

**GAO**

Testimony

Before the Subcommittee on Government  
Efficiency and Financial Management,  
Committee on Government Reform,  
House of Representatives

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**FINANCIAL  
MANAGEMENT**

**Challenges Remain in  
Addressing the  
Government's Improper  
Payments**

Statement of McCoy Williams, Director  
Financial Management and Assurance





Highlights of [GAO-03-750T](#), a report to Subcommittee on Government Efficiency and Financial Management, Committee on Government Reform, House of Representatives

## Why GAO Did This Study

The Subcommittee asked GAO to testify on the Improper Payments Information Act (PL-107-300) and related draft guidance issued by the Office of Management and Budget (OMB), and on GAO recommendations to agencies on actions they can take to prevent or reduce improper payments.

## FINANCIAL MANAGEMENT

# Challenges Remain in Addressing the Government's Improper Payments

## What GAO Found

Improper payments are a longstanding, widespread, and significant problem in the federal government. Agency financial statements for both fiscal years 2002 and 2001 identified improper payment estimates of approximately \$20 billion. OMB recently testified that the amount of improper payments was closer to \$35 billion annually for major benefit programs. As significant as these amounts are, they do not represent a true picture of the magnitude of the problem governmentwide because they do not consider other significant but smaller programs and other types of agency activities that could result in improper payments.

Until recently OMB guidance did not require or offer agencies a comprehensive approach to measuring improper payments, developing and implementing corrective actions, or reporting on the results of the actions taken. Improper payment information varied across agencies and programs and included a mixture of estimated improper payment rates and actual improper payments, and was reported inconsistently in a variety of places, including annual financial statements, performance reports, and the federal budget. None of these reporting mediums provided a comprehensive view of either the scope of the improper payment problem or of individual agency or government efforts to reduce it.

We are seeing increased leadership and actions—both from the Congress and the administration—to address the improper payment problem.

Two recent pieces of legislation provide an impetus for all agencies to systematically address improper payment activity on an annual basis and to identify and recover contract overpayments. To illustrate this, the Improper Payments Information Act of 2002 requires agency heads to annually review all programs and activities that they administer and identify those susceptible to improper payments. For those with estimates of significant improper payments, the legislation requires further analysis and reporting. The National Defense Authorization Act for fiscal year 2002 contains a provision that requires agencies entering into sizeable contracts to carry out a cost recovery program for improper payments made to contractors.

OMB has taken some actions to address our prior improper payment-related recommendations. For example, it has issued draft guidance for agency use in identifying and reporting on improper payments within their programs and activities. Further, preliminary follow up work on our prior recommendations shows a wide range of agency activities regarding improper payment identification and reporting. Some agencies have implemented detailed action plans while others are in the early stages of such work. OMB and the agencies need to continue to work to identify and measure improper payments, set performance goals, implement corrective actions, and report results against those goals.

[www.gao.gov/cgi-bin/getrpt?GAO-03-750T](http://www.gao.gov/cgi-bin/getrpt?GAO-03-750T).

To view the full report, including the scope and methodology, click on the link above. For more information, contact McCoy Williams at 202-512-6906 or [williamsm1@gao.gov](mailto:williamsm1@gao.gov).

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Mr. Chairman and Members of the Subcommittee:

Thank you for the opportunity to discuss the governmentwide improper payment problem. Specifically, I will discuss leadership actions taken by the Congress and the Office of Management and Budget (OMB) to address this problem, and I will highlight the results of our work in this area over the past few years that address actions agencies can undertake to prevent or reduce improper payments.

In general, improper payments are payments the government made in error and often result from a lack of or inadequate systems of internal controls. We use the term improper payments to include inadvertent errors such as duplicate payments and miscalculations; payments for unsupported or inadequately supported claims, payments for services not rendered, payments to ineligible beneficiaries, and payments resulting from fraud and abuse by program participants and/or federal employees.

Because improper payments are a longstanding, widespread, and significant problem in the federal government, few would argue that the goal of reducing them is not a worthy one. As we testified before this subcommittee on April 8, 2003,<sup>1</sup> improper payment estimates disclosed in agency financial statements totaled approximately \$20 billion each year for both fiscal years 2002 and 2001. As significant as these amounts are, they do not present a true picture of the magnitude of the problem governmentwide. OMB recently estimated the amount of improper payments at about \$35 billion annually. While either of these figures represent a considerable amount of wasted taxpayer dollars, the scope of the problem is likely greater because most agencies have not yet estimated or publicly reported the magnitude of improper payments in their programs and activities.

The risk of improper payments and the government's ability to prevent them has important long-term implications. As the baby boom generation leaves the workforce, spending pressures will grow rapidly due to increased costs of programs such as Medicare, Medicaid, and Social Security. Other federal expenditures are also likely to increase. These spending pressures and the increased size of federal programs all but

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<sup>1</sup>U.S. General Accounting Office, *Fiscal Year 2002 U.S. Government Financial Statements: Sustained Leadership and Oversight Needed for Effective Implementation of Financial Management Reform*, [GAO-03-572T](#) (Washington, D.C.: Apr. 8, 2003).

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guarantee that, absent improvement in internal controls and other proactive actions, the risk of even more improper payments will exist.

Our work has demonstrated that attacking improper payment problems requires a strategy appropriate to the organization involved and its particular risks, including a consideration of the legal requirements surrounding security and privacy issues. Our findings in this area have resulted in the identification of strategies to address improper payments and in governmentwide recommendations for proactive leadership at the highest levels of government, in addition to specific procedures designed to help agencies better identify, measure, reduce, and report their improper payments.

In October 2001, we issued an executive guide that provided information on strategies used successfully by public and private sector organizations to address their improper payment problems.<sup>2</sup> We found that the entities using these best practices shared a common focus of improving the internal control system. The components of this control system and a brief definition of each follows.

- Control environment—creating a culture of accountability by establishing a positive and supportive attitude toward improvement and the achievement of established program outcomes.
- Risk assessment—performing comprehensive reviews and analyses of program operations to determine if risks exist and the nature and extent of the risks identified.
- Control activities—taking actions to address identified risk areas and help ensure that management’s decisions and plans are carried out and program objectives are met.
- Information and communications—using and sharing relevant, reliable, and timely financial and nonfinancial information in managing improper payment related activities.
- Monitoring—tracking improvement initiatives, over time, and identifying additional actions needed to further improve program efficiency and effectiveness.

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

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Most recently, in a report issued last August,<sup>3</sup> we pointed out that existing guidance did not require or offer agencies a comprehensive approach to measuring improper payments, developing and implementing corrective actions, or reporting on the results of the actions taken. Improper payment information varied across agencies and programs and included a mixture of estimated improper payment rates and actual improper payments. Moreover, the information was inconsistently reported in a variety of places, including annual financial statements, performance plans, and the federal budget. None of these reporting mediums provided a comprehensive view of either the scope of the improper payment problem or of individual agency or governmentwide efforts to reduce it. As such, there is inadequate substantive information for use in establishing (1) a baseline measure of the extent of improper payments, (2) appropriate response levels to correct improper payment problems, and (3) responsibility—holding organizations and/or individuals accountable for performance and results.

As a result of these findings, we recommended that federal executive branch agencies assign responsibilities for taking actions to minimize improper payments and that OMB assist agencies in developing methods to identify and implement those actions. We also presented matters for congressional consideration to assist agencies in addressing barriers to actions to better manage efforts to reduce improper payments and to help them with improvement efforts.

We are seeing important leadership and action—both from the Congress and from the administration—to address the improper payment problem. Today I will highlight these actions and provide my perspective as to their potential impact. I will also discuss our intent to follow up with the 24 Chief Financial Officer (CFO) Act agencies on our previous recommendations that address actions agencies can take to prevent and reduce improper payments.

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

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## Legislation Mandates Agency Actions to Identify and Act on Improper Payment Problems

Two recent pieces of legislation—the Improper Payments Information Act of 2002<sup>4</sup>, and Section 831 of the National Defense Authorization Act for Fiscal Year 2002<sup>5</sup>—provide an impetus for all agencies to systematically address improper payment activity annually, and to identify and recover contract overpayments.

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### Improper Payments Act

The Improper Payments Information Act of 2002, that this subcommittee sponsored, contains stringent requirements in the areas of improper payment review and reporting. Agency heads are to annually review all programs and activities that they administer and identify those that may be susceptible to improper payments. Across-the-board implementation of this provision will significantly increase the number of agencies analyzing their programs and activities for improper payments and coincides with our recommendation that the 24 CFO Act agencies assign responsibility for establishing procedures for assessing agency and program risks of improper payments.

Once agencies identify their programs that are susceptible to significant improper payments, the legislation requires agencies to estimate the annual amount of improper payments in those programs and activities. For programs for which estimated improper payments exceed \$10 million, agencies are to report to the Congress on actions they are taking to reduce those errors. The report will also include a discussion of the causes of the improper payments identified, actions taken to correct those causes, and the results of the actions taken to address those causes. The provisions of this legislation coincide with our recommendation that CFO Act agencies take actions to reduce improper payments and report to the Congress, OMB, and the agency head on the progress made in achieving improper payment reduction targets and future action plans for controlling improper payments.

The law further requires OMB to prescribe agency guidance to implement the requirements of the act. For years, we have recommended that OMB develop and issue guidance to federal executive agencies to assist them in developing and implementing a methodology for annually estimating and

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<sup>4</sup>Pub. L. No. 107-300, 116 Stat. 2350, (2002).

<sup>5</sup>Pub. L. No. 107-107, 115 Stat. 1012, 1186, (2001).

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reporting improper payments, and for developing goals and strategies to address improper payments. I will discuss OMB's actions in this area later in my statement.

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## Recovery Auditing Legislation

Our October 2001 executive guide on improper payments recognized that some improper payments are inevitable and identified and described improper payment detection activities including recovery auditing. Recovery auditing entails examining payment file information to identify possible duplicate or erroneous payments and taking recovery action. Our guide suggested that the techniques used in recovery auditing could be used more in the federal government not only to identify improper payments already made, but also to analyze records prior to payment to prevent improper payments before they occur. In our opinion, it is both faster and cheaper to proactively identify and prevent potential improper payments than to try to detect such errors and collect them after the fact.

Section 831 of the National Defense Authorization Act for Fiscal Year 2002 contains a provision that requires agencies entering into contracts with costs exceeding \$500 million annually to have cost-effective programs for identifying errors in paying contractors and for recovering amounts erroneously paid. The legislation further states that a required element of such a program is the use of recovery audits and recovery activities. The law authorizes 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, may be credited back to the original appropriation, subject to restrictions as described in the legislation. With the passage of this law, the Congress has removed multiple barriers and granted agencies a much needed incentive for identifying and reducing their improper payments, in addition to recovering those improper payments that slip through agency prepayment controls. The techniques used in recovery auditing (such as examining payment file information to identify duplicate payments or calculation errors) offer the opportunity for identifying weaknesses in agency internal controls, which can then be modified or upgraded to be more effective in preventing improper payments before they occur. Further, accurate assignment of costs and a functioning cost accounting system to track those costs can assist agency management by providing the information needed to identify agency and contractor expenses reimbursable under this legislation.

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## OMB's Actions to Address Improper Payments

OMB's role in managing, implementing, and overseeing governmentwide administrative policy, its interagency perspective, and its leadership role on the various interagency councils make it a key player in the government's effort to reduce improper payments. I would like to briefly discuss two actions—one legislatively and the other administratively driven.

In the legislative area, OMB recently issued draft guidance on implementation of the Improper Payments Information Act of 2002 for agency comment. In this guidance, OMB addressed the specific reporting requirements provided by the act and laid out the steps necessary for agencies to meet those requirements. For example, the draft guidance calculates annual improper payments as the gross total of both over- and under- payments, and sets statistical sampling confidence and precision levels for estimating those payments. It also requires agencies with estimated improper payments in any program or activity exceeding \$10 million to include, along with the estimated amount, a discussion of the amount of actual improper payments the agency expects to recover and how it will go about recovering them in the Management Discussion and Analysis section of their annual Performance and Accountability Report. These actions will help ensure transparency in reporting for those agencies with programs and activities with significant risks for improper payments.

On the administrative side, the President's Management Agenda has identified improper payments as a key element in the administration's initiative to improve financial performance throughout the federal government—one of five governmentwide initiatives that the Agenda addressed. As described in the Agenda, OMB will work with agencies to establish goals to reduce improper payments for each program over \$2 billion. In the past, agencies' financial statements contained a mix of estimated improper payment rates and actually identified improper payments—this was for those agencies that had, in fact, reported improper payments. OMB now requires agencies to provide an improper payment rate based on a statistical sample projected to the universe of payments made. It revised the guidance in its Circular A-11 to require agencies to distinguish between overpayments, underpayments, and total improper payments, and to define the methodology used to develop their error rate. The revision was intended to ensure consistency in the error rates reported by the agencies. The Circular requires agencies to report this information with their initial budget submissions and prohibits agencies from publicly disclosing these submissions. We have stated in the past and continue to maintain that this information should be in the public



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domain since it is necessary to enable oversight and monitoring by interested parties, including the Congress and the public.

Our August 2002 report on improper payments included recommendations to OMB designed to assist agencies with challenges in identifying and measuring their improper payments, setting performance goals, implementing corrective actions, and reporting the results against the goals. OMB has taken some actions to address these recommendations. For example, in October 2002 testimony before this committee, it addressed statutory roadblocks faced by the departments of Labor (Labor), Education (Education), and Housing and Urban Development (HUD) in gaining access to existing information that those agencies could use in verifying the employment status and income of applicants.<sup>6</sup> OMB testified that it had proposed legislation to eliminate the data-sharing barriers at Labor and Education, and that it was in the process of proposing legislation that would assist HUD in accessing much needed data that already exists at the Department of Health and Human Services. While this is a start, identifying and mitigating or eliminating barriers must be an ongoing process as additional agencies begin to address their improper payments and identify additional barriers that restrict their actions to reduce or eliminate improper payments. OMB's efforts in working with the Congress and federal agencies to ensure successful implementation of the provisions of the Improper Payments Information Act of 2002 and other legislation and administrative actions that can impact improper payments are critical to the governmentwide effort to reduce improper payments and facilitate the implementation of our recommendations.

OMB is providing additional leadership through a joint CFO Council and President's Council on Integrity and Efficiency (PCIE) workgroup—the Improper and Erroneous Payments Work Group—to assist agencies in identifying and reducing erroneous payments and to produce documentation that would be meaningful, applied to agencies. The workgroup surveyed agencies concerning the existing use of improper payment indicators and benchmarks, analyzed survey responses, and publicly released lists of indicators and techniques agencies currently use to identify improper payments.

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<sup>6</sup>Office of Management and Budget, Testimony of the Honorable Mark W. Everson, Deputy Director for Management, before the Subcommittee on Government Efficiency, Financial Management, and Intergovernmental Relations, Committee on Government Reform, (Washington, D.C.: Oct. 3, 2002).

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## Limited Information Is Available on Improper Payments at Federal Agencies

As noted in our prior reports and testimonies on this topic, there is no clear picture on the extent of the improper payment problem, only that it is worse than what is now acknowledged. Relatively few federal agencies and their components publicly report improper payment information such as improper payment rates, causes, and strategies for better managing their programs to reduce or eliminate these payments. In reviewing fiscal year 2001 agency and component financial statements of the 24 CFO Act agencies, we found references to improper payments in just 10 agencies in 17 agency programs. This information increased to 17 agencies and 27 programs in fiscal year 2002 agency financial statements. Several of the 17 agencies that acknowledged the existence of improper payments did not present information on the amounts of those payments. While the fiscal year 2002 information is an improvement over fiscal year 2001 in terms of agencies acknowledging improper payments, merely acknowledging that improper payments exist is simply not enough. It is essential for agencies to develop appropriate methodologies for identifying and measuring those payments, identify cost-effective actions to correct them, implement actions to reduce or eliminate improper payments in their programs and activities, and periodically report to agency managers, the Congress, and the public, through publicly available documents.

In our August 2002 report, we made a recommendation to all 24 CFO Act agencies to assign responsibility to a senior agency official for assessing risks, taking actions to reduce, and reporting the results on those actions on agency improper payments. The report described specific actions that we feel are an integral part of that responsibility. As a result of preliminary information received from those agencies, we have found that agencies have begun to assign responsibility to lead and coordinate actions to reduce improper payments. Some agencies have developed detailed action plans to determine the nature and extent of improper payments. Some have set target goals for improper payment rates and have reported progress in their annual accountability reports. For other agencies, methodologies for identifying risks, determining the nature and extent of improper payments, and developing corrective actions are in the early stages of implementation. In ongoing work, we are meeting with officials from the 24 CFO Act agencies to discuss their progress in implementing our recommendations and OMB's draft guidance on implementing the Improper Payments Information Act of 2002.

In closing, I want to emphasize our commitment to continuing our work with the Congress, the administration, and federal agencies to ensure that improper payments are fully addressed governmentwide, and that actions are taken to reduce or eliminate the government's vulnerabilities to the

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significant problem of improper payments. As I stated earlier, recent legislation and other actions have brought the government's improper payment problems to the forefront. Implementing the legislative provisions and other actions is a shared responsibility that will require continued strong support and active and cooperative involvement from the Congress, the administration, and agency management. Effective implementation of the Improper Payments Information Act of 2002 and recovery auditing should help resolve these problems. Along these lines, OMB needs to continue to work with agencies and groups like the CFO-PCIE Erroneous and Improper Payments Workgroup to address challenges in identifying and measuring their improper payments, setting performance goals, implementing corrective actions, and reporting the results against the goals. Further, agency management must work diligently to establish an environment in which improper payments are not acceptable business practices, evaluate program and activity risks for improper payments, identify and implement appropriate corrective actions, and openly report the progress made in reducing improper payments.

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

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## Contact and Acknowledgements

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

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# Related GAO Products

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

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

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

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

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