



G A O

Accountability • Integrity • Reliability

United States General Accounting Office
Washington, DC 20548

November 2, 2001

DISTRIBUTION STATEMENT A
Approved for Public Release
Distribution Unlimited

The Honorable Fred Thompson
Ranking Minority Member
Committee on Governmental Affairs
United States Senate

Subject: Financial Management: Improper Payments Reported in Fiscal Year 2000
Financial Statements

Dear Senator Thompson:

As agreed with your office, this letter is in partial response to your request for an update on our report entitled *Financial Management: Billions in Improper Payments Continue to Require Attention* (GAO-01-44, October 27, 2000). Specifically, it provides information on the amount of improper payments¹ that federal agencies reported in their fiscal year 2000 financial statements and identifies some current improper payment-related actions that the Administration has taken. We identified the amount of improper payments reported by obtaining and reviewing the financial statements of the 24 federal agencies and their related components that the Chief Financial Officers (CFO) Act of 1990, as expanded by the Government Management Reform Act of 1994, and OMB Bulletin No. 01-02, *Audit Requirements for Federal Financial Statements*, require to issue financial statements. Enclosure I lists these agencies and components. We did not independently verify the accuracy of the improper payment information contained in the statements. In addition, we obtained and reviewed documentation on recent Administration initiatives and guidance to agencies on erroneous payment reporting and related issues.

At your request, we are currently (1) determining the extent to which OMB has implemented our prior recommendations dealing with providing governmentwide guidance on identifying and reporting improper payments, (2) assessing the extent to which agencies' fiscal year 2002 performance plans address improper payments, and (3) identifying other actions that might encourage agencies to better report the extent of their improper payments. We will report to you separately on these issues.

¹Improper payments include inadvertent errors, such as duplicate payments and miscalculations; payments for unsupported or inadequately supported claims; payments for services not rendered; payments to ineligible beneficiaries; and payments resulting from outright fraud and abuse by program participants and/or federal employees.

Results in Brief

The amounts of improper payments reported in agency financial statements has remained consistent at about \$20 billion for the past 3 years. Even though these amounts are substantial, agency-specific audits and studies continue to indicate that the extent of the improper payment problem is much more widespread than has been disclosed in agency financial statement reports. As we have previously reported, agencies need to be aware of the extent of their improper payment problems before they can take corrective action to reduce improper payments and thus ensure that federal funds are used for the intended purposes. The *President's Management Agenda, Fiscal Year 2002*, has made the reduction of improper payments a priority. In this regard, the Administration has taken steps to require federal agencies to identify erroneous payments and to discuss planned actions to better manage these payments.

Billions in Improper Payments Reported Although Few Agencies Measure and Report Them

Improper payments are acknowledged to be a widespread and significant problem in the federal government with billions of dollars in such payments reported annually in agency financial statements. For example, federal agency financial statements for fiscal years 1998 through 2000 show improper payments of about \$19.1 billion, \$20.7 billion, and \$19.6 billion, respectively.² Although significant, these amounts are not indicative of the magnitude of improper payments governmentwide. Currently, relatively few agencies report improper payments in their financial statements, even though our audits and those of agency inspectors general continue to identify serious improper payment problems and related internal control issues. The following table summarizes improper payments reported in agencies' fiscal years 1999 and 2000 financial statements.

²*Financial Management: Billions in Improper Payments Continue to Require Attention* (GAO-01-44, October 27, 2000) and *Financial Management: Increased Attention Needed to Prevent Billions in Improper Payments* (GAO/AIMD-00-10, October 29, 1999).

Table 1: Improper Payments Reported by Federal Agencies and Components in Their Fiscal Years 1999 and 2000 Financial Statements

(Dollars in millions)		
Department or agency	Reported in fiscal year	
	1999	2000
Department of Agriculture Food Stamp Program	\$1,290.0	\$1,100.0
Department of Defense Military Retirement Trust Fund	25.3	21.6
Department of Education Education Assistance programs	a	154.0 ^b
Department of Energy No specific program identified	c	a
Department of Health and Human Services Medicare Fee-for-Service Medicaid	14,100.0 ^d	12,470.0 ^e
Department of Housing and Urban Development Housing Subsidy programs	935.0	1,254.0
Department of Justice Federal Bureau of Investigation	c	a
Department of Labor Black Lung Disability Federal Employees Compensation Act Unemployment Insurance	a 19.2 142.3	10.4 14.8 136.0
Department of State Foreign Service Retirement and Disability	c	a
Department of the Treasury Internal Revenue Service United States Customs Service	a 0.4	e c
Department of Veterans Affairs Veterans Benefits	c	c
Office of Personnel Management Retirement Federal Employees' Health Benefits Federal Employees' Group Life Insurance	84.0 93.0 0.2	102.0 71.0 0.0
Social Security Administration Disability Insurance Old Age and Survivors Insurance Supplemental Security Income	1,118.0 1,325.0 1,578.0	1,284.0 1,334.0 1,644.0
Total	\$20,710.4	\$19,595.8

^aThe financial statements did not identify improper payments in these programs.

^bThe independent auditors' Report on Internal Controls, which was included in the Department of Education's fiscal year 2000 financial statements, disclosed \$154 million of duplicate payments related to education assistance programs.

^cThe agencies administering these programs acknowledged making improper payments in their financial statements but did not disclose a dollar amount.

^dHHS acknowledged making improper payments related to Medicaid in the management discussion and analysis section of its fiscal year 1999 financial statements, but did not disclose a specific dollar amount.

^eThe independent auditors' reports, which were included in the fiscal year 2000 financial statements, revealed that these agencies made improper payments, but did not show a specific amount.

Source: GAO analysis based on a reading of the fiscal years 1999 and 2000 financial statements of the federal agencies and their components that the CFO Act and OMB Bulletin No. 01-02 require to prepare financial statements.

A review of the table above shows that, for fiscal year 2000, eight agencies collectively reported improper payments of about \$19.6 billion relating to at least 14 programs. (Some agency financial statements noted that improper payments occurred in multiple programs but did not specify the programs.) These agencies typically reported improper payments as either costs of operations or as accounts receivable. For example, the fiscal year 2000 statements identified about \$14.8 billion as an estimated cost of operations and about \$4.6 billion as accounts receivable. Further, one agency identified \$154 million in improper payments in the auditor's Report on Internal Control, which was included with the agency's financial statements. In addition, three agencies reported improper payments in at least one program, but did not identify the dollar amount of these payments.

About \$19.1 billion (97 percent) of the improper payments reported in the fiscal year 2000 financial statements occurred in the programs administered by the Departments of Agriculture, Health and Human Services, and Housing and Urban Development and the Social Security Administration. This is comparable to the fiscal year 1999 information when about \$20.3 billion (98 percent) of the reported improper payments were in the same programs. However, several changes occurred in the composition of the other agencies reporting improper payments. The Departments of Education, Labor, and the Treasury which did not report improper payments for at least one of their programs in fiscal year 1999, reported them in fiscal year 2000. On the other hand, the Departments of Energy, Justice, and State reported improper payments in programs in fiscal year 1999 but not in fiscal year 2000.

As noted above, only eight of the CFO Act agencies and components required to prepare financial statements reported improper payment amounts in their fiscal year 2000 statements. Recent audits as well as information provided by agency inspectors general continue to demonstrate that improper payments are much greater than have been disclosed thus far in financial statements. For example, historically, the Earned Income Tax Credit (EITC) program has been vulnerable to high rates of invalid claims.³ In 1997, the most recent year for which estimates are available, the Internal Revenue Service (IRS) made approximately \$7.3 billion in improper payments in this program. As we reported in March 2001,⁴ during fiscal year 2000, IRS examiners completed detailed examinations of about 257,000 tax returns claiming approximately \$587 million in these tax credits and found that about 173,000 of these tax returns claiming \$395 million in credits (67 percent) were invalid. Weaknesses in IRS' controls over refund disbursements, particularly those related to EITC, continue to expose the federal government to material losses due to disbursing improper refunds.

Similarly, while the Department of Defense (DOD) reported improper payments related to the Military Retirement Fund for both fiscal years 1999 and 2000, departmentwide estimates of improper payments remain unreported. For example, over the last several years DOD has overpaid its contractors by hundreds of millions of dollars. Specifically, the DOD Office of

³*High Risk Series: An Update* (GAO-01-263, January 2001); *Major Management Challenges and Program Risks: Department of the Treasury* (GAO-01-254, January 2001); and *Financial Audit: IRS' Fiscal Year 2000 Financial Statements* (GAO/AIMD-01-394, March 1, 2001).

⁴*Financial Audit: IRS' Fiscal Year 2000 Financial Statements* (GAO-01-394, March 1, 2001).

Inspector General noted that, during fiscal years 1999 and 2000, the Defense Finance and Accounting Service (DFAS) overpaid contractors \$182.6 million and \$148.3 million, respectively, as a result of inadvertent errors, such as paying the same invoice twice and input errors. These amounts are not an estimate of total improper payments made to contractors. Over half of these overpayments were identified and voluntarily returned to DFAS by the contractor, while the remainder were identified and requested by DFAS. Further, although small in relation to total fiscal year 2000 contract payments,⁵ this amount represents a sizable amount of cash in the hands of contractors beyond what is intended to finance and pay for the goods and services DOD purchases, and is indicative of the need for stronger internal controls within the payment system.

The Administration Has Taken an Important Initial Step in Measuring and Reporting Improper Payments

As we have stated in the past⁶ and will discuss in more detail in our ensuing report, measuring the extent of improper payments is an essential step in assessing the need for and types of corrective actions required to manage improper payments and help ensure efficient and effective program operations. Nondisclosure of improper payment amounts may indicate the absence of a significant level of improper payments or that agencies are unable to or did not attempt to determine or estimate the amount of improper payments in their programs or activities. Obtaining improper payment-related data would give agencies and others with oversight responsibilities baseline information for performing the in-depth analyses necessary for assessing the extent and causes of improper payments and for making cost-effective decisions about enhancing controls to minimize future improper payments.

In this regard, during fiscal year 2001, the Administration took steps to require federal agencies to identify erroneous payments⁷ within selected programs and discuss planned corrective actions to reduce these payments. (Because of the similarity of OMB's definition of erroneous payments with our definition of improper payments, we consider erroneous payments and improper payments as synonymous terms.) Most importantly, *The President's Management Agenda, Fiscal Year 2002*, discusses a governmentwide initiative for improved financial performance. Under this initiative, the Administration plans to establish a baseline of the extent of erroneous payments to serve as a gauge for monitoring progress. As an

⁵The overpayment amount of \$148.3 million is about 0.16 percent of about \$90 billion in total contractor payments made by DOD's Defense Finance and Accounting Service, Columbus facility, in fiscal year 2000.

⁶*Strategies To Manage Improper Payments: Learning From Public and Private Sector Organizations* (GAO-02-69G, October 2001) and *Financial Management: Billions in Improper Payments Continue to Require Attention* (GAO-01-44, October 27, 2000).

⁷OMB Circular No. A-11 notes that erroneous payments are payments made that should not have been made or were made for incorrect amounts. In this context, "payments" include the provision of benefits that do not necessarily involve cash disbursements (e.g., loan guarantees). Examples of erroneous payments include payments to ineligible persons or the wrong organizations, payments in the wrong amount, payments for ineligible services, duplicate or other overpayments, and payments for services never received. Erroneous payments may be due to procedural or administrative errors made by the payor (e.g., providing incorrect account numbers in payment instructions) or errors or fraud by payees or claimants (e.g., underreporting of income by beneficiary). Covered payments include overpayments and underpayments made by the federal government, its direct contractors, and by states or other grant recipients administering federal programs.

expected result, the agenda notes that “More accurate benefit and assistance payments to current recipients will enable programs to serve additional eligible recipients without increasing their budgets and will reduce program costs.” Specifically, the agenda calls for certain agencies to include, in their fiscal year 2003 budget submissions, information on erroneous payment rates, including actual and target rates, where available, for benefit and assistance programs expending over \$2 billion annually. Further, OMB Circular No. A-11, *Preparation and Submission of Budget Estimates*, identifies the agency programs for which the data on erroneous payments is required and specifies reporting requirements for programs where erroneous payment rates are not currently available. (Enclosure II lists the programs for which erroneous payment information is required.) In addition, the management agenda states that OMB will use this information in working with agencies to establish goals to reduce erroneous payments for each program.

Identifying and Correcting Internal Control Weaknesses Is Critical to Efforts to Manage Improper Payments

As repeatedly reinforced by our audit work, many of the causes of improper payments can be traced to the lack of or an inadequate system of internal control. Federal agencies must address these internal control deficiencies in order to resolve their improper payment problems. We recently issued guidance⁸ for federal agencies to consider when (1) developing strategies and planning and implementing actions to strengthen their system of internal control and (2) addressing their improper payment problems. The guidance categorizes the actions into the following areas outlined in the Comptroller General’s *Standards for Internal Control in the Federal Government* (GAO/AIMD-00-21.3.1, November 1999).⁹

- The control environment—creating a culture of accountability by establishing a positive and supportive attitude toward improvement and the achievement of established program outcomes.
- Risk assessments—performing comprehensive reviews and analyses of program operations to determine if risks exist and the nature and extent of the risks identified.
- Control activities—taking actions to address identified risk areas and help ensure that management’s decisions and plans are carried out and program objectives are met.
- Information and communications—using and sharing relevant, reliable, and timely financial and nonfinancial information in managing improper payment-related activities.
- Monitoring—tracking improvement initiatives, over time, and identifying additional actions needed to further improve program efficiency and effectiveness.

Absent improvements in internal controls and other proactive action from the President, the Congress, top-level administration appointees, and agency management officials, improper payments are likely to be a continuing concern. Further, once committed to a plan of action,

⁸*Strategies to Manage Improper Payments: Learning From Public and Private Sector Organizations* (GAO-02-69G, October 2001).

⁹The Federal Managers’ Financial Integrity Act of 1982 required that we issue standards for internal control in government.

federal officials must remain steadfast supporters of the end goals and their support must be transparent to all.

As agreed with your office, unless you publicly announce the contents of this letter earlier, we will not distribute it until 30 days from its date. Then, we will send copies to the Chairman of the Senate Committee on Governmental Affairs and the Chairmen and Ranking Minority Members of the House Committee on Government Reform, Senate Committee on the Budget, and House Committee on the Budget. We will also send copies to the Director of the Office of Management and Budget, the heads of the 24 CFO Act agencies and the Railroad Retirement Board, and respective agency CFOs and inspectors general.

Please contact me at (202) 512-9450 or by e-mail at thompsons@gao.gov if you or your staff have any questions concerning this letter. Key contributors to this letter were Tom Broderick, Barbara House, Bonnie McEwan, and Tarunkant Mithani.

Sincerely yours,

A handwritten signature in cursive script that reads "Sally E. Thompson".

Sally E. Thompson
Director, Financial Management and Assurance

**Federal Agencies and Components Required to Prepare Financial
Statements Under the CFO Act and OMB Guidance**

- Department of Agriculture
 - Food and Nutrition Service
 - Forest Service
 - Rural Development Mission Area
- Department of Commerce
- Department of Defense
 - Department of Army General Funds
 - Department of Navy General Funds
 - Department of Air Force General Funds
 - Military Retirement Trust Funds
 - U.S. Army Corps of Engineers Civil Works Program
 - Department of Army Working Capital Fund
 - Department of Navy Working Capital Fund
 - Department of Air Force Working Capital Fund
- Department of Education
- Department of Energy
- Department of Health and Human Services
 - Centers for Medicare and Medicaid Services
- Department of Housing and Urban Development
- Department of the Interior
- Department of Justice
- Department of Labor
- Department of State
- Department of Transportation
 - Federal Aviation Administration
 - Highway Trust Fund
- Department of the Treasury
 - Bureau of Alcohol, Tobacco and Firearms
 - Internal Revenue Service
 - United States Customs Service
- Department of Veterans Affairs
- Agency for International Development
- Environmental Protection Agency
- Federal Emergency Management Agency
- General Services Administration
- National Aeronautics and Space Administration
- National Science Foundation
- Nuclear Regulatory Commission
- Office of Personnel Management
 - Civil Service Retirement and Disability Fund
 - Federal Employees Health Benefits Program
 - Federal Employees Life Insurance Program
- Small Business Administration
- Social Security Administration

**Programs for Which Erroneous Payment Information Is
Required Per OMB Circular No. A-11**

Department of Agriculture

Food Stamps
Commodity Loan Program
National School Lunch and Breakfast
Women, Infants, and Children

Department of Defense

Military Retirement
Military Health Benefits

Department of Education

Student Financial Assistance
Title I
Special Education – Grants to States
Vocational Rehabilitation Grants to States

Department of Health and Human Services

Head Start
Medicare
Medicaid
TANF
Foster Care – Title IV-E
Child Support Enforcement
State Children's Insurance Program
Child Care and Development Fund

**Department of Housing and Urban
Development**

Low Income Public Housing
Section 8 Tenant Based
Section 8 Project Based
Community Development Block Grants
(Entitlement Grants, States/Small Cities)

Department of Labor

Unemployment Insurance
Federal Employee Compensation Act
Workforce Investment Act

Department of the Treasury

Earned Income Tax Credit

Department of Transportation

Airport Improvement Program
Highway Planning and Construction
Federal Transit – Capital Investment Grants
Federal Transit – Formula Grants

Department of Veterans Affairs

Compensation
Dependency and Indemnity Compensation
Pension
Insurance Programs

Agency for International Development

Environmental Protection Agency

Clean Water State Revolving Funds
Drinking Water State Revolving Funds

National Science Foundation

Research and Education
Grants and Cooperative Agreements

Office of Personnel Management

Retirement Program (CSRS and FERS)
Federal Employees Health Benefits Program
Federal Employees' Group Life Insurance

Railroad Retirement Board^a

Retirement and Survivors Benefits
Railroad Unemployment Insurance Benefits

Small Business Administration

(7a) Business Loan Program
(504) Certified Development Companies
Disaster Assistance
Small Business Investment Companies

Social Security Administration

Old Age and Survivors' Insurance
Disability Insurance
Supplemental Security Income Program

^aNot a CFO Act agency.

(193008)