EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

THE DIRECTOR

April 14, 2011

M-11-16

MEMORANDUM FOR THE HEADS OF EXECUTIVE DEPARTMENTS AND AGENCIES

FROM: Jacob J. Lew
Director

SUBJECT: Issuance of Revised Parts I and II to Appendix C of OMB Circular A-123

Each year, the Federal Government wastes billions of taxpayer dollars on improper payments to individuals, organizations, and contractors. These are payments made in the wrong amount, to the wrong entity, or for the wrong reason. Despite efforts to reduce improper payments, agencies reported an estimated $125 billion in improper payments for Fiscal Year 2010. Whether these payments resulted from inadequate recordkeeping, inaccurate eligibility determinations, inadvertent processing errors, the lack of timely and reliable information to confirm payment accuracy, or fraud, the amount of improper payments is simply unacceptable.

On July 22, 2010, the President signed into law the Improper Payments Elimination and Recovery Act (IPERA; Pub.L. 111-204). IPERA amended the Improper Payments Information Act of 2002 (IPIA; Pub. L. 107-300) and generally repealed the Recovery Auditing Act (Section 831, Defense Authorization Act, for FY 2002; Pub.L. 107-107). IPERA directed the Office of Management and Budget (OMB) to issue implementing guidance to agencies.

OMB is now issuing the attached government-wide guidance on the implementation of IPERA. This guidance is contained in Parts I and II to Appendix C of OMB Circular A-123, *Management's Responsibility for Internal Controls*[1]. Significant components of OMB's guidance include:

- Describing alternative improper payment measurements;
- Expanding payment recapture audits to all types of payments and activities with more than $1 million in annual outlays if cost-effective;
- Improving corrective action plans and incorporating lessons learned from the Recovery Act implementation;
- Distributing funds recovered through payment recapture audits for authorized purposes; and
- Establishing compliance reviews and requirements for agencies deemed non-compliant.

[1] This guidance replaces the previous guidance contained in memorandum M-06-23, issued in August 2006. This guidance also supersedes Sections 3, 4 6, 8, and 9 of memorandum M-11-04, issued in November 2010.

This updated guidance is effective for agencies to use immediately and for Fiscal Year 2011 reporting. Please contact Joseph Pika (202-395-1040), or Flavio Menascé (202-395-7557), in OMB's Office of Federal Financial Management with any questions regarding this guidance.

Attachment

APPENDIX C

Requirements for
Effective Measurement and Remediation
of Improper Payments

TABLE OF CONTENTS

Part I. Improper Payments Elimination and Recovery

This Guidance implements the requirements of the Improper Payments Elimination and Recovery Act of 2010 (IPERA) (Pub. L. No. 111-204), which amended the Improper Payments Information Act of 2002 (IPIA) (Pub. L. No. 107-300) and generally repealed the Recovery Auditing Act (Section 831, Defense Authorization Act, for FY 2002) (Pub. L. No. 107-107). Office of Management and Budget (OMB) Circular A-123, Appendix C, Part I and Part II (which was issued in August 2006 as OMB Memorandum M-06-23) is hereby modified.

A) Identification and Reporting of Susceptible Programs and Activities

1) What agencies are required to comply with the requirements of the Improper Payments Information Act?

The agencies required to comply with IPIA, as amended by IPERA[1], are defined broadly as "a[ny] department, agency, or instrumentality in the executive branch of the United States" as defined in Title 31, Section 102 of the United States Code.

2) What is 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 or underpayments that are made to eligible recipients (including inappropriate denials of payment or service, any payment that does not account for credit for applicable discounts, payments that are for the incorrect amount, and duplicate payments). An improper payment also includes any payment that was made to an ineligible recipient or for an ineligible good or service, or payments for goods or services not received (except for such payments authorized by law). 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 an improper payment.[2]

The term "payment" in this Guidance means any payment or transfer of Federal funds (including a commitment for future payment, such as cash, securities, loans, loan guarantees, and insurance subsidies) to any non-Federal person or entity that is made by a Federal agency, a Federal contractor, a Federal grantee, or a governmental or other organization administering a Federal program or activity.

The term "payment" includes Federal awards subject to the Single Audit Act Amendments of 1996 (SAA) (Pub. L. No. 104-156) that are expended by both recipients and sub-recipients. In limited cases, and with prior approval from OMB, an agency may implement a measurement

[1] Unless otherwise indicated, from this point forward in the Guidance the term "IPIA" will imply "IPIA, as amended by IPERA." Even though IPERA amends IPIA, the authorizing legislation is still named IPIA.

[2] Agencies that use a different method for reporting improper payments that result from documentation issues must present their proposal to OMB for review and approval.

approach that excludes improper payments that have been subsequently corrected and recovered from the annual total reported in its Performance and Accountability Report (PAR) or Annual Financial Report (AFR). If an agency receives such approval from OMB, it should report this in its annual PAR or AFR.

3) What is a payment for an ineligible good or service?

A payment for an ineligible good or service includes a payment for any good or service that is not permitted under any provision of any contract, grant, lease, cooperative agreement, or other funding mechanism.

4) What is a program or activity?

The law anticipates that agencies will examine the risk of, and feasibility of recapturing, improper payments in *all* programs and activities they administer. The term "program" includes activities or sets of activities recognized as programs by the public, OMB, or Congress, as well as those that entail program management or policy direction.[3] This definition includes, but is not limited to, all grants including competitive grant programs and block/formula grant programs, non-competitive grants such as single-source awards, regulatory activities, research and development activities, direct Federal programs, all types of procurements (including capital assets and service acquisition),[4] and credit programs. It also includes the activities engaged in by the agency in support of its programs.

For Federal awards subject to the SAA or otherwise listed in the Catalog of Federal Domestic Assistance (CFDA), Federal agencies should consider using the groupings in the OMB Circular A-133 Compliance Supplement (referred to as "clusters of programs") and the CFDA. However, unless otherwise specified in OMB Circular A-11, each Federal agency, after consultation with OMB, is authorized to determine the grouping of programs which most clearly identifies and reports improper payments for their agency. Agencies must not put programs or activities into groupings that result in significant improper payment rates being masked by the large size or scope of such a grouping. For transparency, the basis for these groupings must be reported in the agency's annual PAR or AFR.

5) Must agencies review intra-governmental transactions and payments to employees?

No. As discussed in Part IA, Section 2, the definition of "payment" in the new law means any payment or transfer of Federal funds to any non-Federal person or entity. Therefore, agencies are not obligated to review intra-governmental transactions and payments to employees. However, any agency may review such payments, and must do so if so directed by OMB.

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[3] The term "program and activity" is referred to in this Guidance as "program."

[4] This is an important change for agencies to consider. Under the new law, agencies are required to review vendor payments as part of their annual risk assessment process. If these risk assessments determine that contract or vendor payments are susceptible to significant improper payments (as defined in Part IA, Section 7, Step 1), then agencies will be required to establish an annual improper payment measurement for these vendor payments (as required by Part IA, Section 7, Step 2). However, agencies also have the opportunity to pursue alternative measurements of these contract or vendor payments, and may follow the steps outlined in Part IA, Section 11.

6) What constitutes an improper loan or loan guarantee payment?

Under a direct loan program, improper payments may include disbursements to borrowers or other third-party payments that are based on incomplete, inaccurate, or fraudulent information. They may also include duplicate disbursements, disbursements in an incorrect amount, or loan funds used for purposes other than those allowed by law, program regulations, or agency policy.

Under a loan guarantee program, an improper payment may include disbursements to intermediaries, third-parties for defaults, delinquencies, interest and other subsidies, or other payments that are based on incomplete, inaccurate, or fraudulent information. They may also include duplicate disbursements, disbursements in an incorrect amount, or any disbursements that are not in compliance with law, program regulations, or agency policy.

7) What are agencies required to do?

Unless an agency has specific written approval from OMB to deviate from the steps explained below, agencies are required to follow these steps to determine whether the risk of improper payments is significant and to provide valid annual estimates of improper payments. (Also, refer below to Part IA, Section 11 which describes some of the possible acceptable alternative methodologies for improper payment measurement.)

Step 1: Review all programs and activities and identify those that are susceptible to significant improper payments.

a. Definition. For the purposes of this Guidance, "significant improper payments" are defined as gross annual improper payments (i.e., the total amount of overpayments plus underpayments) in the program exceeding (1) both 2.5 percent of program outlays and $10,000,000 of all program or activity payments made during the fiscal year reported or (2) $100,000,000 (regardless of the improper payment percentage of total program outlays). The new law establishes a 2.5 percent improper payment rate[5] threshold to determine risk susceptible programs (in addition to the monetary threshold identified above). OMB has determined as a policy matter that, beginning with fiscal year 2013 reporting, agencies should instead apply a 1.5 percent improper payment rate (with other aspects of the above definition unchanged).

b. Systematic Method. All agencies shall institute a systematic method of reviewing all programs and identify programs susceptible to significant improper payments. This systematic method could be a quantitative evaluation based on a statistical sample or it could take into account risk factors likely to contribute to significant improper payments. At a minimum, these risk factors should include:
   - Whether the program or activity reviewed is new to the agency;
   - The complexity of the program or activity reviewed, particularly with respect to determining correct payment amounts;
   - The volume of payments made annually;

[5] Improper payment rates referenced here and throughout this Guidance should be measures of dollars rather than occurrences. In other words, the improper payment rate should be the amount in improper payments divided by the amount in program outlays for a given program in a given fiscal year.

- Whether payments or payment eligibility decisions are made outside of the agency, for example, by a State or local government, or a regional Federal office;
- Recent major changes in program funding, authorities, practices, or procedures;
- The level, experience, and quality of training for personnel responsible for making program eligibility determinations or certifying that payments are accurate;
- Significant deficiencies in the audit reports of the agency including, but not limited to the agency Inspector General or the Government Accountability Office report audit findings, or other relevant management findings that might hinder accurate payment certification; and,
- Results from prior improper payment work.

c. Other Risk Susceptible Programs. OMB may determine on a case-by-case basis (e.g., if an audit report raises questions about an agency's risk assessment or improper payments results) that certain programs that do not meet the threshold requirements described above may still be subject to the annual PAR or AFR reporting requirement.

d. Examples. To further clarify this step, we provide four examples assuming that no exceptions have been made:

Example 1: Under the analysis in Step 1, a program has a potential improper payment rate of 2.25 percent or $14 million. Prior to FY 2013, under this Guidance an agency need not perform Step 2—obtaining a statistically valid estimate of improper payments in the program—because the potential improper payment rate does not exceed 2.5 percent. For FY 2013 and beyond, the agency would need to establish a statistically valid estimate of improper payments in the program because the potential improper payment rate exceeds 1.5 percent and the improper payment amount exceeds $10 million, thus meeting the definition of "significant improper payments."

Example 2: Under the analysis in Step 1, a program has a potential improper payment rate of 2.75 percent or $9 million. Under this Guidance, an agency need not perform Step 2—obtaining a statistically valid estimate of improper payments in the program—because the potential amount of improper payments in the program does not exceed $10 million.

Example 3: Under the analysis in Step 1, a program has a potential improper payment rate of 2.75 percent and $11 million. Under this Guidance, an agency must perform Step 2—obtaining a statistically valid estimate of improper payments in the program—because the potential improper payment rate exceeds 2.5 percent (and for FY 2013 and beyond, it exceeds 1.5 percent) and the potential amount of improper payments exceeds $10 million. The agency must report a statistically valid improper payment rate for the program in its annual PAR or AFR.

Example 4: Under the analysis in Step 1, a program has a potential improper payment rate of .5 percent and $125 million. Under this Guidance, regardless of the potential improper payment rate, the agency must perform Step 2—obtaining a statistically valid estimate of improper payments in the program—because the potential amount of improper payments in the program exceeds $100 million.

Step 2: Obtain a statistically valid estimate of the annual amount of improper payments in programs and activities (unless otherwise noted in this Guidance) for those programs that are identified as susceptible to significant improper payments.

a. Improper Payment Sampling Methodologies. All programs and activities susceptible to improper payments will ensure that their sampling methodologies are approved by OMB prior to conducting its sampling measurement. In addition, agencies should also incorporate refinements to their improper payment rate methodologies based on recommendations from agency staff or auditors (such as their agency Inspector General, the Government Accountability Office, or private auditors).
b. Annual Estimated Amount. For all programs and activities susceptible to significant improper payments, agencies shall determine an annual estimated amount of improper payments made in those programs and activities. Additional instructions on calculating the annual estimated amount of improper payments can be found in Part IA, Section 9 below.
c. Random Sample. The estimates shall be based on the equivalent of a statistically random sample of sufficient size to yield an estimate with a 90 percent confidence interval of plus or minus 2.5 percentage points around the estimate of the percentage of improper payments.[6]
d. Validity. The agency may use their initial determination of the *potential* improper payment in Step 1 and the examples below to aid in determining their sample size; however, agencies must consult with a statistician to ensure the validity of their sample design, sample size, and measurement methodology.
e. Examples. To clarify this step, we provide two examples below.

- The examples illustrate the least complicated scenario in which an agency's payments are either correct or incorrect with the improper payment rate expressed as a simple percentage of the number of payments that were incorrect (attribute sample).
- The examples also assume that a simple random sample of cases is drawn for review from a very large universe of payments.[7]
- However, it is important to note that the examples below (and the formula in the footnote) provide for an improper payment rate estimate, but not an estimate of improperly paid dollars. Furthermore, many agency programs will need to utilize

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[6] Agencies may alternatively use a 95 percent confidence interval of plus or minus 3 percentage points around the estimate of the percentage of improper payments.

[7] Under these assumptions, the minimum sample size needed to meet the precision requirements can be approximated by the following formula, which is used in the examples:

$$n \geq \frac{2.706(1-P)}{\left(\frac{.025}{P}\right)^2 P}$$

Where n is the required minimum sample size and P is the estimated percentage of improper payments (Note: This sample size formula is derived from *Sampling of Populations: Methods and Applications* (3rd edition); Levy, P. S. & Lemeshow, S. (1999); New York: John Wiley & Sons; at page 74. The constant 2.706 is 1.645^2)

more complex sample designs because their payment universe contains divergent dollar amounts and/or types of payments.

- Therefore, most agencies should consult with a statistician to design an appropriate sample that may involve estimates of improperly paid dollars or multiple stages of selection or stratification (rather than a simple random sample), and to ensure that their sample design and size will meet the minimum required precision level in this Guidance.

Example 1: Under the analysis in Step 1, the program has a potential improper payment rate of 3 percent (and at least $10 million). Under this Guidance, the agency needs to draw a random sample of payments from the program that will yield a statistical estimate of the improper payment rate. The 90 percent confidence interval around this estimate should be no more than plus or minus 2.5 percentage points. Using the initial determination of a 3 percent improper payment rate yields a minimum sample size of approximately 126 cases.

Example 2: Under the analysis in Step 1, the program has a potential improper payment rate of 4.5 percent (and at least $10 million). The required minimum sample size to achieve a 90 percent confidence interval around this estimate of 4.5 percent of plus or minus 2.5 percentage points is approximately 186 cases.

a. Use Large Sample Sizes. Because of the imprecision of the risk assessment performed in Step 1, agencies should ensure that they do not select too small of a sample. Because, for a given sample size, the standard error of a percentage estimate increases as the point estimate of the improper payment rate approaches 50 percent, agencies should be conservative and use a higher estimated improper payment rate in their sample size calculations to ensure that they will meet the precision targets.
b. Greater Precision. Furthermore, these guidelines for precision should be taken as the minimum, and agencies are encouraged to increase samples above the minimum to achieve greater precision in their estimates. The agency shall maintain documentation to support the calculation of these estimates.
c. Working with other Entities. In addition, agencies should consider working with entities (i.e., grant recipients) that are subject to A-133 audits to leverage ongoing audits to assist in the process to estimate an improper payment rate and amount.

Step 3: Implement a plan to reduce improper payments.

a. Root Causes. For all programs and activities as determined under Step 2 with improper payments exceeding the thresholds listed earlier in Step 1, agencies shall identify the reasons their programs and activities are at risk of improper payments and put in place a corrective action plan to reduce them (more information on corrective action plans can be found in Part IA, Sections 14 and 15). To determine the root causes for improper payments, agencies may be required to conduct an analysis that produces an improper payment rate at higher levels of confidence and precision than that prescribed by this Guidance. Categories of root causes of an improper payment are defined in OMB Circular A-136 and Part III of Appendix C to Circular A-123.

b. Reduction Targets. When compiling their plans to reduce improper payments, agencies shall set reduction targets for future improper payment levels and a timeline within which the targets will be reached. Reduction targets must be approved by the Director of OMB.
c. Accountability. Agencies must ensure that their managers and accountable officers (including the agency head), programs and program officials, and where applicable States and local partners, are held accountable for reducing improper payments. In addition, for programs that are not implemented directly by Federal or State agencies or government, agencies may also consider establishing these accountability mechanisms. For example, non-Federal entities could include colleges that disburse grants and loans to students, or banks that disburse loans to students. Agencies shall assess whether the organizations have the internal controls, human capital, information systems, and other infrastructure needed to reduce improper payments to minimal cost-effective levels, and identify any statutory or regulatory barriers which may limit the agencies' corrective actions in reducing improper payments.

Step 4: Report estimates of the annual amount of improper payments in programs and activities and progress in reducing them.

a. Reporting. Agencies shall report to the President and Congress (through their annual PARs or AFRs in the format required by OMB Circular A-136 for IPIA reporting) an estimate of the annual amount of improper payments for all programs and activities determined to be susceptible to significant improper payments under Step 1, regardless of the dollar amount of the estimate, as further explained below. Improper payment information from agency PARs and AFRs is subsequently analyzed for inclusion in OMB's government-wide report on improper payments. This information is also posted to the improper payments dashboard created under Executive Order 13520 on Reducing Improper Payments – PaymentAccuracy.gov.
b. Improper payment estimates greater than $10 million. For programs and activities that estimate an improper payment amount that exceeds $10 million, agencies shall include the following in their annual PARs or AFRs to OMB:
    i. The gross estimate of the annual amount of improper payments (i.e., overpayments plus underpayments) made in the program and the methodology used to arrive at that estimate. Agencies are also allowed to calculate and publish in their PAR or AFR a second, additional estimate that is a net total of both over and under payments (i.e., overpayments minus underpayments). The net estimate is an additional option only, and cannot be used as a substitute for the gross estimate. See also Part IA, Section 7, Step 1(a) and Section 9 for a discussion about calculating improper payments.
    ii. A discussion of the causes of the improper payments identified, actions planned or taken to correct those causes, the planned or actual completion date of those actions, and the results of the actions taken to address those causes. Part of this discussion shall include the portion of improper payments attributable to insufficient or lack of documentation, if applicable.
    iii. A discussion of the amount of actual improper payments the agency expects to recover and how it will go about recovering them.

iv. A statement of whether the agency has the internal controls, human capital, and information systems and other infrastructure it needs in order to reduce improper payments to the levels the agency has targeted.
v. If the agency does not have such internal controls, human capital, and information systems and other infrastructure needed to reduce improper payments, a description of the resources the agency has requested in its most recent budget submission to Congress to establish and maintain the necessary internal controls, human capital, and information systems and other infrastructure.
vi. A description of the steps (including timeline) the agency has taken and plans to take to ensure that agency managers, accountable officers (including the agency head), programs and program officials, and where appropriate, States and local partners, are held accountable for reducing and recovering improper payments. The individuals and groups should be held accountable through annual performance appraisal criteria for 1) meeting applicable improper payments reduction targets, and 2) establishing and maintaining sufficient internal controls, including a control environment that prevents improper payments from being made, and promptly detects and recovers any improper payments that are made.
vii. A description of any statutory or regulatory barriers which may limit the agencies' corrective actions in reducing improper payments.

c. Estimates of $10 million or less. If the improper payment measurement gross estimate yields $10 million or less, agencies are still required to report the total in their annual PARs or AFRs to OMB. However, for programs and activities that have estimates less than $10 million, agencies are not required to complete the additional steps outlined above in Step 4(b).

8) When must agencies conduct risk assessments?

As required by the law, agencies shall review all programs and activities they administer the year after IPERA's enactment (i.e., in 2011) to identify those programs and activities that may be susceptible to significant improper payments (including payments from Federal awards subject to the SAA made by recipients and sub-recipients), and at least once every three years thereafter for programs deemed not risk susceptible (agencies that are conducting annual risk assessments may continue to do so). However, if a program experiences a significant change in legislation and/or a significant increase in its funding level, agencies are required to re-assess the program's risk susceptibility during the next annual cycle, even if it is less than three years from the last risk assessment.

If an agency already performs risk assessments of all of its programs and activities on a three-year risk assessment cycle, then the agency may apply to the Director of the Office of Management and Budget for a waiver from the requirement to complete a risk assessment the year after IPERA's enactment. As part of this waiver request, the agency should submit a list of programs and activities that are risk assessed, the most recent year each program and activity was risk assessed and the results of that risk assessment, and the next year that a risk assessment will be performed for each program and activity (any programs or activities previously granted relief from annual reporting by OMB would need to be included in this request). If an agency is already measuring and reporting improper payments in a program or activity (including, but not

limited to, those programs and activities listed in the former Section 57 of A-11), if the agency will measure the program and activity by an established date, or if the program or activity has already been identified through agency risk assessments as susceptible to significant improper payments, then the agency does not need to conduct a risk assessment of that program or activity the year after IPERA's enactment or submit a waiver request for the risk assessment requirement.

9) What payments should be included in the annual estimation of improper payments?

When calculating a program's annual improper payment amount, agencies should only utilize the amount paid improperly. For example, if a $100 payment was due, but a $110 payment was made erroneously, then the amount applied to the annual estimated improper payment amount should be $10, rather than the payment amount of $110. Similarly, if a $100 payment was due, but a $90 payment was made erroneously, then the amount applied to the annual estimated improper payment amount should be $10, rather than the payment amount of $90. However, if a $100 payment was due and made, but there is insufficient documentation to support the appropriateness of the payment or if a duplicate payment was made, then the amount applied to the annual estimated improper payment amount should be $100.

As discussed in previous sections of this Guidance, agencies are required to determine an annual estimate that is a gross total of both over and under payments (i.e., not the net of over and under payments). In addition, agencies are allowed to calculate and publish in their PARs or AFRs a second estimate that is a net total of both over and under payments (i.e., under payments can be subtracted from overpayments).

10) Are agencies required to subject the entire lifecycle of a payment to sampling and/or testing, or may agencies determine the transaction points that have the highest risk of improper payments, and focus their sampling and/or testing accordingly?

Agencies may focus their sampling and/or testing on individual components or transaction points of their programs for the areas posing the highest risk of improper payments, or where they can have the greatest return on investment. This decision and subsequent actions should be documented by agencies in their annual PARs or AFRs, and approved by OMB prior to implementation. The following two examples provide illustrations of how these measurement methodologies can be focused.

> ***Scenario 1.*** An agency may have a program where payments involve five transaction steps before funds reach the ultimate recipient. However, the agency may determine that only two of the transaction steps are high risk. Therefore, only these two transaction steps need sampling, detailed review, and reporting.
>
> ***Scenario 2.*** An agency may develop a measurement approach that focuses on particular areas of the payment cycle or program that could lead to greater return on investment (for instance, these are areas that are within the agency's control and may be egregious errors). Focusing on these particular areas would allow the agency to prevent and reduce improper payments in the most cost-effective manner possible.

11) May agencies use alternative sampling and measurement approaches?

Yes, Section 2(B) of IPERA requires agencies to produce a statistically valid estimate, or "an estimate that is otherwise appropriate using a methodology approved" by the Director of OMB. This section means that agencies may utilize an alternative sampling and measurement approach after obtaining OMB approval. The scenarios described below are examples of the types of approaches that may be approved by OMB as alternatives to the steps provided in Part IA, Section 7 of this Guidance. However, agencies are still required to obtain OMB approval prior to implementation. Use of alternative measurement methodologies should not preclude agencies from performing their risk assessments as required by this Guidance in Part IA, Section 7, Step 1. In addition, if agencies are approved to use either Scenario 1, 2, or 3, all steps within the scenario are required to be completed, and the use of, and justification for, using an alternative sampling and measurement approach must be reported in the agency's annual PAR or AFR. The scenarios below are merely illustrations, and other alternatives may be presented to OMB.

> ***Scenario 1.*** An agency has a previous (less than five years old) baseline improper payment rate, and has a plan in place to obtain another full program improper payment rate within five years from the baseline year.
>
> Step 1: Aging the baseline rate. The agency should use statistical methods to update or "age" the baseline improper payment rate in the intervening years, until the next program rate is established. Specifically, the agency should use available data to extrapolate updates of the baseline rate. At a minimum, the analysis should conclude whether the baseline rate is trending upward, downward, or remaining static.
>
> Step 2: Program component annual measurement. The agency should develop an annual improper payment rate for a component of the program. The component can be defined based on population, program area, or known problem area. To the extent possible, the component chosen for analysis should be based on risk so that the agency is targeting an area of the program in which a significant amount of improper payments is expected to occur. This approach could mean choosing an area because of overall financial exposure, or in the case of State-administered programs, possibly selecting larger states to cover more of the risk. This program component should be statistically sampled annually to obtain an improper payment rate consistent with the statistical rigor requirements of this Guidance in Part IA, Section 7. The goal for the component study is not to extrapolate an improper payment rate for the program as a whole. Rather, the goal is only to estimate an improper payment amount for the relevant program component being studied. Component-specific baseline and target rates, as well as corrective action plans, should be developed to measure and assess agency progress in reducing improper payments in the program component.

Please note, that both Steps 1 and 2 in Scenario 1 are required if this alternative is chosen by the agency and approved by OMB.

Scenario 2. No baseline comprehensive improper payment rate is established and no statistically valid methodology is yet developed to obtain one.

Step 1: Plan for comprehensive baseline measure. A methodology to obtain a comprehensive baseline improper rate must be developed with a timeline that would allow for the first measurement to occur within three years of when the plan was approved by OMB. Statistical rigor must meet, at a minimum, the requirements previously stated in this Guidance in Part IA, Section 7.

Step 2: Program component annual measurement. While the agency is working toward a comprehensive baseline rate, the agency should annually identify a component to measure, and begin to report on this measurement within one year of the plan's approval by OMB. (See Step 2 in Scenario 1 above.)

Step 3: Determine rate. Once the baseline rate is established, and if the rate cannot be re-measured annually, the agency should perform both Steps 1 and 2 of Scenario 1 above to ensure that adequate information on improper payments is obtained on an annual basis. If an agency decides to utilize one of the scenarios listed above, it must complete all of the steps for the scenario selected. It is important to note that agencies are not restricted to using only these two approaches; different strategies may be necessary because of pre-existing legislative requirements and/or prohibitions, or because a different method may be more appropriate in providing results for a particular program. Agencies may also consider non-probabilistic sampling approaches, such as purposive sampling or cut-off samples, when legislative requirements make probabilistic samples untenable (for examples see Part IA, Section 12).

Scenario 3. The risk of improper payments in a program may be part of a larger inefficiency that the agency is attempting to address. For instance, the improper payments in the program may be a subset of a larger initiative, and the agency may only focus on one portion of the improper payments within the program that is under its control rather than the entire inefficiency.

Step 1: Identify program component. The agency should identify the component of the program that it wants to measure and report on. This selection should be a component of the program that is within its control, is a driver of improper payments within the program, and whose measurement would produce benefits that outweigh their costs. Once this selection is identified, the agency should implement a measurement plan that meets the statistical rigors stated in this Guidance in Part IA, Section 7.

Step 2: Continue broader program measurement. During and after the development of the program component improper payment rate, the agency should continue to report the overall program improper payment estimate. Eventually, OMB may notify the agency that it may stop conducting the overall program measurement and instead use the program component measurement in its place, but the agency should continue to report both the component and program improper payment rate until OMB notifies the agency that it may stop doing so.

As detailed above, whether an agency decides to use one of these three scenarios, or proposes a different process, all deviations from Appendix C, Part IA, Section 7, must be approved in advance by OMB.

12) What are Federally-funded, State-administered programs, and may agencies consider other approaches for these types of programs?

Federally-funded, State-administered programs (e.g., Medicaid, TANF, Title I Grants to States, Child and Adult Care Food Program) receive at least part of their funding from the Federal Government, but are administered, managed, and operated at the State or local level. Where programs are administered at the State level, statistically valid estimates of improper payments may be provided at the State level either for all States or for all sampled States annually. If the improper payment estimates are provided at the State level, these State-level estimates should then be used to generate a national improper payment dollar estimate and rate. However, agencies may submit a plan to OMB for approval to provide national level estimates for State-administered programs based on a systematic selection of such programs each year.

One example of this type of approach can be seen in the Title IV-E Foster Care Program, wherein current regulations require that programs be reviewed every three years for compliance. With prior OMB approval, this program has taken the review cycle already in place and leveraged it for IPIA measurement, providing a rolling three-year average improper payment rate.

Alternate methodologies, such as those described above, must be approved by OMB in advance of implementation. The justification to use this type of approach must include a description of the States to be selected each year, the methodology for generating annual national estimates, and a justification for using the proposed plan rather than an estimate based on a random statistical sample.

13) Are programs that are identified as susceptible to significant improper payments and that measure and report improper payments permanently subject to improper payments reporting requirements?

No. If an agency's program or activity is risk assessed as susceptible to significant improper payments, but has documented a minimum of two consecutive years of improper payments that are less than the limits noted in Part IA, Section 7, Step 1 above, the agency may request relief from the annual reporting requirements for this program or activity. This request must be submitted in writing to OMB, and must include an assertion from the agency's Office of Inspector General that it concurs with the agency's request for relief. If OMB approves the request, the agency shall incorporate that program or activity into its risk assessment cycle. However, if significant legislative changes occur, if program funding is significantly increased, or if any change results in substantial program impact, agencies must perform a risk assessment of this program as part of its next reporting cycle even if it has been less than three years since the last risk assessment. If the risk assessment indicates that the program is again susceptible to significant improper payments, the agency will return to the full measurement and reporting

process as required by IPIA. Agencies must continue to report improper payment rates, amounts, and remediation efforts as long as annual improper payments for a program exceed the reporting thresholds.

14) How should agencies prevent or reduce improper payments?

Agencies should utilize the results of their statistical sampling measurements to identify the root causes of improper payments, and implement corrective actions to prevent and reduce improper payments associated with the root causes of improper payments. Agencies should continuously use their improper payment measurement results to identify new and innovative corrective actions to prevent and reduce improper payments. Agencies should ensure that their corrective actions are leveraging new technologies and techniques – such as forensic tools, pre-payment software, and data matches - that are available and that can assist agencies in preventing and reducing improper payments.

In many cases, agencies will implement long-term, on-going corrective actions that will be implemented and refined on a continuous basis (e.g., the corrective action is in place for many years, though it may be refined year-to-year). Agencies should annually review their existing corrective actions to determine if any existing action can be intensified or expanded, resulting in a high-impact, high return-on-investment in terms of reduced or prevented improper payments. Agencies must report on their corrective action plans in their annual PARs and AFRs according to the reporting instructions in Circular A-136.

15) What activities can identify, eliminate and recapture improper payments?

Federal agencies should take all necessary steps to ensure the accuracy and integrity of Federal payments. Generally speaking, program integrity activities fall into three basic categories: prevention, detection, and recovery.

a) Prevention. Prevention activities are by definition proactive, and are designed to prevent improper payments from occurring. These actions are performed prior to payment issuance to ensure that the payment is accurate when made. Examples of this type of activity include pre-payment reviews (including, but not limited to, reviews performed by agency certifying officers), due diligence based on risk prioritization, and predictive modeling.
b) Detection. Detection activities occur subsequent to payment, and are intended to detect improper payments that may have occurred. These actions test the accuracy of payment processes and identify improper payments made during those processes. For example, routine payment verification or quality control would review a universe of payments using different criteria than used on the front-end to detect potential improper payments. Data matching compares two or more data fields or sets to confirm consistent input. Use of forensic tools allows payment patterns or anomalies to be isolated and subjected to further review.
c) Recapture. Recapture or collection activities refer to efforts directed toward recovering improper payments. For example, the Treasury Offset Program is frequently used to recoup delinquent overpayments. In addition, the payment recapture auditing concept has been shown to be effective when either an internal or external organization reviews payments to determine correctness. An innovative direction that some Federal agencies have begun

utilizing is risk sharing with its contractors. For example, one large agency has its contractors assume financial responsibility for any improper payments as unallowable contract costs. In addition, this agency financially penalizes its contractor when the amount of improper payments exceeds two percent of total contract payments. As a result, this program has virtually no improper payments. (Please note that this practice in no way delegates legal responsibility, and agencies should continue to report the entire improper payment amount.)

d) Proven Approaches to Consider. Current practices that are yielding positive results in identifying, preventing, reducing, and recapturing improper payments in certain Federal agencies include:

- Predictive modeling – an automated process whereby transactions that have pre-established criteria or characteristics are automatically deemed high risk and therefore receive increased focus both pre- and post-payment. For State-administered programs, in which States are utilizing unique predictive models, Federal agencies should evaluate which States have the most effective methods and ensure that best practices in this area are disseminated to other States.
- Forensic accounting tools – technology-based tools that apply sound analytics to public and government information (i.e., to scan public, governmental, and private data bases to detect patterns, trends, and/or anomalies for use in risk management or other areas of analysis). This technique can be used to build more effective predictive modeling criteria, identify control weaknesses that are leading to improper payments, and/or inform on the most effective oversight and due diligence activities. These data and forensic solutions have a proven track record in the corporate environment for significantly strengthening organizational oversight of fraud and errors while diminishing the amount of resources necessary to execute, and are being utilized by some Federal agencies. To the extent possible, Federal agencies should engage with outside experts – including employees at other Federal agencies or private sector specialists– that can provide input on data access, aggregation, analytics, algorithms, and more simply, basic fraud or error patterns that the agency should track.
- Data matches – Federal agencies should evaluate Federal, State, local, and private databases to assess whether data matches can help strengthen pre- and post-payment reviews.
- Alignment of due diligence and risk oversight – Federal agencies should structure due diligence and oversight activities so that higher risk transactions generate additional due diligence/review and lower risk transactions generate limited or no due diligence/review.
- Prioritization of verification activities based on effectiveness – Federal agencies should evaluate the return on investment of various outreach efforts (e.g., in-person audits, written notices, phone calls) and utilize those efforts with the greatest return on investment.
- Financial Incentives – Several Federal agencies have established financial incentive programs for State and local governments that administer Federally-funded programs to reward performance in reducing, preventing, and identifying improper payments (e.g., States that do a great job of preventing improper payments in a program receive a financial reward). Agencies that are not currently leveraging these types of financial incentives for the administrators of their programs should determine if they have the authority and resources to create a similar financial incentive program. If an agency

believes that the authority to create such a program does not exist, it should include a legislative proposal as part of its improper payment reporting in its annual PAR or AFR.

16) Are there any lessons learned from the implementation of the American Recovery and Reinvestment Act (Recovery Act) that agencies can use to prevent and reduce improper payments in their programs?

During the implementation of the Recovery Act, OMB, Federal agencies, and the Recovery Accountability and Transparency Board employed several practices that limited improper payments of Recovery Act funds. These best practices included:

- Closely monitoring programs to identify risks that may lead to improper payments before they occur.
- Utilizing cutting edge data mining tools to identify and detect improper payments and patterns between data points.
- Partnering with agency Inspectors General and audit teams to focus on fraud prevention rather than fraud detection (e.g., shift from pay and chase model to pre-payment reviews).
- Training agency staff on tools to find improper payments and minimize the impact of potential risks.

Agencies should consider these and other best practices in developing their programs to eliminate improper payments.

17) Where can agencies find additional information about strategies to reduce and prevent improper payments?

The Government Accountability Office surveyed public and private sector organizations and issued a report on practices to measure and prevent improper payments. That report, "Strategies to Manage Improper Payments: Learning from Public and Private Sector Organizations" (GAO-02-69G, October 2001), may be found on the Internet at www.gao.gov/new.items/d0269g.pdf. In addition, there are documents on the Chief Financial Officers Council web site (www.cfoc.gov) that discuss methods, practices and processes, for identifying, preventing, and recovering improper payments. PaymentAccuracy.gov also highlights agency best practices at reducing, preventing, and recapturing improper payments. Lastly, agencies are encouraged to look at PARs or AFRs for information about strategies used by other agencies.

18) Where and when should agencies report the information required by the Act?

Agencies shall, following the format included in OMB Circular A-136, include a summary of their progress of completing these reporting requirements in the Management's Discussion and Analysis (MD&A) section of their PARs or AFRs. However, the detailed portion of the reporting required by this Guidance is to be included as an appendix to the PAR or AFR. The annual estimate of improper payments reported in the PAR or AFR should coincide with the fiscal year being reported, to the extent possible. Agencies may utilize a different 12-month reporting period if it has been approved by OMB. For example, agencies may report based on

the previous fiscal year's data if it has been approved by OMB (e.g., for the FY 2011 PAR or AFR reporting, agencies may report on FY 2010 data if approved by OMB).

19) Are agencies required to develop a single, overall plan for their improper payment and payment recapture audit efforts?

Agencies have several plans related to their improper payment efforts, which should describe their current efforts to prevent, reduce, and recapture improper payments. For example, agencies have measurement and corrective action plans that were developed under IPIA (prior to IPERA's enactment) and which will be updated per this implementing guidance and IPERA. In addition, agencies also have their previous payment recapture audit plans and updated payment recapture plans that were completed per OMB Memorandum M-11-04, issued in November 2010.

Each agency is encouraged to review its measurement, corrective action, and payment recapture audit plans, and to improve and enhance them per this guidance and IPERA's requirements. In addition, each agency is encouraged to synthesize their plans so that they can be viewed as a single, comprehensive agency plan that identifies and coordinates their efforts to measure, reduce, prevent, and recapture improper payments. If agencies need assistance in synthesizing their plans, then they are encouraged to consult with OMB to create a comprehensive plan. OMB will notify agencies of any additional requirements for the creation or submission of these plans.

B) Payment Recapture Audits

This section of the Guidance implements the requirements of Section 2(h) of the Improper Payments Elimination and Recovery Act that requires agencies to conduct payment recapture audits (also known as recovery audits) for each program and activity that expends $1 million or more annually if conducting such audits would be cost-effective. Previously, payment recapture audits were only required for agencies that entered into contracts with a total value in excess of $500 million in a fiscal year, and for certain other programs.

1) What are the definitions used for payment recapture auditing in this Guidance?

For purposes of this Guidance the following terms and definitions are used:

a) A *Post-Award Audit* refers to a post-award examination of the accounting and financial records of a payment recipient that is performed by an agency official, or an authorized representative of the agency official, pursuant to the audit and records clauses incorporated in the contract or award. An audit is normally performed by an internal or external auditor that serves in an advisory capacity to the agency official. A post-award audit, as distinguished from a payment recapture audit, is normally performed for the purpose of determining if amounts claimed by the recipient are in compliance with the terms of the award or contract, and with applicable laws and regulations. Such reviews involve the recipient's accounting records, including the internal control systems. A post-award audit may also include a review of other pertinent records (e.g., reviews to determine if a proposal was complete, accurate, and current); and reviews of recipients' systems established for identifying and returning any improper payments received under its Federal awards.

b) A *Payment Recapture Audit* is a review and analysis of an agency's or program's accounting and financial records, supporting documentation, and other pertinent information supporting its payments, that is specifically designed to identify overpayments. It is not an audit in the traditional sense. Rather, it is a detective and corrective control activity designed to identify and recapture overpayments, and, as such, is a management function and responsibility.

c) A *Payment Recapture Audit Program* is an agency's overall plan for risk analysis and the performance of payment recapture audits and recovery activities. The agency head will determine the manner and/or combination of payment recapture activities to be used that are expected to yield the most cost-effective results (see definition below). These activities should include a management improvement program as defined below, if appropriate. A copy of this program shall be provided to the agency's Inspector General annually.

d) A *Cost-Effective Payment Recapture Audit Program* is one in which the benefits (i.e., recaptured amounts) exceed the costs (e.g., staff time and resources, or payments for the payment recapture audit contractor) associated with implementing and overseeing the program.

e) A *Payment Recapture Audit Contingency Contract* is a contract for payment recapture audit services in which the contractor is paid for its services as a percentage of overpayments actually collected. Clear evidence of overpayments must be provided by the contractor to the appropriate agency official. More information on contingency contracts can be found in the remaining sections of Part IB.

f) A *Management Improvement Program* is an agency-wide program to address the deficiencies in an agency's internal controls over payments identified during the course of implementing a payment recapture audit program, or other agency activities and reviews.
g) A *Recapture Activity* is any activity by an agency to attempt to identify and recover overpayments identified by a payment recapture audit or a post-award audit.

2) What are agencies generally required to do when implementing a payment recapture audit program?

Agencies shall have a cost-effective program of internal control to prevent, detect, and recover overpayments. A program of internal control may include policies and activities such as prepayment reviews, a requirement that all relevant documents be made available before making payment, and performance of post-award audits. Effective internal controls should include payment recapture auditing techniques such as data matching with Federal, state and local databases; and data mining and predictive modeling to identify improper payments. However, for agencies that have programs and activities that expend more than $1 million in a fiscal year, a payment recapture audit program is a required element of their internal controls over payments if conducting such audits is cost-effective. These payment recapture audits should be implemented in a manner designed to ensure the greatest financial benefit to the Federal government.

3) Should agencies establish targets for their payment recapture audit programs?

Yes, all agencies are required to establish annual targets for their payment recapture audit programs that will drive their annual performance. The targets shall be based on the rate of recovery (i.e., amount of improper overpayments recovered divided by the amount of improper overpayments identified). An agency shall set different payment recapture targets for the different types of payments it makes (for example, a given agency might set a target that encompasses all contract payments lumped together, and another target that encompasses all grants payments lumped together).

Agencies have the discretion to set their own payment recapture targets for review and approval by OMB, but agencies shall strive to achieve annual recapture targets of at least 85 percent within three years (with the first reporting year being FY 2011, the second FY 2012, and the third FY 2013). If an agency believes it cannot achieve an 85 percent annual recapture target by FY 2013, it must provide OMB with supporting analysis that warrants a lower target and must seek approval from OMB before setting its target(s). In addition, OMB reserves the right to notify specific agencies that they need to establish stricter targets, or additional measures, as well. Lastly, agencies may also identify and implement additional metrics beyond the recovery rate to evaluate their payment recapture audit programs, but these metrics shall not be used as a substitute for establishing annual recovery rate targets.

4) What is the scope for payment recapture audit programs?

a) All programs and activities[8] that expend $1 million or more annually – including grant, benefit, loan and contract programs - shall be considered for payment recapture audits.

[8] The term "programs and activities" has the same definition and meaning as that contained in Part IA, Section 4.

b) Agencies shall review their different types of programs and activities and prioritize conducting payment recapture audits on those categories that have a higher potential for overpayments and recoveries. Agencies should utilize known sources of improper payment information and give priority to recent payments and to payments made in programs identified as susceptible to significant improper payments. Possible sources of improper payment information include: statistical samples and risk assessments, agency post-payment reviews, prior payment recapture audits, agency Inspector General reviews, Government Accountability Office reports, self-reported errors, reports from the public, audit reports, and the results of the agency audit resolution and follow-up process.
c) Agencies shall conduct a payment recapture audit program in a manner that will ensure the greatest financial benefit for the government.
d) Agencies may exclude payments from certain programs and activities from payment recapture audit activities if the agency determines that payment recapture audits are not a cost-effective method for identifying and recapturing improper payments.
e) The payment recapture audit contractor may, with the consent of the employing agency, notify entities (including individuals) of potential overpayments made to such entities, respond to questions concerning potential overpayments, and take other administrative actions with respect to overpayment claims made or to be made by the agency. However, the payment recapture audit contractor will not have the authority to make final determinations relating to whether any overpayment occurred and whether to compromise, settle, or terminate overpayment claims.
f) To the extent possible, any underpayments identified through the payment recapture audit process should also be corrected by the agencies. Agencies may include provisions that authorize payments to payment recapture auditors for underpayments identified.
g) Payment recapture auditing activities should not duplicate other audits of the same (recipient or agency) records that specifically employ payment recapture audit techniques to identify and recapture overpayments. At a minimum, agencies should coordinate with their Inspectors General and other organizations with audit jurisdiction over agency programs and activities.
h) Instances of potential fraud discovered through payment recapture audit and recapture activities shall be reported immediately to the agency Inspector General.

5) What criteria should an agency consider in determining whether a payment recapture audit is cost-effective?

An agency may consider the following criteria in determining whether a payment recapture audit is cost-effective:

a) The likelihood that identified overpayments will be recaptured. For example:
   - Whether laws or regulations allow recovery;
   - Whether the recipient of the overpayment is likely to have resources to repay overpayments from non-Federal funds;
   - Whether the evidence of overpayment is clear and convincing (e.g., the same exact invoice was paid twice) as opposed to whether the recipient of an apparent overpayment has grounds to contest; and
   - Whether the overpayment is truly an improper payment which can be recovered rather than a failure to properly document compliance.

b) The likelihood that the expected recoveries will be greater than the costs incurred to identify the overpayments. For example:
   - Can efficient techniques such as sophisticated software and matches be used to identify significant overpayments at a low cost per overpayment or will labor intensive manual reviews of paper documentation be required?
   - Are tools available to efficiently perform the payment recapture audit and minimize payment recapture audit costs? Payment recapture audits are generally most efficient and effective where there is a central electronic database (e.g., a database that contains information on transactions and eligibility information) where sophisticated software can be used to perform matches and analysis to identify recoverable overpayments (e.g., duplicate payments).

Agencies are encouraged to use limited scope pilot payment recapture audits in areas deemed of highest risk (e.g., based on IPIA risk assessments) to measure the likelihood of cost-effective payment recapture audits on a larger scale.

6) What should an agency do if it determines that a payment recapture audit program would not be cost-effective?

If an agency determines that it would be unable to conduct a cost-effective payment recapture audit program for certain programs and activities that expend more than $1 million, then it must notify OMB and the agency's Inspector General of this decision and include any analysis used by the agency to reach this decision. OMB may review these materials and determine that the agency should conduct a payment recapture audit program to review these programs and activities. In addition, the agency shall report in its annual PAR or AFR: 1) a list of programs and activities where it has determined conducting a payment recapture audit program would not be cost-effective; and 2) a description of the justifications and analysis that it used to determine that conducting a payment recapture audit program for these programs and activities was not cost-effective.

7) Should the agency follow any particular procedures when conducting payment recapture audits of grants payments?

Agencies with grant programs shall consider payment recapture auditing contracts at the grant recipient level. Federal agencies should work with State and local governments to ensure that they have enough resources to conduct payment recapture audits (for example, through direct funding, allowable administrative expenses, or contingency contracts). Generally, Federal agencies should not look to pass-through entities for repayment of improper payments identified by payment recapture audits for funds they pass-through until repayment has been made by the sub-recipient or the final payee. Federal agencies should also coordinate among themselves to reach partnerships with grant recipients to ensure a coordinated, cost-effective approach to implement these payment recapture audit requirements. The cognizant agency assignment model used in the Single Audit or cost allocation processes can help in streamlining the coordination between the Federal agencies and grant recipients.

8) Can Federal agencies provide money to States and Local governments for Financial Management Improvement efforts?

Yes. Many programs are Federally-funded but State-administered, and Federal agencies should support State efforts to reduce improper payments in these programs. As authorized in IPERA and this guidance, agencies may use up to 25 percent of funds recovered under a payment recapture audit program to support Financial Management Improvement Programs (see Part IB, Sections 15(b) and 17 for additional information on these programs), including providing a portion of this funding to State and local governments to support their Financial Management Improvement Programs.

9) Who may perform payment recapture audits?

Payment recapture audits may be performed by employees of the agency, by any other department or agency of the Federal government acting on behalf of the agency, by non-Federal entities (as defined in OMB Circular A-133) expending Federal awards, by contractors performing payment recapture audit services under contracts awarded by the executive agency, or any combination of these options.

10) May payment recapture audit services be performed by contractors?

Yes. With respect to contracts with private sector contractors performing payment recapture audits, agencies may utilize a number of options, including a contingency contract with a private sector contractor, to conduct payment recapture audit services. With the passage of IPERA, agencies are allowed and encouraged to utilize contingency contracts for private sector contractors to implement the authorities under the new law to review all types of payments and activities.

However, certain types of payments recovered may not be available to pay the payment recapture audit costs (for instance, amounts recovered due to interim improper payments made under ongoing contracts if these amounts are still needed to make subsequent payments under the contract, recoveries from an appropriation other than a discretionary appropriation, or recovered overpayments from an appropriation that has not expired). Therefore, agencies would need to establish other funding arrangements (such as through appropriations) when making payments to private sector payment recapture audit contractors in such cases where recoveries cannot be used to pay contingency fee contracts.

11) What is the role and authority of Inspectors General?

Nothing in this Guidance should be construed to impair the authority of an Inspector General under the Inspector General Act of 1978 or any other law. However, because the payment recapture audit program required by this Guidance is an integral part of the agency's internal control over its payments, and therefore a management function, independence considerations would normally preclude the Inspector General and other agency external auditors from carrying out management's payment recapture audit program.

Agencies' Inspectors General and other external agency auditors are encouraged to assess the effectiveness of agencies' payment recapture audit programs as part of their internal control work on existing audits (e.g., the annual financial statement audit, or as a separate audit).

12) Are there any specific requirements when using a contracted payment recapture auditing firm?

Agencies should require contractors to become familiar with the agency's specific policies and procedures, and take steps to safeguard the confidentiality of sensitive financial information that has not been released for use by the general public and any information that could be used to identify a person.

At a minimum, each contract for payment recapture audit services shall require the contractor to:

a) At least twice a year, provide reports to the agency on conditions giving rise to overpayments (e.g., root causes of overpayments) identified by the auditor and any recommendations on how to mitigate such conditions. The results of such analyses and related recommendations will be considered by the agency as part of its management improvement program. If requested, the agency should provide such information to its Office of Inspector General;
b) Notify the agency of any overpayment identified by the contractor pertaining to the agency or to any other agency or agencies that are beyond the scope of the contracts; and
c) Report to the agency and the agency's Office of Inspector General credible evidence of fraud or vulnerabilities to fraud, and conduct appropriate training of contractor personnel on identification of fraud.

Agencies may allow payment recapture auditors to establish a presence on, or visit, the property, premises, or offices of any subject of payment recapture audits. Such physical presence is not prohibited, and may in fact allow the payment recapture auditor to do a more thorough review of the subject's payments, and related documentation and payment files.

13) Are there any prohibitions when using a payment recapture auditing contractor?

In addition to provisions that describe the scope of payment recapture audits (and any other provisions required by law, regulation, or agency policy), any contract with a private sector firm for payment recapture audit services shall include provisions that prohibit the payment recapture audit contractor from:

a) Requiring production of any records or information by the agency's contractors. Only duly authorized employees of the agency can compel the production of information or records from the agency's contractors, in accordance with applicable contract terms and agency regulations;
b) Acting as an agent for the Federal government in the recovery of funds erroneously paid;
c) Using or sharing sensitive financial information with any individual or organization, whether associated with the Federal government or not, that has not been officially

released for use by the general public, except for an authorized purpose of fulfilling the payment recapture audit contract; and

d) Disclosing any information that identifies an individual, or reasonably can be used to identify an individual, for any purpose other than as authorized for fulfilling its responsibilities under the payment recapture audit contract.

14) Who performs recovery activities once the improper payments are discovered and verified?

The actual collection activity may be carried out by Federal agencies, or non-Federal entities expending Federal awards as appropriate. However, agencies or non-Federal entities may use another private sector entity, such as a private collection agency, to perform this function, if this practice is permitted by statute. As noted above in Section 13, the payment recapture audit contractor itself may not perform the collection activity, unless it meets the definition of a private collection agency, and the agency involved has statutory authority to utilize private collection agencies. Agencies shall ensure that applicable laws and regulations governing collection of amounts owed to the Federal government are followed.

15) What is the proper disposition of recovered amounts?

Funds collected under a payment recapture audit program can be used for the following purposes:

a) Overpayments from discretionary accounts that were appropriated after enactment of IPERA (i.e., after July 22, 2010) and that have expired, and that are collected under a payment recapture audit program, shall be available to the executive agency to reimburse the actual expenses incurred by the executive agency for the following purposes:
   i. To reimburse the actual expenses incurred by the executive agency for the administration of the program (including payments made to other agencies that carry out payment recapture audit services on behalf of the agency); and
   ii. To pay contractors for payment recapture audit services.

b) Any expired, recaptured discretionary amounts that were appropriated after enactment of IPERA (i.e., after July 22, 2010) that are not used to reimburse expenses of the executive agency or pay payment recapture audit contractors—as described above in Part IB, Section 15(a)—shall be used for: a financial management improvement program, the original purpose of the funds, Inspector General activities, or returned to the Treasury as miscellaneous receipts or returned to trust or special fund accounts. Each agency shall determine the actual percentage of recovered overpayments used for the purposes outlined in this section (up to the maximum amount allowed in the law and this Guidance). Specifically:
   i. Up to 25 percent of the recaptured funds may be used for the financial management improvement program described below in Part IB, Section 17. This funding shall be credited, if applicable, for that purpose identified by the agency head to any agency appropriations and funds that are available for obligation at the time of collection. These funds shall be used to supplement and not supplant any other amounts available for that purpose, and shall remain available until expended. As discussed in

Part IB, Section 8, such funds can go to non-Federal entities such as state and local governments if the agency determines that is the best disposition of the funds to support its financial management improvement program.

ii. Up to 25 percent of the recaptured funds may be used for the original purpose. This funding shall be credited to the appropriation or fund, if any, available for obligation at the time of collection for the same general purposes as the appropriation or fund from which the overpayment was made, and shall remain available for the same period of availability and purposes as the appropriation or fund to which credited. If the appropriation from which the overpayment was made has expired, the funds shall be newly available for the same time period as the funds were originally available for obligation. However, any funds that are recovered more than five fiscal years after the last fiscal year in which the funds were available for obligation shall be deposited in the Treasury as miscellaneous receipts.

iii. Up to 5 percent of the recaptured funds shall be available to the agency Inspector General. The agency Inspector General may use this funding to carry out the law's requirements, and perform other activities relating to investigating improper payments or auditing internal controls associated with payments. However, the funding shall remain available for the same period of availability and purposes as the appropriation or fund to which it is credited.

The remainder of the recaptured, expired discretionary funds that were appropriated after enactment of the law (e.g., July 22, 2010) and that are not used for the purposes outlined earlier in this section shall be deposited in the Treasury as miscellaneous receipts.

c) Any overpayments from discretionary funds that are recaptured from appropriations enacted after IPERA was enacted (i.e., appropriations enacted after July 22, 2010) but that have not expired are to be returned to the appropriation from which it was made without using it for any purposes outlined above in Part IB, Section 15(a) and 15(b).

d) Any overpayments from mandatory fund accounts, trust fund accounts or special fund accounts (like revolving funds) shall revert to those accounts without using the payments for the purposes outlined above in Part IB, Section 15(a) and 15(b).

e) When required or authorized by other provisions of law, any funds remaining after reimbursing expenses of the executive agency and paying payment recapture audit contractors, shall be credited to a non-appropriated fund instrumentality, revolving fund, working-capital fund, trust fund, or other fund or account.

f) Contingency fee contracts shall preclude any payment to the payment recapture audit contractor until the recoveries are actually collected by the agency.

g) All funds collected and all direct expenses incurred as part of the payment recapture audit program shall be accounted for specifically. The identity of all funds recovered shall be maintained as necessary to facilitate the crediting of recovered funds to the correct appropriations and to identify applicable time limitations associated with the appropriated funds recovered.

h) Overpayments that are identified by the payment recapture auditor, but that are subsequently determined not to be collectable or not to be improper, shall not be considered "collected" for proceed disposition purposes outlined in this section.

i) A few programs and payments have separate statutory authority and requirements to conduct payment recapture audits and are not required to follow the disposition of

recovered funds outlined above for funds recovered from these programs and payments. For instance, under Section 302 of Division B of the Tax Relief and Health Care Act (Section 1893 of the Social Security Act; 42 U.S.C. 1395ddd) and Section 6411 of the Patient Protection and Affordable Care Act (Pub. L. No. 111-148), the Department of Health and Human Services is required to conduct reviews of certain Medicare program payments to identify and recover improper payments, and States are required to conduct similar reviews under Medicaid. Similarly, under the authority of 31 U.S.C. 3726, the General Services Administration audits agency transportation payments for improper payments. Agencies with oversight of such programs and payments may choose to follow the disposition uses outlined in this Guidance, but are not required to do so.

16) Can agencies review funds appropriated prior to the enactment of IPERA under their payment recapture audit program, and what should they do with any funds that are recaptured?

Yes, agencies may review payments from appropriations that were enacted before IPERA was signed into law, and would have the same authorities as before IPERA was enacted. Any recovered funds from appropriations prior to IPERA's enactment may not be used for the purposes outlined above in Part IB, Section 15(b). Instead, for expired and active funds that were appropriated prior to IPERA's enactment that were subsequently recovered by the agency, agencies may use the recovered funds to reimburse the agency for its expenses and to pay the contractor. For those funds that were appropriated prior to IPERA's enactment but which have expired, the remainder of the recovered funds (after reimbursing the agency and paying the contractor) should be returned to the Treasury as miscellaneous receipts. For funds that have not expired, the remainder of the recovered funds (after reimbursing the agency and paying the contractor) shall be returned to the program account.

17) Are agencies authorized to implement Financial Management Improvement Programs?

Yes. IPIA authorizes agencies to implement "financial management improvement programs." Such programs shall take the information obtained from the payment recapture audit program (as well as other audits, reviews, or information that identify weaknesses in an agency's internal controls), and ensure that actions are taken to improve the agency's internal controls to address problems that directly contribute to agency improper payments. In conducting its financial management improvement programs, agency heads may also seek to reduce errors and waste in programs and activities other than where funds are recaptured.

18) What are the reporting requirements for payment recapture audits?

In accordance with OMB Circular A-136, agencies must report annually on their payment recapture audit program in their PARs and AFRs. The report shall include the following information:

a) A general description and evaluation of the steps taken to carry out a payment recapture audit program, including a discussion of the methods used by the agency to identify and recapture overpayments;

b) The total amount of payments subject to review, the actual amount of payments reviewed, the amounts identified for recapture, and the amounts actually recaptured in the current year. Report separate totals from amounts attributable to internal agency activities from payment recapture audit contractors;
c) A description and justification of the classes of payments excluded from payment recapture audit review by the agency;
d) The amounts recaptured, outstanding, and determined to not be collectable, including the percent each category represents of the total overpayments identified for recapture by the agency;
e) If a determination has been made that certain overpayments are not collectable, a justification for that determination;
f) An aging schedule of the amounts outstanding;
g) A summary of how recaptured funds were disposed of;
h) A discussion of any conditions giving rise to improper payments (i.e., root causes) and how those conditions are being resolved (i.e., corrective action plans); and
i) If applicable, an explanation of why recapture audits were not performed on all programs and activities (i.e., not cost-effective).

In addition, agencies are required to complete a separate, annual report to OMB and Congress by November 1 that describes any recommendations identified by the payment recapture auditor on how to mitigate conditions giving rise to overpayments, and any corrective actions the agency took during the preceding fiscal year to address the auditor recommendations. This report shall describe agency efforts during the previous fiscal year (for example, for the November 1, 2011 report, the agency would describe recommendations and actions between October 1, 2010, and September 30, 2011; subsequent reports would describe efforts for subsequent fiscal years). Agencies should also provide this report to their Inspector General when they provide it to OMB and Congress. This report is required for agencies that utilize Federal employees or external contractors to conduct their payment recapture audits.

19) How are improper payment statistical measurements different from payment recapture audit efforts?

Improper payment statistical measurements evaluate a small number of payments in a program or activity to determine if the payments were improper or proper. The results of these reviews are then extrapolated to the universe of payments in a program or activity to determine the program or activity's annual improper payment amount and rate. Payment recapture audits are not statistical samples, and instead are targeted examinations of high-risk payments which most likely can be cost-effectively recaptured (e.g., cash collected from the final payee exceeding collection costs).

Part II. Compliance with the Improper Payment Requirements

This section includes guidance that is intended to assist agency management and Inspectors General in implementing Section 3 of IPIA related to compliance with the law.

A) Responsibilities of Agency Inspectors General

1) When should each agency Inspector General begin reviewing improper payment performance to determine whether the agency is in compliance with IPIA?

Each agency Inspector General should review agency improper payment reporting in the agency's annual PAR or AFR, and accompanying materials, to determine if the agency is in compliance with IPIA. Agency Inspectors General should begin reviewing these materials for FY 2011 annual reporting and in subsequent years.

2) When should the agency Inspector General complete its review of agency compliance with IPIA?

An agency Inspector General should review the agency's annual PAR or AFR, and accompanying materials, and complete its review and determination within 120 days of their publication.

3) Who should the agency Inspector General notify when it has completed its determination of whether an agency is in compliance with IPIA?

Each fiscal year, the agency Inspector General should determine whether the agency is in compliance with IPIA. Once it has completed its assessment, the agency Inspector General must submit its results to:

- The agency head;
- The Senate Homeland Security and Government Affairs Committee;
- The House Committee on Oversight and Governmental Reform;
- The Comptroller General; and
- The Controller of the Office of Management and Budget.

4) What should each agency Inspector General review to determine if an agency is in compliance with IPIA?

To determine compliance with IPIA, the agency Inspector General should review the agency's PAR or AFR (and any accompanying information) for the most recent fiscal year. Compliance with IPIA means that the agency has:

- Published a PAR or AFR for the most recent fiscal year and posted that report and any accompanying materials required by OMB on the agency website;
- Conducted a program specific risk assessment for each program or activity that conforms with Section 3321 of Title 31 U.S.C. (if required);

- Published improper payment estimates for all programs and activities identified as susceptible to significant improper payments under its risk assessment (if required);
- Published programmatic corrective action plans in the PAR or AFR (if required);
- Published, and has met, annual reduction targets for each program assessed to be at risk and measured for improper payments;
- Reported a gross improper payment rate of less than 10 percent for each program and activity for which an improper payment estimate was obtained and published in the PAR or AFR; and
- Reported information on its efforts to recapture improper payments.

If an agency does not meet one or more of these requirements, then it is not compliant with IPIA. In addition, as part of its review of these improper payment elements, the agency Inspector General should also evaluate the accuracy and completeness of agency reporting, and evaluate agency performance in reducing and recapturing improper payments. For example, when reviewing the program improper payment rates, corrective action plans, and improper payment reduction targets, the Inspector General should determine if the corrective action plans are robust and focused on the appropriate root causes of improper payments, effectively implemented, and prioritized within the agency, to allow it to meet its reduction targets. As part of its report, the agency Inspector General should include its evaluation of agency efforts to prevent and reduce improper payments, and any recommendations for actions to further improve the agency's or program's performance in reducing improper payments.

B) Responsibilities for Agencies

1) What are the requirements for agencies not compliant with IPIA?

Agencies that are not compliant with IPIA must complete several actions. For agencies that are not compliant for one fiscal year, within 90 days of the determination of non-compliance, the agency shall submit a plan to the Senate Homeland Security and Government Affairs Committee and the House Committee on Oversight and Governmental Reform describing the actions that the agency will take to become compliant. The plan shall include:

- Measurable milestones to be accomplished in order to achieve compliance for each program or activity;
- The designation of a senior agency official who shall be accountable for the progress of the agency in coming into compliance for each program or activity; and
- The establishment of an accountability mechanism, such as a performance agreement, with appropriate incentives and consequences tied to the success of the senior agency official in leading agency efforts to achieve compliance for each program and activity.

For agencies that are not compliant for two consecutive fiscal years for the same program or activity, the Director of OMB will review the program and determine if additional funding would help the agency come into compliance. If the Director of OMB determines that additional funding would help the agency become compliant, the agency shall obligate an amount of additional funding determined by the Director of OMB to intensify compliance efforts. When providing additional funding for compliance efforts, the agency shall:

- Exercise reprogramming or transfer authority to provide additional funding to meet the level determined by the Director of OMB; and
- Submit a request to Congress for additional reprogramming or transfer authority if additional funding is needed to meet the full level of funding determined by the Director of OMB.

For agencies that are not compliant for three consecutive fiscal years for the same program or activity, within 30 days of the determination of non-compliance, the agency will submit to Congress:

- Reauthorization proposals for each (discretionary) program or activity that has not been in compliance for three or more consecutive fiscal years; or
- Proposed statutory changes necessary to bring the mandatory program or activity into compliance.

In addition, OMB may require agencies that are not compliant with the law (for one, two, or three years in a row) to complete additional requirements beyond those requirements listed above. For example, if a program is not compliant with the law, OMB may determine that the agency must re-evaluate or re-prioritize its corrective actions, intensify and expand existing corrective action plans, or implement or pilot new tools and methods to prevent improper payments. OMB will notify agencies of additional required actions as needed. Lastly, agencies should share any plans or proposals required by this section with their respective Inspectors General.