Federal CFO Insights
Improper Payments — Accountability of CFOs

Improper payment background

In an environment of challenging economic conditions and with an expectation that the U.S. Federal agencies must "do more with less," improper payments are generating significant public, media, and political scrutiny, and have become a top priority for Chief Financial Officers (CFOs). The scope of Federal improper payments — attributable to 124 programs across 22 agencies totaling $124.7 billion in Fiscal Year (FY) 2014 — is enormous, and is higher than the prior three years. Three agency programs with the highest dollar estimates accounted for about $80.9 billion (65%) of total reported improper payments.[1]

Enacted on January 10, 2013, the Improper Payments Elimination and Recovery Improvement Act of 2012 (IPERIA) expands on earlier legislation and emphasizes the strategic use of data in identifying and controlling improper payments. It builds upon the previous requirements of the Improper Payment Information Act of 2002 (IPIA) and the Improper Payment Elimination and Recovery Act of 2010 (IPERA) by increasing the responsibilities of the Office of Management and Budget (OMB) and individual agencies' Offices of Inspector General (OIG). OMB revised the guidance for Appendix C to OMB Circular A-123 on October 20, 2014 to create a more efficient and unified framework for continued assistance to CFOs. This also expands upon the requirements for identifying, reducing, and recovering improper payments, and incorporates the new elements introduced into improper payment compliance by IPERIA.

The CFO should have a well thought out strategy to incorporate the updated OMB A-123 Appendix C requirements to fully leverage the organization's current improper payment program and provide a basis for moderating its design for optimum cost and efficiency.

This article is intended to provide Federal CFOs with key elements to consider for improving their agency's improper payment program to not only address the compliance aspects of requirements; however also it is an opportunity to make a difference with fighting improper payments and demonstrating financial stewardship and accountability to enhance public trust.

Current OMB directives regarding improper payments

The OMB issued the updated A-123 Appendix C guidance to transform the improper payment compliance framework to create a more unified, comprehensive, and less burdensome set of requirements. CFOs of Federal agencies should be aware of the key areas updated and reinforced by the new Appendix C guidance, as discussed below, and take action in areas where their agencies could improve their compliance.

Classify priorities by reviewing current programs

The first step CFOs should take to comply with OMB regulations is to review all of its programs and classify them into one of three categories based on monetary thresholds.

Figure 1 illustrates the three classification categories and thresholds as well as the required actions for which CFOs are now responsible. If a program is designated as "High Priority," it must report improper payment indicators more frequently than in the annual report. CFOS must report data for "Susceptible to Significant Improper Payments (IP)" programs in the agency's annual report and must implement corrective actions for continued improper payment reduction. Low-risk programs are required to be re-assessed at least every three years to determine if the categorization is still appropriate. These programs do not need to be tested, however the risk assessment results should be reported in the AFR at summary-level.

Figure 1: A-123 Appendix C classification thresholds and actions[2]

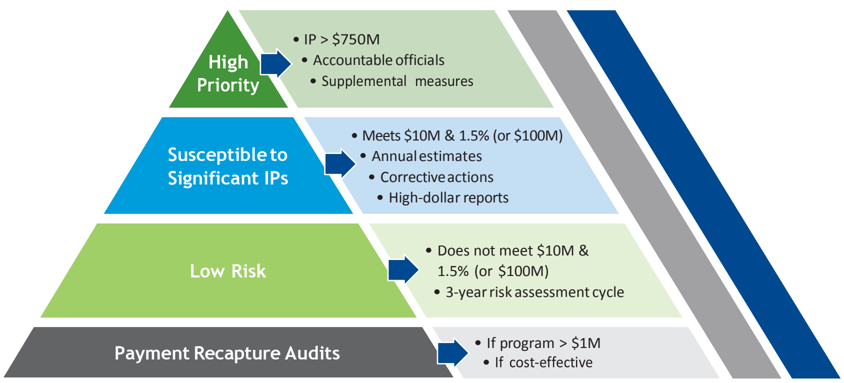


Figure 2: Improper payment categories in former versus New A-123 Appendix C guidance

Former Improper Payment Categories

- Documentation and administrative errors
- Authentication and medical necessity errors
- Verification errors

New Improper Payment Categories

- Program design or structural issue
- Inability to authenticate eligibility
- Failure to verify data (5 sub-categories)
- Administrative or process error (3 sub-categories)
- Medical necessity
- Insufficient documentation to determine
- Other reason

Expansion of improper payment categories

Once a program is classified as either "High Priority", "Susceptible to Significant IPs" or "Low Risk", and testing of payments has been performed on the "High Priority" and "Susceptible to Significant IPs", there needs to be a standardized means of reporting improper payment data. In the past, agencies found that the three required improper payment categories were limited and, in some cases, not applicable to their programs. The newly issued guidance expands the categories to seven, plus sub-categories (Figure 2), beginning with FY 2015 reporting. The new categories show a more detailed breakdown of improper payments and can assist CFOs with discovering more effective remediation actions to reduce improper payments. CFOs should ensure systems are in place to properly classify improper payments into one of the new categories and consider the impact on their organizations.

New requirements for improper payments internal controls

Beginning in FY 2015, every agency will be required to develop a narrative of their internal control status to provide reasonable assurance that the controls are in place and effective, including a table evaluating the five internal control components: Control Environment, Risk Assessment, Controls Activities, Information and

Communication, and Monitoring. OMB will then analyze this data to monitor progress towards strengthening internal controls and determine if an audit is warranted. As a result, CFOs should review their existing internal controls over improper payments and begin taking action to improve any deficiencies.

Do Not Pay initiative

In an effort to reduce improper payments, the Do Not Pay initiative will create a central database to ensure that Federal funds are paid only to eligible recipients. The Treasury Department is building a continuously monitored system of databases for agencies to incorporate into their eligibility reviews. CFOs should work with Treasury to incorporate this resource into their agency's vendor and payment procedures.

Recapture audits

Agencies are required to conduct payment recapture audits for any program with more than $1 million in annual expenditures, if an audit is determined cost effective. Such audits were previously required only for contracts with a total value of $500 million or more. As part of the revamped internal controls within the updated Appendix C, CFOs must establish the necessary internal controls for their organizations to detect improper payments and conduct recapture audits.

Taking action towards reducing improper payments

Government-wide improper payments have declined by over 15% since FY 2010. The OMB can claim some credit for issuing relevant and comprehensive guidance, but much of the credit should be given to individual agencies and their CFOs. CFOs have the ultimate responsibility for implementing the procedures necessary to comply with all applicable regulations and reducing improper payments. As such, a methodology for an effective improper payment compliance and control program is crucial, and includes developing and implementing a plan that incorporates the elements of assessment, identification and reporting, and remediation.

Assess the risk

Agencies must conduct risk assessments for each program to identify those which are susceptible to significant improper payments. A comprehensive risk assessment involves a systematic method to consider all quantitative and qualitative risk factors combined with statistical analysis. Examples of risk factors CFOs should consider include: payment processing methods, program age and complexity, and the business nature of fund recipients.

Identify and report on the improper payment program and results

In order to identify improper payments, agencies must implement an OMB-approved statistical sampling methodology, test the sampled payments, and calculate annual improper payment rates for each tested program. The testing should be able to identify fraud, waste, and abuse. In their annual financial report to Congress, CFOs are required to submit the resulting data on improper over- and under-payments and what actions they have taken or will take to reduce and recover improper payments.

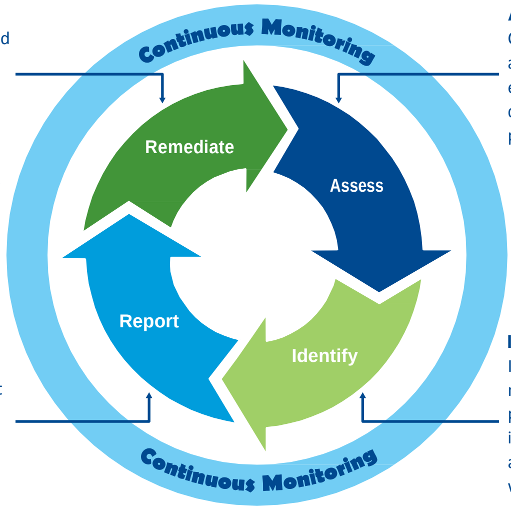
Remediate through continuous improvement

Internal controls are the first line of defense and all controls regarding improper payments should be evaluated for effectiveness and correction of deficiencies. CFOs should ensure that all stakeholders and process owners are kept up to date on the requirements, communicate effectively, and retain proper records to ensure compliance. This agency-wide effort begins with a well-informed and vigilant CFO. These defense mechanisms can be combined with continuous monitoring tools to prevent or quickly identify improper payments.

Continuous monitoring

Agencies can formulate corrective action plans, where applicable, and leverage improper payment leading practices to enhance compliance. When developing a plan to reduce improper payments, CFOs should set realistic reduction targets to be approved by OMB, and develop a timeline to realize results. Continuous monitoring of reviews for detecting improper payments and assessing the progress of meeting the goals will allow CFOs to develop and execute a more effective remediation strategy. Implementing continuous monitoring controls will also provide them with business process improvements allowing for real-time, evidence-based solutions.

Figure 3: Approach to evaluate improper payments



- Data-driven decision making
  Having too much data can sometimes be problematic in deriving meaningful insight. However, data analytics can be an essential part of helping CFOs derive meaning and use that data to become risk intelligent, and therefore better manage decision-making and preventive processes. They can leverage data-driven decision making and preventative measures to reduce improper payment and meet government guidance, and the challenges of political pressures, OIG audits, and public scrutiny.

- Real-time detection
  An effective strategy for preventing improper payments involves deploying both technical infrastructure and human capital designed to prevent improper disbursement of funds. Technology that continuously monitors funds provides analysis of payment data in near-real time and queues up potential problems for review prior to disbursement. This helps the CFO move from “pay and chase” to “protect and prevent.”

- Data matching
  It is critical for CFOs to consider all external data sets to help mitigate their problem sets. One example is the Treasury-developed ‘Do Not Pay’ database, which allows agencies to cross-reference its transactions or procurements against the database in real-time to reduce improper payments.

- Predictive analytics
  Predictive analytics involves carefully applying advanced data mining techniques to identify patterns and anomalies to make predictions about future events. A thorough understanding of data can provide insights as to which disbursements are indicative of improper payments, for example, which medical reimbursement claims are more likely to be fraudulent; how many medical claims per person or doctor are likely to be filed; or who is likely to request certain services and what motivates them to do so. CFOs who understand the potential of this capability will have a powerful new tool to protect their agency’s assets and optimize operations.

Tools to help control improper payments

OMB has established a cross-agency payment accuracy goal of 97% by FY 2016[3] and has issued guidance in several areas to improve agency performance to achieve this goal. Agencies must grapple with an ever-expanding list of requirements and limited resources. One of the most effective tools is the establishment of an integrated internal controls program, which enables Federal agencies to adopt a more streamlined, consistent, and reliable process that eliminates duplicative efforts and wasted resources. A list of resources that can assist CFOs in developing and establishing their improper payment internal control programs can be found at the end of this document.

A well-defined plan for preventing improper payments should include:

- Continuous program/activity monitoring and reporting
- Remediation strategies to uphold or enhance internal controls
- Training materials and guidance for all stakeholders
- Technological tools to increase prevention and a reduction of improper payments

CFOs should understand and utilize available resources such as internal and external data for decision making, a sound technical infrastructure, and legislative guidance to train and inform personnel to improve implementation.

Benefits to CFOs of Reducing Improper Payments

Taxpayer focus on government spending versus outcomes is at an all-time high and the CFO is the agency's best champion for addressing these challenges. An essential step in achieving this is to assess the agency's programs to determine if a program or activity is susceptible to significant risk of improper payments; doing so will provide numerous benefits for the CFO and the agency, including the following:

- Compliance — remain compliant to avoid additional funding challenges such as submitting reauthorization proposals to Congress
- Reputation — maintain public trust by consistently meeting expectations in areas of integrity, quality, safety, fairness, and reliability
- Political benefits — continuation or increase in funding for programs and/or activities

By implementing an effective improper payment prevention and detection approach, CFOs have an opportunity to support their agencies in optimizing the use of funds to achieve agency mission objectives and contribute to citizen centric services and government-wide long term plans.

Sources

- OMB A-123 Appendix C Revision: http://www.whitehouse.gov/sites/default/files/omb/memoranda/2015/m-15-02.pdf
- GAO Highlights: http://www.gao.gov/assets/670/664692.pdf

Endnotes

1. *Improper Payments: Government-Wide Estimates and Use of Death Data to Help Prevent Payments to Deceased Individuals* presented by Beryl H. Davis March 16, 2015
2. Appendix C to Circular No. A-123, Requirements for Effective Estimation and Remediation of Improper Payments, M-15-02 (October 20, 2014) http://www.whitehouse.gov/sites/default/files/omb/memoranda/2015/m-15-02.pdf
3. *Key Practices to Sustain and Renew Your Commitment to Ending Improper Payments* by Wendy Morton-Huddleston and Calandra Dixon. Journal of Government Financial Management, Summer 2014

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