



*U.S. DEPARTMENT OF COMMERCE
Office of Inspector General*



*NATIONAL OCEANIC AND
ATMOSPHERIC ADMINISTRATION*

*Opportunities to Strengthen Internal
Controls Over Improper Payments*

Final Report No. BSD-16186-0001/July 2005

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MEMORANDUM FOR: Maureen Wylie
Chief Financial Officer

FROM: Allison Lerner *Allison Lerner*
Acting Assistant Inspector General for Auditing

SUBJECT: *Opportunities to Strengthen Internal Controls
Over Improper Payments*
Final Audit Report No. BSD-16186-5-0001

Attached is our final report on the National Oceanic and Atmospheric Administration (NOAA) Finance Office's internal controls over improper payments on contracts and purchase orders. We found that the Finance Office's internal controls over improper payments on contracts and purchase orders are generally effective and provide reasonable assurance regarding the prevention, detection, and correction of such payments. However, we did identify opportunities for the Finance Office, after appropriate consideration of costs and benefits, to strengthen its controls, thereby further reducing its susceptibility to improper payments. Specifically, these include prepayment audits, retention of key payment certification documents, and reports of erroneous payments data. A detailed listing of the improper payments associated with these areas was separately provided to NOAA managers during the audit. Our recommendations appear on page 7. NOAA's response to our draft report is summarized in the report and its complete response is included as Attachment I.

Introduction

In Fiscal Year 2003, NOAA disbursed a total of \$3.2 billion. As the steward of taxpayer dollars, NOAA is accountable for using these funds properly, which includes ensuring that payments are made only for those products or services that have been satisfactorily delivered and that amounts paid are warranted and accurate. According to the Government Accountability Office (GAO), improper payments—that is, payments made in duplicate, for incorrect amounts or vendors, unsupported claims, services not rendered, or as a result of fraud—cost the federal government approximately \$20 billion a year.¹

To address this problem, Congress passed two laws in Fiscal Year 2002 requiring agencies to systematically identify and recover incorrect payments.

1. The Improper Payments Information Act of 2002² requires agency heads to annually review, starting with Fiscal Year 2004, all programs and activities they administer, systematically identify those susceptible to improper payments, and estimate the overpaid amounts. When estimates are significant (that is, they exceed both 2.5% of annual

¹ GAO-03-750T dated May 13, 2003, page 1.

² Public Law No. 107-300 (2002).

program payments and \$10 million), the legislation requires further analysis and reporting.

2. The National Defense Authorization Act for Fiscal Year 2002³ requires that agencies entering into contracts valued in excess of \$500 million in a fiscal year identify and recover any erroneous payments made to contractors.

In Fiscal Year 2003, NOAA submitted to the Department's Office of Financial Management an erroneous payment risk assessment in which it concluded that it has controls in place to mitigate having large numbers of erroneous payments. As a result, the agency did not see a need for replacing its current controls for detecting improper payments with new systems and reporting requirements, but the risk assessment did identify a need for improved oversight of the payments process because of erroneous payments due to error by a payment technician. Also, in Fiscal Year 2004, NOAA began providing quarterly data on erroneous payments to the Department, which, together with input from other bureaus, was used to assess the level of such payments Department-wide.

NOAA processes its payments and those of other Commerce bureaus through the NOAA Finance Office in Germantown, Maryland, and its four administrative support centers (ASCs), located in Norfolk, Virginia; Kansas City, Missouri; Boulder, Colorado; and Seattle, Washington. Payment processing responsibilities include, among others, auditing vouchers, entering accounting data into the Commerce Business System, correlating payments with U. S. Department of the Treasury Disbursing Offices, and resolving payment-related problems. NOAA processes financial documents in the Commerce Business System. The Finance Office coordinates ASC financial activities and establishes and ensures the adequacy of financial management policies, systems, procedures, and internal controls.

Objectives, Scope, and Methodology

We conducted an audit of payments made by the NOAA Finance Office during Fiscal Year 2003 on its contracts and purchase orders to (1) determine whether it made significant improper payments and (2) assess the effectiveness of its internal controls to prevent, detect, and correct improper payments. We assessed the reliability of computer-generated Commerce Business System disbursement and refund data for purchase orders and contracts by tracing all items selected for audit to supporting payment and refund documents in vendor files.

We used the following methodology:

- **Review of federal laws, regulations, guidance, policies, and procedures.** We examined the following federal laws, regulations, guidance, policies, and procedures that provided background relevant to improper payments: Improper Payments Information Act of 2002 and Office of Management and Budget Memorandum M-03-13, (5/21/03); the National Defense Authorization Act for Fiscal Year 2002; General Records Schedules of the National Archives and Records Administration (44 USC 3303); GAO's *Standards*

³ Public Law No. 107-107, 115 Stat. 1012, Section 831, p. 1186 (2001).

for *Internal Control in the Federal Government*⁴; OMB Circular A-123, *Management Accountability and Control*⁵; the Department of Commerce’s *Cash Management Policies and Procedures Handbook*; the *Commerce Acquisition Manual*; NOAA’s *Cashier’s Handbook* and *Organization Handbook*; and guidelines and policy and procedure memoranda for VISA convenience checks.

- **Examination of relevant documents.** We analyzed NOAA purchase orders, contracts, invoices, receiving reports, and other payment file documents; Fiscal Year 2003 Erroneous Payment Risk Assessment; Fiscal Year 2004 quarterly erroneous payments data; and written responses to our questions concerning improper payments.
- **Interviews.** We spoke with officials and staff at NOAA’s Finance Office, Central Administrative Support Center (CASC), Western Administrative Support Center (WASC), and program offices, and at the Department’s Office of Financial Management.
- **Audit Sampling and Review of Refund Data.** We selected a judgmental sample of 1,650 payments totaling \$11.7 million, made under purchase orders and contracts and processed by the Finance Office during Fiscal Year 2003 (see Table I). For each sampled payment, we examined the supporting voucher file, which contained the purchase order or contract, vendor invoice, receiving report, payment log, and related documents. When appropriate, we also spoke with the accounting technician who processed the payment.

Payment Type	Population		Audit Sample			
	Amount	Numbers	Amount	Percent	Numbers	Percent
Purchase Orders	\$60.7 million	6,408	\$5.9 million	10	1,123	18
Contracts	273.8 million	3,979	5.8 million	2	527	13
Totals	\$334.5 million	10,387	\$11.7 million	4	1,650	16

We also reviewed (1) Fiscal Year 2003 Commerce Business System data and supporting documentation for 30 vendor refunds, totaling \$80,106, received by the Finance Office and the ASCs in order to identify improper payments, and (2) documents related to improper payments from Fiscal Years 1999, 2001, 2002, and 2004 that we identified during our review of Fiscal Year 2003 vendor files. We included these additional improper payments with the results from our review of Fiscal Year 2003 payments (see Table II).

We performed our fieldwork from August 2003 to September 2004 at NOAA’s Finance Office in Germantown, Maryland, and at its headquarters in Silver Spring, Maryland. We conducted our review in accordance with generally accepted government auditing standards and under the authority of the Inspector General Act of 1978, as amended, and Department Organization Order 10-13, dated May 22, 1980, as amended.

⁴ Reissued in November 1999.

⁵ Revised June 21, 1995.

NOAA should consider opportunities to strengthen controls over its payments process for purchase orders and contracts

We found that NOAA's Finance Office generally has effective internal controls to prevent, detect, and correct improper payments made on contracts and purchase orders and hence does not make a significant number or dollar amount of such payments. We identified only 68 improper payments from a total of 1,680 payments reviewed (1,650 sampled payments and 30 vendor refunds) totaling roughly \$99,000. We recognize that internal controls over improper payments should—and we believe the Finance Office's do—provide reasonable assurance that agency objectives are being met. Nevertheless, we also believe that NOAA should be aware of the events or circumstances surrounding the improper payments identified to afford it the opportunity to take whatever actions that it deems are appropriate, based on costs and expected benefits, to strengthen internal controls.

Responsibilities for agency internal controls and proper disbursements are delineated by federal and Department requirements. The GAO's *Standards for Internal Control in the Federal Government* and OMB Circular A-123, *Management Accountability and Control*, require that agencies continually assess, evaluate, and strengthen their internal controls to assure accountability and proper stewardship of federal resources. The Department's *Cash Management Policies and Procedures Handbook*⁶ requires that an authorized official certify all invoices as legal and proper for payment, and describes prepayment audits of invoices as a means for officials to exercise effective control over disbursements.

Before invoices are certified for payment, NOAA accounting technicians process them for payment through the Commerce Business System and then designated accountants, financial payment specialists, or supervisors conduct prepayment audits.⁷ Prepayment audits are intended to ensure that payments have the required administrative authorizations, are legal, made in accordance with the terms of the applicable agreement, are for the correct amount and payee, use proper forms or electronic approval procedures, and comply with the Prompt Payment Act. Invoices not approved for payment are returned to the technician for resolution. Despite this *preventive* control, 66 (97%) of the 68 improper payments (see Table II, next page) we identified were attributable to processing errors by accounting technicians that should have been intercepted during the prepayment audit, but were not. A listing of the 66 improper payments identified, along with related details, was previously provided to NOAA officials.

NOAA program offices and contracting officer's technical representatives (COTRs) also play an important role in the payments process. The offices issue purchase orders and contracts for goods and services and COTRs review and recommend approval of invoices. Per the *Commerce*

⁶ Chapter 4, Sections 5.03a and b.

⁷ During Fiscal Year 2003, the bureau initiated prepayment audits by such designated individuals at the Finance Office. Before this time, certifying officers would have conducted any such audits.

Table II					
Description of Error	Organization Responsible/Number of Improper Payments and Overpayment Amounts^{1/}				
	NOAA Finance Office	CASC^{1/}	WASC^{2/}	Total	
Duplicate payment	8/\$34,359 ^{4/}		2/\$6,740	10/\$41,099	
Wrong vendor or invalid amount paid	4/39,127	4/\$3,930		8/43,057	
Disregarding services outside performance period	41/9,806			41/9,806	
Inadequate invoice support	1/164	3/1,260		4/1,424	
Other	1/68 ^{5/}		2/54 ^{6/}	3/122	
Totals	55/\$83,524	7/\$5,190	4/\$6,794	66/\$95,508^{7/}	

^{1/} CASC – Central Administrative Support Center			
^{2/} WASC – Western Administrative Support Center			
^{3/} All invoices relate to purchase orders, unless otherwise noted.			
^{4/} 2 invoices, totaling \$27,882, relate to a contract.			
^{5/} Unexplained overpayment of invoice total.			
^{6/} Improper payment of Prompt Payment Act interest penalty.			
^{7/} Fiscal year in which overpayments made:	Amount	No. of Payments	
1999	\$21,734	1	
2001	6,568	2	
2002	3,993	25	
2003	63,117	37	
2004	<u>96</u>	<u>1</u>	
TOTALS	<u>\$95,508</u>	<u>66</u>	

Acquisition Manual,⁸ contracting officers delegate authority to COTRs to manage and oversee certain aspects of contracts to ensure the contractor’s performance meets the contract’s standards, technical requirements, and timeframes at the stipulated price or within the estimated cost. Once approved, invoices are sent to the Finance Office or an ASC for payment, as appropriate. When properly exercised, the COTR’s duties help prevent improper payments. We identified two improper purchase order payments, made in Fiscal Year 2003, that relate to erroneous actions by the COTR (\$3,174). These payments, along with related details, were included in the listing provided to NOAA officials.

While the improper payments identified in our limited sample did not reflect serious oversight lapses, the related control weaknesses, if not corrected, leave NOAA susceptible to improper payments that may go undetected by the bureau *and* the vendor or may be detected only by a vendor who does not make unsolicited refunds. As noted earlier, NOAA’s risk assessment, although low, did identify a need for improved oversight of the payments process because of erroneous payments due to error by a payment technician. We point out the 68 improper payments identified in our audit so that NOAA may, pursuant to OMB Circular A-123, act proactively, based on costs and expected benefits, to prevent future problems.

⁸ Part 13.01, Section 2, #2: “Definitions.”

NOAA should comply with federal and Department records retention requirements

The Department's *Cash Management Policies and Procedures Handbook*⁹ requires the heads of payment offices to ensure that payment-related records or vouchers are retained for specified periods¹⁰ (typically 6 years and 3 months) and are available for review by the Department's Inspector General and the Government Accountability Office. GAO's *Standards for Internal Control in the Federal Government* states that "Internal control and all transactions...need to be clearly documented, and the documentation should be readily available for examination.... All documentation and records should be properly managed and maintained." We found that NOAA does not systematically maintain such documentation and is therefore not in compliance with related federal regulations.

NOAA's Finance Office did not maintain certified copies of the Commerce Business System's PM101A report. The PM101A report is a key payment certification document that the prepayment auditor uses to identify, review, and certify for payment each purchase order voucher processed by accounting technicians. Prepayment auditors verify their review by certifying on the PM101A report that supporting vouchers have been examined and the listed amounts are correct and proper for payment. The PM101A reports also contain information that the Finance Office may need to resolve issues, evaluate personnel, and conduct other essential operations, and that the government may need to protect and support its interest in any litigation that may arise. Therefore, these reports are subject to federal and departmental records retention requirements of 6 years and 3 months, and NOAA must maintain them for that period of time.

We attempted to obtain the certified reports that support the purchase order payments in our Fiscal Year 2003 judgmental sample, but learned that they had been discarded because, according to a Finance Office official, they were not considered official records subject to federal retention requirements. As a result, we could not confirm that prepayment auditors had reviewed and certified accounting technicians' purchase order vouchers as correct and proper for payment.

NOAA needs to strengthen its reporting of erroneous payments

To comply with reporting requirements of the Improper Payments Information Act, the Department asked all bureaus to report erroneous payment data quarterly, beginning in Fiscal Year 2004. NOAA's method for compiling this data does not capture the universe of potential erroneous payments. Therefore, the bureau cannot provide assurance that its estimates of erroneous payments are reasonable or that it is safeguarding government assets and effectively protecting public resources.

NOAA's quarterly reports are drawn from Commerce Business System data on NOAA-generated refund requests to vendors, its receipt of these amounts, and its receipt of refunds identified solely by the vendor and voluntarily returned. Unaccounted for are erroneous

⁹ Chapter 4, "Disbursements," Section 4.0, "Responsibilities."

¹⁰ The Department's requirement is based on the retention period specified in General Records Schedule 6, *Accountable Officers' Accounts Records*, issued by the Archivist of the United States under the authority of 44 USC 3303a(d). NOAA's May 2003 Erroneous Payment Risk Assessment also stipulates this time frame.

payments that both NOAA and vendors miss, or that only vendors identify but do not voluntarily refund. NOAA has no control procedure for determining or estimating such amounts.

We discussed this problem with a Finance Office official, who stated that NOAA recognizes the need to capture missed improper payments and plans to implement changes in Fiscal Year 2005. We believe these changes should include post-payment audits of vouchers or other periodic tests of internal controls, such as internal control reviews, to enable NOAA to estimate the incidence and amounts of unidentified erroneous payments.

Recommendations

The Under Secretary for Oceans and Atmosphere should ensure that:

1. NOAA reviews the events or circumstances surrounding the OIG-identified improper payments and takes the action that it deems appropriate, based on costs and expected benefits, to strengthen the bureau's internal controls over its payments process for purchase orders and contracts.
2. NOAA's Finance Office complies with federal and Department requirements for retaining all payment-related records, i.e., its certified Commerce Business System PM101A reports, for the required 6 years and 3 months.

NOAA Response

NOAA concurs with recommendations 1 and 2 but does not concur with recommendation 3¹¹, which was originally included in our draft report. Regarding recommendation 1, NOAA said it reviewed the events or circumstances surrounding the OIG-identified improper payments and will take action based on costs and benefits to strengthen its internal controls over payment processes. With respect to recommendation 2, NOAA responded that the certified PM101A reports are now being retained in compliance with retention requirements. Concerning recommendation 3, NOAA believes that its automated and manual internal controls upfront during the payment process are more cost effective than after-the-fact reviews for identifying erroneous payments. It cites specific examples of both types of controls and states that our sampling and that by the Department's Office of Financial Management support its belief.

NOAA also recommended two changes to our draft report. First, it stated in its response that our reference to the Commerce Administrative Management System (CAMS) should be the Commerce Business System (CBS). Second, it asserted that the \$8,000 expenditure that we included in Table II of our report because NOAA used the wrong payment method¹² is not an improper payment. NOAA explained that the correct vendor was paid and that the method of

¹¹ Recommendation #3: The Under Secretary for Oceans and Atmosphere should ensure that NOAA strengthens its reporting of erroneous payments by implementing post-payment audits or other periodic internal control reviews of vouchers to identify and report erroneous payments that it does not routinely recognize through solicited and unsolicited refunds.

¹² NOAA paid an invoice for services to a foreign vendor by check rather than electronically, as required by U. S. Department of the Treasury regulations.

disbursement, via a check or electronic payment, is not a factor in identifying an improper payment. It recommended that the \$8,000 expenditure be removed from Table II. NOAA's full response is included as Attachment I to this report.

OIG Comments

NOAA's reply is responsive to our recommendations 1 and 2. We have removed recommendation 3 because we believe that the automated and manual internal controls, both current and proposed, for identifying the universe that NOAA cites in its response should function as effective *compensating* controls to prevent, detect, and correct improper payments. The intent of our recommendation to implement post-payment audits of vouchers was to ensure that NOAA's reporting of erroneous payments to the Department is reasonable and captures the universe of potential erroneous payments. NOAA's compensating controls meet that intent. NOAA should continue to use these controls to strengthen its reporting process for erroneous payments. While we feel these controls are adequate, in accordance with the Office of Management and Budget's Circular A-123, *Management Accountability and Control*¹³, which calls for continuous monitoring of controls, NOAA should test or verify the effectiveness of these controls at the end of Fiscal Year 2005 to ensure that they are functioning as designed.

We agree with NOAA's two recommended changes to our draft report. We have replaced all references to the Commerce Administrative Management System (CAMS) with the Commerce Business System (CBS). Also, we have removed the \$8,000 expenditure from Table II because it is not an improper payment. However, we call NOAA's attention to U. S. Department of the Treasury regulations that address the management of federal agency disbursements.¹⁴ These regulations state that "Subject to Section 208.4, and notwithstanding any other provision of law, effective January 2, 1999, *all* (emphasis ours) Federal payments made by an agency shall be made by electronic funds transfer."¹⁵ We reviewed the eight cases specified in Section 208.4, "Waivers," in which payment by electronic funds transfer is not required, but concluded that none applied. Clearly, NOAA should have made the payment electronically, as required by Treasury regulations. Nevertheless, this isolated occurrence does not impact our overall conclusion that the NOAA Finance Office's internal controls over improper payments on contracts and purchase orders are generally effective and provide reasonable assurance regarding the prevention, detection, and correction of such payments.

As required by DAO 213-5, please provide us an audit action plan addressing recommendation #3 within 60 days of this memorandum. The format for the plan can be found in Exhibit 7 of the DAO. Should you need to discuss the contents of this report or the audit action plan, please call me at (202) 482-1577, or Ronald Lieberman, Director, Business and Science Division, at (202) 482-2689.

We appreciate the cooperation and courtesies your staff extended to us during our review.

¹³ Revised June 21, 1995.

¹⁴ 31CFR208.

¹⁵ 31CFR208.3.

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