

Improper and Erroneous Payments in the Federal Government

Executive Summary

Improper and erroneous payments—payments that should not have been made or were made for incorrect amounts because of errors, poor business practices, or intentional fraud or abuse—are a significant problem for the Federal Government. The General Accounting Office (GAO) estimates that improper payments cost the Federal Government at least \$20 billion a year, and there is strong evidence that the costs actually exceed this level. A recent tally by the Office of Management and Budget put erroneous payments at more than \$30 billion a year.

The President has made the reduction of improper and erroneous payments a focus of his Management Agenda. In support of that effort, this paper has been developed by a joint workgroup composed of members from the Chief Financial Officers Council (CFOC) and the President's Council on Integrity and Efficiency (PCIE). It describes the different kinds of improper and erroneous payments, discusses some of the most important causes for such payments, and offers suggestions and recommendations to address the problem.

Improper and erroneous payments are as diverse as the range of activities the Government performs. The workgroup has identified a number of problems that increase the risk of such payments across the spectrum of Government payments. The most important include:

- **a weak or incomplete program control environment** – the systems, procedures, and practices, including rigorous oversight, that can help to prevent or correct improper and erroneous payments;
- **risks inherent in the regulatory and policy structure** that defines and supports each Federal program, many of which stem directly from policy choices and mandates; and
- **a lack of attention toward, as well as restrictions on, Government-wide coordination and information-sharing** including better alignment of program eligibility policies, sharing of data, consistency in measuring improper and erroneous payments, and dissemination of best practices.

While the total elimination of improper payments will not be either cost-effective or politically feasible, the Federal Government can and must take positive action to reduce and, to the extent possible, *prevent* this problem. The joint CFOC/PCIE workgroup recommends the following:

- All agencies should make fostering an effective internal control environment a priority, and support the effort with resources and incentives.
- Every Government official should recognize that risk of improper payments is an inherent part of any policy made that results in, or affects, Government payments. Both Congress and the Executive Branch should consciously and explicitly balance the risk of error or fraud against other important policy imperatives. In some areas, careful review of existing authorizing statutes is needed to strike a better balance.
- The President's Management Council should take responsibility for coordinating policy addressing Government-wide improper and erroneous payment issues and proposing legislative, regulatory, budgetary, and policy initiatives to the Office of Management and Budget that can mitigate the risks of improper payments.
- The CFOC should lead an effort engaging program officials to improve the consistency of measurement for erroneous and improper payments.

Improper and Erroneous Payments in Federal Programs: A Framework for Action

Payments—transfers of cash, in-kind benefits, goods, services, loans and loan guarantees, insurance subsidies, and other items of value—between Federal agencies and contractors, vendors, partners and beneficiaries are fundamental to the operation of Government. Each payment entails a risk of error or impropriety, and thus of potential loss or diversion of Federal resources.

These risks cannot be avoided; they are inherent to all business, including the business of Government. But minimizing them through effective policies and strong management practices is fundamental to the Federal responsibility for effective stewardship of taxpayer resources. Failure to implement an effective control environment to prevent erroneous and improper payments jeopardizes continued confidence in the Government's ability to meet its many missions and responsibilities.

This paper, developed jointly by the members of the Chief Financial Officers Council (CFOC) and the President's Council on Integrity and Efficiency (PCIE)¹ is part of a continuing effort to raise the awareness of improper payments within the Federal community, with an eye toward significant improvement. It is intended to describe in broad terms the different kinds of improper payments that may occur, and identify some of the most important causes for such payments. It offers a number of recommended changes in laws, policies, and management practices that can reduce the risk of improper payments, thus saving taxpayer dollars.

Definition. General Accounting Office (GAO) Report Number GAO-02-749, August 2002, defines improper payments as payments that should not have been made or were made for incorrect amounts. Specifically, this includes:

- inadvertent erroneous payments, such as duplicate payments, and incorrectly calculated payments (which may include underpayments);
- unsupported or inadequately supported payments of claims;
- payments for services not rendered or services rendered to ineligible beneficiaries; and
- payments resulting from fraud and abuse by program participants and/or Federal employees.

This definition is similar to that used by the Office of Management and Budget (OMB). As a clarification, the term "payment" tends to be associated with a disbursement of cash. "Improper payment" as used here also applies to non-cash payments, such as loan guarantees, services received by ineligible persons or participants, and services made in error. This definition also is in alignment with the Congressional definition found in H.R. 4878 as passed by the House and agreed to by the Senate.

Understanding the Causes of Improper Payment Risks. Government payments can be generally categorized by a wide range of criteria, including the nature of the value being transferred, the recipient of the payments, and the legal and/or regulatory parameters by which the payment must be made. Similarly, improper payments can be characterized by the types of control weaknesses that cause them and the level of risk of erroneous or improper payment. The CFOC/PCIE workgroup has identified three areas for improvement that contribute significantly to the risk of improper and erroneous payments across Government: the program control environment; policy and program structure; and consistency, coordination and standardization.

¹ Members of the CFOC and the PCIE are listed in Appendixes A and B respectively.

The Program Control Environment

Government programs operate in an environment that is prone to human error and, in some cases, malfeasance. While much attention has been focused on a few specific programs at “high risk” for improper payments, these programs tend to be the largest in size, rather than those at uniquely high risk. They also tend to be the programs with systems already in place to identify and measure improper payments. This does not imply that improper payments do not occur in other programs, only that they are not identified or reported.

In reality, all Federal agency operations – from the smallest procurement contract, to the largest entitlement program – must deal with the risk of improper payments. It is primarily the responsibility of agency and program managers to develop and implement a set of systems, procedures, and practices that can help to prevent or correct errors and discourage or mitigate the impact of malfeasance. Both the Executive Branch and Congress, however, share a responsibility to ensure that agencies have the necessary authority and resources to develop and implement such systems, procedures, and practices. The President has accepted this responsibility by including this issue in his Management Agenda. GAO describes these collective practices as an agency’s “program control environment,” which is also defined in OMB Circular A-123, revised June 21, 1995, as:

... the establishment and maintenance of an environment throughout an organization that sets a positive and supportive attitude toward internal control and conscientious management....

Full descriptions of a strong internal control environment have been provided by both OMB² and GAO.³ These must be followed to address this issue adequately. Examples of key factors that impact the internal control environment include:

- the *integrity and ethical values* maintained and demonstrated by management and staff;
- management’s *commitment to a level of competence* among personnel that allows them to accomplish assigned duties and understand the importance of good internal control;
- *management’s philosophy and operating style*, including the degree of risk the agency is willing to take, attitudes towards performance-based management, information systems, and other functions;
- the agency’s *organizational structure*, as a framework for planning, directing, and controlling operations to achieve agency objectives;
- good *human capital policies and practices*, including appropriate practices for hiring, training, supervising, compensating, and disciplining personnel.

Implementation of specific internal control strategies should balance benefits and costs. However, because most agencies have not determined the extent of improper and erroneous payments occurring in their operations, they are unable to evaluate the cost effectiveness of current controls or of potential improvements.

Emphasis on several aspects of internal control can facilitate efforts to prevent and minimize erroneous payments. These strategies are addressed in greater detail in a separate paper on a website which will be identified in the future.

Eligibility Controls. Eligibility controls are established to determine *initial* eligibility to receive payments or benefits and to ensure *continued* eligibility for recurring payments. Weaknesses

² “Management Accountability and Control,” OMB Circular A-123, revised June 21, 1995

³ “Standards for Internal Control in the Federal Government,” United States General Accounting Office Report, GAO/AIMD-0021.3.1, November 1999

such as inadequate written procedures, weak automated system controls for determining eligibility, and lack of training of managers and employees cause erroneous payments.

Oversight and Monitoring Controls. Oversight and monitoring controls are critical for identifying problems and assessing progress related to erroneous payments. While 12 of the 19 agencies that responded to our survey reported efforts to perform oversight and monitoring of improper and erroneous payments, none of these agencies reported a comprehensive approach to measuring improper payments, developing and implementing corrective actions, or reporting on the results of the actions taken.

An agency's relationship with Congress and Central agencies impacts the control environment. Congress legislates the programs that agencies undertake, monitors their progress, and must appropriate the resources necessary to support effective internal and external oversight. Central agencies provide policy and guidance on many different matters. Furthermore, external studies, audits, and investigations contribute to a good overall control environment. However, there are times when comprehensive, timely, and accurate information needed for external oversight is not available because of limited program resources, or because of reluctance to impose undue burden upon program partners, cooperators, and participants.

Secondary Party Controls. Many programs are operated by the Federal Government in partnership with state or local governments or private intermediary organizations, and are particularly vulnerable to improper payments. Authorizing legislation for such programs often requires the Federal Government to set program standards in regulations, and provide all or part of the program funding, while the other entities manage the day-to-day program operations. As such, Federal agencies must depend on state, county, and local officials and other entities to ensure that initial and continued eligibility requirements are met and that payment amounts are determined correctly. Budget resource levels in states and local governments also impact improper payments. Even when a program is 100% Federally funded, state and local offices levy controls which impact resource levels.

While program structures of this type are generally driven by policy considerations other than improper payments, Federal agencies must shape their control environment to minimize the risks of improper payments in the context of that structure. Agencies often do not have the oversight resources to ensure that secondary party controls are implemented properly to prevent erroneous payments. In this environment, second-party organizations that manage Federal programs often have little incentive to ensure payment accuracy.

E-Commerce Infrastructure. Complete and accurate data at the point-of-entry, using edit checks and other means, minimizes improper and erroneous payments. Reducing the need to enter data more than once is also helpful in ensuring accurate payments. E-commerce can be designed to provide timely and accurate data by placing data entry at the origin and reducing the requirement for multiple data entry. Unfortunately, upgrading and developing program and financial systems is an inordinately costly method for reducing the improper and erroneous payments. Timely and accurate data for making payment decisions cannot be expected in the absence of systems remediation.

Policy and Program Structure

Few, if any, government programs and functions are designed with integrity and accuracy as their primary purpose. Generally, programs exist to accomplish a mission or fulfill a responsibility not directly served by the private sector—such as national defense, social improvement, or market support. The policies and program structures required to meet these missions may entail greater or lesser risks of improper payments, depending on the nature of the benefits, the services provided, and the circumstances of those served.

Delivering services expeditiously while ensuring that the recipient is entitled to the payment and that the payment is accurate can present significant challenges. In many instances the mandated goal of providing fast and accurate payments to significant numbers of claimants/recipients conflicts with the goal of reducing improper and erroneous payments. Federal, state, and local entities are challenged to ensure that laws and regulations achieve program results without creating an environment in which improper and erroneous payments are prevalent. However, some policy choices greatly impact the risk of improper payments.

Complexity of Requirements. Complex requirements imposed on some Federal programs inadvertently increase the risk of improper and erroneous payments. Such laws and regulations confuse both beneficiaries and agencies. The confusion makes it difficult to identify and correct improper and erroneous payments. The complexities are often designed to target eligibility to those in greatest need, thereby reducing program costs. However, the improper payments made because of program complexity and the lack of a sufficient control environment eventually increase the total cost to the taxpayer.

Conflicting Legislation. Erroneous payments also occur because of conflicts between various legislative requirements. There are available Federal databases that could be used to help reduce erroneous payments. However, legislation such as the Privacy Act and Internal Revenue Code impede obtaining and using data from certain sources even though the data might significantly assist in ensuring that payments were made correctly.

Weakened Enforceability. Limited enforcement of eligibility and payment requirements can result in the creation of erroneous payments. Insufficient monitoring and oversight fosters an atmosphere that leads to erroneous payments and fraud. Agency or partner resources are often not adequate to provide enforcement.

Government-wide Consistency, Coordination, and Standardization

The issues of improper payments are nearly as diverse as the payments themselves. Coordination, information sharing, and consistency in evaluating risk and measuring improper payments are essential to resolving the issues. However, significant barriers to effective coordination still exist.

Quality and Integration of Data. Instrumental to preventing improper and erroneous payments is the data used in determining the correctness of a payment. Valid and authorized data need to be recorded and processed according to management and program requirements to ensure that proper payments are made. Poor data quality can produce improper and erroneous payments. Properly designed management controls, such as use of computerized edit checks, help to minimize erroneous payments. Many systems are not properly integrated and depend on extracting and re-entering payment data.

Limits on Data Sharing. The inability of many agencies to share data with other agencies and between their own systems may hamper agencies' ability to detect and reduce improper and erroneous payments. Data collected by one Federal agency can be used to verify data required by another agency, to identify inconsistencies and help ensure that payments are appropriate. Although databases exist in some Federal agencies that could assist other agencies in preventing erroneous payments, these databases are not always used effectively. In some cases, legislative prohibitions prevent agencies from matching the data in their databases with that in other agencies' databases. In other cases, the technical ability or impracticality of exchanging or comparing databases presents significant challenges. The incidence of improper and erroneous payments could be greatly reduced if impediments to data matching and sharing are identified and removed and privacy can be assured.

Measuring Improper Payments. While specific requirements define what constitutes an improper or erroneous payment for each program, more consistency in definition and measurement among programs is necessary. Consistent estimates or measures of the rate and amount of improper payments enables managers and others to measure progress over time and determine whether action is needed to reduce the potential for future improper payments. Following are some of the techniques used to measure and estimate improper and erroneous payments.

- **Periodic Study** – a study of payments made in a program that occurs on a quarterly, semi-annual, or annual basis, that determines the accuracy of payments made. Periodic studies could include audits, internal reviews, or other assessments.
- **Judgmental Sample** – a non-statistical sample of payments based on an established threshold criterion. An example could be all payments greater than \$1,000.
- **Statistical Sample** – a sample of payments when verification of all payments is impractical. A method used to evaluate the accuracy of the payments made using a valid sample that can be projected to the entire universe.
- **Trend Analysis** – an analysis of data from past periods used to show improvement or decline as well as to estimate future amounts. A trend analysis would be useful to determine if certain types of payments are more susceptible to errors.
- **Risk Analysis/Measurement** – an analysis of payment-related information, such as a comparison of program participants with demographic estimates of the eligible population that can be used to assess the risk of improper payments when direct measurement of such payments is infeasible or prohibitively costly.

The various types of payments have been successfully measured using specific techniques. The following table provides illustrations of measurement techniques for the various types of payments, and indicates which types of payments are common to each type of recipient.

| Types of Payments | Payment Recipients | | | | | |
|-----------------------------|---------------------|-----------------------------|--------------|-------------------------|----------------------|----------------------|
| | Foreign Governments | State and Local Governments | Corporations | Individuals or Families | Businesses, or Farms | Educational Entities |
| Aid/Relief | P | | | | | |
| Grants | | | | | J | J |
| Entitlements/ Benefits | | | | S, R | | |
| Services Provided | | P | | | P | |
| Contract Payments/ Invoices | | | | | S | |
| Claims or Vouchers | | | | S | S | |
| Payroll | | | | J | J | |
| Loan Guarantees | T | T | T | | T | |

P=Periodic Study, S=Statistical Sample, J=Judgmental Sample, T=Trend Analysis, R=Risk Analysis

Reporting Improper Payments. GAO has recommended that the rate and amount of improper and erroneous payments be reported periodically on a consistent basis. Such reporting would allow greater oversight, provide management with a measurement of progress, and assist in identifying whether further actions are needed. At present, improper and erroneous payment reporting is inconsistent Government-wide. Few agencies report improper payments in financial statements or other required reports. Further, the data reported are not necessarily or easily comparable.

Coordinated Approach Among Program Officials. While the issue of improper and erroneous payments is being coordinated within the CFO and OIG communities, including OMB and GAO, there is not a coordinated effort among program officials. OMB should continue to strengthen its role, especially among its budget staff, in assessing program payment risks.

E-Commerce Standards. The key to effective E-commerce is the development of the Public Key Infrastructure (PKI) environment. The ability of Government agencies to implement E-commerce has been hampered by the delays in the procurement and implementation of PKI technology for ensuring data integrity. Likewise, many agencies are developing different and potentially incompatible PKI technologies that could further slow any implementation. GAO recently testified that the development of a Federal Bridge Certification Authority is needed; without it, agencies may not be able to properly exchange data. If these issues are not properly managed, electronic transactions could be more susceptible to fraud and abuse than the traditional paper environment.

Mitigating/Minimizing Risks of Improper Payments – A Range of Action is Needed

Improper and erroneous payments have a clear detrimental impact on the Federal Government's credibility and ability to manage its costs. The payments are caused by a variety of factors, and impacted by an array of pressures and perspectives, including important constituencies that have little tolerance for the types of Government controls needed to reduce and prevent improper payments.

While the total elimination of improper payments will not be either cost-effective or feasible as a policy matter, the Federal Government can and must take positive action to reduce this problem. Needed actions include changes in law, regulation, policy, and practice, and will require funding, resources, authorities, and political and other support. OMB has a central management role in ensuring that these actions take place across the Executive Branch. Federal agencies need to become more proactive in identifying and mitigating risks before payments or services are actually provided, rather than just instituting programs to recover them after the fact. The recommendations below are offered as initial steps in this area:

The Control Environment

- All agencies must make fostering and supporting an effective internal control environment a priority.⁴ The need for controls should not be focused on a limited number of high-profile "at-risk" programs, but should be extended to all payments on a cost-effectiveness basis, so that less visible, but potentially larger and more correctible improper payment problems are managed effectively.
- Best practices in support of an effective control environment need to be disseminated and understood by all agencies. Agencies should analyze their programs, operations, and activities for improper payment risks, and work to identify innovative methods to overcome them. OMB's Deputy Director For Management must take the lead in collecting and promoting best practices from across the Federal Government and private industry.

⁴ As described in OMB Circular A-123 and GAO/AIMD-0021.3.1

- Standards and mechanisms of internal control; including an integrated, up-to-date IT environment and strong oversight programs; need to be implemented and supported with adequate staff and infrastructure resources at a level that balances the costs of these systems and structures against the costs of improper payments.
- Some control improvements could be supported and promoted by incentives with payments to agencies targeted to risk-mitigation and collection/recoupment strategies. Similarly, the Government should permit agencies to retain a portion of these collections to support ongoing control activities.

Policy and Program Structure

- Because payments are a critical part of almost every operation in Government, minimizing the risk of improper payments is the responsibility of every Government official. Assessing the risk of improper payments should be an inherent part of any policy made that may result in, or affect, a payment.
- Congress and the Executive Branch may need to balance a heightened risk of error or fraud against other important policy imperatives. They should do so consciously and explicitly.
- In some areas, careful review of existing authorizing statutes is needed to explore changes to policies and program requirements to mitigate the risk of improper payments.
- When policy imperatives drive decisions to require “high-risk” transactions (such as risking program participation by ineligible recipients in order to ensure the broadest possible access for eligible recipients) legislative and executive policymakers should commit the attention and resources necessary to lower these risks to an acceptable level as an inherent part of implementation. OMB should assess improper payment risks and potential actions and resources needed to minimize and manage these risks effectively in proposed legislation and budget requests. Congress should consider tasking the Congressional Budget Office with a similar assessment responsibility.

Consistency, Coordination, and Standardization

- The President’s Management Council should be charged with coordinating policy addressing Government-wide issues and proposing legislative, regulatory, budgetary, and policy initiatives to OMB that can mitigate the risks of improper payments. The Council, composed of the Deputy Secretaries of all Federal departments and headed by the Deputy Director of OMB, must identify common issues and support initiatives for further consideration across broad categories of payments, such as entitlements, contracts and grants, and administrative payments (payroll, transactions, and invoices). The Council should treat this as a *program* issue and not just a *financial* matter. Program officials must be a central part of the solutions to these issues.
- These cross-Governmental efforts should be led by policy and program officials from the affected agencies, with support from CFO and OIG officials, program stakeholders, academics, and consultants or experts as necessary. Participants should work to pinpoint opportunities to share or leverage data, data mining capabilities, program delivery techniques, and risk identification and mitigation processes.
- OMB should, during reviews of proposed legislation and regulations, seek opportunities to harmonize legislative and regulatory proposals to reduce the potential for error, such as discrepancies in the eligibility criteria of programs targeted to similar populations, and otherwise ensure program integrity.
- The CFOC should lead an effort, enlisting program officials, to improve the consistency of measurement for erroneous and improper payments. The wide range of payment types made by the Government, and the variation in the availability of data to measure and assess improper payments, create an environment where a single measurement methodology or standard is impracticable. However, increased consistency of measurement across programs and functions is needed to support effective decision-making and allocation of resources. Standard sets of measurement options could be identified for the different payment types.
- Consistent improper or erroneous payment information should be reported in GPRA performance plans, and the budget.

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