OFFICE OF THE SECRETARY

FY 2014 Compliance with Improper Payment Requirements

FINAL REPORT NO. OIG-15-029-I

MAY 15, 2015

U.S. Department of Commerce
Office of Inspector General
Office of Audit and Evaluation

FOR PUBLIC RELEASE

UNITED STATES DEPARTMENT OF COMMERCE
The Inspector General
Washington, D.C. 20230

May 15, 2015

INFORMATION MEMORANDUM FOR SECRETARY PRITZKER

Todd J. Zinser

FROM: Todd J. Zinser

SUBJECT: *FY 2014 Compliance with Improper Payment Requirements* Final Report No. OIG-15-029-I

This memorandum provides our final report on FY 2014 improper payment reporting. We conducted this review to comply with the requirements of the Improper Payments Information Act of 2002 (IPIA)—as amended by the Improper Payments Elimination and Recovery Act of 2010 (IPERA) and the Improper Payments Elimination and Recovery Improvement Act of 2012 (IPERIA)—and Office of Management and Budget (OMB) Circular A-123, Appendix C, "Requirements for Effective Estimation and Remediation of Improper Payments."

Our review focused on assessing whether the Department's improper payment reporting in its FY 2014 *Agency Financial Report* complied with all applicable reporting requirements. We also evaluated the accuracy and completeness of the Department's reporting, as well as its performance in reducing and recapturing improper payments.

Overall, we found that the Department met the applicable OMB criteria for compliance with IPIA for FY 2014. However, we determined that the Department could further enhance its improper payment detection and prevention practices related to risk assessments. Our report contains three recommendations to address this condition. In accordance with Department Administrative Order 213-5, within 60 days of the date of this memorandum, we request an action plan that responds to our recommendations.

We are also issuing a copy of this report to the Senate Committee on Homeland Security and Governmental Affairs; House Committee on Oversight and Government Reform; Comptroller General of the United States; and Controller, OMB.

We would like to thank the Department's staff and management for its cooperation during our review. Please contact me at (202) 482-4661 if you would like to discuss the results of this review.

Attachment

Report In Brief

MAY 15, 2015

Background

The **Improper Payments Information Act of 2002** (**IPIA**) requires federal agencies to (1) identify programs susceptible to improper payments; (2) estimate improper payment amounts for such programs; and (3) report these estimates, along with actions taken to reduce improper payments for programs with estimates that exceed $10 million in improper payments. The **Improper Payments Elimination and Recovery Act of 2010** and **Improper Payments Elimination and Recovery Improvement Act of 2012** amended IPIA by expanding on the previous requirements and broadening recovery requirements for overpayments.

Broadly defined, *improper payments* are those the federal government has made in the wrong amount, to the wrong entity, or for the wrong reason. In FY 2014 the Department reported $9.4 million in overpayments, of which more than $7.2 million were identified through its ongoing improper payment monitoring and minimization efforts and recaptured.

Why We Did This Review

We initiated this engagement to review the Department's compliance with IPIA—as required by the Office of Management and Budget's (OMB's) government-wide implementation guidance, Circular A-123, *Management's Responsibility for Internal Control*, Appendix C, "Requirements for Effective Estimation and Remediation of Improper Payments." Specifically, we (1) assessed whether the Department complied with all applicable reporting requirements and (2) evaluated the accuracy and completeness of its reporting, as well as its performance in reducing and recapturing improper payments.

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WHAT WE FOUND

To comply with IPIA and OMB Circular A-123, Appendix C, the Department implemented procedures in FY 2014 to detect and prevent improper payments—conducting selected program risk assessments, engaging a contractor to perform payment recapture audits, conducting routine monitoring procedures, disclosing required data in the U.S. Department of Commerce FY 2014 *Agency Financial Report* (*AFR*), and publishing and posting on the web the FY 2014 *AFR*. These assessments revealed no programs or activities susceptible to significant risk of improper payments.

During the FY 2014 risk assessment process, the Department did not identify any programs or activities susceptible to significant improper payments. The Department's routine monitoring efforts in FY 2014 did identify almost $9.4 million in overpayments, of which more than $7.2 million was confirmed by the Department as recaptured. Based on these activities, we found the Department met the applicable OMB criteria for compliance with IPIA. A summary of the Department's relevant FY 2014 practices and results appear in the Department's FY 2014 *AFR*.

Our review of the actions taken by the Department to comply with IPIA and OMB requirements identified that the Department can further improve the risk assessment process. Specifically, we found that risk assessment process could be improved in the following three areas: consideration of required risk factors; inclusion of payments to employees; and documentation of significant changes in legislation and funding of its programs and activities.

WHAT WE RECOMMEND

We recommend that the Deputy Chief Financial Officer and Director for Financial Management strengthen the risk assessment process by

1. adding assessment areas that result in consideration of all OMB required risk factors and providing guidance on topic requirements or factors that should be addressed within each area of the risk assessment;

2. establishing a policy or procedure to ensure that changes and updates to laws and regulations affecting improper payment requirements are identified and implemented timely, including providing notification of such changes to bureaus; and

3. providing bureaus with guidelines to determine what constitutes significant changes in legislation and funding within the Department's programs and activities and requesting timely notification of such changes so that program and activity risk assessment can be performed in the next annual cycle.

Contents

COVER: Detail of fisheries pediment,
U.S. Department of Commerce headquarters,
by sculptor James Earle Fraser, 1934

Introduction

As required by the Office of Management and Budget (OMB) Circular A-123, *Management's Responsibility for Internal Control*, Appendix C, "Requirements for Effective Estimation and Remediation of Improper Payments"[1]—government-wide guidance on detecting and preventing improper payments—we initiated this review to determine whether the Department complied with the Improper Payments Information Act of 2002 (IPIA), as amended by the Improper Payments Elimination and Recovery Act of 2010 (IPERA) and the Improper Payments Elimination and Recovery Improvement Act of 2012 (IPERIA).

Broadly defined, *improper payments* are payments the federal government has made for the wrong amount, to the wrong entity, or for the wrong reason.[2] Congress enacted IPIA to encourage agency management to plan and take actions to reduce such payments. It requires federal agencies to (1) identify programs that were susceptible to improper payments, (2) estimate improper payment amounts for such programs, and (3) report these estimates along with actions taken to reduce improper payments for programs with estimates that exceed $10 million. IPERA and IPERIA amended IPIA[3] by expanding on these previous requirements[4] and broadening recovery requirements for overpayments.

During FY 2014, the Department made approximately $12.9 billion in total outlays. As mandated by IPIA, the Department implemented various internal controls intended to detect and prevent significant improper payments. As a result, the Department reported $9.4 million in overpayments, of which $7.2 million in recaptured overpayments were identified through its ongoing improper payment monitoring and minimization efforts. A summary of the Department's FY 2014 improper payment practices and results appears in the "Other Information" section of the *U.S. Department of Commerce FY 2014 Agency Financial Report* (*AFR*).

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[1] Revised by OMB Memorandum M-15-02, October 20, 2014.

[2] According to IPERA, Public Law 111-204, §2(e), an *improper payment* is any payment that should not have been made or that was made in an incorrect amount (including overpayments and underpayments) under statutory, contractual, administrative, and other legally applicable requirements. It includes any payment (1) to an ineligible recipient, (2) for an ineligible good or service, (3) that is duplicate, (4) for a good or service not received, or (5) that does not account for credit for applicable discounts.

[3] Going forward, unless otherwise indicated, the term *IPIA* will denote *IPIA, as amended by IPERA and IPERIA* throughout this report.

[4] Beginning in FY 2013, IPERA defines *significant improper payments* as exceeding (1) 1.5 percent of program outlays and $10 million of all program or activity payments made during the fiscal year or (2) $100 million. IPERIA amended the definition of "payments" to include payments to employees (e.g., salary, locality pay, travel pay, and other payments to federal employees) in risk assessments, and, where appropriate, in improper payments estimates. In addition, IPERIA requires agencies to include all improper payments, regardless of whether the improper payment has been or is being recovered, in the reported improper payment estimate.

Objectives, Finding, and Recommendations

Our review focused on the Department's efforts to conduct risk assessments in order to properly identify and report programs/activities that are susceptible to significant improper payments as required by OMB Circular A-123. Specifically, our objectives were to (1) assess whether the Department complied with all applicable reporting requirements and (2) evaluate the accuracy and completeness of its reporting, as well as its performance in reducing and recapturing improper payments.

OMB Circular A-123[5] instructs OIG to review the Department's adherence to six requirements for compliance with IPIA. Four of the requirements relate to programs and activities susceptible to significant improper payments. The Department is responsible for determining whether its programs and activities are susceptible to the risk of significant improper payments. In accordance with the Disaster Relief Appropriations Act of 2013, the Department identified that programs and activities receiving funds under the Disaster Relief appropriation are susceptible to significant improper payments. As a result, all of the OMB compliance requirements were applicable to the Department in FY 2014.

We reviewed the results of the Department's actions to detect and prevent improper payments, as well as improper payment data reported in the AFR, and found that the Department met the six OMB criteria for compliance with IPIA, as described in table 1 (see next page). However, the Department needs to strengthen its annual risk assessment process to ensure that all required risk factors, payments to employees, and significant changes in programs are considered.

[5] OMB Circular A-123, Appendix C, § II(A)(3).

Table I: Improper Payment Requirements

Requirement	Compliance Requirement Met
Published the *AFR* and posted on agency website	Yes
Conducted program-specific risk assessments[a]	Yes
Published improper payment estimates for all programs and activities identified as susceptible to significant improper payments in the *AFR*	Yes
Published programmatic corrective action plans for all programs and activities susceptible to significant improper payments in the *AFR*	Not reported[b]
Published and met annual reduction targets for each program assessed to be at risk and estimated for improper payments (OMB Circular A-123 requirement for all programs and activities identified as susceptible to significant improper payments in the *AFR*)	N/R[b]
Reported a gross improper payment rate of less than 10 percent for each program or activity for which an improper payment estimate was obtained and published in the *AFR* (OMB Circular A-123 requirement for all programs and activities identified as susceptible to significant improper payments in the *AFR*)	N/R[b]

Source: OIG analysis of Departmental data

[a] Under OMB Circular A-123, Appendix C, OIG reviews compliance with this requirement by verifying that the Department did complete required program risk assessments, but not necessarily that those assessments used appropriate methodology. Although we found that the required assessments were completed, in this report we make recommendations for improving those assessments in accordance with OMB standards.

[b] Because the Department's testing of Disaster Relief Appropriation Act funds identified an improper payment estimate of zero percent with no improper payments, it did not have information to publish related to corrective actions, annual reduction targets, and gross improper payment rates.

Improper Payment Elimination Practices Are Compliant with IPIA, but Further Improvement Is Needed in the Risk Assessment Process

To meet the requirements of IPIA and OMB Circular A-123, Appendix C, the Department performed procedures and reported the results of its FY 2014 actions to detect and prevent improper payments, including

- risk assessments of selected programs and activities;
- engagement of a contractor to obtain the status of sustained disallowed costs for grants and other cooperative agreements and perform payment recapture audits of
    - closed and expired[6] contracts and obligations of selected bureaus and
    - expired grants and other cooperative agreements;
- routine monitoring procedures, such as postpayment reviews;

[6] *Closed* contracts and obligations have completed the closeout process; *expired* refers to those for which the period of performance has ended, and last payment was made, but the closeout process has not been completed.

- disclosure of required data in the FY 2014 *AFR*; and
- publication and Internet posting of the FY 2014 *AFR*.

Each year, the Department evaluates a subset of its programs and activities based on a 3-year rotational schedule for conducting risk assessments. During the FY 2014 risk assessment process, the Department did not identify any programs or activities susceptible to significant improper payments. However, as required by the Disaster Relief Appropriations Act of 2013, the Department identified the $326 million received by the National Oceanic and Atmospheric Administration under the Act as susceptible to significant improper payments. OMB requires the Department to calculate and report a statistically valid improper payment estimate for the FY 2014 reporting period. Accordingly, the Department engaged an independent contractor to perform statistical sampling of disbursements made under the Disaster Relief Appropriations Act resulting in an improper payment estimate for these funds. The independent contractor found no improper disbursements and provided an improper payment estimate of zero percent. The Department reported these results in its FY 2014 *AFR*, along with other required information. Based on these activities, we found that the Department met the applicable OMB criteria for compliance with IPIA as described in table 1.

Our review of the actions taken by the Department to comply with IPIA and OMB requirements identified that the Department can further improve the risk assessment process. Specifically, we found that risk assessment process could be improved in the following three areas: consideration of required risk factors; inclusion of payments to employees; and documentation of significant changes in legislation and funding of its programs and activities.

Required Risk Factors

OMB Circular A-123, Appendix C, requires that all agencies, unless specific written approval has been granted, review all programs/activities and identify those that are susceptible to significant improper payments through risk assessments. Further, OMB Circular A-123, Appendix C provides nine required risk factors[7] that should be considered in evaluating program/activities during the risk assessment process.

For FY 2014, we reviewed three completed risk assessments and found that the Department did not include consideration of all required risk factors. Although the Department uses a standardized risk assessment document which requires discussion of specific elements of the program or activity control environment, the level of detail and topics covered in each of the risk assessment areas varied by bureau. This resulted in some

[7] OMB Circular A-123, Appendix C, § I(A)(9) includes the following risk factors: (1) whether the program or activity reviewed is new to the agency; (2) the complexity of the program or activity; (3) the volume of annual payments; (4) whether payments or payment eligibility decisions are made outside of the agency; (5) recent major changes in program funding, authorities, practices, or procedures; (6) the level, experience, and quality of training for personnel responsible for eligibility determinations or certifying accuracy of payments; (7) inherent risks of improper payments due to the nature of programs or operations; (8) significant deficiencies in the audit reports of the agency; and (9) results from prior improper payment work.

risk assessments covering more risk factors than others. Our review of the assessment areas listed in the three selected risk assessments identified that those areas did not cover all required risk factors. We considered a risk factor included if it was specifically mentioned in the risk assessment or the risk assessment included language relevant to the risk factor. Guidance provided to the bureaus does not specifically identify the required risk factors and other topics that must be considered and addressed within each assessment areas.

Not including required significant risk factors could result in risk assessments that fail to evaluate key risks related to improper payments. Further, omitting risk factors could also result in the Department being unnecessarily exposed to certain risks that, left unmitigated, could result in significant improper payments.

Excluded Payments

IPERIA, signed into law on January 10, 2013, includes important changes intended to increase the accuracy of agency improper payment estimates. One key addition to the improper payment estimate framework is the inclusion of payments to employees in the definition of improper payments. OMB implementation guidance related to IPERIA was not issued until October 2014; however, its requirements were effective starting in FY 2014. This made it difficult for the Department to make changes to the FY 2014 risk assessment process, which was already underway. As a result, the Department's FY 2014 risk assessments did not include payments to employees, such as salary, locality, and travel pay.

Payments to employees can represent a significant portion of total disbursements, with spending on pay and benefits representing approximately 14 percent of the federal discretionary budget between 2004 and 2010.[8] Excluding payments to employees in risk assessments means that risks associated with those payments are not considered. Risk assessments lacking consideration of relevant risks may lead to inadequate evaluation and mitigation of risks which could lead to improper payments. Additionally, excluding payments to employees could result in inaccurate improper payment estimates. In performing our work, we found that the Department's improper payment policy and procedures did not include procedures related to updating and modifying improper payment practices as a result of changes to laws and regulations.

Significant Changes in Legislation/Funding

OMB Circular A-123, Appendix C, requires that agencies reassess program risk susceptibility in the next annual cycle when a low-risk program experiences significant change in legislation or significant increase in its funding level. Modifying scheduled risk assessments for programs with these changes helps to ensure that changes in the risk profile of a program or activity are identified in a timely manner. Further, identification of changes to the risk profile allows the program or activity more time to respond to new or heightened risks.

[8] GAO Report to the Ranking Member, Committee on the Budget, U.S. Senate, *Federal Workforce, Recent Trends in Federal Civilian Employment and Compensation*, January 2014.

Our review of documented policies/procedures found that the Department did not have a formal process to identify significant changes in legislation or funding of programs and activities. The Department stated that although there was no documented process, the identification of significant changes is a responsibility that it shares with the bureaus. However, the Department could not demonstrate that significant changes were identified for use in scheduling risk assessments for FY 2014. Significant changes in funding or legislation have the potential to increase the overall risk of the program or activity. Without a process to identify significant changes and schedule risk assessments accordingly, the Department will not be able to assess new risks in a timely manner. New and increased risks without appropriate risk responses raise the likelihood of improper payments occurring.

Recommendations

We recommend that the Deputy Chief Financial Officer and Director for Financial Management strengthen the risk assessment process by

1. adding assessment areas that result in consideration of all OMB required risk factors and providing guidance on topic requirements or factors that should be addressed within each area of the risk assessment;

2. establishing a policy or procedure to ensure that changes and updates to laws and regulations affecting improper payment requirements are identified and implemented timely, including providing notification of such changes to bureaus; and

3. providing bureaus with guidelines to determine what constitutes significant changes in legislation and funding within the Department's programs and activities and requesting timely notification of such changes so that program and activity risk assessment can be performed in the next annual cycle.

Summary of Agency Response and OIG Comments

We reviewed the Department's response, included in appendix B. Overall, the Department was pleased that our office found that the Department met the applicable criteria for compliance with IPIA and agreed to implement our recommendations to enhance its processes. We look forward to reviewing the Department's corrective action plan.

Appendix A: Objectives, Scope, and Methodology

Our objectives were to (1) assess whether the Department complied with all applicable improper payment reporting requirements and (2) evaluate the accuracy and completeness of its reporting, as well as its performance in reducing and recapturing improper payments. The scope of our review of the Department's compliance with IPIA included Departmental processes and practices for assessing and identifying programs and activities susceptible to improper payments, along with procedures in place to detect and prevent improper payments, during FY 2014.

To meet our objectives, we obtained an understanding of internal controls and practices by

- communicating with officials in the Department's Office of Financial Management to gain an understanding of risk assessment and improper payment recapture processes;
- requesting, obtaining, and analyzing documents related to the FY 2014 risk assessment and improper payment recapture processes—including relevant procedures, assessment results, and contractor reports; and
- reviewing the "Improper Payments Information Act (IPIA) of 2002, as Amended, Reporting Details" section in the *AFR*.

We also reviewed the Department's compliance with applicable provisions of IPIA and OMB Circular A-123, Appendix C, as amended by OMB Memorandum M-15-02.

We conducted our field work from January 2015 to March 2015 in Washington, DC. We performed this review under authority of the Inspector General Act of 1978, as amended, and Department Organization Order 10-13, dated April 26, 2013. The review was conducted in accordance with the *Quality Standards for Inspection and Evaluation* (January 2012) issued by the Council of the Inspectors General on Integrity and Efficiency.

Appendix B: Agency Response

UNITED STATES DEPARTMENT OF COMMERCE
Chief Financial Officer and
Assistant Secretary for Administration
Washington, D.C. 20230

MAY - 6 2015

MEMORANDUM FOR Andrew Katsaros
Principal Assistant Inspector General
for Audit and Evaluation

FROM: for Lisa Casias
Deputy Chief Financial Officer and
Director for Financial Management

SUBJECT: Comments on Draft Report Entitled, "*Office of the Secretary FY 2014 Compliance with Improper Payment Requirements*"

This memorandum responds to the draft report from the Office of Inspector General (OIG), entitled "Office of the Secretary FY 2014 Compliance with Improper Payment Requirements," issued on April 29, 2015. I am pleased the draft report states that the Department has met the Office of Management and Budget Circular No. A-123, Appendix C criteria for compliance with the Improper Payments Information Act of 2002, as amended.

We plan to implement the three recommendations on page 6 to further improve the Department's erroneous payments risk assessments process and content.

Thank you for the opportunity to provide comments. If you have any questions or comments, please feel free to call me at (202) 482-1207.

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