criteria in OMB Guidance Limit Agency Reporting

For purposes of assessing what programs and activities are at risk of improper payments, IPFA states that agency heads must review their agencies' programs and activities to determine those that are susceptible to significant improper payments. The law does not define susceptibility. In its implementing guidance, OMB directed that a program or activity is susceptible to significant improper payments if it meets two criteria—potential improper payments exceeding \$10 million and 2.5 percent of program payments. Therefore, both criteria must be met for an agency to subject the program to the later steps requiring the agency to estimate improper payments and address the various improper payment reporting requirements.

As I stated earlier, the information developed during a risk assessment forms the foundation upon which management can determine the nature and type of corrective actions needed. It also gives management baseline information for measuring progress in reducing improper payments. Thus, these assessment criteria affect how agencies identify, estimate, report on, and reduce those programs susceptible to significant improper payments. For example, of the 23 agencies that reported assessing all programs and activities, we found that 6 agencies limited their risk assessment reviews to only those programs that would likely meet OMB's definition of programs susceptible to significant improper payments. Two of these 6 agencies reported that they did not perform a comprehensive risk assessment for those programs with outlays of less than \$10 million because the programs would not have exceeded both of OMB's threshold criteria. The remaining 4 agencies did not perform a comprehensive risk assessment of programs with outlays ranging from \$40 million to \$200 million, generally citing the threshold criteria as the reason for their exclusion.

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<sup>32</sup>Department of Justice, United States Attorney's Office, Southern District of Texas, News Release, "Local Businessman Pleads Guilty to Conspiracy to Defraud Medicare of \$40 Million," May 30, 2006.

We also noted instances where agencies with large program outlays reported that their programs or activities were not susceptible to significant improper payments because the improper payment estimates only exceeded one of OMB's criteria for reporting improper payment information, another example of how OMB's criteria could materially affect the extent to which agencies report improper payment information in their PARs. From our review of the 57 agency programs and activities that were included in the total \$38 billion improper payment estimate, we identified 20 programs or activities that reported improper payment estimates exceeding \$10 million, but not 2.5 percent of program outlays. We also identified 1 program that reported an error rate exceeding 2.5 percent of program outlays, but not \$10 million. See table 2 for additional details.

**Table 2: Agency Improper Payment Estimates Included in the Governmentwide Total That Met One of the Two OMB Reporting Criteria**

	Department or agency	Program or activity	Program outlays (in millions)	Fiscal year 2005 improper payment estimate (in millions)	Fiscal year 2005 improper payment error rate (percentage)	Previous OMB Circular No. A-11 reporting requirements
1	Department of Agriculture	Marketing Assistance Loan Program (previously Commodity Loan Programs)	\$6,400.0	\$45.0	0.70	X
2		Federal Crop Insurance Corporation	3,170.0	28.0	0.89	
3		Farm Security and Rural Investment	1,027.0	16.0	1.55	
4	Department of Defense	Military Retirement Fund	35,700.0	49.3	0.14	X
5		Military Health Benefits	7,500.0	150.0	2.00	X
6		Military Pay	69,100.0	432.0	0.63	
7	Department of Education	Student Financial Assistance—Federal Family Education Loan	10,085.0	16.0	0.16	
8		Title I	12,520.0	149.0	1.19	X
9	Department of Energy	Payment programs	24,114.0	14.5	0.06	
10	Department of Health and Human Services	Head Start	6,865.0	110.0	1.60	X

				Fiscal year 2005 improper payment estimate (in millions)	Fiscal year 2005 improper payment error rate (percentage)	Previous OMB Circular No. A-11 reporting requirements
	Department or agency	Program or activity	Program outlays (in millions)			
11	Office of Personnel Management	Retirement Program (Civil Service Retirement System and Federal Employees Retirement System)	54,800.0	152.2	0.28	X
12		Federal Employees Health Benefits Program	29,400.0	196.5	0.67	X
13	Railroad Retirement Board	Retirement and Survivors Benefits	9,185.4	150.6	1.64	X
14	Small Business Administration	Small Business Investment Companies	1,568.2	10.5	0.67	X
15	Social Security Administration	Old Age and Survivors' Insurance	493,300.0	3,681.0	0.74	X
16		Disability Insurance <sup>a</sup>				X
17	Department of State	International Information Program-U.S. Speaker and Specialist Program	41.0	1.9	4.63	
18	Tennessee Valley Authority	Payment programs	7,080.0	36.3	0.05	
19	Department of Veterans Affairs	Compensation	28,960.0	322.9	1.12	X
20		Dependency and Indemnity Compensation <sup>a</sup>				X
21		Education programs	2,661.0	64.0	2.40	
Total			\$803,476.6	\$5,625.7		13

Source: GAO analysis of fiscal year 2005 PARs and annual reports.

<sup>a</sup>Agency combined with the above program.

We identified, in total, 21 programs or activities with improper estimates exceeding \$5.6 billion that meet only one of OMB's reporting criteria. Most of these program estimates greatly exceeded \$10 million and, without certain stipulations, could have avoided reporting improper payment information under OMB's reporting criteria. However, OMB has required that 13 of these 21 programs estimate improper payments regardless of dollar amount or error rate, because they had previous reporting

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requirements under OMB Circular No. A-11.<sup>33</sup> Nonetheless, if the Circular No. A-11 requirements did not apply or agencies decided not to voluntarily report on their improper payment estimates that were under OMB's reporting threshold, OMB's definition of significant improper payments could potentially mask the full scope of improper payments.

Although we do not know the extent of improper payments that are not reported, a limited number of agencies voluntarily provided information in their PARs that allowed us to determine the amount of improper payments for certain programs and activities that were excluded from the total improper payments estimate of \$38 billion for fiscal year 2005. For example, the Department of Education identified three programs with estimated improper payments exceeding \$10 million for each program, which totaled about \$155 million in improper payments. In light of OMB's criteria, because these estimates did not exceed 2.5 percent of program outlays, they were not included in the agency's total improper payment estimate. In another example, the Department of Defense (DOD) OIG reported<sup>34</sup> it had identified about \$23 million in improper payments related to the procurement of fuel at the Defense Energy Support Center during fiscal year 2005. DOD did not report this information in its PAR since the improper fuel payments did not exceed 2.5 percent of program payments.

As these examples illustrate, OMB's current criteria for identifying risk-susceptible programs limit the disclosure of valuable information that the Congress, the public, and others with oversight and monitoring interests need to hold agencies accountable for reporting and reducing improper payments. Thus, amending existing IPIA provisions to define risk-susceptible programs and activities, such as the use of a specific dollar threshold, would allow for more complete disclosure and transparency of governmentwide improper payment reporting and, in turn, would require OMB to revise its implementing guidance to reflect such amendments as well as align existing guidance with the intent of the act.

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<sup>33</sup>See footnote 8.

<sup>34</sup>Department of Defense, Office of Inspector General, *Financial Management: Improper Payments for Defense Fuel*, D-2006-094 (Washington, D.C.: June 29, 2006).



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## IPIA Definition of Improper Payments Excludes Certain Payments from Reporting

IPIA defines an improper payment as a payment that should not have been made or that was made in an incorrect amount (including overpayments and underpayments) under statutory, contractual, administrative, or other legally applicable requirements. This includes any payment to an ineligible recipient, any payment for an ineligible service, any duplicate payment, any payment for services not received, and any payment that does not account for credit for applicable discounts.

On August 28, 2003, OMB advised the Social Security Administration (SSA) on improper payment reporting. Under this advice, SSA was allowed to exclude from its estimate of improper payments those payments that it made following constitutional, statutory, or judicial requirements, even though those payments were subsequently determined to be incorrect. These payments were deemed by OMB to be “unavoidable” improper payments,<sup>35</sup> as there are no administrative changes SSA could implement that would eliminate such payments, nor would SSA be likely to receive other relief from such requirements.

As we previously reported,<sup>36</sup> although the definition of improper payments does not use the terms avoidable<sup>37</sup> or unavoidable, we agree with OMB that a payment that was made because of a legal requirement to make the payment subject to subsequent determinations that the payment is not due should not be included in an agency’s estimate of its improper payments. We agree with OMB’s conclusion not because it is an “unavoidable” payment but rather because it does not meet the definition of an improper payment under the act.

In its Supplemental Security Income (SSI) program, SSA disburses disability payments to recipients at the beginning of the month based on the income and asset levels recipients expect to maintain during the month.<sup>38</sup> If SSA initially determines that an overpayment occurred, court

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<sup>35</sup>OMB defines “unavoidable” payments as payments resulting from legal or policy requirements.

<sup>36</sup>GAO, *Post-Hearing Questions Related to Agency Implementation of the Improper Payments Information Act*, [GAO-05-1029R](#) (Washington, D.C.: Sept. 16, 2005).

<sup>37</sup>OMB defines “avoidable” payments as payments that could be reduced through changes in administrative actions.

<sup>38</sup>Some government programs pay benefits in advance under the assumption that the beneficiary’s circumstances, such as income and asset levels, will remain the same during the period for which payment was rendered.

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decisions<sup>39</sup> and language in the Social Security Act allow individuals to continue receiving the same amount of SSI benefits pending the results of a hearing to determine eligibility. If the initial determination is affirmed, the payments made during the hearing and appeals processes are considered overpayments, which SSA may recover using a variety of means.<sup>40</sup>

In this example, SSA, because of the statutory requirement, must make the payment. The statute requires SSA to make the payment until applicable due process requirements result in a determination that the person is ineligible; therefore, the mandatory payments whether subsequently deemed to be correct or incorrect, have not been made to an ineligible recipient at the time they were made. Accordingly, the facts would not support inclusion of these overpayments as improper payments as defined under IPIA. However, if as a result of the due process procedures, it is subsequently determined that the recipient is no longer eligible for benefits and SSA makes a payment subsequent to these procedures, that amount would be an improper payment.

Yet, we would not go so far as to conclude that any payment that is unavoidable should not be included as an improper payment under IPIA. Rather, the exclusion of payments should be made individually on a fact-specific basis using the definition provided in IPIA. In addition, we believe that agencies should track and monitor these types of payments as part of their debt collection efforts and have the ability to readily report this type of information upon request. OMB currently does not require SSA to report in its PAR details relating to these types of overpayments, nor does OMB require governmentwide reporting of these types of overpayments, thus the magnitude of this issue is unknown. Having agencies annually report on these types of overpayments would provide the Congress, agency management, and other decision makers valuable information with which to determine the extent of these types of overpayments and to make policy decisions, if needed, to appropriately address this issue.

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<sup>39</sup> *Cardinale v. Mathews*, 399 F. Supp. 1163 (D.D.C. 1975), and *Goldberg v. Kelly*, 397 U.S. 254 (1970).

<sup>40</sup> 42 U.S.C. §§ 423(g)(2) and 404.

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## Agencies' Reporting of Recovery Auditing Information Questionable

We noted discrepancies in selected agencies' reporting of recovery audit information and limited reviews over contract payments. As a result, reporting for recovery auditing information may not represent an accurate view of the extent of agencies' efforts. From our review of agencies' PARs and discussions with OMB, we determined that 21 agencies reported entering into contracts with a total value in excess of \$500 million and thus were subject to recovery auditing requirements under section 831 of the National Defense Authorization Act for Fiscal Year 2002. Generally, these agencies reported on their recovery auditing efforts, such as the amount identified for recovery and the amount recovered. However, we noted a few instances where the agency amount of contract costs identified for recovery was considerably lower than the corresponding OIG amount identified from current year audit reviews. These discrepancies raise questions as to whether the agency amount identified for recovery should have been much higher, thereby significantly decreasing the reported agency-specific and overall governmentwide high rate of recovery. We also noted that 5 of the 21 agencies did not review all of their agency components as part of their recovery audit efforts, and 2 agencies reported that recovery auditing was not cost beneficial.

Section 831 of the National Defense Authorization Act provides an impetus for applicable agencies to systematically identify and recover contract overpayments. The law authorizes federal agencies to retain recovered funds to cover in-house administrative costs as well as to pay contractors, such as collection agencies. Any residual recoveries, net of these program costs, are to be credited back to the original appropriation from which the improper payment was made, subject to restrictions as described in legislation. As we previously testified,<sup>41</sup> with the passage of this law, the Congress has provided agencies a much-needed incentive for identifying and recovering their improper payments that slip through agency prepayment controls.

Recovery auditing is a method that agencies can use to recoup detected improper payments. Recovery auditing is a detective control to help determine whether contractor costs were proper. Specifically, it focuses on the identification of erroneous invoices, discounts offered but not received, improper late penalty payments, incorrect shipping costs, and multiple payments for single invoices. Recovery auditing can be conducted

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<sup>41</sup>GAO, *Financial Management: Challenges Remain in Addressing the Government's Improper Payments*, [GAO-03-750T](#) (Washington, D.C.: May 13, 2003).

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in-house or contracted out to recovery audit firms. The techniques used in recovery auditing offer the opportunity for identifying weaknesses in agency internal controls, which can be modified or upgraded to be more effective in preventing improper payments before they occur for subsequent contract outlays.

Nonetheless, effective internal control calls for a sound, ongoing invoice review and approval process as the first line of defense in preventing unallowable contract costs. Given the large volume and complexity of federal payments and historically low recovery rates for certain programs, it is much more efficient to pay bills and provide benefits properly in the first place. Aside from minimizing overpayments, preventing improper payments increases public confidence in the administration of benefit programs and avoids the difficulties associated with the “pay and chase” aspects of recovering improper payments. Without strong preventive controls, agencies’ internal control activities over payments to contractors will not be effective in reducing the risk of improper payments.

For fiscal year 2005, OMB expanded the type of recovery auditing information that agencies are to report in their annual PARs. Prior to fiscal year 2005, agencies were only required to report on the amount of recoveries expected, the actions taken to recover them, and the business process changes and internal controls instituted or strengthened to prevent further occurrences. In addition, OMB was not reporting agencies’ recovery audit activities on a governmentwide basis in its annual report on agencies’ efforts to improve the accuracy and integrity of federal payments. In fiscal year 2005, OMB required applicable agencies to discuss any contract types excluded from review and justification for doing so. In addition, agencies were required to report, in a standard table format, various amounts related to contracts subject to review and actually reviewed, contract amounts identified for recovery and actually recovered, and prior year amounts.

Twenty-one agencies reported over \$340 billion as amounts subject to review for fiscal year 2005, while the contract amounts reviewed totaled over \$287 billion. In addition, the 21 agencies reported identifying about \$557 million in contracts for recovery, which represented less than two-tenths of a percentage of the \$287 billion amount reviewed. Of the \$557 million identified, agencies reported recovering \$467 million in improper payments, an 84 percent recovery rate. However, we found two instances where the agency amount of contract costs identified for recovery was considerably lower than the corresponding OIG amount identified from current year audit reviews. These discrepancies raise

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questions as to whether the agency amount identified for recovery should have been much higher, thereby significantly decreasing the agency-specific and overall high rate of recovery.

For example, for fiscal year 2005, NASA reported in its PAR that it had identified and recovered \$617,442 in contract payments, a 100 percent recovery rate. Yet, the NASA OIG reported<sup>42</sup> it had identified over \$515 million in questioned contract costs during fiscal year 2005. Of this amount, NASA management decided that \$51 million in contract costs should be pursued for recovery. When comparing the \$51 million in questioned contract costs identified for recovery to the \$617,442 NASA actually recovered, the recovery rate decreases from the reported 100 percent recovery rate to a 1.2 percent rate.<sup>43</sup> In another example, DOD reported in its PAR that it had identified for recovery \$473 million and recovered about \$419 million in contract payments, an 89 percent recovery rate. However, the DOD OIG reported<sup>44</sup> it had identified over \$2 billion in questioned contract costs as of September 30, 2005. When comparing the \$2 billion in questioned contract costs<sup>45</sup> to the \$419 million DOD actually recovered, the recovery rate significantly decreases from a reported 89 percent recovery rate to 21 percent.

These two discrepancies alone significantly decrease OMB's reported overall recovery rate of 84 percent to a 22 percent recovery rate. Other factors would also suggest the recovery rate is indeed much lower. We noted other instances where OIG-reported questioned costs exceeded agency contract amounts identified for recovery. Because these costs were

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<sup>42</sup>National Aeronautics and Space Administration, Office of Inspector General, *Semi-Annual Reports October 1, 2004-March 31, 2005 and April 1-September 30, 2005* (Washington, D.C.).

<sup>43</sup>We found that the recovery rate could have been higher than the 1.2 percent calculation had we solely used the OIG reported amounts regarding the universe of questioned contract costs and subsequent amounts recovered. Specifically, the OIG reported that of the \$51 million in questioned contract costs decided by NASA management, \$16 million had been recovered. This results in a recovery rate of about 31 percent. While this recovery rate is higher than our calculated 1.2 percent recovery rate, it is still significantly lower than the 100 percent recovery rate reported by NASA in its PAR.

<sup>44</sup>Department of Defense, Office of Inspector General, *Semi-Annual Reports October 1, 2004-March 31, 2005 and April 1-September 30, 2005* (Washington, D.C.).

<sup>45</sup>The OIG reported that the \$2 billion in contract costs were deemed questionable because they did not comply with rules, regulations, laws, contractual terms, or a combination of these. Thus, we used the entire \$2 billion to illustrate the disparity between what the OIG and agency reported.

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not specifically identified as contractor costs versus other payment types, we were unable to determine how much of the OIG-identified questioned costs related to contract costs.

In addition, another factor that may call into question the reported high recovery rate is that 5 of the 21 agencies did not review all of their agency components as part of their recovery audit efforts, and 2 agencies (HUD and Labor) reported that recovery auditing was not cost beneficial. For example, HUD determined that based on its review of \$206.6 million in contract payments, none were found to be improper. Thus, HUD determined that pursuit of an ongoing recovery auditing program was not cost beneficial or necessary. Because section 831 of the National Defense Authorization Act requires agencies to carry out a cost-effective program for identifying errors made in paying contractors and for recovering amounts erroneously paid to contractors, agencies have determined that they may opt out of conducting a recovery audit if it is not deemed to be cost beneficial. However, neither of the two agencies that determined it was not cost beneficial to conduct a recovery audit provided support in their fiscal year 2005 PARs for this determination.

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## GAO Recommendations for Continued Progress in Capturing the Full Extent of Improper Payments

Our November 2006 report included one matter for congressional consideration and four recommendations for executive action. Specifically, to ensure that the full extent of improper payments is being captured, the Congress should consider amending existing IPIA provisions to define specific criteria, such as a dollar threshold, agencies should use to identify which programs and activities are susceptible to significant improper payments, thereby triggering improper payment estimating and reporting requirements. In addition, to facilitate agencies' progress in ensuring accurate and complete improper payments and recovery auditing reporting, we recommended that OMB take several actions regarding (1) risk assessment methodologies and the level of detail necessary to meet the annual improper payment reporting requirements, (2) statistically valid estimates, (3) extent of payments agencies make under statute or judicial determinations that later are determined to be overpayments, and (4) agencies' rationale that recovery auditing is not cost beneficial.

OMB generally agreed with our recommendations and also agreed with our assessment that challenges remain in meeting the goals of IPIA. However, in a subsequent letter to GAO, OMB's Controller raised concerns about the report, including the timing of our analysis and report issuance, which I previously discussed in this testimony. In its original comments, OMB emphasized that progress in estimating and reporting improper

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payments had been made by agencies in fiscal year 2005 and highlighted initiatives under way to measure improper payments in other programs susceptible to significant improper payments. OMB pointed out that agencies estimated improper payments for 17 additional programs for fiscal year 2005, and that this number will increase by 10 programs for fiscal year 2006. OMB also said that beginning with fiscal year 2007, it expects HHS to begin reporting component error rates for its Medicaid, Temporary Assistance for Needy Families, and State Children's Health Insurance programs.

While we agree with OMB that there has been progress, we continue to question the validity of certain agencies' risk assessment methodologies used to identify, estimate, and report improper payments for all risk-susceptible programs and are concerned with how OMB defines high-risk programs for purposes of agencies' improper payment reporting. Our continuing concern with OMB's criteria relates to those agencies with large program outlays that have improper payment estimates that exceed the \$10 million threshold but not the 2.5 percent of program payments threshold. Applying the 2.5 percent threshold criteria to large programs could exclude potentially billions of dollars of improper payments from being reported.

According to OMB, the rationale for its threshold criteria is to ensure that agencies focus their resources on programs with the highest levels of risk for improper payments. OMB commented that going forward, it is now requiring agencies to track any programs that exceed the \$10 million threshold but have an error rate of less than 2.5 percent. OMB stated that this tracking facilitates a framework that would appropriately mitigate the risk that high-risk programs will be left out of IPIA reporting activities. We view this as a positive step. Although OMB's recently revised implementing guidance was outside the scope of our recent review, our preliminary assessment found no mention of this tracking requirement. The guidance does state that OMB may determine on a case-by-case basis that certain programs that do not meet the threshold requirements may still be subject to the annual PAR improper payment reporting requirement. In light of OMB's stated intention to require agencies to track such programs, we believe it is key that the revised implementing guidance clearly reflects this tracking requirement and that agencies be required to publicly report this information as part of their annual improper payments reporting. Visibility over this type of information would help facilitate the Congress's understanding of the nature and extent of the governmentwide improper payments problem.

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In closing, Mr. Chairman, improper payments are a serious problem. Agencies are working on this issue at different paces, and OMB has continued to provide important leadership. We recognize that measuring improper payments and designing and implementing actions to reduce them are not simple tasks and will not be easily accomplished. The ultimate success of the executive branch's effort to reduce improper payments depends, in part, on each agency's continuing diligence and commitment to meeting the requirements of IPIA and the related OMB guidance. Full and reasonable disclosure of the extent of the problem could be enhanced by modifying the act's underlying criteria used to identify which programs and activities are susceptible to significant improper payments. OMB's implementing guidance can also be strengthened in several key areas. With the ongoing imbalance between revenues and outlays across the federal government, and the Congress's and the American public's increasing demands for accountability over taxpayer funds, identifying, reducing, and recovering improper payments become even more critical. Fulfilling the requirements of IPIA will require sustained attention to implementation on the part of OMB and the agencies, as well as continued congressional oversight, such as this hearing today, to monitor whether desired results are being achieved.

Mr. Chairman, this concludes my prepared statement. I would be happy to answer any questions that you or other members of the Subcommittee may have at this time.

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## Contact and Acknowledgments

For further information about this testimony, please contact McCoy Williams at (202) 512-9095 or [williamsml@gao.gov](mailto:williamsml@gao.gov). Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this testimony. In addition to the above contacts, the following individuals made key contributions to this testimony: Carla Lewis, Assistant Director; Sharon Byrd; Francine DelVecchio; Francis Dymond; Lisa M. Galvan; Jacquelyn Hamilton; Christina Quattrociocchi; Donell Ries; and Chris Rodriguez.



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