U.S. Department of Agriculture

Office of Inspector General
Midwest Region

Audit Report

USDA's Progress To Implement the Improper Payments Information Act of 2002

Report No. 50601-0010-Ch
February 2006

UNITED STATES DEPARTMENT OF AGRICULTURE
OFFICE OF INSPECTOR GENERAL
Washington, D.C. 20250

DATE: February 13, 2006

REPLY TO
ATTN. OF: 50601-0010-Ch

TO: Charles Christopherson
Chief Financial Officer

FROM: Robert W. Young /s/
Assistant Inspector General
for Audit

SUBJECT: USDA's Progress to Implement the Improper Payments Information Act of 2002

Reducing improper payments continues to be a priority of Congress and a major focus of the President's Management Agenda. The Office of Inspector General (OIG) identified this as one of six management challenges confronting the Department of Agriculture (USDA) because of problems identified in our audits and because the breadth and complexity of the Department's programs and delivery systems make fulfillment of this initiative difficult.

Our fiscal year (FY) 2004 review of the Department's implementation of the Improper Payments Information Act of 2002 (IPIA) disclosed that the work performed and results generated by the agencies were ineffective in providing the information necessary to ascertain if improper payments were being made and to what extent. Risk assessments, which are to be conducted to establish the susceptibility of programs to improper payments, were not conducted in a meaningful manner. As a result, only six of 179 programs were identified as "high risk," and five of those were identified independently by the Office of Management and Budget (OMB), requiring statistical projections of dollar losses and remediation plans. We attributed this poor performance to weak Departmental guidance.

We recommended, and the Office of the Chief Financial Officer (OCFO) promptly agreed, that the risk assessment process be significantly strengthened through a measure that would quantify evidence as to a program's degree of susceptibility for improper payments. We provided OCFO with a detailed description in our audit report as to how this methodology should be conducted. We also assisted the Department by providing training to the agencies. The caliber of OCFO's revised guidance was so high that OMB sought to share it with other Departments. We note that OCFO's efforts, in our view, have been laudable throughout the process.

In FY 2005, we reviewed five agencies' implementation of the OCFO strengthened guidance. Although we identified improvements, we concluded that, in general, the five agencies had not fully implemented the guidance. This was attributed to the individual agencies not establishing controls over the risk assessment process to ensure adherence to the instructions. As a result, the five agencies could not support their conclusions that the nine programs we reviewed were at low risk for improper payments.

In our opinion, not prescribing controls that provide reasonable assurance IPIA requirements were met indicates management's attention and commitment to this critical area is questionable. Although USDA added five new programs as high risk in FY 2005, only two of those were supported by risk assessments (the remaining three were based on the judgment of agency officials). For USDA to fulfill its responsibilities under a law devised to save and safeguard taxpayers' assets and foster efficiency in Government operations, considerable management attention is warranted.

To emphasize the USDA's commitment to identifying and reducing improper payments, we recommend that you meet with the Under and Assistant Secretaries to ensure upper management's oversight of the risk assessment process. Attached is our letter report detailing the status of agencies' activities in fulfilling OMB's requirements for the high risk programs.

cc:
Charles F. Conner
Deputy Secretary

Attachment
USDA's Progress to Implement the Improper Payments Information Act of 2002
50601-10-Ch
February 2006

BACKGROUND

The Improved Financial Performance section of the President's Management Agenda of 2002 (PMA), issued in 2001, emphasized the need to identify erroneous payments and to set goals to reduce those payments. In order to establish a baseline of improper payments across the Government, agencies were to include, beginning with their 2003 budget submissions, information on actual and target improper payment rates, where available, for benefit and assistance programs over $2 billion. The Office of Management and Budget's (OMB) Circular A-11, *Preparation and Submission of Budget Estimates for 2001 and 2002*, Section 57, instructed agencies with specially identified programs to submit estimated improper payment data, assessments of agency efforts to minimize improper payments, and action plans to correct and prevent those payments with their initial budget submissions for FYs 2003 and 2004. Four USDA programs were subject to OMB requirements: FNS' Food Stamp Program (FSP), National School Lunch and Breakfast Program (NSLP), and Special Supplemental Nutrition Program for Women, Infants, and Children (WIC); and the Farm Service Agency's (FSA) Commodity Loan Program (now known as the Marketing Assistance Loan Program).

In September 2004,[1] we issued an audit report on FNS compliance with the OMB requirements. We reported that FNS had provided improper payment estimates for the FSP but had not provided any quantitative information regarding improper payments in the NSLP and WIC programs. At the time of the audit, FNS had only begun to develop plans to estimate improper payments in the NSLP and WIC. FNS officials were concerned that they lacked statistically valid nationwide estimates for those programs. However, we found that FNS could have used available information from numerous sources—such as OIG audits, contracted studies, and internal reviews, qualified as necessary—to establish baseline information on improper payments in response to OMB's data requests.

In November 2002, the President signed the Improper Payments Information Act of 2002 (IPIA), which expanded the prior reporting requirements to include all programs that may have significant improper payments. The Act required agencies to annually review all programs and activities and identify those that may be susceptible to significant improper payments and to then estimate the annual amount of those payments. Agencies were to report to Congress those programs and activities where the annual estimated improper payments exceeded $10 million. In May 2003, OMB issued guidance to agencies for estimating and reporting improper payments, including a provision that agencies base their estimates on valid statistical samples.[2] OMB defined significant improper payments as those exceeding an annual threshold of $10 million and 2.5 percent of program payments.[3]

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[1] Food and Nutrition Service Compliance with Improper Payments Reporting Requirements, Report No. 27601-0032-Ch, dated September 2004.
[2] Implementation Guidance for the Improper Payments Information Act of 2002, Public Law 107-300.
[3] See OMB Memorandum M-03-13, dated May 21, 2003.

The OMB guidance also required agencies to report, beginning in the FY 2004 Performance and Accountability Report (PAR), an annual estimated amount for all programs identified with significant improper payments. Within USDA, OCFO was designated as the lead agency for coordinating and reporting the Department's efforts to implement the IPIA. OCFO provided instructions to agencies in August and October 2003.

In FY 2004, we reviewed the OCFO's actions to implement the IPIA, specifically its role in assessing the Department's programs for the risk of improper payments. We conducted audits in six agencies[4] to determine whether their risk assessments were performed in compliance with the IPIA and the implementing guidance of OMB and OCFO.[5] We found that risk assessments performed by the six agencies were not adequate to determine their programs' susceptibility to improper payments. As a result, we recommended that OCFO issue more prescriptive, detailed guidance to help agencies properly assess and report the risk of improper payments in their programs. OCFO concurred with our recommendation to strengthen its guidance and agreed to monitor the agencies' implementation of the new guidance, which was issued in November and December 2004.

The revised guidance detailed a process for the agencies to follow in performing risk assessments, including tests of transactions, to support their determinations regarding their programs' risk for improper payments. OCFO also provided a template for the agencies to use to make the risk assessment process uniform. In addition, OCFO hosted monthly meetings, to which all agencies were invited, to discuss IPIA issues and any problems encountered with the revised guidance.

OBJECTIVES

The objective of this audit was to assess USDA agencies' efforts to implement OCFO's revised guidance regarding improper payment reporting requirements, including (1) the agencies' actions to conduct risk assessments of selected programs and report results to OCFO, and (2) the agencies' conclusions that the programs were at low risk for improper payments. We also requested information from the 6 agencies regarding their actions to quantify the extent of improper payments and implement corrective actions for the 11 USDA programs determined to be at significant risk for improper payments.

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[4] The six agencies were Cooperative State Research, Education and Extension Service; Farm Service Agency; Natural Resources Conservation Service; Rural Business-Cooperative Service; Rural Housing Service, and Rural Utilities Service.

[5] USDA Compliance with the Improper Payments Information Act of 2002, Report No. 50601-0008-Ch, dated January 2005.

SCOPE AND METHODOLOGY

We performed the audit at USDA Headquarters in Washington, D.C. We obtained the revised guidance OCFO provided to agencies in November and December 2004, as well as the risk assessments for 286 programs that agencies had submitted to OCFO as of April 30, 2005. We performed cursory reviews of the risk assessments for 86 of the largest programs, representing 42.5 percent of the total estimated dollar outlays. We relied on OCFO's color-coded ranking of the programs based on the FY 2005 estimated outlays.[6]

For the 86 risk assessments, we analyzed the vulnerability criteria, outlay dollars, and the extent and adequacy of the risk assessment documentation provided to OCFO. Based on this review, we selected nine programs in five agencies and visited the selected agencies to review their risk assessments and supporting documentation. The 9 programs had estimated outlays totaling $13.2 billion for FY 2005 and represented 31 percent of the estimated outlays for the USDA programs that fell into OCFO's top 3 categories for program outlays. (See exhibit A for a list of the programs audited.) The results of our audits are summarized here and were reported to the appropriate agencies through individual audit reports.

In addition, for those programs determined to be at high risk for improper payments, we requested an update from the appropriate agencies on their actions to comply with the IPIA, and the OMB and OCFO guidance. We requested information on the agencies' efforts to (1) quantify program error rates and the dollar value of the errors, including a timeline for completion of the actions, and (2) their implementation of corrective actions to reduce the errors. Although we did not audit the information received from the agencies, we have included a summary of the status of the high-risk programs in this report.

This audit was conducted during the period July through September 2005. The audit was performed in accordance with *Government Auditing Standards*.

FINDINGS AND RECOMMENDATIONS

We found that all five of the agencies included in our review need to strengthen controls to ensure they fully comply with OCFO guidance for implementing the IPIA. Although OCFO provided the agencies with detailed written guidance, supplemented by monthly meetings to provide further assistance, the agencies did not collect and analyze sufficient evidence in performing their risk assessments. As a result, the agencies were not able to fully support their decisions that the nine programs we reviewed were, in fact, at low risk for improper payments.

In regard to the Department's 11 high-risk programs, officials from the responsible agencies reported to us that they have completed the required statistical samples for 7 of the high-risk programs, with the remaining 4 statistical samples expected to be completed between 2006 and 2009.

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[6]OCFO divided the programs into six categories: Blue - $0-10 million; Green - $10-50 million; Orange - $51-200 million; Purple - $200-400 million; and Black-$400 million+. The final category, known as "Red Programs," was established for those programs already designated by agencies as high risk.

<u>Risk Assessment Documentation Did Not Support Low Risk Rankings</u>

Our audit disclosed that agencies lacked documentation to support their conclusions that the nine programs we reviewed were at low risk for improper payments. Specifically, we found that transactions were not always tested in sufficient numbers to provide reliable information as to the adequacy of internal controls to deter improper payments; the scope of the tests performed could not be determined from the support maintained by the agencies; and the results of the tests were not always analyzed to determine their impact on improper payments. We attributed this to a general lack of controls over the risk assessment process to ensure that it adheres to OCFO's guidance. While we are unable to conclude that the programs reviewed are susceptible to significant improper payments, we concluded that the agencies' risk assessment documentation is not sufficient to support their rankings of the programs as low risk.

As a result of our previous audit,[7] OCFO officials revised their IPIA guidance to provide more detailed instructions to USDA agencies. The guidance directs agencies to work with their program, financial, internal review, budget, and performance management staff to complete risk assessments; list the internal controls in place to prevent improper payments for each of the vulnerabilities identified; and test a judgmentally selected sample of transactions. The test of transactions is intended to provide quantitative evidence of the adequacy of the design and functionality of internal controls in place to mitigate improper payments. According to the OCFO guidance, the sample of transactions tested should be sufficiently large to support the agency's assertion that internal controls are working, and agencies should use their professional expertise to determine the appropriate sample size. Testing performed as part of a program's quality assurance process is acceptable, including State reviews, program reviews, and other compliance or internal reviews.

We found that none of the risk assessments reviewed included an adequate test of transactions – a key provision of the revised OCFO guidance. For instance, FSA tested only 22 payments from a universe of over 13.7 million payments nationally for both the Direct and Counter-Cyclical Programs and did not segregate the few transactions tested by program. The Rural Business-Cooperative Service (RBS) did not provide information on the number of loans tested or the universe from which they were selected. We could not determine the scope of the Rural Housing Service (RHS) and Rural Utilities Service (RUS) tests of transactions because the tests performed for RHS' Community Facility Direct Loan Program included guaranteed loans in addition to direct loans and the tests for RUS' Water and Waste Grant Program included loans in addition to grants. In neither case could we determine the type of transaction tested or the universe from which they were selected. We also noted that the Cooperative State Research, Education and Extension Service's (CRSEES) test of transactions did not cover the post-award phase; this was necessary to assess controls over the actual use of the grant funds.

[7] USDA Compliance with the Improper Payments Information Act of 2002, Report No. 50601-0008-Ch, dated January 2005.

Further, FSA, RBS, RHS, and RUS had not assessed the results of their tests of transactions to determine their impact on improper payments. For example, the documented results of FSA's test of transactions for the Direct and Counter-Cyclical Programs did not confirm that 8 of the 22 payments tested were correct. Similarly, FSA could not locate documentation on 11 of the 25 transactions tested for the Crop Disaster Program. We also found that FSA tested the transactions by recalculating the payments based on the forms received from field offices rather than verifying that the information on the forms was accurate and the individual was actually eligible for the amount of payment received.

In the most serious example of the agencies' failure to follow OCFO guidance, FSA's risk assessments concluded that the four programs we reviewed were at low risk for improper payments, even though the risk assessment documentation reported that audits and FSA's own County Operations Reviews would have supported a high risk rating. FSA officials stated that they decided to rank the programs as low risk because the tests of transactions did not disclose significant deficiencies in program controls. However, the FSA official responsible for the risk assessments told us that he decided to rank these programs as low risk because of his personal knowledge and experience with the programs. Although management's experience and knowledge can be useful, OCFO guidance specifies that the determination of a program's risk for improper payments should be based on a formal assessment of the vulnerabilities the program is exposed to and the internal controls that exist to mitigate those vulnerabilities, and their effectiveness confirmed by tests of transactions.

We also found that the agencies did not fully integrate their own internal reviews of program compliance into the risk assessment process. For example, FSA officials have established compliance activities in virtually all of their programs, as they mentioned in the risk assessments provided to OCFO, yet they did not compile those results and analyze them to determine whether any improper payments were disclosed. We reported this condition to FSA officials over a year ago and, in response to a recently issued audit report, they agreed to integrate internal reviews into the process. Risk assessment officials in the other agencies also cited internal reviews in their risk assessments, but they did not obtain, analyze, and maintain the results of those reviews in their files. As a result, they could not support the decisions they made based on this information.

Officials of the agencies audited gave various reasons for the problems described above. We were informed that sufficient staff was not assigned to conduct the risk assessments; responsible staff members were unaware of requirements or incorrectly believed they met requirements when they did not; managers used personal knowledge and experience to make determinations; and managers complained that resources had not been made available to meet the IPIA mandate. In our opinion, not prescribing controls that provide reasonable assurance IPIA requirements were met indicates managements' attention and commitment to this critical area is questionable.

Recommendation

We recommend that you meet with the Under Secretaries to emphasize the importance of the risk assessment process as part of the PMA—specifically, the need to support conclusions made in the risk assessment and to establish the methods and measures necessary to perform a credible job.

Future Audit Efforts

The Department had 11 programs that agencies have determined are at high risk for improper payments. (See exhibit B). We contacted the six agencies responsible for those programs and requested information on each agency's progress in performing a statistical sample of the programs and estimating the amount of improper payments annually. We did not perform audit work to verify agency officials' responses or the validity of their sampling processes.

Five of the agencies—FNS FSP, Forest Service (FS), FSA, Natural Resources Conservation Service (NRCS), and RHS—reported that they had performed the statistical sampling as required for a total of seven of the high-risk programs, with estimated outlays of $37.4 billion. The error rates ranged between 0.3 percent and 5.88 percent, and the improper payments identified by the agencies totaled over $1.5 billion, with FNS' FSP accounting for 90 percent of that amount. Four of the agency managers also identified the causes of the improper payments and the corrective actions they planned to take to mitigate them.[8] Of the seven programs, agency officials (FSA) reported that the statistical sampling results projected to be less than $10 million for two programs. As a result, the agency is not required to develop corrective action plans for these programs.

FNS and the Risk Management Agency (RMA) had not performed statistical sampling for the four other high-risk programs—FNS' Child and Adult Care Food Program (CACFP), NSLP, and WIC, and RMA's FCIC Fund—to establish program error rates and identify improper payment dollar amounts. The four programs had estimated outlays totaling $18.9 billion. FNS officials reported to us that they started to sample the WIC program for vendor error and they reported to OMB that results for all three programs will be available between 2006 and 2009, although they did note that the WIC certification error measurement and a nationally representative study for CACFP was dependent on funding being available. RMA revised its methodology for determining program error rates in 2005. The new process includes a random sampling of program policies, and the first results will be available in 2006.

As mentioned earlier, we only requested an informational update from the agencies; we did not audit their statistical sampling processes or the information provided. However, we plan to conduct an audit of the agencies' efforts to comply with IPIA requirements for these high-risk programs next.

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[8] FSA had recently completed statistical sampling for its three high-risk programs. The contractor that performed the FSA sampling included recommendations for each program tested, but FSA management did not report to us regarding the corrective actions they planned to take for the MAL program for which improper payments were estimated in excess of $10 million.

Exhibit A – PROGRAMS AUDITED

AGENCY	PROGRAM	AUDIT NUMBER
Cooperative State Research, Education and Extension Service (CSREES)	Extension Activities: Smith-Lever Act Section 3 (b) & (c) Funds	13601-0001-Ch
Farm Service Agency (FSA)	Direct Payment Program	03601-0013-Ch
FSA	Crop Disaster – USA Program	Same
FSA	Conservation Reserve Program	Same
FSA	Counter-Cyclical Payments Program	Same
Rural Business-Cooperative Service (RBS)	Business and Industry Guaranteed Loan Program	34601-0004-Ch
Rural Housing Service (RHS)	Direct Community Facility Loan Program	04601-0011-Ch
RHS	Section 502 Rural Housing Loan (Direct) Program	Same
Rural Utilities Service (RUS)	Water and Waste Grant Program	09601-0001-Ch

Exhibit B – Status of High Risk Programs

AGENCY	PROGRAM	STATISTICAL SAMPLE PERFORMED	PERCENTAGE ESTABLISHED (ERROR RATE)	DOLLAR ERROR IDENTIFIED
FNS	Food Stamp Program	Yes	5.88%	$1,381,200,000
FNS	Child and Adult Care Food Program	No	N/A	N/A
FNS	National School Lunch/Breakfast Program	No	N/A	N/A
FNS	Special Supplemental Nutrition Program for Women, Infants and Children Program	No	N/A	N/A
FS	Wildland Fire Management Suppression Program	Yes	3.27%	$65,000,000
FSA	Marketing Assistance Loan Program	Yes	0.7%	$44,800,000
FSA	Milk Income Loss Contract Program	Yes	0.3%	$664,000
FSA	Loan Deficiency Program	Yes	0.8%	$4,500,000
NRCS	Farm Security and Rural Investment Programs	Yes	1.54%	$15,800,000
RHS	Rental Assistance Program (Section 521 Rental Assistance)	Yes	2.59%	$20,088,000
RMA	FCIC Program Fund	No	N/A	N/A
TOTAL				$1,532,052,000

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