

CRS Report for Congress

Improper Payments Information Act of 2002: Background, Implementation, and Assessment

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**Prepared for Members and
Committees of Congress**

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Summary

On November 26, 2002, the Improper Payments Information Act (IPIA) was signed into law as P.L. 107-300 (116 Stat. 2350). Augmenting previous financial management reform laws, the IPIA seeks to increase financial accountability in the federal government, and thus reduce wasteful spending. The law requires agencies to identify each year programs and activities vulnerable to significant improper payments, to estimate the amount of overpayments or underpayments, and to report to Congress on steps being taken to reduce such payments.

In May 2003, the Office of Management and Budget (OMB) issued guidance to agencies on the implementation of the IPIA, which was revised and incorporated into OMB Circular A-123 as Appendix C in August 2006. OMB's guidance, while consistent with some provisions of the IPIA, has been criticized on several counts. Whereas the statute requires agencies to report to Congress on all programs with more than \$10 million in estimated improper payments, OMB added an additional threshold, such that agencies must only report on programs with improper payments that exceed both \$10 million and 2.5% of total program payments. Critics have identified a number of examples of programs with improper payments over \$10 million that are not reported to Congress because they do not also meet the 2.5% threshold. In the 2006 update of its guidance, OMB stated that it may determine on a case-by-case basis that some programs are to be subject to annual Performance and Accountability Report requirements, even if they do not meet the 2.5% threshold.

OMB's guidance has also been criticized for permitting agencies to exempt some programs from the IPIA's annual requirement for risk assessment. Under the act, every program and activity is to be reviewed each year. OMB's guidance, however, now allows agencies to review a program once every three years if it has been deemed low-risk. Critics say this runs counter to the language and intent of the IPIA, and that it leaves open the possibility that improper payments might go undetected during the exemption period.

For FY2007, OMB reported a government-wide error rate of 3.5%. This figure does not cover an estimated 16% of at-risk outlays — about \$292 billion — which lack improper payment estimates and are not yet reflected in the error rate, including a number of major programs. Until valid estimates become available for all risk-susceptible programs, the full extent of the improper payments problem will remain unknown.

On January 31, 2008, S. 2583, the Improper Payments Elimination and Recovery Act of 2008, was introduced. On July 30, 2008, the Senate Committee on Homeland Security and Governmental Affairs by voice vote ordered that S. 2583, with a substitute amendment, be reported favorably. A companion bill, H.R. 5467, was introduced on February 14, 2008, but no further action has occurred.

This report will be updated as events may warrant.

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Improper Payments Information Act of 2002: Background, Implementation, and Assessment

Background

Legislative History and Intent

On November 26, 2002, the Improper Payments Information Act (IPIA) was signed into law as P.L. 107-300 (116 Stat. 2350). Augmenting previous financial management reform laws, the IPIA is intended to increase financial accountability in the federal government, and thereby reduce wasteful spending. The law requires agencies to identify each year programs and activities vulnerable to significant improper payments, to estimate the overpayments or underpayments exposure, and to report on steps taken to reduce such payments. As explained more fully below, improper payments generally include any payment that should not have been made or was made for an incorrect amount.

Previously, there was no government-wide requirement for agencies to estimate or report in any systematic way on improper payments, although it is generally acknowledged that billions of dollars are involved. The Office of Management and Budget (OMB) estimated, for example, that in FY2005, improper payments under 47 federal programs totaled approximately \$37.3 billion.¹

The IPIA was introduced in the 107th Congress as H.R. 4878 on June 6, 2002, by Representative Stephen Horn, with a group of bipartisan cosponsors, and referred to the House Committee on Government Reform. The Subcommittee on Government Efficiency, Financial Management, and Intergovernmental Relations held a markup on the measure on June 18, 2002, and approved the bill, as amended, by unanimous voice vote. On July 9, 2002, H.R. 4878 was considered under a suspension of the rules and passed the House, as amended, by voice vote. On October 9, 2002, the Senate Committee on Governmental Affairs ordered H.R. 4878 to be reported favorably, with a substitute amendment. On October 17, 2002, the bill, as amended, passed the Senate by unanimous consent, and on November 12, under a suspension of the rules, the House agreed to the Senate amendment by voice

¹ Testimony of Clay Johnson III, Deputy Director for Management, Office of Management and Budget, U.S. Congress, Statement before Senate Subcommittee on Federal Financial Management, Government Information, and International Security, *An Assessment of Improper Payment Information Act of 2002*, hearings, 109th Cong., 2nd sess., December 5, 2006, at [[http://hsgac.senate.gov/_files/ClayJohnsonTestimony05Dec2006Improper Payments.pdf](http://hsgac.senate.gov/_files/ClayJohnsonTestimony05Dec2006ImproperPayments.pdf)].

vote. The President signed H.R. 4878 into law on November 26, 2002 (P.L. 107-300).

The problem of improper payments had received attention in previous Congresses. During House floor debate on H.R. 4878, Representative Horn noted that hearings held in the past “clearly demonstrated the need” for such legislation.

Since the 104th Congress, the subcommittees I have chaired have held approximately 100 hearings on wasteful spending within the Federal Government. Time and again witnesses from the General Accounting Office and agency inspectors general have told the subcommittee that poor accounting systems and procedures have contributed to the government’s serious and long-term problems involving improper payments.²

In the written report of the Senate Committee on Governmental Affairs to accompany H.R. 4878, the provisions of the bill were explicitly linked to GAO recommendations offered in a best practices guide for agencies in managing improper payments, prepared at the request of the committee chairman, Senator Joseph Lieberman. The guide suggested that determining the nature and extent of risks for improper payments was a crucial step; H.R. 4878 would begin the process of improving the management of improper payments, following GAO’s guidance, “by requiring that agencies annually estimate the amount of improper payments, and report on the steps they are taking to reduce the amounts of those payments in the largest programs.”³

Major Provisions

The IPIA directs each executive branch agency, in accordance with OMB guidance, to review all its programs and activities each year, identify those susceptible to significant improper payments, and estimate the amount of improper payment exposure. Agencies are then to report annually to Congress on improper payments, using a standardized methodology determined by OMB.⁴

With respect to any program or activity with estimated annual improper payments exceeding \$10 million, each agency is also required to provide a report on agency actions to reduce such improper payments, including (1) the causes of the

² Rep. Stephen Horn, “Debate on H.R. 4878,” remarks in the House, *Congressional Record*, daily edition, vol. 148 (July 9, 2002), p. H4379.

³ See General Accounting Office, *Strategies to Manage Improper Payments*, GAO-02-69G, October 2001. Cited in U.S. Congress, Senate Committee on Governmental Affairs, *Improper Payments Information Act of 2002*, report to accompany H.R. 4878, 107th Cong., 2nd sess., S.Rept. 107-333 (Washington: GPO, 2002), p. 2.

⁴ The IPIA originally set a deadline of March 31 for agencies to report to Congress on their improper payments in the prior fiscal year. The improper payments reports are now included in the performance and accountability reports, or PARs, due to the President (via OMB) and Congress 45 days after the close of an agency’s fiscal year, generally November 15. See OMB Circular A-136, “Form and Content of the Performance and Accountability Report (PAR),” at [<http://www.whitehouse.gov/OMB/bulletins/b01-09.pdf>].

improper payments and the results of the actions taken to address them; (2) whether the agency has information systems and other necessary infrastructure to reduce such payments to “minimal cost-effective levels”; (3) if not, budgetary resources requested to accomplish needed changes in information systems and infrastructure; and (4) steps the agency has taken to ensure that managers are held accountable for reducing improper payments.

Improper payment is defined as any payment that should not have been made or that was made in an incorrect amount. This includes duplicate payments, payments to ineligible recipients or for ineligible services, or for services not received or that do not reflect applicable discounts. The act covers payments made by a federal agency, a federal contractor, or a governmental or other organization administering a federal program or activity.

Previous Improper Payment Efforts

The IPIA codified and expanded efforts already underway in the executive branch to reduce improper payments. In 2001, the Bush Administration designated improving financial performance as one of five government-wide initiatives in the President’s Management Agenda (PMA). The establishment of a baseline on the extent of erroneous (improper) payments for major federal benefit programs was a key component of the financial management initiative.⁵ Agencies were to include information on erroneous payment rates for benefit and assistance programs over \$2 billion as part of their FY2003 budget submissions. In July 2001, revisions to OMB Circular A-11 in Section 57 implemented this objective, requiring 15 federal agencies to include improper payment information with their initial FY2003 budget materials to OMB. Enactment of the IPIA extended improper payment reporting requirements to all executive branch departments and agencies, lowered the threshold from \$2 billion to \$10 million, and designated Congress (as well as OMB) to receive the annual agency reports.

Implementation

Initial Guidance From OMB

In May 2003, OMB distributed a guide to instruct agencies on the implementation of the IPIA.⁶ The guide provided detailed definitions of “improper” or “erroneous” payments and of “program” and “activity,” and then outlined four

⁵ See U.S. Office of Management and Budget (OMB), *The President’s Management Agenda — FY2002* (Washington: OMB, 2001), pp. 19-21. For an overview of the PMA, see CRS Report RS21416, *The President’s Management Agenda: A Brief Introduction*, by Virginia A. McMurtry.

⁶ OMB, “Improper Payments Information Act of 2002 (Public Law 107-300),” Memorandum for Heads of Executive Departments and Agencies from Mitchell E. Daniels, May 21, 2003, M-03-13. IPIA guidance was subsequently revised and incorporated into Appendix C of OMB Circular A-123.

steps to be taken by the agencies. First, agencies were required to review systematically all their programs and activities and identify those which are susceptible to significant erroneous payments, defined as “annual erroneous payments in the program exceeding both 2.5% of the program payments and \$10 million.” Second, agencies were to determine an annual estimated amount of erroneous payments made in those programs and activities found susceptible to significant errors; this calculation was to be based on a statistical random sample sufficiently large “to yield an estimate with a 90 percent confidence interval” within 5% precision. The third step was to determine why the particular programs were at risk, and then put in place a plan to reduce the erroneous payments. The last step was agency reporting to the President (via OMB) and Congress on the estimates of the annual amount of erroneous payments in its programs and activities and on progress in reducing them.

Revision of OMB Circular A-123

In the summer of 2006, OMB issued a new appendix to OMB Circular A-123,⁷ updating the guidance in M-03-13. Appendix C, titled “Requirements for Effective Measurement and Remediation of Improper Payments,”⁸ contained two parts; the first addressed IPJA reporting and the second, recovery auditing.⁹ It began with new language, expanding and clarifying the definition of an improper payment:

An improper payment is any payment that should not have been made or that was made in an incorrect amount under statutory, contractual, administrative, or other legally applicable requirements. Incorrect amounts are overpayments and underpayments (including inappropriate denials of payment or services). An improper payment includes any payment that was made to an ineligible recipient or for an ineligible service, duplicate payments, payments for services not received, and payments that are for the incorrect amount. In addition, when an agency’s review is unable to discern whether a payment was proper as a result of insufficient or lack of documentation, this payment must also be considered in error.¹⁰

Other noteworthy features in the update included provisions for alternative sampling methodologies, reporting requirements for certain low risk programs, and guidance for federal agencies that fund state-administered programs. The revision also contained a best practices listing for preventing, identifying, detecting, and recovering improper payments. Finally, while the definition of “significant erroneous

⁷ See OMB, *Management’s Responsibility for Internal Controls*, Circular No. A-123 revised, December 21, 2004, at [http://www.whitehouse.gov/omb/circulars/a123/a123_rev.pdf].

⁸ See OMB, “Requirements for Effective Measurement and Remediation of Improper Payments,” Appendix C to OMB Circular A-123, August 10, 2006, available at [http://www.whitehouse.gov/omb/circulars/a123/a123_appx-c.pdf]. Hereafter, Appendix C.

⁹ Recovery auditing is designed to identify and then recoup erroneous payments by reviewing large volumes of purchase and contract records using ongoing, systematic procedures for data analysis.

¹⁰ Appendix C, p. 2.

payments” found in the previous OMB guidance was retained, A-123 Appendix C provided elaboration: “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 reporting requirement. This would most likely occur in programs with relatively high annual outlays.”¹¹

Scorecard Standards and Ratings

The Bush Administration designated Eliminating Improper Payments (EIP) as a separate program initiative in the PMA in 2004.¹² Under the EIP initiative, which is ongoing, 15 federal agencies receive quarterly scorecard ratings from OMB for their efforts to identify, eliminate, and recover improper payments.¹³ The scorecard uses a stoplight rating system of green for success, yellow for mixed results, and red for unsatisfactory. Agencies are rated against six EIP “standards for success,” or core criteria (listed below). If an agency meets all six of the criteria, it receives a “green” rating; if it meets the first four criteria, but not the fifth and sixth, it is rated “yellow;” and if an agency fails to meet any one of the first four criteria it is rated “red.” The criteria an agency must meet to “get to green” in the EIP initiative include the following:

- Have a risk assessment in place that identifies all programs that are at significant risk of improper payments;
- Have an OMB-approved plan for measuring improper payments on an annual basis and meet milestones established in the plan;
- Have an OMB-approved corrective action plan that includes reduction targets;
- Be in compliance with improper payments reporting requirements;
- Demonstrate that improper payments are being reduced consistent with reduction targets; and
- Have established improper payment recovery targets, and show it is actively meeting these targets.¹⁴

¹¹ Ibid., p. 4. An example is given of a program with \$10 billion in annual outlays and a 1% error rate (below the 2.5% error rate threshold), yet resulting in \$100 million in improper payments. In such an instance, OMB may require that the program be designated as high risk and included in the agency’s annual PAR (as a part of IPRA reporting).

¹² See discussion in *Fiscal Year 2006 Budget of the U.S. Government* (Washington: GPO, 2005), p. 54. OMB, *Improving the Accuracy and Integrity of Federal Payments*, January 25, 2005, p. i, at [http://www.whitehouse.gov/results/agenda/ipia_govt_wide_report.pdf].

¹³ The 15 agencies that receive scorecard ratings for Eliminating Improper Payments are: the Departments of Agriculture, Defense, Education, Health and Human Services (HHS), Homeland Security (DHS), Housing and Urban Development (HUD), Labor, Transportation (DOT), Treasury, and Veterans Affairs (VA); and the Environmental Protection Agency (EPA), the National Science Foundation (NSF), the Office of Personnel Management (OPM), the Small Business Administration (SBA), and the Social Security Administration (SSA). Acronyms cited are used in **Figure 1**.

¹⁴ The White House, *Scorecard Standards for Success*, available at [<http://www.whitehouse.gov/results/agenda/standardsforsuccess08-2007.pdf>].

As indicated in **Figure 1**, results in the initial round for the EIP scorecards, released December 31, 2004, indicated that no agencies received “green,” five were “yellow,” and 10 were “red.”¹⁵ By June 30, 2008, the scorecard showed that five agencies were “green” in status, eight agencies were “yellow,” and two were “red.” In three and a half years, the number of agencies receiving green increased from zero to five, and the number of agencies receiving red declined from 10 to two. The first agency to attain green was the Department of Housing and Urban Development (HUD) on the June 2005 scorecard, joined the next quarter by the Department of Labor. The only agency to receive red grades throughout the period depicted was the Department of the Treasury.

Further examination of the data in **Figure 1**, however, discloses a more complicated picture. For example, the first three quarters in FY2007 had the same totals for the red (two), yellow (nine), and green (four) grades. Yet, there were noteworthy changes from the March to June 2007 ratings: HHS advanced from red to yellow, while DHS slipped from yellow back to red.

With respect to the most recent scorecards depicted in **Figure 1**, the grades recorded for June 30, 2007, and September 30, 2007, were identical, as were the grades for December 31, 2007, and March 31, 2008. During the last four quarters, HUD slipped from green to yellow for December 2007 and March 2008, but had returned to green by June 30, 2008. The only other change during this period was the movement of SBA from yellow to green. One might arguably suggest that many of the agencies (8 out of 15) are experiencing some difficulty in progressing from yellow to green in the scorecards.

The up and down arrows in **Figure 1** indicate a change in grade from the previous quarter. During the 15 quarters covered, there were 19 instances where an agency’s grade changed from one quarter to the next. Most of the changes (16) reflect an improvement in rating, with the National Science Foundation (NSF) jumping from red to green in the final quarter of 2005 (hence the double arrows). On the other hand, there were four instances when an agency’s grade was lowered from one quarter to the next. The Department of Veterans Affairs (VA) received four yellows followed by four greens and then slipped back to yellow for the last three quarters. The Small Business Administration (SBA) started with red, advanced to yellow for four quarters and then to green for three quarters, but slipped back to yellow for the three quarters, before returning to green. The DHS went from four reds to six yellows, and then, for the last five quarters entered in the chart, regressed back to red.

In addition to the “current status” grades (provided in **Figure 1**), OMB, since 2005, also has given the agencies a grade for “progress in implementation.”¹⁶ These

¹⁵ Ibid., *Scorecard - December 31, 2004*, at [<http://www.whitehouse.gov/results/agenda/200412scorecard.pdf>].

¹⁶ Since the quarter ending December 31, 2004, was the first quarter for which agency efforts in the eliminating improper payments initiative were rated, there were no progress scores given. Electronic versions of scorecards for progress in implementation grades are (continued...)

ratings have been predominantly green from the outset (for the quarter ending March 31, 2005, 11 green and four yellow). For the quarters ending December 31, 2005, and March 31, 2006, all agencies included in the scorecard received green, except for the Department of the Treasury.¹⁷ For the next six quarters, either two, three, or four agencies received a yellow grade, but the group of agencies not receiving green varied somewhat from quarter to quarter. By June 30, 2007, there was just one yellow (Treasury), but for the first time, an agency (DHS) received a red grade for progress in implementation. In the September 2007 scorecard, DHS had moved back up to green; the only yellow was for Treasury. The same ratings (14 green and 1 yellow) appeared in the December 2007 scorecard. By March 2008, two more agencies (Education and DHS) were back in the yellow category, and the scorecard for June 30, 2008, remained unchanged from the previous quarter.

It is not clear that how useful scorecard ratings are as indicators of agency results in eliminating improper payments. While OMB's standards for success overlap with IPFA objectives, the scorecard ratings themselves do not appear to be tightly linked to improper payments rates or amounts. The Department of Labor (DOL), for example, improved from a "yellow" rating at the start of FY2005 to a "green" by the end of that fiscal year, even though its error rate increased during that time.¹⁸ Similarly, the Department of Housing and Urban Development (HUD), received a "green" rating in each quarter of FY2006, despite reporting nearly \$1.5 billion in improper payments that year.¹⁹ Under the present scorecard grading system, then, an agency may receive the highest rating even when its error rate increases, or when the dollar value of its improper payments reaches into the billions. As discussed in more detail below, an apparent increase in error rate or total amount of improper payments due an agency may actually reflect "progress" in identifying risk-susceptible programs and achieving viable estimates for more programs.

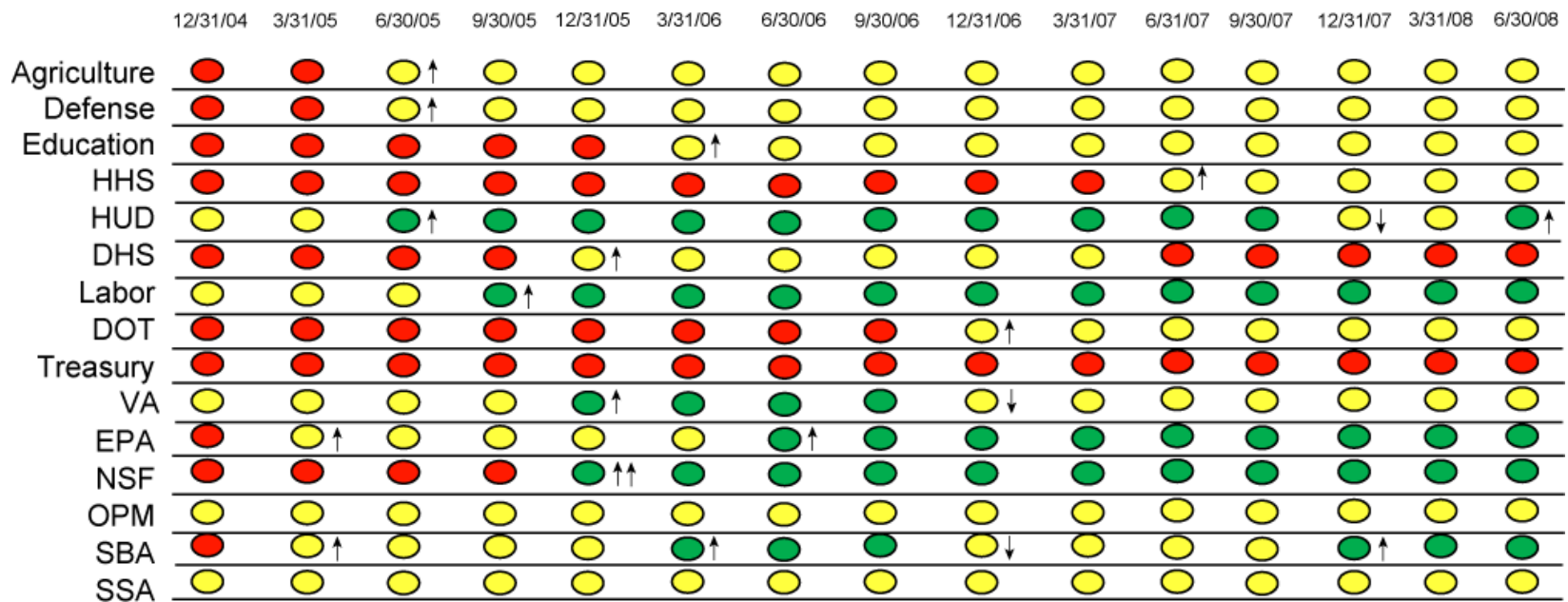
¹⁶ (...continued)

available at [<http://www.whitehouse.gov/results/agenda/scorecard.html>].

¹⁷ The Department of the Treasury did receive a grade of green for progress in implementation for the quarter ending March 31, 2005, but subsequently has consistently been rated as yellow.

¹⁸ OMB, *Improving the Accuracy and Integrity of Federal Payments*, January 31, 2007 at [http://www.whitehouse.gov/omb/financial/reports/2007_ipia_report.pdf].

¹⁹ Ibid.

Figure 1. Eliminating Improper Payments Initiative's Quarterly Scorecards, FY2004-FY2008

Source: Office of Management and Budget. Electronic version of scorecards available at [<http://whitehouse.gov/results/agenda/scorecard.html>].

Trends in Improper Payments

Since IPIA reporting began for FY2004, OMB has published aggregate improper payments data in an annual report titled “Improving the Accuracy and Integrity of Federal Payments.”²⁰ **Table 1** shows government-wide improper payments rates and totals for the first four years of IPIA reporting.

Table 1. Improper Payment Trends, FY2004-FY2007

(in millions)

	Federal Outlays ^a	Improper Payments	Error Rate
FY2004	\$1,035,308	\$45,077	4.4%
FY2005	\$1,224,920	\$38,472	3.1%
FY2006	\$1,394,027	\$40,588	2.9%
FY2007	\$1,561,752	\$54,984	3.5%

Source: Office of Management and Budget, *Improving the Accuracy and Integrity of Federal Payments*, January 31, 2008.

- a. Column does not represent total federal outlays, but only includes outlays that (1) have been determined to be at risk and (2) have improper payments estimates. See the Federal Outlays section for more information.

Error Rate

The data in **Table 1** show that the error rate declined in each of the two fiscal years after the government-wide baseline for improper payments was established in FY2004, then increased in FY2007. In its 2007 report, OMB suggested that the declining error rate between FY2004 and FY2006 was largely due to two factors: a reduction in improper payments reported under the Medicare Fee-for-Service program, and low improper payment rates among the programs that reported for the first time in either FY2005 or FY2006.²¹ GAO has argued that, while improper payments have declined significantly under the fee-for-service component of Medicare, that was not necessarily a consequence of improved accountability of program dollars, but rather was due largely to “refinements” in the way HHS calculated the program’s improper payments estimate.²²

²⁰ OMB’s annual improper payments report is issued in the January or February following the end of the fiscal year that it covers. It is made available to the public through OMB’s website, at [http://www.whitehouse.gov/omb/financial/fia_improper.html].

²¹ Medicare is comprised of a fee-for-service component (Parts A and B), a managed care component (Part C), and a prescription drug benefit component (Part D).

²² Testimony of McCoy Williams, GAO Director of Financial Management and Assurance, *Improper Payments: Agencies’ Efforts to Address Improper Payment and Recovery Auditing Requirements Continue*, U.S. Congress, Senate Subcommittee on Federal Financial Management, Government Information, Federal Services, and International Security,

(continued...)

The overall error rate increased from 2.9% in FY2006 to 3.5% in FY2007. The increase was driven by the relatively high error rate — 12.4% — of the 14 programs reported for the first time in FY2007. Programs in the FY2007 cohort issued \$128 billion in risk-susceptible payments, of which \$15.9 billion were deemed improper. Just one of these programs, the Medicaid Fee-for-Service program, with \$70 billion outlays and an error rate of 18.4%, accounted for \$12.9 billion in improper payments.

Error rate reductions are evident, however, when one compares the rates for programs reporting in FY2004 with the rates for this same group of programs in subsequent years. **Table 2** shows how the error rates for programs first reported in previous fiscal years declined in FY2007.

Table 2. Cohort Error Rates, FY2004-FY2007

Year First Reported	FY2004 Error Rate	FY2005 Error Rate	FY2006 Error Rate	FY2007 Error Rate
FY2004	4.4%	3.4%	3.2%	3.1%
FY2005		1.0%	2.0%	1.1%
FY2006			1.4%	0.5%
FY2007				12.4%
Overall	4.4%	3.1%	2.9%	3.5%

Source: Office of Management and Budget, *Improving the Accuracy and Integrity of Federal Payments*, January 31, 2008.

According to OMB’s assessment in the January 2008 report, the majority of improper payment errors reduced in the last four years resulted from agencies “ensuring the availability of supporting documentation necessary to verify benefit accuracy. This type of improvement provides greater confidence in the accuracy of Federal payments.” With respect to the remaining payment errors, they resulted from “challenges when verifying recipient eligibility in means-tested programs.” While documentation errors generally are not associated with incorrect payments, “eligibility errors result in beneficiaries receiving an incorrect amount of funds.”²³

Amount of Improper Payments

The data in **Table 1** also show that the dollar amount of the government’s improper payments declined in FY2005, and then increased in FY2006 and FY2007. The initial decrease was the result of reductions in improper payments under Medicare, and the increase in FY2006 was largely due to the \$1.57 billion jump in

²² (...continued)

hearings, 110th Cong., 1st sess, March 29, 2007, GAO-07-635T.

²³ OMB, *Improving the Accuracy and Integrity of Federal Payments*, January 31, 2008, p. ii, at [http://www.whitehouse.gov/omb/financial/reports/2008_ipia_report.pdf].

estimated improper payments under USDA's Marketing Loan Assistance Program.²⁴ In FY2007, the amount of improper payments grew by \$14.4 billion, with two newly reported programs accounting for most of the increase: Medicaid Fee-for-Service (\$12.9 billion in improper payments) and National School Lunch (\$1.4 billion in improper payments). That the fluctuation of improper payments can be driven by changes in individual programs is indicative of the concentrated nature of the problem. In FY2007, for example, nine programs accounted for 90.2% of reported improper payments, and just three programs — Medicare Fee-for-Service, Medicaid Fee-for-Service, and the Earned Income Tax Credit — accounted for 63.7% of all reported improper payments that year.²⁵

Federal Outlays

The federal outlays data in **Table 1** represent the amount of risk-susceptible dollars for which federal agencies have developed improper payments estimates. In FY2007, agencies had estimates in place for approximately \$1.56 trillion out of \$1.85 trillion (84%) in total at-risk outlays. Compared to FY2004, this represents a \$526 billion increase in risk-susceptible expenditures with estimates in place. It also indicates, however, that 16% of at-risk outlays — about \$292 billion — lacked improper payment estimates. A number of major programs are among those lacking estimates, including the State Child Health Insurance Program (SCHIP), Temporary Assistance for Needy Families (TANF), and Medicare Prescription Drug Benefit (Part D). In the 2008 report, OMB noted that delays in reporting error measurement in remaining programs occur because “many State-administered programs are subject to complex regulatory guidelines that need to be followed before conducting error measurements.” For example, agencies need to receive feedback from program recipients about “viable alternatives for measuring error. Consequently, development of a national and statistically valid error measurement can take months and even years to complete.”²⁶ Until all these programs have estimates, however, the full extent of the improper payments problem will remain unknown.

Continuing Concerns

Reporting Threshold

There has been criticism of OMB's definition of “*significant* [emphasis added] improper payments.” In addition to the \$10 million threshold in estimated improper spending established by the statute, OMB required that the improper payments represent at least 2.5% of total program payments. The Chairman and Ranking

²⁴ Ibid.

²⁵ Ibid. The nine programs that accounted for 90.2% of FY2007 reported improper payments were Medicare Fee-for-Service, Medicaid Fee-for-Service, Earned Income Tax Credit, Unemployment Insurance, Supplemental Security Income, Food Stamps, Public Housing/Rental Assistance, National School Lunch, and Old-Age, Survivors, and Disability Insurance.

²⁶ OMB, *Improving the Accuracy and Integrity of Federal Payments*, January 31, 2008.

Minority Member of the House Subcommittee on Government Efficiency and Financial Management, Representative Todd Platts and Representative Marsha Blackburn, sent a letter to OMB in August 2003 questioning the 2.5% minimum threshold. Likewise, according to a news article, Senators Charles Grassley and Max Baucus, then the Chairman and Ranking Minority Member of the Senate Finance Committee, stated in a January 9, 2004, letter to then OMB Director Joshua Bolten that OMB should not have established the 2.5% threshold and should have simply required that agencies report all programs generating estimated improper payments of more than \$10 million. The Senators reportedly observed that, by adding the 2.5% threshold, “The improper payments figures that will eventually be reported to the public will look better and feel better than they really are....”²⁷

According to GAO, the 2.5% threshold could mask the extent of the improper payments problem. In a 2006 report reviewing agency PARs from FY2005, GAO identified many examples of agency programs with estimated improper payments over \$10 million that were not included in the agency’s improper payments estimate because they did not meet the 2.5% threshold.²⁸ For example, GAO said that the Department of Education did not report on three programs that each had estimated improper payments exceeding \$10 million — \$155 million in total — because in each case those payments represented less than 2.5% of program outlays.²⁹ If the 2.5% criterion were applied to large programs, GAO concluded, billions of dollars in improper payments could go unreported.³⁰ OMB has defended the 2.5% threshold, stating it was established “to ensure that agencies were focusing their resources on programs with the highest levels of risk for improper payments.”³¹

As noted above, revised IPIA guidance, issued by OMB in 2006 as Appendix C to Circular A-123, addressed this issue to some extent. Language in the updated version stated explicitly that OMB could require a large program with relatively high annual outlays, but that failed to meet the 2.5% criteria, to be considered as high risk and included in the agency’s annual IPIA reporting. Such a determination, however, would be done by OMB on a case-by-case, nonmandatory basis. The clarification in Appendix C, arguably, thus may be viewed as not going far enough by some in Congress who in the past have taken issue with OMB’s addition of the 2.5% prerequisite.

²⁷ Cited by Amelia Gruber, “OMB Defends Actions on Improper Payments,” *GovExec.com*, January 14, 2004.

²⁸ GAO, *Improper Payments: Agencies’ Fiscal Year 2005 Reporting Under the Improper Payments Information Act Remains Incomplete*, GAO-07-92, December 2006, pp. 41-45.

²⁹ *Ibid.*, p. 44.

³⁰ *Ibid.*, p. 54.

³¹ Letter from Linda Combs, OMB Controller, to McCoy Williams, GAO Director of Financial Management and Assurance, October 26, 2006.

Annual Review Exemption

As previously described, the IPIA requires agencies to review all their programs and activities each year to determine whether they are at risk for significant improper payments. OMB's 2006 revised guidance, however, permits agencies to exempt programs from the annual review requirement (which OMB refers to as a risk assessment) for two years if a program is determined not to be risk susceptible. Thus, if a program were reviewed in 2007 and deemed not at risk, then the program would not have to be reviewed again until 2010.³² At a hearing on improper payments held in March 2007, McCoy Williams, Director of Financial Management and Assurance at GAO, testified that OMB had discussed the proposed changes with GAO prior to issuing the revised guidance. According to the witness, "We [at GAO] advised OMB that the provision to perform risk assessments every 3 years for those programs not deemed risk-susceptible was inconsistent with the IPIA requirement for agencies to review all programs and activities annually."³³

OMB's exemption from the IPIA's annual review requirement might exacerbate the consequences of inaccurate risk assessments. Agencies are still refining their procedures for identifying risk-susceptible programs. In some cases, improvements in risk assessment methods have resulted in programs being designated as risk susceptible that previously had been considered low-risk. The Department of Agriculture (USDA), for example, enhanced its risk assessment methodology in FY2006, and, as a consequence, it determined that four programs were susceptible to significant improper payments that year which had been considered low-risk the previous year.³⁴ USDA reported that those four programs had total outlays of \$12.8 billion and had issued a combined \$804 million in improper payments.³⁵ While OMB praised the agency for identifying "previously undetected" improper payments, USDA could have claimed OMB's annual review exemption for the four programs after determining they were low-risk in FY2005.³⁶ Had it done so, USDA would not have been required to re-assess those programs until FY2008, and hundreds of millions of dollars in improper payments might have gone undetected for another two years.

In addition, the exemption has been applied not just to individual programs, but, to entire agencies. In FY2007, four agencies reported that they did not conduct new

³² OMB's guidance would require a program to be re-assessed if it experienced a significant legislative change or a major increase in funding, even if that assessment would occur less than three years from the last risk assessment.

³³ Testimony of McCoy Williams, March 29, 2007, GAO-07-635T, p. 6.

³⁴ The four programs were Direct and Counter-Cyclical Payments, Conservation Reserve Program, Farm Service Agency (FSA) Disaster Programs, and the Non-insured Assistance Program. U.S. Department of Agriculture, "Improper Payment and Recovery Auditing Details," *FY2006 Performance and Accountability Report*, November 15, 2006, at [<http://www.ocfo.usda.gov/usdarpt/pdf/par09.pdf>].

³⁵ Ibid.

³⁶ OMB, *Improving the Accuracy and Integrity of Federal Payments*, January 31, 2007, p. 4.

risk assessments, on the grounds that previous risk assessments had determined no new programs were risk-susceptible, and therefore they could claim OMB's three-year exemption for the entire agency.³⁷ In this way, agencies might use OMB guidance to declare themselves exempt from certain IPIA requirements.

Federal Government's Use of Recovery Auditing

In 2002, Congress included in Section 831 of the National Defense Authorization Act (P.L. 107-107) provisions requiring agencies to identify, and attempt to recover, overpayments to contractors. These provisions — commonly referred to as the Recovery Auditing Act — apply to agencies that enter into contracts valued at \$500 million or more in a fiscal year. Agencies are allowed to use recovered funds to offset the cost of recovery activities, including the use of private sector firms or other agencies. Any remaining recovered funds are to be credited back to the original appropriation, or deposited in the Treasury as miscellaneous receipts, if the appropriation is no longer available.

OMB's guidance on recovery auditing requires agencies to establish policies and procedures (internal controls) that prevent, detect, and recover overpayments to contractors resulting from payment errors.³⁸ OMB also requires agencies to report on their recovery auditing efforts in their PARs. In addition to data on the amount of contracts reviewed, the amount of improper payments identified, and the amounts recovered, agency reporting must include a description of recovery audit activities, a corrective action plan to address the root causes of payment error, and a description of any management improvement program carried out by the agency. OMB, in turn, includes data on agency recovery audit efforts in its annual IPIA report.

The data provided by OMB show that since recovery auditing activities began in FY2004, federal agencies have recovered only half of the \$1.699 billion in improper payments identified for recovery. To put it another way, the government has yet to recover almost \$850 million in erroneous payments to contractors. The recovery rate varies widely among the agencies, ranging from a high of 100% at the Environmental Protection Agency and the Department of Commerce, to a low of 0.5% at the Department of Homeland Security (DHS). The low recovery rate at DHS is significant, as the department has only recovered \$2.4 million out of \$506.0 million in erroneous payments. Moreover, GAO has raised concerns about the quality of recovery efforts to date at DHS, and has called for DHS management to increase its oversight and monitoring of recovery auditing efforts across the

³⁷ Testimony of McCoy Williams, GAO Director of Financial Management and Assurance, *Improper Payments: Agencies' Efforts to Address Improper Payment and Recovery Auditing Requirements*, U.S. Congress, Senate Subcommittee on Federal Financial Management, Government Information, Federal Services, and International Security, hearings, 110th Cong., 2nd sess., Jan. 31, 2008, GAO-08-438T. The agencies were the General Services Administration, the Department of Health and Human Services (HHS), the Department of the Interior, and the National Science Foundation.

³⁸ OMB, "Requirements for Effective Measurement and Remediation of Improper Payments," Appendix C to OMB Circular A-123, August 10, 2006.

department.³⁹ The Department of Defense (DOD) had a recovery rate of 69.5% in FY2007, but because of the prodigious value of its contracts (totaling \$723 billion from FY2004-FY2007), it has \$262 million in erroneous payments it has yet to recover.⁴⁰ Thus, DOD and DHS account for 90% of the \$850 million in erroneous payments to contractors that the government has identified, but not recovered.

Congressional Oversight

The House Subcommittee on Government Efficiency and Financial Management held oversight hearings on improper payments in May and July 2003, as did the House Subcommittee on Government Management, Finance, and Accountability in July 2005 and April 2006.⁴¹ In the Senate, the Subcommittee on Federal Financial Management, Government Information, and International Security held improper payments hearings in July 2005, and in March and December 2006.⁴²

Hearings in the 110th Congress. On March 29, 2007, the Senate Subcommittee on Federal Financial Management, Government Information, Federal Services, and International Security, reformulated after the 2006 elections, held a hearing titled “Eliminating and Recovering Improper Payments.”⁴³ In addition to testimony from McCoy Williams of GAO, referred to above, three other witnesses appeared at the hearing.⁴⁴ On January 31, 2008, the subcommittee held another

³⁹ GAO, *Department of Homeland Security: Challenges in Implementing the Improper Payments Information Act and Recovering Improper Payments*, GAO-07-013, Sept. 2007, pp. 28-32, at [<http://www.gao.gov/new.items/d07913.pdf>].

⁴⁰ OMB, *Improving the Accuracy and Integrity of Federal Payments*, Jan. 31, 2008, p. 34.

⁴¹ U.S. Congress, House Committee on Government Reform, Subcommittee on Government Efficiency and Financial Management, *Show Me the Tax Dollars — How Much Is Lost to Improper Payments Each Year?*, hearing, 108th Cong., 1st sess., May 13, 2003 (Washington: GPO, 2003); and *ibid.*, *Show Me the Tax Dollars Part II — Improper Payments and the TennCare Program*, July 14, 2003 (Washington: GPO, 2003); and *ibid.*, Subcommittee on Government Management, Finance, and Accountability, *Implementing the Improper Payment Information Act - Are We Making Progress?* 109th Cong., 1st sess., July 20, 2005, at [http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=109_house_hearings&docid=f:26655.pdf]; and *ibid.*, *The Improper Payments Information Act — Are Agencies Meeting the Requirements of the Law?*, April 5, 2006.

⁴² U.S. Congress, Senate Subcommittee on Federal Financial Management, Government Information, and International Security, *Improper Payments: Where Are Truth and Transparency in Federal Financial Reporting?*, hearing, 109th Cong., 1st sess., July 12, 2005 (Washington: GPO, 2005); and *Reporting Improper Payments: A Report Card on Agencies' Progress*, hearing, March 9, 2006, at [<http://hsgac.senate.gov/index.cfm?Fuseaction=Hearings.Detail&HearingID=329>]; and *An Assessment of the Improper Payments Information Act of 2002*, hearing, December 5, 2006.

⁴³ U.S. Congress, Senate Subcommittee on Federal Financial Management, Government Information, Federal Services, and International Security, *Eliminating and Recovering Improper Payments*, hearing, 110th Cong., 1st sess., March 29, 2007, at [<http://hsgac.senate.gov/index.cfm?Fuseaction=Hearings.Detail&HearingID=431>].

⁴⁴ The other witnesses were David Norquist, Chief Financial Officer, Department of (continued...)

hearing focused on “Eliminating Agency Payment Errors.” McCoy Williams again appeared for GAO, and Daniel Werfel, Acting Controller, testified for OMB.⁴⁵

Mr. Williams indicated that his testimony was based on a GAO report sent to the subcommittee the previous week,⁴⁶ and that, despite the improvements to date, challenges continue with respect to IPIA implementation. Mr. Williams outlined five specific problems. One issue is the comprehensiveness of agencies’ risk assessments. Despite the IPIA requirement for an annual review of all agency programs that may be susceptible to significant improper payments, the review of 2007 PARs by GAO indicated that not all agencies reported conducting risk assessments. Some agencies reported that they did not conduct a risk assessment of all their programs, since “OMB guidance allows agency programs deemed not risk-susceptible to conduct a risk assessment generally every three years.”⁴⁷

A second problem, according to GAO, relates to the inclusiveness of improper payment estimates. GAO found that estimates have not been developed for all of the programs identified as risk-susceptible for improper payments. The \$55 billion improper payment estimate for FY2007 did not cover 14 programs with FY2007 outlays totaling approximately \$170 billion. A third challenge cited by GAO involves IPIA noncompliance issues. A few auditors reported on IPIA compliance problems as a part of their audits of an agency’s FY2007 financial statements. According to GAO, these noncompliance issues “related to the key requirements of the act, including risk assessments, sampling methodologies, implementing corrective actions, recovering improper payments, and inadequate documentation.”⁴⁸ Another omission in some of the agency reports involved the absence of discussion on possible statutory or regulatory barriers impeding agencies’ ability to reduce improper payments. The fifth problem relates to management challenges in the design or implementation of necessary internal controls, which are critical in efforts to identify improper payments and prevent them in the future.

Daniel Werfel, OMB’s Acting Controller, also testified at this 2008 Senate subcommittee hearing. He noted three important trends in the IPIA data from FY2004 through FY2007. First, agencies are expanding the universe of high-risk

⁴⁴ (...continued)

Homeland Security; Timothy B. Hill, Chief Financial Officer, Centers for Medicare and Medicaid Services; and Lee White, Executive Vice President, PRG-Schultz, Inc.

⁴⁵ A second panel at the hearing consisted of four officials from federal agencies, including the Chief Financial Officer from the Department of Agriculture, and witnesses from the Federal Communications Commission, the Department of Health and Human Services, and the Social Security Administration. Testimony available at [<http://hsgac.senate.gov/public/index.cfm?Fuseaction=Hearings.Detail&HearingID=07ef1211-d286-4e99-87fb-b67deaf9debf>], visited Aug. 2008.

⁴⁶ GAO-08-377R

⁴⁷ *Eliminating Agency Payment Errors*, p. 7. This matter has been a point of continuing disagreement between OMB and GAO since the addition of Appendix C to OMB Circular A-123 in 2006.

⁴⁸ *Ibid.*, p. 14.

programs that are measured each year. Second, agencies are moving forward toward “closing all reporting gaps so that the full extent of government-wide improper payments” will be known within a few years. Third, after an agency “has identified and reported payment errors, it is able to implement corrective actions and reduce those errors in subsequent years.” Mr. Werfel, in reviewing these trends, stated that after four years of IPIA implementation, “agencies generally have the tools in place to ensure that all high risk activities are identified and measured.” Agencies do not, however, “currently have the full complement of tools they need” to eliminate improper payments.⁴⁹

Mr. Werfel then suggested three strategies to address this deficiency. First, maximize the impact of program integrity dollars. In other words, concentrate efforts on the higher risk, larger dollar amount programs; nine programs account for 90% of the FY2007 government-wide improper payment total. Second, address challenges in eligibility verification. Such errors accounted for about 80% of total improper payment errors in FY2007. Third, Mr. Werfel supported enactment of specific program reforms recommended by the Administration, most recently being re-proposed in the President’s FY2009 budget.⁵⁰

There has not been an oversight hearing focused exclusively on the IPIA in the House during the 110th Congress. On June 3, 2008, however, the Subcommittee on Government Management, Organization, and Procurement, held a hearing titled “Oversight of Federal Financial Management.”⁵¹ Testimony provided by OMB reviewed the status of financial reporting government-wide, as well as at the agency level. Mr. Werfel then referred to other improvement initiatives, including reducing improper payments. He praised Congress for taking a step toward enacting some reforms supported by OMB, “including discretionary funding (above the cap) for activities with a proven track record of reducing error and generating program savings” in the FY2009 budget resolution (S.Con.Res. 70).⁵²

Legislation to Amend the IPIA in the 110th Congress. On the same day as the hearing mentioned above, Senator Tom Carper, chairman of the subcommittee, introduced S. 2583, the Improper Payments Elimination and Recovery Act of 2008.⁵³

⁴⁹ Testimony of Daniel Werfel before the Senate Subcommittee on Federal Financial Management, Government Information, and International Security, Jan. 31, 2008, p. 2. Statement at [http://hsgac.senate.gov/public/_files/WerfelFINAL.pdf], visited Aug. 2008.

⁵⁰ Ibid., pp. 2-4. The program reforms supported by the Administration were included as an attachment to this OMB testimony. A measure incorporating these reforms has yet to be introduced in the 110th Congress.

⁵¹ With respect to other witnesses at the hearing, a witness from GAO addressed the FY2007 U.S. Government Financial Statements, and a DOD spokesman testified on the department’s efforts in financial management modernization. Statements available at [<http://governmentmanagement.oversight.house.gov/story.asp?ID=1982>]

⁵² Statement of Daniel Werfel before the House Subcommittee on Government Management, Organization, and Procurement, June 3, 2008, p. 4.

⁵³ Sen. Tom Carper, “Statement on Introduction of S. 2583,” remarks in the Senate, (continued...)

On July 30, 2008, the Senate Committee on Homeland Security and Governmental Affairs by voice vote ordered that S. 2583, with an amendment in the nature of a substitute, be reported favorably.

S. 2583, as reported, would amend the IPIA to expand and strengthen ongoing efforts to identify, reduce, and recover improper payments due the federal government. For example, the threshold for agency heads to identify programs as “susceptible to significant improper payments” would be broadened, creating the likelihood that more agencies would have to report on additional programs, while the floor for program expenditures subject to recovery auditing would be lowered. Expanded reporting requirements regarding corrective action to be taken would be placed on the agencies and OMB. Agency inspectors general would be newly tasked with the responsibility of preparing annual compliance reports, and these would be included with the annual financial statements. A time-tiered approach for remediation of an agency’s noncompliance status would be established, ranging from submission of a corrective action plan to Congress to mandatory submission of reauthorization proposals, which, if not approved by Congress, would trigger a freeze in level of authorizations. S. 2583 as reported also would allow the OMB director to establish pilot programs on compliance enforcement to test potential accountability mechanisms along with incentives or penalties to ensure statutory compliance with law and, ultimately, elimination of improper payments.

In the House, a companion bill, H.R. 5467, was introduced on February 14, 2008, but no further action has occurred.

⁵³ (...continued)

Congressional Record, daily edition, vol. 154 (Jan. 31, 2008), pp. S544-S547.