



UNITED STATES ENVIRONMENTAL PROTECTION AGENCY
WASHINGTON, D.C. 20460

OFFICE OF
INSPECTOR GENERAL

January 16, 2003

MEMORANDUM

SUBJECT: Final Status of Preliminary Research Results on Improper Contract Payments
Report No. 2003-2-00003

FROM: Alan Bogus /S/
Project Manager

TO: Judy Davis, Director
Office of Acquisition Management
Office of Acquisition and Resources Management

Ronald Bachand, Director
Financial Services Division
Office of the Chief Financial Officer

Juliette McNeil, Director
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The Office of Inspector General (OIG) of the Environmental Protection Agency (EPA) has completed its preliminary research on improper contract payments. This memorandum follows on to our previously issued report, "Status of Preliminary Research Results on Improper Contract Payments (2002-M-00010, March 28, 2002). This current memorandum summarizes the results of our preliminary research, and provides suggestions and a recommendation for corrective action. We do not plan to conduct any additional work on improper contract payments at this time. We appreciate your staff's cooperation during this portion of our work.

Action Required

In accordance with EPA Manual 2750, you are requested to provide a written response within 90 calendar days of the date of this memorandum. Since this memorandum primarily addresses recommendations for maintaining statistics on improper contract payments, we request the Director, Financial Services Division, as the primary action official, to take the lead in coordinating and providing us a written response. A corrective action plan for agreed-upon actions, including milestone dates, should be included. We have no objections to the further release of this memorandum to the public. For your convenience, this report will be available at

<http://www.epa.gov/oig/eroom.htm>. Should you or your staff have any questions, please contact me at (202) 566-2538.

Scope and Methodology

We limited our work to reviewing the data in the Agency's Contract Payment System (CPS). We looked at CPS data for the purpose of developing profile indicators of trends and anomalies as a basis to identify potential improper contract payments. Such work was limited to reviewing selected invoices and supporting documents to validate the profile. We performed a review of the accuracy of contractors' bank routing and account numbers in CPS to validate a profile to identify improper contract payments. Utilizing the results found, we used "data mining" and analytical techniques to compare such information to other Agency databases. We matched the database of contractors' bank routing and account numbers to a database of employee bank routing and account numbers to identify possible trends and anomalies. Similarly, we matched the database of contractors' and EPA employees' identification numbers.

We also performed a review of credit invoices in CPS to identify potential improper contract payments. We expanded upon our previous report's findings and reviewed a sample of invoices for contractors with the predominance of revised invoices. We followed up on the Agency's ongoing Task Force efforts to review improper payments in light of the ongoing government-wide initiatives and related guidance to reduce improper payments.¹ We held discussions with EPA project officers, contracting officers, and finance personnel, in addition to various financial institution representatives. Our work was conducted from May 2002 through October 2002. We conducted our preliminary research in accordance with the general standards of the *Government Auditing Standards*, as issued by the Comptroller General of the United States.

Our results are based on a limited review of more than 47,600 transactions and 1,450 contracts in CPS with approximately \$2 billion in disbursements for fiscals 2000-2001. Therefore, our results cannot be used to provide an overall assessment as to the causes and extent to which improper contract payments may or may not occur at EPA, nor provide an overall assessment of the validity of the contract payments. While our work included understanding the internal controls over the contract payment process, we did not perform an assessment of those controls. It should be noted that our annual financial statement audits have not disclosed any significant

¹ *The President's Management Agenda, Fiscal 2002*, the Office of Management and Budget's *Federal Financial Management Report* (May 2002), and numerous General Accounting Office reports highlight the impact of improper payments on federal programs and the need for actions to strengthen the system of internal controls over areas where improper payments occur. Also, under the fiscal 2002 Defense Authorization Act (Public Law 107-107, subchapter section 831), federal agencies are required to use recovery auditing methods to identify and track overpayments to contractors. The law requires the Office of Management and Budget to issue guidance on implementing the recovery auditing program. Similarly, the Improper Payments Information Act of 2002 (Public Law 107-300) directs each executive agency to review all of its programs and activities annually, identify those that may be susceptible to significant improper payments, estimate the annual amounts of improper payments, and submit those estimates to Congress before March 31.

control weakness in the contract payment process. We applied the Office of Management and Budget’s guidance for “erroneous payments” when assessing improper contract payments.

Results in Brief

Consistent with our prior report,² we continued to find a limited number of instances where improper contract payments had occurred on EPA contracts. While we did not find any additional improper contract payments based on our review of credit invoices, we believe the existence of credit invoices and the basis for their occurrence indicates that improper contract payments occurred. In addition, we found an instance where EPA made an improper contract payment, based on our review of invoices for contractors with a predominance of revised invoices.

Although we found a number of instances in which payments were made to different contractors with identical bank routing and account numbers, these payments did not result in the Agency making improper contract payments. In addition, we did not find any improper contract payments based on our analysis of matching contractors’ and EPA employees’ bank routing and account numbers or identification numbers. Finally, while we would concur that the number of improper contract payments found to date seemed to be minimal and the Agency appears highly focused on providing high quality and accurate contract payments, we found the Agency does not keep statistics on improper contract payments to validate the extent, magnitude, and causes of improper contract payments.

We recommend that the Agency develop statistics on improper contract payments to validate the extent, magnitude, and possible causes of improper contract payments. We continue to encourage the Agency to expand the scope of its Task Force efforts from its current assessment of only the Agency’s State Revolving Fund programs to its performing an overall assessment of improper payments for all Agency programs and activities.

Improper Contract Payments Found in our Review of Sample Invoices

Consistent with our prior report, we continued to find a limited number of instances where improper contract payments had occurred on EPA contracts. We believe that improper contract payments occurred based on our review of credit invoices and a review of invoices for contractors with a predominance of revised invoices.

² During our prior review, we found a limited number of instances where the Agency (1) made duplicate contract payments, and (2) submitted payment information with incorrect contractor Taxpayer Identification Numbers to the Department of Treasury. These instances of duplicate payments indicated to us that improper contract payments were occurring on EPA contracts. However, we had not been able to determine the causes and the extent to which improper contract payments were occurring. Our initial review disclosed that in most instances, the Agency identified and promptly corrected any duplicate payments. We did not believe at that time that the limited number and scope of these instances were significant to warrant recommendations for corrective action.

Using credit invoices³ in CPS as a potential profile indicator, we selected a non-statistical sample of 31 credit invoices out of the universe of 545 credit invoices totaling \$6.4 million. While we did not find any additional improper payments based upon our review of credit invoices, we believe the existence of credit invoices and the basis for their occurrence indicates that improper contract payments had occurred on EPA contracts. While 8 of the credit invoices in our sample involved indirect rate/provisional cost adjustments and were not deemed as improper, we found that the remaining 23 credit invoices were a result of correcting a previous improper contract payment (see table below). The results indicate potential systemic causes that allowed the improper payments to occur. In addition, we could not validate that credit invoices in CPS could be used as a profile indicator for identifying additional potential improper contract payments.

Type of Occurrence	No. of Instances
Contractor submitted cost adjustments/overcharges	12
Reversal of previous duplicate payments	7
Adjustments for additional suspensions previously paid	4
Total	23

Expanding upon our previous report’s work on revised invoices, we reviewed contractors in CPS with the predominance of revised invoices. We selected a non-statistical sample of 29 invoices from a universe of all invoices for 3 of the top 5 contractors.⁴ We considered the invoice amount, invoice amount paid, period of performance, delivery/task orders that might be duplicated, and the sequence of invoice numbers. We identified to the Agency that a duplicate payment for \$318 occurred and necessitated correction; payment was recovered and additional internal controls implemented in fiscal 2002 to prevent a recurrence.

Identical Contractor Bank Routing and Account Numbers

We found that payments made to different contractors with identical bank routing and account numbers did not result in the Agency making improper contract payments. Using identical bank routing and account numbers in CPS as a profile indicator, we found that \$229 million in payments were made to 25 contractors under 10 identical bank routing and account numbers.

³ Credit invoices are negative invoice amounts or amounts due to EPA from a contractor; credit invoices are a normal part of the business cycle in contract payments. EPA offsets the amount due from the contractor against the next contract payment. Credit invoices can result from a valid payment, as the payment was initially proper but subsequently adjusted (indirect rate/provisional costs adjustments). Credit invoices can also result from an improper payment, which is a payment that should not have been made (contractor adjustments/overcharges, duplicate payments, suspension adjustments), when the improper payment is subsequently corrected.

⁴ The 3 contractors represented 25 percent, or 666 revised invoices, of a total of 2,667 revised invoices.

Using the contractor name in CPS, we attempted to validate the profile indicator that different contractors should not be receiving payments under identical bank routing and account numbers. We found that the payments were not improper because the contractor had either made an “assignment of claims”⁵ or had merged or been acquired during the period.

Comparison of Contractor and EPA Employee Data

We did not find any improper contract payments based on our analysis of matching contractor and EPA employee databases. To determine whether any relationships exist between contractors and EPA employees, we used “data mining” and analytical techniques to compare information in CPS to other Agency databases. We matched the database of contractors’ bank routing and account numbers to a database of EPA employees’ bank routing and account numbers. Similarly, we compared the contractors’ Taxpayer Identification Numbers to EPA employees’ Social Security Numbers. We did not find any matches. Accordingly, we could not develop additional profiles to identify potential improper contract payments.

Statistics Lacking on Improper Contract Payments

The Agency does not keep statistics on improper contract payments to validate the extent, magnitude, and causes of improper contract payments. Our previous report noted that the Agency appears highly focused on providing high quality and accurate contract payments. However, despite the system of controls over processing contract invoice payments and annual quality assurance reviews, improper contract payments occurred. While we would concur that the number of improper contract payments found to date seemed to be minimal, the Agency has not developed statistics to measure improper contract payments. Without such statistics, the Agency cannot determine how often improper contract payments may occur, the nature of the improper payments, or the causes of the improper payments. Statistics could include recoveries and refunds; also statistics on improper payments prevented could indicate contractor procedural problems, emerging fraud scams, or EPA control weaknesses or inefficiencies.

Statistics on improper contract payments are also important because improper payments can impact a program’s ability to achieve its intended outcome. Government-wide initiatives and related guidance have all cited the need to reduce improper payments. Agencies have been encouraged to perform risk assessments of their programs and activities. If program risks are known and quantified, then Agency management can determine whether the problem is significant enough to require corrective action, and assess whether any additional cost-effective controls are needed to reduce improper payments. Such statistics would also be important as the Agency begins to assess the need to establish a cost recovery audit program.

⁵ Federal Acquisition Regulation 52.232-23, “Assignment of Claims,” notes a contractor under the Assignment of Claims Act may assign its rights to be paid amounts due or to become due as a result of the performance of this contract to a bank, trust company, or other financing institution, including any Federal lending agency.

Expanded Scope Encouraged on the Agency's Task Force on Improper Payments

As previously reported, based on guidance from the Office of Management and Budget, the Agency established an Agency-wide Task Force to review improper payments applicable to the Clean Water and Drinking Water State Revolving Fund (SRF) programs, which total \$2.2 billion in the Agency's operating plan. Since our previous report, the Agency's assessment of these programs found a minimal number and amount of SRF improper payments, and determined that existing processes and controls over SRF disbursements were reasonable. The Agency developed recommendations related to SRF improper payments, including assigned responsibility for monitoring improper payment rates and ensuring corrective actions are taken when improper payments are found.

Consistent with our prior report, we continue to encourage the Agency to expand the scope of its Task Force efforts to perform an overall assessment of improper payments for all Agency programs and activities. We believe the Task Force efforts should not be limited to the SRF programs; the efforts should be expanded consistent with government-wide initiatives and guidance to assess all Agency programs and activities. For example, approximately 58 percent of the Agency's \$8 billion in total costs are associated with grant programs, and only about half of that total is associated with the SRF programs. Other grant programs include categorical assistance to states and tribes, and research grants to universities and other nonprofit institutions. These programs should also be assessed for potential improper payments.

OIG Completes Research Activities on Improper Contract Payments

We do not plan to continue our research to develop profile indicators that would possibly identify additional improper contract payments. While we found instances of improper contract payments and identified some trends and anomalies, we believe the results do not provide a basis for continuing our work.

We continue to stress the need for valid statistical data on improper contract payments. We believe a further review of credit invoices in CPS would (1) provide indicators as to potential causes for some improper contract payments, and (2) allow the Agency to begin to quantify the amount of improper contract payments. We also believe the Agency can conduct additional analysis using revised invoice submissions as a valid profile indicator, based on our prior report, to look for additional potential improper contract payments.

Recommendation

We recommend that the Director, Financial Services Division develop statistics on improper contract payments to validate the extent, magnitude, and possible causes of improper contract payments as related to the CPS. Once statistics are developed, an assessment should be performed to determine whether an Agency cost recovery program needs to be established.

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