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REPORTING IMPROPER PAYMENTS: A REPORT CARD ON AGENCIES' PROGRESS

HEARING

BEFORE THE

FEDERAL FINANCIAL MANAGEMENT, GOVERNMENT INFORMATION, AND INTERNATIONAL SECURITY SUBCOMMITTEE

OF THE

COMMITTEE ON HOMELAND SECURITY AND GOVERNMENTAL AFFAIRS UNITED STATES SENATE

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REPORTING IMPROPER PAYMENTS: A REPORT CARD ON AGENCIES' PROGRESS

THURSDAY, MARCH 9, 2006

U.S. SENATE,
SUBCOMMITTEE ON FEDERAL FINANCIAL MANAGEMENT,
GOVERNMENT INFORMATION, AND INTERNATIONAL SECURITY,
OF THE COMMITTEE ON HOMELAND SECURITY
AND GOVERNMENTAL AFFAIRS,
Washington, DC.

The Subcommittee met, pursuant to notice, at 2:33 p.m., in room SD–342, Dirksen Senate Office Building, Hon. Tom Coburn, Chairman of the Subcommittee, presiding.

Present: Senators Coburn and Carper.

OPENING STATEMENT OF SENATOR COBURN

Senator COBURN. The Subcommittee on Federal Financial Management will come to order.

Let me first thank each of our panelists for being here. This is not an exciting subject for most people, but it is, nonetheless, a very important subject when it comes to the process and the unsustainable course we find ourselves on over the next few years.

I appreciate the frankness with which many of our panelists have dealt with our Subcommittee and the general cooperative nature. And I want to thank you in advance for that.

This will probably be a fairly long hearing because of the nature and extent of the questions and the importance of it. We are here again, this is our third hearing on improper payments in just over 8 months. A lot of people find the subject dry and overly technical. Some people think payment errors are simply too arcane to interest taxpayers. When you look at the total amount of money, it is far from a small amount of money.

This Subcommittee is dedicated to continue having hearings on the subject, first of all, because if the American people were aware of some of these numbers, they would vote us all out of office and probably fire most in the executive agencies when they see the scope of the problem.

Let me give you an example of what I mean. The Federal Government pays out a lot of money to individuals, organizations, businesses, States, and local government. Between this year and last year, $83 billion of those payments were wrong. The vast majority of them, greater than 95 percent, were overpayments.

That means that $83 billion didn't go to accomplish the goals that the government set out. And it meant that $83 billion could have been used to help somebody. It could have been used to offset

the tremendous deficit that we are facing. This amount translates into over $300 for every man, woman, and child in America.

If we eliminated improper payments, we could do a lot of things with that money that would make a significant difference in this country. The $83 billion would fund everything we are going to need, four times fold, for Hurricane Katrina this year. It would pay completely for this year's war effort in Iraq, rather than charging it to our children.

There are several problems I want to outline in my opening statement, and then we will get into details after we have heard our panelists. The first problem is that the $83 billion is an underestimation. It is much greater than that. That is only what we know about based on agency reporting.

At our first hearing, we heard that $45 billion improper payments represented only 23 of the 35 Federal agencies that were required to report improper payment information, and those reports only showed the agencies that performed a risk assessment of programs and activities, just the first step in complying with the improper payments law.

Eight months later, that number is not changed, and the $37 billion in improper payments for last year represents again only 23 agencies. It is not easy to bring the agencies into compliance, and I know that Linda Combs and the CFO Council are working hard to do that. But I think they would agree with me that it is still not good enough. The law does not exempt any agency from reporting.

Here we have a poster that shows the worst offenders. The Department of Health and Human Services, the Department of Agriculture, and Department of Housing and Urban Development have a combined total of seven programs that are not reporting on these programs whose total outlays last year equaled $228 billion.

There are two major programs and activities at the Department of Agriculture that have failed to report—School Programs and WIC. At HHS, four major programs are not reporting improper payments—Medicaid, TANF, Child Care, and Development Fund, the State SCHIP Program.

At HUD, the Community Development Block Grant Program has failed to report. We will be inviting representatives from both USDA and HUD back to testify before this Subcommittee on their failure to comply with the law.

Major programs from these three agencies with combined budgets of over $200 billion are not yet reporting their payment errors. So we can't even estimate how much is in error each year.

Some of the lowest payment error rates we have seen are around 3 percent. And if we pretended that these agencies had about 3 percent, we would be still looking at another $7 billion in improper payments. And I suspect it is much higher.

One of the worst examples is the Medicaid Program, or health safety net for the poor. Outlays for this program were almost $200 billion last year. In 2004, the program told us they would be reporting their payment errors by this year. But last summer, we heard that they wouldn't be able to do it until 2008. That wasn't acceptable news then, and it is not acceptable news now.

Second problem. Reporting agencies report unacceptable rates. Not all programs are out of compliance with the law. Some are reporting, and the reports are deplorable.

The worst example by far is the earned income tax credit with a payment error rate of 28 percent. That is $1 in every $4 that goes to that program is improper, most of which are improper overpayments. That means at least a quarter of the payments paid out by the program are wrong, and they are increasing in error, not decreasing.

Not all the news is bad. Food Stamp rate is going down, though it is still staying high. The Department of Labor's Unemployment Insurance Program and other agencies have implemented great public policies that help bring the payment error rate down.

And I would note, and we will be talking about this later, the Department of Labor has to work through State programs to do that. And what we have heard in this Subcommittee is many agencies say we can't get the information because we have to work through State programs. But the Department of Labor has shown that you can do that and that you can, in fact, know what the improper payment rate is, and you can bring it down.

Transparency is the means. It is not the end. This Subcommittee is not going to rest until every program of every agency is in compliance with the improper payments law. I think most people know that I mean what I say and I say what I mean. And so, we will be back here multiple times until we get to that point.

The law doesn't tell us what to do when reporting reveals bad news. Transparency is the first and foundational principle of accountability, but it is only the beginning, not the end. You still need performance programs, and programs can be compliance with the law, but still have astronomical payment error rates. It is important that the American people have confidence to know what is going on, how the money is being spent.

The solution. Can you imagine the accounts payable department of Wal-Mart or Microsoft reporting an error rate of 28 percent or even 3 percent? What would happen to the people in the position of responsibility if 3 percent of the payments were overpayments for everything that Wal-Mart bought or Microsoft bought? The people responsible for that would not be there.

So it is not that we don't have people trying. It is not that there aren't hurdles in terms of the bureaucracy to get there. But it is something that we have to solve for our children and our grandchildren.

Congressional responsibility. We have some as well. Accountability in the Federal Government requires political will on the part of our elected officials. I say, unfortunately, because our system of checks and balances intended by our Framers is broken, only Congress has the power to pull the plug on programs that are fleecing the taxpayers.

Instead of providing a check on wasteful spending, Congress prefers writing a blank check to the Executive Branch, no matter the waste, fraud, or abuse of that money. No matter or not, whether they are complying with the law. When we have offered amendments to cut the funding of programs with unacceptably high payment error rates, those amendments have failed.

Congress should be in the business of protecting the taxpayer from being forced to subsidize broken systems. It also should be in the business of protecting the future. Financial systems that aren't working, that aren't measuring results, or are measuring results that are unacceptable without appropriate action is an unacceptable thing for Congress to be accepting.

The Department of Defense has over 4,000 financial reporting systems that don't even talk to each other. Like the board of directors of a corporation is supposed to look out for all its shareholders, the American people rely on Congress to look out for their investments by scrutinizing the government's performance on these and other problems. America needs to require Congress to take that responsibility seriously.

In the meantime, this Subcommittee will not give up. We will keep trying to make the case to our colleagues until these amendments start passing or agencies find a way to get the results the taxpayers deserve.

I want to again thank our witnesses for coming today. Each one of them faces a monumental task. This is not an easy problem to solve. Cleaning up financial systems has had a great start under President Bush and his management team. I am very appreciative for that. I applaud their efforts, and I hope that this hearing will help efforts back at the agencies that are affected.

[The prepared statement of Senator Coburn follows:]

PREPARED STATEMENT OF SENATOR COBURN

Well, here we are again. This is our third hearing on Improper Payments in just over 8 months. A lot of people find this subject dry or overly technical. Some people think payment errors are simply too arcane to interest the taxpayers.

But this Subcommittee is going to keep having hearings on the subject, because I think if the American people heard some of these numbers, they would vote us all out of office, and they'd be right to do so. Let me give you an example of what I mean. The Federal Government pays out a lot of money to individuals, organizations, businesses, States, and local governments. Between this year and last year, $83 billion of those payments were wrong. Most of those errors were overpayments rather than underpayments. That means we just threw away the better part of $83 billion.

That translates into almost $300 for every man, woman, and child in America. We could buy every American an iPod! Remember that $300 tax refund check the President's tax cuts sent out a couple years ago? If we eliminated improper payments, we'd be able to do it all over again without the hassle of a nasty floor debate. More seriously, we could use that $83 billion to pay for this year's war effort in Iraq, or fund this year's Katrina reconstruction efforts four times over.

But the $83 billion is an underestimation. that's only what we know about, based on agency reporting. At our first hearing, we heard that $45 billion in improper payments represented only 23 of the 35 Federal agencies required to report improper payment information—and those reports only showed that agencies had performed a risk assessment of programs and activities—the first step in complying with the law. Eight months later, that number has not changed, and the $37 billion in improper payments for last year represents again, only 23 agencies. Now, I know that it is not easy to bring these agencies into compliance and I know that Linda Combs and the CFO council are working hard on this. But I think they would agree with me that it's still not good enough. The law does not exempt any agency from reporting.

The Department of Health and Human Services, the Department of Agriculture and the Department of Housing and Urban Development have a combined total of seven programs that are not yet reporting for programs whose total outlays equal about $228 billion. There are two major programs and activities at the Department of Agriculture that have failed to report: School Programs, and Women, Infants, and Children (WIC). At HHS, four major programs are not reporting improper payments information: Medicaid, Temporary Assistance for Needy Families (TANF), Child

Care and Development fund, and the State Children's Insurance Program. At HUD, the Community Development Block Grant program has also failed to report. I will be inviting representatives from both USDA and HUD back to testify before this Subcommittee on their failure to comply with the law. Major programs from these three agencies with combined budgets of over $200 billion are not yet reporting their payment errors, so we cannot even estimate how much they are wasting each year.

Some of the lowest payment error rates we've seen are around 3 percent. Let's pretend that these non-reporting programs have error rates at that so-called low rate—we would still be looking at almost $7 billion in wrong payments from these non-reporters. And I suspect that it's actually much higher, because, appallingly, very few programs who do report are reporting a rate as low as 3 percent.

One of the worst examples is the Medicaid program, our healthcare safety net for the poor. Outlays for this program were almost $200 billion last year. In 2004, the program told us they'd be reporting their payment errors by this year. But last summer, we heard that they wouldn't really be able to do it until 2008. That wasn't acceptable news, and I hope I'll hear some better news today.

Not all programs are out of compliance with the law. Some are reporting, and the reports are deplorable. The worst example by far is the Earned Income Tax Credit program, with a payment error rate of 28 percent. That means that at least a quarter of payments paid out by this program are wrong. Social Security Administration programs also have unacceptable rates, which have actually been increasing.

Not all the news is bad. The Food Stamps rate is going down, tough it is still stunningly high. Department of Labor's Unemployment Insurance program and other agencies have implemented some good policies to help bring the payment error rate down.

This Subcommittee will not rest until every program of every agency is in compliance with the Improper Payments law. But the law only requires reporting. The law doesn't tell us what to do when the reporting reveals bad news. Transparency is the first and foundational principle of accountability, but it's only the beginning, not the end. You still need performance. Programs can be in compliance with the law but still have astronomical payment error rates.

I think I know why. Can you imagine the Accounts Payable Department at Microsoft or Wal-Mart reporting an error rate of 28 percent, or even 3 percent? In the private sector, there are consequences for poor performance. In the Federal Government, the natural consequence of either failing to report payment errors or reporting an unacceptable error rate should be that you lose your funding. Why should taxpayers support a program that wastes a third, a tenth, or even 3 percent of their investment? Taxpayers should not have to tolerate programs that have outrageous waste just because those programs are founded on good intentions, or because the financial officers in those agencies are working long hours and trying hard to fix the problem. There should come a time when it's no longer acceptable to fund a program that's wasting a significant fraction of its budget.

Unfortunately, accountability in the Federal Government, unlike in the private sector, requires political will on the part of elected officials. I say "unfortunately" because our system of checks and balances intended by the Framers is broken. Only Congress has the power to pull the plug on programs that are fleecing the taxpayers. Instead of providing a "check" on wasteful Washington spending, Congress prefers writing a "blank check" to the Executive Branch, no matter the waste, fraud, or abuse of that money.

When we have offered amendments to cut the funding of programs with unacceptably high payment error rates, those amendments have failed. Congress should be in the business of protecting the taxpayer from being forced to subsidize broken systems. Homeland Security's contract to get its financial reporting systems in order was such a failure, they recently just cut their losses on that contract and have proposed to start over next year. Department of Defense has over four thousand financial reporting systems that don't talk to each other. Like the Board of Directors of a corporation is supposed to look out for all its shareholders, the American people rely on Congress to look out for their investment by scrutinizing the government's performance on these and other problems. Americans need Congress to take that responsibility seriously.

In the meantime, we will not give up. This Subcommittee will keep harping on these themes. We will keep trying to make the case to our colleagues until these amendments start passing or the agencies find a way to get the results the taxpayers deserve.

I want to thank our witnesses for coming today. Each one of them faces a monumental task. Cleaning up financial systems in the Federal Government is not for the faint of heart. I applaud their efforts and I hope that this hearing will help those efforts back at the agencies.

Senator COBURN. I would like to recognize my Ranking Member and good friend, Senator Carper.

OPENING STATEMENT OF SENATOR CARPER

Senator CARPER. Thanks, Mr. Chairman. How are you today?

Senator COBURN. I am better.

Senator CARPER. Good.

To our witnesses—Mr. Williams, Hon. Linda Combs—nice to see you both. Thanks for joining us, and we look forward to your testimony and that of the other panels who follow.

I am going to probably repeat a little bit of what the Chairman has said, and I would ask you just to bear with me. I have a statement. I am going to ask you to enter it for the record.

Senator COBURN. Without objection.

Senator CARPER. And I will just summarize it if I can. We have a budget deficit that David Walker was telling us the other day that he said set aside cash-basis accounting. He said think of accrual accounting. And he said this is not a $300 billion deficit. This is really about a $600 billion or $700 billion deficit.

And that makes what we are talking about here today and what some of you are trying to do even all the more worthwhile. If there are $50 billion worth of improper payments, if we can only somehow reduce that by half, that is a huge improvement.

If there are $350 billion in tax revenues that are going uncollected out there, if we could only get a third of that, that is a third of the deficit right there, and it is money that we have to go after rather than increase our debt.

And as I think the Chairman has already talked about, back in 2002, when the Improper Payments Information Act was adopted—were you in the House then?

Senator COBURN. No.

Senator CARPER. I was here in the Senate, got to vote for it. But I don't think many of our colleagues had much of a sense of what it could mean.

And I think the Administration has shown a real commitment to making it work. We have had great support from GAO—and with the appointment and confirmation of Ms. Combs to be our, I will call her CFO, if you will, at OMB. That is a lot of alliteration. That is a lot of acronyms there. But with her confirmation, I am encouraged that we are going to make good progress.

I was tempted, I forgot to bring this magazine because it was a great magazine. What is it called?

Ms. COMBS. Government Executive.

Senator CARPER. Government Executive. Your picture is on the cover of it. I wanted so badly to hold it up and just to be able to brag on you a little bit, on the work that you are doing.

But OMB has now made the elimination, I believe, of improper payments a top management priority, and the leadership of Linda Combs is going to be critical if we are going to actually make the progress we need to make.

There is some evidence now that all of the attention paid to improper payments in recent years is starting to pay off. We are encouraged by that. I am told that reported improper payments among Federal agencies were about $37 billion in 2005. That is

down by about 17 percent from fiscal year 2004, when I think the estimate was about $45 billion. So we are heading in the right direction.

And as we learned at a hearing we had last summer that some of us were present at, the official improper payments estimates we will hear discussed today are probably just the tip of the iceberg. And the estimates for some programs that we know are at risk for improper payments, one of them is Medicaid, are not included in this $37 billion tally.

In addition, GAO will testify today, I believe, that some agencies are not doing as rigorous a job as they ought to be doing in assessing the programs that they administer to determine whether or not they are at risk for waste. Still others, GAO has found, have not even conducted the necessary assessments for all of their programs. Those are obviously things we are concerned about.

And I say in closing, I understand that OMB-issued guidance that the agencies use to conduct their work under the Improper Payments Information Act may perhaps unintentionally leave significant amounts of waste that is unreported. We would like to find out if that is the case.

Agencies apparently must only report on and develop remediation plans for improper payments that both exceed $10 million and make up at least 2.5 percent of program outlays. So it has to be at least $10.5 million and make up at least 2.5 percent of program outlays. And our concern is that might leave a fair amount of money on the table. So I think there may be a good reason why the guidance was written as it was, and perhaps we can talk about that and find out if that is the case.

So, again, it is an important hearing. I am just pleased that we didn't have one hearing and kind of let this one go, but to continue to be diligent and to do the oversight that this Subcommittee is becoming known for, and under the leadership of our Chairman. And I am just pleased to be his compadre.

Thank you.

[The prepared statement of Senator Carper follows:]

PREPARED STATEMENT OF SENATOR CARPER

Thank you, Mr. Chairman, for continuing this Subcommittee's focus on the problem of improper payments.

As you know, our country is currently in the midst of some very trying fiscal times. The size of the Federal budget deficit and the burden our growing national debt force Congress every day to make difficult decisions about what to do with scarce resources. This situation makes our work on this Subcommittee even more important.

Every dollar wasted because of lax financial management—whether due to error or fraud—is a dollar that can't be used to fund worthy programs or to lessen the debt burden on future generations.

As you know, Mr. Chairman, our predecessors on this Subcommittee worked back in 2002 to enact the Improper Payments Information Act—legislation that, for the first time, required all agencies to determine which programs are at significant risk for waste, estimate the amount those programs are spending improperly each year, and then come up with a plant to do something about it.

In addition, OMB has now made the elimination of improper payments a top management priority and, under the leadership of Linda Combs and others, has been working hard to help agencies comply with the Improper Payments Information Act.

There's some evidence now that all of the attention paid to improper payments in recent years is starting to pay off. Reported improper payments among Federal

agencies were about $37 billion in fiscal year 2005. This is down 17 percent from the fiscal year 2004 estimate of about $45 billion.

As we learned at a hearing last summer, however, the official improper payments estimates we hear about are only the tip of the iceberg. Estimates for some programs we know are at risk for improper payments, like Medicaid, are not included in the $37 billion tally.

In addition, GAO will testify today that some agencies are not doing as rigorous a job as they should be in assessing the programs they administer to determine whether or not they're at risk for waste. Still others, GAO has found, have not even conducted the necessary assessments for all of their programs. Finally, I understand that the OMB-issued guidance that agencies use to conduct their work under the Improper Payments Information Act may, perhaps unintentionally, leave significant amounts of waste unreported.

Agencies must only report on and develop remediation plans for improper payments that both exceed $10 million and make up at least 2.5 percent of program outlays. In a large program, Mr. Chairman, this could mean that improper payments that you, me or any casual observer would deem significant are largely being ignored.

There may be a good reason why the guidance was written this way but I don't know of any private company that would ignore such large payment errors. We should see to it that the Federal Government no longer does either.

Thank you again, Mr. Chairman, for your commitment to this issue. I look forward to hearing some more today about the progress that is or isn't being made and to seeing what we might need to do in Congress to make sure we have a better picture of the problem and are giving agencies all of the tools they need to address it.

Senator COBURN. Thank you very much, Senator Carper.

Our first panel is Linda Combs, Controller, Office of Management and Budget. She served in that position since June 2005. Prior to her time as controller, she served as Assistant Secretary for Budget and Programs, and CFO at the Department of Transportation.

She also has a history of serving as the chief financial officer at the Environmental Protection Agency and served in various oversight roles in executive-level management positions at the Department of Education, Veterans Affairs, and Treasury. That makes her extremely well qualified in terms of her knowledge of all of these other agencies, and we are very pleased that she is in the position that she is in.

Also on the first panel is McCoy Williams, Director, Financial Management and Assurance Team in the Government Accountability Office. He has worked with this Subcommittee quite well. We are very appreciative of his help and direction.

He has worked in the financial management and audit issue area since 1980 and is responsible for GAO's financial management work at the Department of Defense, Homeland Security, Veterans Affairs, State, NASA, and USAID. He also covers government-wide improper payments work in financial management systems.

Welcome to you both. Your complete statement will be made a part of the record, and Ms. Combs, you are recognized.

TESTIMONY OF THE HON. LINDA M. COMBS,[1] CONTROLLER, OFFICE OF MANAGEMENT AND BUDGET

Ms. COMBS. Thank you very much, Senator Coburn, Senator Carper, and Members of the Subcommittee.

[1] The prepared statement of Ms. Combs appears in the Appendix on page 58.

And I must say, Senator Carper, I, too, thought of bringing that magazine today. And I thought I would sit it up right here, and you could have the magazine instead of me. [Laughter.]

Thank you so much for letting us be here today. I am pleased to be here. It is a very important topic, and I am pleased to discuss the Administration's efforts to improve accuracy and integrity in our Federal payments.

There is no more important topic that we can be discussing today than the American taxpayer's money. The effectiveness and the efficient stewardship of taxpayer dollars is extremely important to all of us, and I can't tell you how much I appreciate the collaborative spirit and the continuing partnership and cooperation. We get an awfully lot out of these hearings ourselves because we need to also know what our partners think are important, and we want to respond and be aggressive in responding to not only what we believe is important, but what you believe is important as well.

The President has made the elimination of improper payments one of his highest priorities. During fiscal year 2005, the Federal Government made substantial progress in meeting the President's goal to eliminate improper payments. And most significantly, the government-wide improper payment total reported in 2004 did, indeed, decrease from $45.1 billion to $37.3 billion. And that was a reduction in $7.8 billion, or 17 percent.

We have some wonderful news to share in some of these programs. Medicare reported improper payments decreased by more than $9 billion, or 44 percent. USDA reported an error rate of less than 6 percent in the Food Stamp Program, and that is the lowest error rate in that program's history.

The Department of Labor, as you mentioned earlier, has reduced improper UI payments—unemployment insurance payments—by approximately $600 million in fiscal year 2005. And this represents a greater than 15 percent decrease in the level of improper payments for this program since last year's reporting.

The Department of Housing and Urban Development has reduced improper payments in their program by more than $1.8 billion since 2000.

There are a couple of programs, as we will talk about, I am sure, today, who have reported some increases. But the government-wide improper payment total is trending significantly downward.

Our CFOs and our program officers in various departments are working very hard to continue to leverage new technologies, to generate more cost-efficient methods for measuring and eliminating improper payments, and doing many other things that probably don't show up on any of our reports.

But another critical accomplishment in 2005 was that Federal agencies reported error measurements on an additional 17 programs. And as you mentioned earlier, that is what we need to do. We need to continue to get the right measurement rates.

We have an error measurement in place for approximately 85 percent of all the payments that were deemed risk susceptible by Federal agencies. And although we are proud of that record, we are not satisfied with it.

Also of note, in direct response to suggestions made by this Subcommittee in some of our previous hearings, agency reporting on

improper payment to vendors is now included in our government-wide reporting as well. And that is not an insignificant number either. But providing a more complete picture on government-wide improper payments is what we both seek in the transparency here.

But specifically, Federal agencies reviewed $365 billion in vendor payments in 2005, and they identified $557 million in improper payments, of which $467 million, or 84 percent of that, has been recovered.

Because 95 percent of the reported improper payment total continues to reside within the seven programs that we talked about in our first hearing, we continue to focus on these agencies. But we certainly want to be open to pursue aggressive strategies in any other programs that are deemed worthy by this Subcommittee or by GAO. And we have embarked upon a lot of case-by-case work with different programs and different agencies.

We also have within the President's 2007 budget an aggressive legislative agenda that will help us in the arena of improper payments as well. But with the tools that we have with IPIA and our Administration's management initiatives, the Federal Government today is in a stronger position to build on dynamic reduction in improper payments that we have achieved this year and to ensure that an error measurement is provided for all higher risk programs.

With the goal of ensuring that each taxpayer dollar is spent wisely, efficiently, and for the purpose for which it was originally intended, we remain committed to eliminating Federal improper payments. We look forward to continuing to work with the Congress and with this Subcommittee to see that objective is, indeed, accomplished.

Thank you.

Senator COBURN. Thank you, Ms. Combs. Mr. Williams.

TESTIMONY OF McCOY WILLIAMS,[1] DIRECTOR, FINANCIAL MANAGEMENT AND ASSURANCE TEAM, U.S. GOVERNMENT ACCOUNTABILITY OFFICE

Mr. WILLIAMS. Thank you, Senator Coburn and Senator Carper.

I am pleased to be here today to discuss the government-wide problem of improper payments in Federal programs and activities. Our work over the past several years has shown that improper payments are a long-standing, widespread, and significant problem in the Federal Government.

The extent of the problem initially had been underestimated because only a limited number of agencies reported their annual payment accuracy rates and estimated improper payment amounts prior to the passage of the Improper Payment Information Act of 2002. Our work has also shown that primary causes of improper payments are a lack of internal controls or a breakdown in existing controls.

Mr. Chairman, fiscal year 2005 marked the second year that Federal agencies government-wide were required to report improper payment information in their performance and account-

[1] The prepared statement of Mr. Williams appears in the Appendix on page 63.

ability reports. The act has increased visibility over improper payments to a higher, more appropriate level of importance.

It requires executive agency heads, based on guidance from OMB, to identify programs and activities susceptible to significant improper payments, estimate amounts improperly paid, and report on the amounts of improper payments and their actions to reduce them. Further, in fiscal year 2005, OMB began to separately track the elimination of improper payments under the President's Management Agenda.

Mr. Chairman, the Federal Government has made progress under the leadership of OMB in identifying programs susceptible to the risk of improper payments. At the same time, significant challenges remain to effectively achieve the goals of the act.

For example, while progress has been made, the full magnitude of the problem remains unknown because some agencies have not yet prepared estimates of improper payments for all of their programs. We note in my written statement that seven major agency programs with outlays totaling about $228 billion have not reported improper payment estimates, even though these agencies had been required to report this information since 2002 with their fiscal year 2003 budget submissions under previous OMB Circular A–11 requirements.

Further, agency auditors have identified major management challenges related to agencies' improper payment estimating methodologies and significant internal control weaknesses for programs susceptible to significant improper payments. Mr. Chairman, we recognize that measuring improper payments and designing and implementing actions to reduce them are not simple tasks and will not be easily accomplished. The ultimate success of the government-wide effort to reduce improper payments depends on the level of importance each agency, the Administration, and the Congress place on the efforts to implement the act.

In closing, I want to thank you and the Members of this Subcommittee for your continued interest in this problem and providing important leadership to ensure that this problem is properly addressed. I look forward to working with this Subcommittee as well as Federal agencies and the Administration in the future to address this problem.

This concludes my statement. I would be pleased to answer any questions that you or Senator Carper may have. Thank you.

Senator COBURN. Thank you, Mr. Williams.

Well, let me just start, and we will try to get through these. Several of the questions we have, we will try to put in written form for you, Ms. Combs. I have way too many questions, but I still want the answers, and so I won't delay all of our other witnesses with all of the questions.

According to the testimony we have received from HHS and our confirmation is there really wasn't a reduction in Medicare improper payments. There was a change in methodology, which actually said they measured it wrong last year. Is that correct?

Ms. COMBS. I think what happened last year and, of course, our good friend and CFO, Charles Johnson, is here——

Senator COBURN. Right.

Ms. COMBS [continuing]. As a witness today, and he can certainly substantiate this. But I look on what happened as a good news story because I think what they did is they actually corrected some audit findings that they had the year before. In other words, they were counting payments as improper because they could not find an audit trail.

Senator COBURN. Right. It is good news in that their methodology is much improved, and the actual payment error is probably lower than what they thought it was.

Ms. COMBS. That is exactly how I view it.

Senator COBURN. So that is good news. But it does say that we really haven't reduced the payments, and that is the point I want to make.

As we go through these questions, I want you to know I appreciate everybody out there that is working. For the first time, our government is going to have some financial accountability, and I don't mean to belittle that at all as we try to go through this hearing.

And I have confidence in those that are testifying today, in their leadership potential and what they are going to do. But I think it still behooves us to outline where the problems are.

I heard you say, Ms. Combs, 85 percent of the susceptible agencies are the higher risk programs. And then I heard Mr. Williams talk about the necessity of and the law government-wide. And I have some real problems with where we are on that because you can make it look good if you don't look at all of it.

And the question I would have to you is that if you were running anything other than this, you would have the same financial controls in business or any other, in State governments, they have the same financial controls at every level. In other words, there should not be anybody exempted, even though the act and the arbitrary definition that OMB put out of 2.5 percent or $10 million.

To most people in this country, if you wasted, overpaid $9.99 million, that is more than they will ever see in their entire lifetime. And so, to me, I read the law, and it says everybody is required to report. What is your understanding of that?

Ms. COMBS. That is my understanding as well. And what I don't want to leave the impression of is that we are certainly not giving anyone a pass.

What we have, and it is in my written testimony, and there is a chart attached. And it shows specifically that there is one piece of that pie, and it is practically this piece of the pie you have up on your chart. But one of the things I want to make very clear is just because we have 15 percent still yet to go doesn't mean we are not looking at those.

It also does mean that 15 percent is the hardest part to get because what we are saying is we can't yet get the error rate for that. And there are many reasons for that. I can certainly explain and embellish that in some of the answers we give to you.

Senator COBURN. Well, let me ask you just a little more specifically. If the Department of Labor can get a payment error rate on unemployment insurance that runs through the States, and yet HHS can't get one on Medicaid that runs through the States? Tell me why the difference is so great.

Ms. COMBS. Well, I am glad you have CFO Sam Mok here today because this success story is, indeed, a good one for, I think, a legislative model. And I think you will hear him talk about some of the things they did as far back as 1987 to actually set their program up, set it in place, so that it can actually operate in the way that it is operating today.

And I think it is a model. I think it is a great opportunity for us to look at that and do the collaboration and look at the transparency that we both seek in order to do that. I think they have been at this for quite a while. They used some mechanisms in setting this up that serve them well today, and I think that having that single entity in the State helps them an awfully lot because they are in control of this.

Some of these programs that are causing the most difficulty right now in your thinking and in mine, they don't have a way to go out and collect some of this information. They are prohibited, in essence, from collecting some of that. So I think you will hear some of that from some of our colleagues today as well.

Senator COBURN. Are you suggesting that there could be legislative changes that would alleviate the collection of data?

Ms. COMBS. I am suggesting that there probably are some things we need to look at together——

Senator COBURN. OK.

Ms. COMBS [continuing]. With these programs and with our State colleagues as well. And I have used every available opportunity or some available opportunities—probably not every one. When we would have some of our State treasurers in town, for example, to ask them, Are there things that we can do together that would get at some of these things?

And I think if we could figure out a way to not be legislatively prohibited from doing those things and pair those other collegial working relationships together, we probably could make a very good start at this.

Senator COBURN. So what you are really telling me is the Department of Labor has some better practices that work?

Ms. COMBS. They do.

Senator COBURN. So why can't those be replicated at the other agencies?

Ms. COMBS. I think they could be replicated if the legislation in the other agencies will let them do the same things that the Department of Labor has been doing for several years now.

Senator COBURN. Well, it would seem to me that the Administration would mandate that they do it, not let them do it. Is there a problem with motivation?

Ms. COMBS. No, sir. I don't think it is the motivation.

Senator COBURN. Will you make a commitment to this Subcommittee that you will give us the list of the legislative changes you think need to be made so that the other agencies can have the flexibility to be able to measure improper payments?

Ms. COMBS. We would love to work with you on that. And then there are some in our President's budget for 2007.

Senator COBURN. All right. Senator Carper.

Senator CARPER. Just to follow up on that last point, if I could?

If we are serious about reducing improper payments, it was helpful to have passed the 2002 legislation. If we are serious in reducing improper payments, it is helpful to have an administration that is serious not just at OMB, but throughout the agencies, where particularly those that are making a lot of payments are serious about doing something about it.

If we are serious about reducing improper payments, I think it is helpful probably for us to have oversight hearings to put a spotlight on those that are doing a good job to reduce improper payments and, frankly, to put a spotlight on those that aren't doing as much as they can and ought to.

What further can we do to be helpful? You bring in sort of a different perspective than we do to this problem. What further can we do on this Subcommittee, on our full Committee, in the Legislative Branch that would add to the efforts that are already under way?

Ms. COMBS. Thank you for asking, Senator Carper. There are six legislative proposals in the President's 2007 budget that directly have a direct bearing on our ability to further the improper payments initiative forward. And the projected savings are in the billions of dollars for each and every one of these.

The unemployment insurance, even the one that has such a good record, we have a recommendation there, where we can make that even better. The child tax credit. The computational complexity of that program, and I think you will probably hear that from Mr. Everson when he comes to testify before you. The rules and the complexity of that is part of the legislative proposal.

But any of these legislative proposals will make a step in the right direction. And while they may look like, "Oh, well, we could do a lot more than this," every step is a good step if it is in the right direction. So I would encourage you to support the Food Stamps portion of that and the ones that are in the President's budget.

Senator CARPER. Good. Thanks.

Ms. COMBS. Thank you.

Senator CARPER. Let me ask Mr. Williams a question next, if I could?

Mr. WILLIAMS. Yes.

Senator CARPER. And I think there was some discussion at our last hearing about requiring some of our agencies to obtain regular independent audits of their internal controls as part of the effort to beef up the process and the procedures that we are using to try to reduce improper payments.

I understand that since that hearing, a panel convened by OMB determined that internal control audits would not be beneficial. And I don't know if you were aware of this, but if you are or you are not, I would ask you if maybe you can share, either today or for the record, your views on that determination, the fact that the internal control audits are deemed not to be very beneficial.

And on the question of whether or not OMB or even Congress should require internal control audits at least for certain select agencies that have really big improper payment problems?

Mr. WILLIAMS. Yes, Senator Carper. If you look a little bit closer at the legislation that required the particular report, there was a provision that requires GAO to take a look at the report that is

issued by PCIE and the CFO Council and to give our assessment of the report.

We are currently in the process of performing that assessment as we hold this hearing today. Several things about the overall issue of internal control reporting. As a policy, we have basically concluded that there are several factors that you need to look at.

First of all, if you look at this area of improper payments, as I stated in my opening statement, a breakdown in the internal controls or lack of internal controls is a primary cause for some of the improper payment issues or the problem that we are dealing with today. What we have determined is, is that you need to look at the scenario in which you are currently working with as far as the agency is concerned.

If the agency has a mature internal control environment, then we have come to the conclusion that it would be a good idea to get an opinion on internal controls. And the way we look at that is by getting that opinion on the internal controls, what you have is an independent set of eyes that is validating what management has asserted.

We also have come to the conclusion that if you have an operation that have several material internal control weaknesses, there are compliance issues, and going into that audit, you basically know that there is a lot of work that needs to be done, then we don't think it would be an efficient use of resources to get an opinion on the internal controls. That those resources could probably be better used for the purpose of working with management to try to correct the problems that have caused auditors in the past to identify material control weaknesses, reportable conditions, and noncompliance issues.

So we have tried to break it down into various components with the ultimate goal of somewhere down the road, if you can address these internal control weaknesses, if you can get a mature system of internal controls in place across the government. We, in general, think that would be a good concept because it would be those independent set of eyes looking at what management is asserting as far as this internal control environment.

Senator CARPER. Thanks.

Mr. Chairman, I have some more questions. I will submit them for the record. Is this our only——

Senator COBURN. I am going to go one more round.

Senator CARPER. OK. Good enough.

Senator COBURN. Ms. Combs, would you submit to this Subcommittee the programs that report more than $10 million in improper payments but are less than 2.5 percent?

Ms. COMBS. Yes, I will be happy to do that.

Senator COBURN. DOD, SBA, and SSA, all have programs that expend billions of dollars annually, but they are not considered to be at risk for making "significant improper payments" because they do not meet OMB's criteria for significant. Mr. Williams, which programs did GAO identify as expending billions of dollars, but are not considered to be at risk for making significant improper payments?

Mr. WILLIAMS. Mr. Chairman, in my written statement, we have identified several agencies that actually reported the amounts be-

cause of the requirement that OMB placed on the agencies in the implementation of the act. And there are several programs that we have identified that if you go through the exercise of looking at the two criteria that were laid out, and you could come to the determination that these agencies would not have to report based on the criteria.

There were two or three in the Department of Defense—Military Retirement Fund, military health benefits, Education's Title 1. Department of Energy, some payment programs. Department of Health and Human Services, Head Start, railroad retirement, board retirement and survivors benefit, SBA investment and Social Security Administration, Old Age Survivors Insurance and Disability Insurance Programs.

So these are some of the programs that, if you look at them and there had not been this particular requirement that if you were under the old A–11, you would be excluded from reporting amounts under the $10 million, 2.5 percent criteria.

And by the way, Mr. Chairman, that amount, if you take a look at the performance and accountability reports for 2005, would have resulted in about $4.3 billion not being included. In other words, that $38 billion would have been actually $4.3 billion less.

Senator COBURN. OK. I am aware that there is some revised guidance that OMB has proposed that would allow programs that have been at low risk for over a 2-year period to request a waiver in having to report improper payments. Is that true?

Ms. COMBS. We have a very aggressive program on improper payments, and as I mentioned to you, we are looking and are eager to work collaboratively. To the extent that high-risk programs are identified, we will put extra scrutiny on those. I have no intention of reducing that.

Senator COBURN. Yes, it is not true then?

Ms. COMBS. Let me just say this. We have been collecting, for 3 years now, comments, considerations that people wish to have in any kind of revisions, and we are looking at some revisions because it is probably about time to think about those. But in terms of releasing or making things less, we are not in that posture.

Senator COBURN. Are you comfortable with this definition of 2.5 percent of $10 million? I have to tell you, I am tremendously uncomfortable with that.

Ms. COMBS. Well, in my testimony and in some of our discussions, one of the things that we have talked about is we can't do everything at one time. And I know you and I agree on that. And I think one of the things that I have to keep thinking about are those seven programs. I have to keep a rifle eye on those seven programs that we identified originally that make up 95 percent of this. And if I keep my eye on that, we are going to get a lot done.

And one of the ways to help agencies keep their eye on that is to leave that 2.5 percent, $10 million in our assessment. So I would like to continue that. But as I have said, if there are specific other programs that we find in our assessments, that GAO finds, or that you find in whether it is this or some of your other efforts that you are working with, that you want us to look at on a case-by-case basis that don't meet that threshold, we are more than happy to put them in our mix.

Because through the President's Management Agenda, we monitor a lot of these 118 programs, not just the ones you have talked about. And there are at least eight of them that I am aware of that we have handled on a case-by-case basis in that way, and I am happy to have your input and include more of those.

Senator COBURN. Are you aware of the GAO report that came out on defense purchasing on performance bonuses?

Ms. COMBS. No, sir. I am not.

Senator COBURN. It is a very revealing report. As a matter of fact, it is very disturbing because, and I think this is right, it is between 80 and 90 percent of the performance bonuses paid, the contractor did not meet the performance bonus requirements. And if that isn't an improper payment, I don't know what it is. And yet we have the Pentagon says they don't have any improper payments.

And so, I am going to submit the rest of my questions, and I am just going to ask you one more. Community Development Block Grant and Medicaid, are you going to commit to get us the improper payment on those big programs? I mean, we don't have it. And there is a good estimate to say $40 billion in Medicaid is improperly paid. Fourteen billion just what looks like in New York City.

And we are sitting here saying that if, in fact, we wait until the end of fiscal year 2008 to get the data on Medicaid and if my estimate is two times too high, it is still going to mean $40 billion got spent that shouldn't have gotten spent. And that is a significant amount of money. Why should we have to wait until 2008 to get improper payments on Medicaid?

Ms. COMBS. Well, we certainly share your concern about the complexity and about the magnitude of what that program will entail. But I think to get that comprehensive error rate, it is going to require an awfully lot of work, and you have an expert witness here to talk to you today about how much work that is going to require and what the complexities of that is.

We are happy to work with you, and if you find some ways that you think we can enhance that and improve that from a time standpoint, we certainly want to work with you to do that.

Senator COBURN. One last question, and I will hand it over to Senator Carper. The 2005 performance and accountability report said that it had no programs susceptible to significant improper payments. And I just want to read this for the record.

Department of Commerce, none. General Services Administration, which I know is not the fact based on the hearings that we have had here, none. The Department of Homeland Security, no improper payments? I can show you a ton of improper payments just on what they have done in Louisiana and Mississippi.

The Department of Interior. NASA, we can't even get them to answer or even to give us a response. The Nuclear Regulatory Commission and the Securities and Exchange Commission. We have had a hearing on the SEC, how they spent, I think, something like $27 million more than they should have on a building, and yet that doesn't come up under improper payments.

So how confident are you of these agencies' assertion that they have no improper payments?

Ms. COMBS. It may not come up under the improper payment initiative, but it certainly comes up under the recovery audit initiative.

Senator COBURN. Right. So does that not mean that maybe this definition of "significant" needs to be changed?

Ms. COMBS. Well, I am happy to look at any of those programs that you would like me specifically to look at and report back to this Subcommittee. I am happy to work in any way we can to address your specific concerns on that.

I do know that most of the Departments that you have mentioned in your question there, they certainly have plenty of contracts. And that is why the recovery audit is so important for them.

Senator COBURN. Right. Thank you.

Mr. Williams, any comment on that, and then I will turn it over.

Mr. WILLIAMS. I would just add the point that we took a close look at this particular statement also as we were reviewing the performance and accountability reports. And I guess the question that came to my attention, having responsibility for the Department of Homeland Security, also for NASA, and looking at some of the control weaknesses, Homeland Security I believe had 10 material internal control weaknesses. There were two reportable conditions, and I think there were seven issues of noncompliance. And that was one of the agencies in which, I think, the auditors of the financial statement questioned the quality of the assessment that the agency performed.

So I think you have raised a question that needs to be debated and discussed a little bit further as we go along in trying to address this issue.

Senator COBURN. Thank you. Without objection, I have about 14 other pages of questions that I would like to enter for the record.

Senator CARPER. I think you should ask them all, Senator. [Laughter.]

Senator COBURN. No, I don't think so. I want supper tonight, and I know everybody else does, too. So I will submit those for the record, and if both Mr. Williams and Ms. Combs would respond to those, I would very much appreciate it.

Senator CARPER. I have a couple of questions I would like to offer for the record and ask you to respond in writing, if you would?

Mr. WILLIAMS. OK.

Senator CARPER. I just want to come back and revisit—I apologize for being so slow on the uptake on this. But do I understand that there is roughly seven or so programs or agencies that are responsible for about 95 percent of the improper payments that are being reported? Could you just mention those briefly, please?

Ms. COMBS. Yes. Medicare, EITC, unemployment insurance, SSI, OASDI, HUD rental assistance, Food Stamps, and then there is a small portion of others that make up the 100 percent. But those I just mentioned make up 95 percent.

Senator CARPER. And just in relative terms, of those seven or so, which is the largest?

Ms. COMBS. Medicare.

Senator CARPER. Or did you sort of list them in order of their magnitude?

Ms. COMBS. Somewhat.

Senator CARPER. All right. Which of the seven is heading in the right direction most quickly?

Ms. COMBS. Most quickly, well, we have a head start here with unemployment insurance, I think. While they make up about 9 percent of that, they certainly have a great model, as we have talked about earlier today. And the others, I think, would be Medicare and the HUD rental assistance and Food Stamps that I mentioned in my testimony.

Senator CARPER. So, again, you said unemployment insurance (UI), Medicare, HUD rental assistance, and Food Stamps?

Ms. COMBS. Food Stamps, right.

Senator CARPER. Are generally the better performers?

Ms. COMBS. They have had some very good successes.

Senator CARPER. And of the others that you have not mentioned—EITC and SSI, OASDI—can you just characterize how we are doing in those three? Or how the agencies responsible for them are doing?

Ms. COMBS. Well, I think all of them are responding well. The question is how hard is it to get success? And I think you have the representatives, I believe, are here from each one of those other programs to talk with you today.

Senator CARPER. OK. We will let them speak for themselves.

The major programs that are not included here, that are not reporting improper payments, and I have heard Medicaid mentioned a time or two. What are some of the other larger programs for which improper payments are not being reported?

Ms. COMBS. Well, the error rates that have not yet been accumulated or assessed for those were on primarily the first chart that was up here.

Senator CARPER. Which, fortunately, you can see, but we cannot.

Ms. COMBS. Oh, you can't see it—the Department of Agriculture's School Programs.

Senator CARPER. School lunch and breakfast programs?

Ms. COMBS. School Programs.

Senator CARPER. OK.

Ms. COMBS. The Health and Human Services Children's Insurance Program. Department of Agriculture, Women, Infant, and Children. Health and Human Services, Medicaid. Health and Human Services, Child Care and Development Fund. Health and Human Services, Temporary Assistance for Needy Families. And Department of Housing and Urban Development, Community Development Block Grants are the major programs that we understand have not yet reported their improper payment estimates.

Senator CARPER. Of those that you have mentioned, and the Chairman was good enough to give me a listing here, it says at the bottom of the page that total outlay is about $227 billion in a year. So, from reading this, what we should understand is that while roughly seven agencies are responsible for 95 percent of the known improper payments, there is a bunch of pretty big programs for which we just don't know?

Ms. COMBS. That is correct.

Senator CARPER. And could you just give us a sense—and you have probably done this before, and I am going to ask you to do

it again—when do you think some of these big programs are going to be in a position to report improper payments?

Ms. COMBS. Some of them are going to report in 2007, and some of them are going to report in 2008.

Senator CARPER. Do you think we will have them all by 2008? Are you saying everybody will be in by then?

Ms. COMBS. Probably not all of them, unless you hear something different than we have been hearing.

Senator CARPER. OK. Who do you think might still not be able to report by the end of 2008?

Ms. COMBS. Probably Medicaid. Which one? TANF and child care, it looks like. The Temporary Assistance for Needy Families and Child Care Development Fund. We yet do not have an estimate of when they might be able to report.

Senator CARPER. OK. Do we have somebody coming before us today from HHS? We do, don't we?

Ms. COMBS. Yes.

Senator CARPER. Maybe we can talk about that a little bit further.

Ms. COMBS. I am sure he is my very good friend now. [Laughter.]

Senator CARPER. He or she, you never know.

All right. Well, Ms. Combs, thanks so much for being with us today. And Mr. Williams, good to see you.

Ms. COMBS. Thank you.

Mr. WILLIAMS. Thank you.

Senator CARPER. Thank you very much for your help. We look forward to continuing to work with you.

Mr. WILLIAMS. Thanks.

Senator COBURN. Thank you all very much.

Ms. COMBS. Thank you.

Senator COBURN. And you will be receiving a list of questions for both of you. And timeliness in that response, if you could have that back to us in a couple of weeks, we would appreciate it very much.

Thank you.

Our next panel is Mark Everson, Commissioner of the Internal Revenue Service. Prior to his time at the IRS, he was Deputy Director for Management for the Office of Management and Budget, where he provided government-wide leadership to Executive Branch agencies to strengthen Federal management and improve program performance.

With him today is the James Lockhart, Deputy Commissioner of the Social Security Administration. He is the agency's Chief Operating Officer and a member of the Executive Committee of the President's Management Council.

Mr. Lockhart served as Executive Director for the Pension Benefit Guaranty Corporation under the previous Administration and has served in various private sector positions.

Welcome, each of you. Mr. Everson, you will be recognized first. Your complete statement will be made part of the record.

TESTIMONY OF THE HON. MARK EVERSON,[1] COMMISSIONER, INTERNAL REVENUE SERVICE

Mr. EVERSON. Thank you, Mr. Chairman. Nice to see you again, Senator Carper.

I am pleased to be with you again to talk about our performance under the Improper Payments Information Act. Before I turn to that, though, I would like to give you a brief update on the subject that we talked about last October, the tax gap.

You will recall at that time that we had not yet finalized our estimate. I think you may have seen in recent weeks we have now done that, and the estimate came in at that top end of the range, basically, of what we had for 2001—$345 billion for the gross tax gap. But that is $290 billion after the late payments and our enforcement activities. I point this out because we are already using the——

Senator CARPER. Would you say that last part again, if you will? That is what after?

Mr. EVERSON. The number $345 billion is the estimate of the gross noncompliance. But because the tax gap is defined as what is paid on a timely basis, is it timely or not? So if you get a late payment that comes in, you say to us you owe $10,000, but you only sent us $3,000, there is a $7,000 underpayment gap there.

So if it comes in late or we do something from the enforcement activities, we consider that a recovery. That is the $55 billion. So that brings the $345 billion down ultimately to $290, but over time.

We are already using this research to change our audit selection model. So that is good news. That will make us more effective, and it will also drive down the no-change rate, where we audit somebody but really don't find anything.

As the President's proposed fiscal year 2007 budget does, it continues to rebuild our enforcement efforts as well through more enforcement activities. I am thankful for this Subcommittee, and the full Committee, for the support it has provided over the last several years to securing or for securing adequate funding for the IRS.

And I would like to also note that in the 2007 request, there are additional legislative proposals for incremental reporting. This is, indeed, a set of what could be viewed as modest proposals, but they are very significant because this is really the first time since 1986 that any administration has made new proposals on reporting. We think that will have a big impact.

There are two that are particularly of interest to this Subcommittee. I will be testifying next week in terms of government contracting. One is about due process, collection procedures for employment taxes, and the other is about additional reporting for payments made by governmental entities, Federal, State, and local.

So those are all very important developments, and I hope the Subcommittee will support us on those.

Senator COBURN. We will. And at Senator Carper's request and my agreement, we are going to have another hearing on that.

Mr. EVERSON. Great.

Senator COBURN. You have just not been noticed on it, but we will give you plenty of time.

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[1] The prepared statement of Mr. Everson appears in the Appendix on page 90.

Mr. EVERSON. OK. I have a busy hearing schedule, and I somehow thought I would hear back from you on this.

Senator COBURN. You will.

Mr. EVERSON. Let me turn to the EITC for just a minute or two. The EITC is one of the Nation's most successful anti-poverty programs. It lifts millions out of poverty each year. In fiscal year 2005, 22 million taxpayers received $40 billion through the EITC.

It is a refundable Federal tax credit that offsets income tax owed. If the credit exceeds the amount of taxes owed, a lump sum payment is provided to those who qualify. At the IRS, our philosophy concerning the EITC is clear. Everyone who qualifies for the credit should receive it, but only those who qualify.

Senator CARPER. Can I interrupt for just a second? Mr. Chairman, the chart has just been replaced. I don't know if this is a chart we are supposed to be able to see or not.

Mr. EVERSON. I am happy to have it face your way instead of mine. [Laughter.]

Senator CARPER. Oh, yes. Let me just say to our staff that you can actually put the chart in a place so that they can see it and we can, too. And I would ask you that, maybe just pull it toward you? There you go. That is great. Thank you.

Mr. EVERSON. In 2005, the IRS spent approximately $165 million on EITC activities. These funds supported an EITC compliance program, which conducted over 500,000 audits and prevented $2 billion in EITC refunds from being paid in error. We estimate that EITC enforcement efforts have directly protected an estimated $6.5 billion from 2002 through 2005.

Nevertheless, this chart points out erroneous payments under the program remain too high. Our latest estimates are that even after our efforts, $9.5 to $11.5 billion, or 23 to 28 percent—and since we are interested in accuracy, I would ask that maybe we have 23 to 28 percent instead of just the high end—is paid out erroneously each year.

As we continue our efforts to improve the EITC program and reduce erroneous claims, let me make the following observations. EITC administrative expenditures are a tiny fraction of program benefits. Current administration costs are less than 0.5 percent of the benefits delivered. These costs are quite low compared to other benefit programs in which administrative costs can run as high as 20 percent.

Let me depart for just a second. Food Stamps. The Food Stamps Program budget is $3 billion to deliver $30 billion in benefits. If we were to take that ratio for the EITC, we would add $4 billion to the IRS budget. Our whole budget right now to run a $2.2 trillion system is only $10.6 billion. So we would be talking about a very real departure in how we do business.

I would also point out that the current improper payment estimating technologies are not precise enough for us to capture annual estimates of good reliability, which is really what the act would want us to do. Going forward, we propose to simplify EITC eligibility requirements, and we will continue to refine our efforts to better enforce the law.

In summary, I would just like to make three points. We have a balanced approach to administering the EITC. Again, we want

those who qualify to get it. This program enjoys the highest participation rate for any of these big benefit programs, something like 80 percent. That is a good thing for our country. But again, we want to make sure that we aren't paying out more than we should.

We also plan to grow the use of community-based volunteer organizations to help people prepare their returns here. We have seen that as an effective way of getting people to claim the credit without having to take these predatory RALs, these refund anticipation loans. I am sure if Senator Akaka were here today, he would be grilling me about RALs. That is one of his most pointed remarks whenever I see him.

And the final thing I would say is that adopting the President's budget request would be helpful. There are several constructive points in here. They won't make a huge difference in this, but they will help simplify the credit, and we think they are good ideas.

Thank you.

Senator COBURN. Mr. Lockhart.

TESTIMONY OF THE HON. JAMES B. LOCKHART III,[1] DEPUTY COMMISSIONER, SOCIAL SECURITY ADMINISTRATION

Mr. LOCKHART. Senator Coburn and Senator Carper, thank you for inviting me here today to discuss the efforts the Social Security Administration (SSA) is undertaking to strengthen and maintain the integrity of the Old-Age, Survivors and Disability Insurance (OASDI) Program and the second program we administer, the Supplemental Security Income Program, referred to as SSI.

In 2005, Social Security paid $520 billion in benefits to over 48 million retirees, survivors, disabled persons, and their dependents. SSI is a needs-based program, and it paid $38 billion to over 7 million disabled and aged individuals.

The importance we put on improper payments can be noted that one of our nine strategic objectives is to detect and prevent fraudulent and improper payments and improve debt management. As you can see with the charts I attached to the testimony, our combined error rate for the two programs have been about 1 percent, which is well below the OMB's threshold guidance of implementing the improper payments act of 2.5 percent. But I hasten to add both of these programs are included—both SSI and Social Security—despite Social Security being well below the 2.5 percent limit.

In measuring payment accuracy, Social Security considers as proper those payments it is required to make under statute or court order. Both OMB and GAO have affirmed this to be a correct methodology. However, I think it is very important to emphasize that we pursue the recovery of all overpayments, not just those considered to be improper. I would like to add also, our collection effort is very successful. Over time, we collect over two thirds of the overpayments.

In 2004, Social Security's improper overpayment rate was a very low 0.5 percent on overpayments and 0.2 percent on underpayments. Despite these low percentages, we are committed to taking the steps to further reduce these levels. That is very important in

[1] The prepared statement of Mr. Lockhart appears in the Appendix on page 99.

a program the size of Social Security, where each 0.5 percent increase in payment accuracy equals $2.6 billion of error prevented.

SSI is a much more complicated program than Social Security in that we must know income, living arrangements, in-kind support, and resources. In 2004, our SSI error rates were 6.4 percent for overpayments and 1.3 percent for underpayments.

We build accuracy controls into every payment decision we make at Social Security. In addition, we have two major processes to prevent and detect improper payments. They are continuing disability reviews (CDRs) and redeterminations of eligibility for SSI. About $8 program dollars are saved for every $1 administrative dollar spent on these reviews. As an example, in 2004, redeterminations enabled us to collect or prevent $2.4 billion in overpayments and $1.3 billion in underpayments.

We have developed plans and performance goals to support the President's Management Agenda initiative of eliminating improper payments, and we report our progress every quarter to OMB. We also developed a specific SSI corrective action plan in June 2002 to help get SSI off GAO's high risk list. Even though GAO did remove us from the high risk list in 2003, the plan is updated regularly, and I meet monthly with the accountable executives.

We are making great strides in preventing improper payments by obtaining beneficiary information from independent sources sooner and by using technology more effectively. For example, we have data matches with a number of Federal and State agencies, and we have developed jointly with the States the Electronic Death Registry (EDR).

We are testing an automated telephone process for SSI recipients to report monthly wages. We have a very successful pilot in the New York region to gather information electronically about unreported bank accounts and work directly from financial institutions.

The President's 2007 budget request includes two legislative proposals for Social Security. One would simplify the administration of our workers' compensation offset provisions and the other would establish a mandatory system for collecting data on pension income from noncovered State and local employment. These two proposals will prevent $2.8 billion improper payments over the next 10 years. We are also working a plan to simplify SSI, focusing on the very complex in-kind support and maintenance rules.

Last, in the President's budget, there is a request to increase funding to do additional continuing disability reviews through a discretionary cap adjustment of $201 million, which would save over $2 billion in program costs.

Finally, I would like to confirm we are very committed to continue to work with Congress and OMB to eliminate improper payments. I would be happy to answer any questions you have.

Senator COBURN. Any comments, Mr. Williams?

Mr. WILLIAMS. No, sir. Not at this time.

Senator COBURN. First of all, I know that both of you are dedicated in what we are trying to accomplish here, and I want to thank you for your efforts.

Mr. Lockhart, did I hear you say, did I understand that of the overpayments that you all make, two thirds are re-collected?

Mr. LOCKHART. That is correct.

Senator COBURN. OK. So your net overpayment is a third of what you are actually reporting in terms of the improper overpayments?

Mr. LOCKHART. That is correct.

Senator COBURN. All right. Thank you.

So, for example, on SSI, yours would be 2.1 percent overpayment net, after collection. In other words, you go back and get it back?

Mr. LOCKHART. Right. We go back and get it back. Some we can do almost automatically because they are still receiving benefits. In SSI, we can take 10 percent out a month. In disability, we can take the whole check.

Others, we have all sorts of debt collection activity. But over a 5- to 10-year period, we do collect over two thirds.

Senator COBURN. On the EITC program, Commissioner, is there a number that brings that down, that 23 to 28 percent?

Mr. EVERSON. The numbers I cited, the $2 billion, are before that. And EITC, again, the distinction between it and almost anything else is there is no front-end eligibility verification as there is with all of these other programs. What Congress did allow the agency to do was to take a look, and then what we will do is we will hold the refund if we have a suspicion.

If we are going to do an audit, and these audits that I mentioned—I think of the $2 billion, something like $1.3 billion was the amount that was held. There is the other piece of what we call "math errors," where there are certain problems facially on the return, where we hold another $300 or $400 million.

And then there is the last piece that gets you up to $2 billion, another $300 million. That happens later basically through an audit or document matching. And then what happens is you don't participate, you don't get the money the next year. You are not eligible to file again, or it is offset in a subsequent period, or maybe in some instances you get it back.

But by and large, we don't get a lot back. We don't have the same ability to get it back as Jim's people do.

Senator COBURN. So would that mean that you need statutory changes to change the front end to improve this eligibility?

Mr. EVERSON. Well, the basic choice that the Congress made was to embed the largest means-tested benefits program in the tax code when they set up the EITC. And so, we are on the honor system here, and there is error. There is a high degree of error, and there is fraud. I can't tell you with precision what the balance is between the two.

So there are a number of things that can be done here. One is clearly simplification, and that applies not just to the EITC, but to other credits. There are something like seven education credits. When I testify before the tax panel, we believe simplification is an important thing to do.

Senator COBURN. Both for you and for the——

Mr. EVERSON. For everybody. That is right. I think as I mentioned last October, we believe that complexity obscures understanding. That makes it tougher for the person who desires to be compliant to comply. It also makes it easier for that person who seeks to not comply to be noncompliant.

But the big change here, if you really wanted to drive this down—again, I drew the comparison to Food Stamps—and this

would be a big change. You would have a front-end eligibility requirement, as you do in most of these other programs. Then you would have higher program costs, not $165 million, or 0.4 percent of the benefits paid. And then you would get a much cleaner program.

Now, on the other hand, sir, think about this. We have an 80 percent participation rate. This program does very good things for people, for families, and for communities around the country. That would change, no doubt, as well. So it is a policy choice.

Senator COBURN. Well, by your data, 20 percent of those people aren't eligible? You have 20 percent of the people who aren't eligible taking money from the program——

Mr. EVERSON. That is exactly right. The money is being spent to a certain degree in the wrong place. The way I think about this, if you say it is a $40 billion program, and 20 percent of the people aren't eligible, maybe it ought to be paying out $50 billion. But then you would have to reduce it by the quarter that you are talking about. You would have to spend $35 or $38 billion that way.

Senator COBURN. Have you all done an analysis to look at? The goal is, is we have EITC, and we know who we want to get that.

Mr. EVERSON. Yes.

Senator COBURN. Have you done an analysis on what the cost would be for program management to get that range down to where you don't have such—and I believe this is correct. Correct me if I am wrong. This isn't error. Most of it is fraud.

Mr. EVERSON. No, I don't agree with that, sir.

Senator COBURN. You don't.

Mr. EVERSON. I do not.

Senator COBURN. Is most of it error and not fraud?

Mr. EVERSON. I don't think we know for sure, but I think the people who have looked at this most broad, the academics, have sort of said probably, maybe there is about a third that is clear error. Maybe at the other end, maybe there is about a third that has got some intentional distortion of the eligibility. And then there are lots of questions in between, if you will.

Senator COBURN. How much do we pay out every year in EITC dollars?

Mr. EVERSON. Forty billion dollars. Let me explain that, if you will. The first $5 billion of that is a reduction of income tax that individuals would otherwise pay.

Senator COBURN. Right. But it is still paid?

Mr. EVERSON. That is right. And then the next $35 billion is actually cash out.

Senator COBURN. So it is $40 billion. So let us go between 23 and 28 percent, let us set it on 25 percent. That is $10 billion.

Mr. EVERSON. Yes, sir.

Senator COBURN. And a third of that is fraud. So that is $3 billion a year. The question I would have to you is what do we have to spend to find that $3 billion? Where is the break-even line for you as an agency, and what can we do to help you to where we get to that point?

Mr. EVERSON. Well, this gets back into the overall tax gap question. We spend about 5 percent of our personnel resources on the

EITC, and that is roughly proportional with the tax gap, the component of the tax gap.

On the other hand, though, if you look at the number of audits—I mentioned 500,000. That is a huge proportion of the 1.2 million audits we did last year. This is the single-highest audit rate for individuals because of this history.

If the Congress threw an extra billion dollars at me, sir, in all good conscience, I would not spend it in this area. I might put some small piece of it there, but I would be working on corporations, high-income individuals, and the small businesses area, where if I could just digress for one second?

Floyd, if we could have the chart on the reporting because I think it is pertinent? The bar chart on what kind of reporting we have?

It gets back to where we were talking about last—no the other chart, right. It gets back to the President's proposals. Look out to the left here. We talked about wages. If the noncompliance rate for salary and wages where we have reported. We know how much you make as a senator. Even if you don't tell us, the Senate tells us. The noncompliance rate there is 1 percent.

If you go all the way out here to where there is little or no information reported, and this is individuals operating small businesses, the noncompliance rate is 1 in 2. This, if you will, is squarely in the middle.

So, obviously, to run a rational program, what we want to do is attack all of these areas, but we will be devoting more audit resources here, and also we want to get a little more reporting.

The last thing I will say on this is—I am making a commercial here for U.S. senators, not on this particular EITC subject—is these proposals, they just treat—we want to get credit cards as an example—credit card issuers to give us information on receipts that they get for businesses. This is no different than 150 million employees already get some reporting on their wages. That is what we are trying to do.

Senator COBURN. Senator Carper.

Senator CARPER. I think the Chairman asked a part of a question on the EITC that I was going to ask. But I don't know that he asked this part while I was out of the room. Let me just ask it, Commissioner Everson.

Are the errors per EITC recipient usually fairly large, or are they usually fairly small? And can you maybe quantify them?

Mr. EVERSON. I am not sure I understand what you mean. If we look at the credit here, just to familiarize you. Do you have this chart, Floyd?

These are relatively small amounts of money. This shows the credit. It maxes out at $4,400 if you were a family and you have two children. And then it actually declines as your income goes up, and it is in the mid 30s now.

So on any individual return, it is a relatively small amount of money compared to what we do on the corporations that is at stake. But again, there are 22 million taxpayers that are claiming this.

I think the other element of your question, though, is we see, where we do see the fraud, you may have read about. There was

a lot of discussion a couple of months ago about the refund fraud program that we have. We do see rings of people who generate false returns, and they somehow find it right at this sweet spot, if you will, where the credit maximizes.

They send us a return that shows the income to be $15,000, the person working, and then claiming the $4,400 credit. So that is in there, too.

Senator CARPER. OK. I am going to ask you the same question I asked the earlier panel that Mr. Williams was on, and that is I think you have spoken to this already, each of you. What can we do to be of direct assistance, particularly to you, Mr. Everson, to try to ratchet down the EITC overpayments? And to our panel is it deputy administrator?

Mr. LOCKHART. Commissioner.

Senator CARPER. To our deputy commissioner, particularly for the programs that you spoke to, SSI and others. But what specifically? I know you mentioned there are two legislative initiatives. But just go back and revisit those for us.

Mr. EVERSON. The first point is this Subcommittee has been great in terms of supporting the President on making sure there is adequate funding. I think the oversight of this Subcommittee has been second to none in the tax areas outside of finance because your colleagues on the Permanent Subcommittee on Investigations are constantly looking at our issues.

Your own inquiries on the tax gap, I am very appreciative of that. The more we can educate members to understand what is at stake here, and then take solutions like the incremental reporting, which will be terribly important, that is principally what you can do.

If you really want to get after this problem, this 25 percent problem, you do need to think of this question—the construction of the program. Do you want to have a front-end eligibility verification as opposed to just a back-end?

But again, I caution you, this program has a great participation rate and lifts millions out of poverty. We need to have an important national discussion on that if we really want to move it down to 5 percent or something.

Senator CARPER. All right. Mr. Lockhart.

Mr. LOCKHART. Well, certainly, first of all, thank you for having a hearing, and this is my first opportunity to talk to you. But I really appreciate you——

Senator CARPER. What was your job in the Clinton Administration?

Mr. LOCKHART. It was President Bush "41" Administrative. I ran the Pension Benefit Guaranty Corporation.

Senator CARPER. Would you like to have that job again?

Mr. LOCKHART. It was pretty bad then.

Senator CARPER. It is a lot worse now. That could be a whole other hearing, Mr. Chairman.

Mr. LOCKHART. So I really appreciate you having this hearing and your offer. Certainly, there are two proposals in the President's budget. One on simplifying the workers' compensation offset. If you get disability benefit, in some States, your disability benefit is low-

ered if you are getting workers' compensation. So we have a proposal to simplify that. That is a very messy workload.

We also have one to get pension reporting of people that are getting pensions that can be offset against Social Security, and that is for State and local workers.

We are also in the process of putting one together to help simplify the very complicated SSI program. In SSI, the reason for the high error rate is basically the complexity of the program. And one of the complexities and really intrusiveness of the program is that we have to know monthly what your income is, what your rent is, who is paying for your food, clothing, and all of these sort of things, and we need to try to simplify that.

And then, last, we have a tremendous payback from what we call our stewardship work.

Senator CARPER. What does that mean?

Mr. LOCKHART. The work to ferret out improper payments. We find in our redetermination process, which, again, is looking at SSI and looking at all those complexities, we get a payback of close to $9 for every dollar we spend. And then from continuing disability reviews, which are basically look to see that the person is still disabled, we get a payback of almost 10 to 1.

So those are tremendous paybacks that we can give. But unfortunately, one is in the administrative bucket of expenses, and the other is the program bucket. And it is over a longer period of time, and it is hard to get them funded in a proper way.

Senator CARPER. All right. Mr. Lockhart, I think you mentioned something about working with States, and I think I heard you say electronic death registry. Did you say that?

Mr. LOCKHART. Yes, I did.

Senator CARPER. I think I understand, but tell us how it works.

Mr. LOCKHART. Well, we have been working over the last few years to have States electronically report all death records, and at the same time, we verify the Social Security number so we know it is a good death report, if you will.

And we now have it up and running in 10 States and the District of Columbia. We funded another 10 States and New York City, and we are looking this year to award contracts to as many States as funding allows. It will be going to the Department of HHS as part of legislation that was passed a couple of years ago.

But this will not only be good for Social Security, but for any benefit-paying program to know if people are dead and no longer deserve benefits. And we are going to make it available to everybody.

Senator CARPER. When you say "we are going to make it available to everybody," do you mean for other programs where it would be helpful to have that kind of information?

Mr. LOCKHART. Yes, other government programs.

Senator CARPER. That is good to hear.

Are we going to have another round here, Mr. Chairman?

Senator COBURN. I hadn't planned on it.

Senator CARPER. Could I ask one more question of Commissioner Everson, please?

Senator COBURN. Sure.

Senator CARPER. Commissioner Everson, I want to go back to something that I heard you say. Like I think most of us here, we believe the EITC is a real good program, and it is one of those things that Republicans like Ronald Reagan and Democrats like Bill Clinton and myself and others think, all of us, basically this is a good thing.

And we all want to figure out how we can reduce the overpayments, and you mentioned how it really sounds like fraud, these rings that are created to go out and bilk taxpayers out of refunds. You mentioned the cost of administering the program——

Mr. EVERSON. Yes, sir.

Senator CARPER [continuing]. On a percentage basis, which is actually very small. I think you said maybe 0.5 percent?

Mr. EVERSON. Yes, sir. As part of our budget, we spend about $165 million a year on this out of a total of $10.6 billion that, as you know, is our whole budget. So it is small, and that contrasts with the figure I saw. I looked at the President's budget—$3 billion for Food Stamps against $30 billion of expenditure.

So you could, no doubt, spend more, a lot more on this and do better on the error rate. You are still left with the fact that it is at the back end, which is not the most effective way to deal with this.

But again, you have to balance this out with your first point, with which I agree, that this program is very important, and it does have a high participation rate. So there is a dampening effect on this that you see, the degree to which you do more.

Senator CARPER. Did you say the participation rate, Mr. Commissioner, is 80 percent?

Mr. EVERSON. About 80 percent is what we estimate, plus or minus a few points. Yes, sir.

Senator CARPER. That is pretty high. Is that counting the people who are not eligible who are still participating? Is that in that number or not?

Mr. EVERSON. No, it is not, sir. But we think that is 80 percent of the eligible people are participating.

Senator CARPER. And I would just ask you to answer—you don't have to answer it here—but for the record. You have spoken to it, the point about whether or not if we are not encouraging you to dramatically raise your administration costs.

But the question that is in the back of my mind here, maybe the front of my mind, is if you were to spend a bit more money for administration, how would that help us to address the improper payments, the overpayments? And if you can see if there is some kind correlation? I am sure you have looked at that.

Mr. EVERSON. Yes.

Senator CARPER. Or folks, before you have looked at that. And just for the record, if you could just share some of that with us?

Mr. EVERSON. Yes, sir. Certainly.

Senator CARPER. Good. Thanks so much.

Thanks, Mr. Chairman.

Senator COBURN. The point of diminishing returns, I think, is what he is looking for.

I just want to have one other question. This idea between avoidable and unavoidable overpayments, I think I understand it. Would

you try to explain it to me because I have a little concern that we start using this language, we are liable to see other departments start describing "avoidable" and "unavoidable" payments. So would you clarify that for me, Mr. Lockhart?

Mr. LOCKHART. I would be happy to. We look at overpayments in two categories—first, improper, and the other category is required by statute or law. And those are the ones that are unavoidable.

A simple example is due process. When someone's benefit is reduced or eliminated, they have 60 days to appeal. And if they appeal, we don't cut their benefits until that appeal is decided.

Senator COBURN. But the problem I have with that is that reported as an improper payment is not an improper payment. It is not an improper payment because you are following the law.

Mr. LOCKHART. Right.

Senator COBURN. It is like continuing SSI for somebody or somebody's Social Security after they die, but you don't have the notice that they are dead.

Mr. LOCKHART. Right.

Senator COBURN. You can't stop it because they might be dead. You can only stop it when you know they are dead. And so, the point is that is not an improper payment.

Mr. LOCKHART. Right. But it is an overpayment, and we go out and collect it when we find out about it.

Senator COBURN. Yes. But that is not an improper payment because you are actually following the law. Mr. Williams, do you have any comments on that?

Mr. WILLIAMS. I would agree with that. We talked about this with our attorneys. And as you correctly stated, if the statute requires you to continue to make the payment as you go through the due process, by definition of the improper payments act, that is not an improper payment.

At the point that a decision is reached, a ruling is made on it, and it is determined that person is required to pay that money back, it becomes a receivable. But at no point in time should that be classified as an improper payment.

What we at GAO further believe is that because you have this particular scenario, we believe that it is a good practice to continue to track these types of activities because for informational purposes, it is good information to provide to the Congress and decisionmakers in case there is a need for some type of change in legislation, etc..

Senator CARPER. Before we finish, could I ask one more questions before we finish?

Senator COBURN. Yes. Let me finish this point.

Each of you have made note of recommendations in the President's budget. Would you be so kind as to send those specifically to me for your Department so we can look at them as things will move faster if we can get everything back together before the Subcommittee.[1] And you will have a multitude of questions coming

[1] Copy of the "FY 2007 Budget Proposal" submitted for the Record by Mr. Lockhart appears in the Appendix on page 52.

from us that, if you would, please answer, we would appreciate, on a timely basis.

Mr. EVERSON. Yes.

Mr. LOCKHART. Be happy to.

Senator COBURN. Senator Carper.

Senator CARPER. Just one more for Commissioner Everson. Mr. Commissioner, you mentioned in your testimony, somewhere I think you mentioned the word "certification?" That you are using or testing to determine how effective certification is in reducing improper payments in the EITC.

Mr. EVERSON. Yes, sir.

Senator CARPER. Could you just give us a little more in terms of detail about what those tests involve and how effective they have been, if you have had a chance to make that determination? And what kinds of unintended consequences you have discovered?

Mr. EVERSON. Well, sir, we have been testing over the last 2 years or so in the tens of thousands to try and provide some form of an up-front verification of eligibility. And if I were to characterize the results so far, I would say that the results do drive down the improper payments, but it appears they also dampen participation. So there is this tradeoff that I mentioned before.

Senator CARPER. And have you reached some conclusion as to whether the costs or the unintended consequences is greater?

Mr. EVERSON. I haven't reached a conclusion yet. We have a little ways to go on this. But I think we will be left, again, with what I would consider this fundamental policy choice of right now we let people claim this on a tax return, and with a minimum of hassle, if you will, if you really want to change this, do you go to what is a more traditional benefits program model?

Senator CARPER. OK. Thanks so much.

Senator COBURN. I would like to make a note. Don't we want the ineligible not to be getting the money?

Mr. EVERSON. I absolutely agree with that, sir.

Senator COBURN. Thank you all very much.

Our next panel is Assistant Secretary Charlie Johnson from HHS. Mr. Johnson serves as Assistant Secretary for Budget and Technology and Finance at the Department of Health and Human Services.

Prior to his service at HHS, Assistant Secretary Johnson was appointed to Chief Financial Officer at the Environmental Protection Agency. He has spent 31 years in the public accounting profession and served on numerous boards and committees related to accounting and management.

We also have Samuel Mok, CFO at the Department of Labor. Mr. Mok was confirmed by the Senate in January 2002 to be the Chief Financial Officer at the Department of Labor. Prior to his time at the Department of Labor, he served as Chief Financial Officer and Controller of the Treasury Department, where he was responsible for implementing many management programs to enhance financial reporting and control.

Mr. Mok has extensive private sector accounting and auditing experience and also served in active duty as a lieutenant in the U.S. Army.

I want to recognize each of you and recognize that Mr. Johnson has been here before. We thank him for returning. Your full statements will be made a part of the record.

Mr. Mok, you are recognized for 5 minutes.

TESTIMONY OF THE HON. SAMUEL T. MOK,[1] CHIEF FINANCIAL OFFICER, U.S. DEPARTMENT OF LABOR

Mr. MOK. Thank you, Senator Coburn and Ranking Member Carper.

I appreciate the opportunity to testify before this Subcommittee today to discuss the Department of Labor's compliance with the Improper Payment Information Act of 2002.

In fiscal year 2005, the Department had three programs classify at high risk for improper payments. The Unemployment Insurance Benefits Program had nearly $3 billion in improper payment, with an estimated overpayment rate of 9.5 percent. The Federal Employees Compensation Act, otherwise known as FECA, benefits had $3 billion in improper payments, with an estimated error rate of 0.1 percent. And the Workforce Investment Act, otherwise known as WIA, grant programs had $8 billion in improper payment, with an estimated error rate of 0.2 percent.

I am pleased to report that the Department met its improper payment reduction and recovery targets for each of these programs in fiscal year 2005. Improper payment fell approximately about $600 million, a 15 percent decrease over the previous years.

While statistical sampling allows estimation of improper payments for most of the Department's programs, WIA grants pose unique challenges. Grants to States, cities, counties, private, nonprofits, and other organizations fall under the single audit act. We found that it is more efficient and effective to rely on the findings of a single audit to monitor grant recipient funding.

By analyzing all of the available single audit reports for WIA grants, we are able to develop a proxy for improper payments to estimate the improper payment rate. Our program with the highest dollar outlay and the highest rate of improper payments is the UI program. This Federal-State partnership is based on Federal law, but it is administered by State employees under State law.

In the UI program, the sooner the State finds an improper payment, the sooner the State can cut off the benefits and start collecting the overpayment. In 2004, the Department entered into an agreement with the Social Security Administration that essentially allows State UI agencies to cross-match UI claim information against Social Security records. This helped prevent payments to persons working under stolen Social Security numbers and helped to determine the correct benefit amounts for individuals receiving pensions.

The Department funds States to use data in a State directory of new hires to detect and prevent improper payments to beneficiaries who continue to collect despite having returned to work. State directory cross-matching has saved at least, in our estimate, $150 million in the last 2 calendar years. The reason is States have gained access to the National Directory of New Hires to tap em-

[1] The prepared statement of Mr. Mok appears in the Appendix on page 110.

ployment information from a wider variety of employers, including Federal agencies and multi-State employers who report all the new hires to a single State. Such cross-matching is an effective way to reduce improper payments.

The President's fiscal year 2007 budget includes legislative proposal and funding request to better help States deter, detect, and collect UI overpayments. These include allowing States to use a percentage of all recoverable payment for benefit payment control activities and requiring States to impose at least a 15 percent penalty on fraud overpayments and allowing States to permit collection agencies to retain a percentage of fraud overpayment recovered.

Further, requiring employers to report start work date to the State directory of new hires. And last, but not least, authorizing the U.S. Department of Treasury to intercept Federal income tax refund to recover overpayment of UI benefits. We believe that these legislative proposals would reduce overpayment and increase overpayment recoveries and delinquent tax collections by an estimate of $5.4 billion over the next 10 years.

The President's fiscal year 2007 budget requests $10 million to prevent and detect fraudulent UI claims filed using personal information stolen from unsuspecting workers, an effort to combat identity theft. And $30 million to help States better assess claimants' eligibility and provide re-employment assistance.

In closing, I would emphasize that the Department of Labor recognizes the important stewardship challenges of ensuring the funds go to their intended purposes, and eliminating improper payment is a task that we must continue to pursue with great diligence.

Thank you, and I will be glad to take any questions you may have, Mr. Chairman.

Senator COBURN. Thank you. Mr. Johnson, welcome back.

TESTIMONY OF THE HON. CHARLES JOHNSON,[1] ASSISTANT SECRETARY FOR BUDGET, TECHNOLOGY, AND FINANCE, U.S. DEPARTMENT OF HEALTH AND HUMAN SERVICES

Mr. JOHNSON. Well, thank you.

Senator COBURN. I think you kind of got slammed before you got up here.

Mr. JOHNSON. I was going to say I heard a lot of nice things said about the Department of Labor, and I heard a lot of things said about the Health and Human Services. It is sort of like "beauty and the beast," and I am not the beauty.

But let me report to you on where we are because I do think we have had some successes, and certainly we have some challenges. I think all seven of our programs have been mentioned. Let me just briefly go through each one, if I may?

In Medicare, in fiscal 2005, we reported a Medicare fee-for-service error rate of 5.2 percent. And that rate is, of course, significantly lower than the 10.1 percent that we reported in the previous year. And I think you correctly pointed out that the significant drop in the rate is primarily attributable to our measures taken to

[1] The prepared statement of Mr. Johnson appears in the Appendix on page 119.

ensure that necessary documentation is in place. That I consider to be the low-hanging fruit. I think there is no question about that.

I would like to speak about Medicaid and SCHIP together. We have looked at a lot of options to measure Medicaid and SCHIP. We have concluded that the best way to measure this is the same way we measure our Medicare program. Medicaid and SCHIP are just 50 different Medicare programs conducted by 50 different States.

And so, we have engaged contractors this year that are going to develop a national Medicaid error rate. And these reviews will be much the same as they are in Medicare. By the end of 2008, all 50 States will have been surveyed. We are going to start with 17. After the first 17, we will have a pretty good idea of what that error rate is going to be.

Under Head Start legislation, grantees are required to be monitored at least once every 3 years. We reported a Head Start payment error rate reduction from 3.9 in 2004 to 1.6 in 2005. This is primarily achieved by reinforcing the requirement that 90 percent of the served populations come from low-income family. That was, again, maybe you can call it low-hanging fruit, but it had to happen.

On the Foster Care Program, we developed a methodology for estimating a national payment error rate centered around eligibility reviews, and those are required by regulation. That, too, dropped from 10.33 percent to 8.6 percent. So we have had drops in the first three programs I have mentioned, and that is the success part.

Let me tell you about TANF. We have had many pilots which are successful, and yet we have not identified an efficient and effective approach for determining an estimate of improper payments in the TANF program. By design, States are given great flexibility in the administration of this program. There were also statutory limitations with regard to the information that the Department can request of States.

But in the meantime, we have installed alternative procedures to stop improper payments immediately upon discovery. The first initiative is our PARIS system. It is the Public Assistance Reporting Information System.

It provides—again, similar to Department of Labor—a matching program, matching the capability to identify improper payments in Medicaid, TANF, and Food Stamps. Thirty-four States, the District of Columbia, and Puerto Rico are using the PARIS system and reporting millions of dollars in annual savings. That is a self-reporting system.

Even more promising is the use of our National Directory of New Hires, again referred to by the Department of Labor. That matches the database with new hires under W4s, quarterly wage data, and unemployment compensation, finding great success with that.

We had a pilot in the District of Columbia in which 33 percent of the individuals reviewed were identified as being employed. Over 81 percent of those identified were verified as actually being employed. The vast majority of those recipients were not known to be employed by the TANF agency. So, again, these matching programs really do work, and we have 30 States, the District of Columbia, and Puerto Rico now on that program.

Senator COBURN. You said 81 percent. Is that what you said?

Mr. JOHNSON. Eight-one percent of——

Senator COBURN. Were employed?

Mr. JOHNSON. First, we found a third of the people that we looked at went on this list as hitting a match. And when we hit the match, then in subsequent verification of whether or not they really were employed, 81 percent were, indeed, employed.

Senator COBURN. So 24 percent of the people?

Mr. JOHNSON. That is right.

Senator COBURN. OK. It is kind of like EITC, isn't it?

Mr. JOHNSON. Yes. And so, we are sold on this as a program. The problem with this is it doesn't get us to, by definition, the national error rate that is required by the act.

In the child care program, as with TANF, the child care program legislation gives the States great flexibility in the design and administration of the program. With child care, we have initiated an improper payment pilot in which 18 States participated. Based upon these pilots, we believe we now have a methodology to evaluate participant eligibility, which is the highest risk area, and we think we are on our way with at least a plan.

So, in conclusion, we have valid improper payment systems and are reducing error rates in three of the seven programs—that is, Medicare, Head Start, and foster care. In Medicaid and SCHIP, we have developed and are implementing a plan similar to the Medicare model, which we believe will be equally successful.

In the two programs we have not yet developed a methodology, that is the TANF and the child care program. In TANF, as I mentioned, we have implemented data match systems, which allow us to reduce improper payments, and in child care, we are engaged in a pilot that we think has some real promise to lead us to methodology that will comply with the act.

I would like to leave you with one very interesting statistic, though. And I think the American taxpayer is well served by the money spent at HHS to combat both improper payments and particularly health care fraud and abuse. Since 1997, we have spent $5.7 billion on our Medicare program integrity work, $5.7 billion, but have recovered approximately $82 billion, a 14 to 1 cost-benefit ratio. So we do have some good news to report to you, Senator Coburn.

Thank you again for the opportunity to talk about the Department's improper payments, and I will also be pleased to answer any of your questions.

Senator COBURN. Thank you. I just want to address a little business. I don't think OMB likes you. [Laughter.]

Well, the reason I say that is our last hearing, your testimony didn't come in on time. And this hearing, we got it last night. And we had a little discussion about that, and either they are gunning for you or they are not getting it soon enough.

And I would also say that Mr. Mok's testimony didn't come in until yesterday as well. And I don't know if that is an OMB problem, or it is a problem with it getting there. But I can't do the job if I don't have your information in time to study it.

I mean, my staff can study it. They can stay up all night. But I can't stay up all night and then be sharp and ask you the ques-

tions that the American taxpayers want. So I just ask for your indulgence, 48 hours sooner than you did this time try to get it. This hearing has been on for quite a while, and I would just appreciate that help.

Mr. JOHNSON. You have my apology, and from our end, we will do better.

Mr. MOK. Same here.

Senator COBURN. I am pleased to hear progress. I am still confused how we can be making better progress in one program that is State run, and we can't in other areas. And the unemployment insurance is still way too high in terms of improper payments, and most of that is overpayments. It is not underpayments.

And tell me how, even though I know both of you are dedicated to making these things happen, what can you learn—for Mr. Mok. And actually, the question really is, is did this really start in 1987, or did you all really start good management 5 years ago or 4 years ago?

Ms. Combs really alluded to the fact that you all were improving and had a lower error rate because it started a long time ago. Not to question her word, but is that what happened? Is that why you are where you are today and improving, or is it because management things and management principles were applied, and audit trails were followed, and programs were put in place to actually lower this?

Mr. MOK. I think Ms. Combs is right and what you said earlier is right, too. I think there are many factors. We have put together a program, which today is known as the Benefit Accuracy Measurement Program, since 1987.

So in the 1970s, we had been requiring the States to report statistics to us. In 1987, we have this program that we measure and assess. So we have a history of collecting data and trying to collect some of these overpayments. But I will also say that since President Bush came into office, with the PMA and other initiatives, there is a culture to get this overpayment recovered and also eliminate overpayment to the best of our ability.

At the Department of Labor, I am also very fortunate because under the leadership of Secretary Elaine L. Chao, she is a Harvard MBA. She understands finance. She also inherited the United Way after its fiasco, financial crisis. So she understands very well that if you don't pay attention to financial management, horrible things can happen.

So my office receives incredible support from her and my contemporaries to effect a good program to live up to President Bush's promises to reduce improper payments, and we have an excellent working relationship with the States and also excellent working relationship with other assistant secretaries, primarily because of the culture fostered by Secretary Chao to go after these problems.

So it is really a foundation that I have been fortunate to inherit, and we are able to leverage that. And also the stability of the management team helps. Because the Labor Department, again under Secretary Chao, has probably one of the most stable management teams.

I am currently the longest-serving CFO in the history of the U.S. Department of Labor. So I learn from my mistakes, and so we are able to do some good things there.

Senator COBURN. That is great. Well, what you are saying is leadership really matters?

Mr. MOK. Yes, sir.

Senator COBURN. And what the President has instituted is really going to matter, and the key is, is it carried down? Mr. Johnson.

Mr. JOHNSON. Let me discuss TANF because that has been maybe our most difficult to penetrate and get a national error rate.

I was formerly chief of staff to now Secretary Leavitt when he was governor of the State of Utah. And of course, the TANF program had a couple of provisions. You were able, by design, to use that money in a manner that would best fit your State. And it was sort of a hands off from the Federal Government and hands on by the State.

I can tell you that in our State, and I suggest probably in every State, that they are also working hard to reject and eliminate improper payments. We have a data survey out to them asking them, "What are you doing in your individual State?" We will compile those. They will be on a Web site as a best practices.

We are trying to get at this in another way. And yes, I guess we could as a public policy decide, look, the flexibility that we have given the States on design of the program and on the amount of data that we can request from them, we could legislate that and, of course, get all the cooperation that we needed through legislation.

We are trying to work at it in a different method, and maybe we are wrong. Maybe we need to revisit that. But we would be happy to work with you on that issue.

Senator COBURN. Are you having trouble getting cooperation from the States?

Mr. JOHNSON. Well, they are cooperative in telling us what they are doing. But if you ask them to spend some money—and all of these things take money—and to get a statistically valid rate, then, yes. There is some resistance.

Senator COBURN. So let us go back. Your oral testimony was, I believe, with TANF in one area, where you are running a demonstration project, hooking up——

Mr. JOHNSON. We are doing the matches, yes.

Senator COBURN. You are doing the matches?

Mr. JOHNSON. Yes.

Senator COBURN. And of the 30 percent that you looked at that was not accurate, 81 percent of that actually were employed?

Mr. JOHNSON. And that is in the District of Columbia.

Senator COBURN. That is here in Washington, DC?

Mr. JOHNSON. Yes. So I don't say that is representative.

Senator COBURN. Well, I am not going to generalize that, but I am just saying here is one where it looks like you have 24 percent improper overpayment on TANF?

Mr. JOHNSON. Right.

Senator COBURN. And what is the total payments for TANF for a year in this country?

Mr. JOHNSON. I think $17 billion, if someone can help me?

Senator COBURN. $17 billion. So let us say that it is not 24 percent. Let us say it is 8 percent. It is a billion dollars a year.

Mr. JOHNSON. Right.

Senator COBURN. Tremendous amounts of money. Well, what I would like, Mr. Johnson, is for you to give to this Subcommittee any suggestions that you might like to see that would tend to incentivize the States to be much more cooperative in terms of improper payment because if the States really won't be cooperative with you and yet you are being hammered by us, then it is up to us to give you the tools to get the information.

Mr. JOHNSON. Yes. And I do think that they are incented when we give them these data matching programs. They are incented to use those because that is to their benefit. But that doesn't translate to a national error rate calculation. We can give you the results of all of that, and I think you get the same benefit. But if you want exact compliance with the act and a statistically valid error rate, that is a different issue, and we are trying to do both.

Senator COBURN. How about for Medicaid? You got an FMAT match on administrative cost. What do they get, $8 or $9 for every dollar they spend?

Mr. JOHNSON. Not that high, but——

Senator COBURN. OK, $6 or $7 for every dollar they spend on administrative costs from the Federal Government. The point is you would think that they would gold mine that to get you the data.

Mr. JOHNSON. Now on Medicaid, it is true these contracts, they are cooperating. They are paying part of the contractual price, yes.

Senator COBURN. So the real problem is not a problem on SCHIP and Medicaid?

Mr. JOHNSON. No, that is not the problem.

Senator COBURN. The problem is on TANF, children's care?

Mr. JOHNSON. Yes. And again, we think we may have that solved. But TANF is going to remain our most difficult program to get a statistical measurement.

Senator COBURN. And there is a good guess that there might be a billion, at least a billion dollars a year there? Well, if you take a third of what is happening in DC.

Mr. JOHNSON. Sure. Right.

Senator COBURN. And you say Washington, DC is three times worse than the rest of the country, on average, you get a billion dollars. And if it is only two times worse, you get a billion and a half.

Mr. JOHNSON. And I think that is why we are getting these. As we put out these matching programs, we are getting reports back from the State—again, State reporting——

Senator COBURN. Right.

Mr. JOHNSON. That they are saying, yes, it is millions of dollars that they are saving individually. We can compile all of that.

Senator COBURN. Do all of the States have this now?

Mr. JOHNSON. They have access to it.

Senator COBURN. How many of them are not using it?

Mr. JOHNSON. Well, 34 States are. So 16——

Senator COBURN. Sixteen are not.

Mr. JOHNSON. If my math is right.

Senator COBURN. Your math is usually right. It is not what we want to see all the time, but it is usually right.

Senator Carper.

Senator CARPER. Thanks so much, gentlemen. Good to see you. And Mr. Williams, nice to see you again.

Mr. WILLIAMS. Thank you.

Senator CARPER. You just got yourself a permanent seat there, don't you?

Mr. Williams, let me just start off with you. Any observations you would like to share, sort of reflecting on the testimony and responses of our other two witnesses?

Mr. WILLIAMS. Yes, not only the other two on this panel, but on the previous panel. I think that one of the things that I did in preparing for this hearing was to realize that I am looking at agencies across the government, and I am not an expert in all of these agencies. So I talked to some of our experts and made sure I got as much information about these various programs.

And the feedback that I got from our experts is consistent with some of the things that I have heard today as far as what the Congress can do to help out, and that relates to simplification of some of the processes. That really could be of benefit.

Senator CARPER. Could you give us maybe an example of that?

Mr. WILLIAMS. I think when we were talking about the earned income credit. In talking to our experts, one of the things that they pointed out to me was that while the tax code is complicated, their thinking was the section that related to the earned income credit was probably one of the more complicated sections of the code.

And to take that a step further, a lot of people that qualify for it might not have the most education and is aware of how to go about filling it out. So that is something that you might want to take into consideration when you are looking at simplification of a process. That is one thing that they pointed out to us.

They also pointed, and I have testified to this over the years, and that is when you are looking at these various programs, you definitely want to take into consideration cost-benefit factors. And I think there was a lot of discussion about that today. And I would concur with those statements that the way I like to put it, why would you spend a dollar and one cent to get back a dollar. So I would concur with those statements.

Most recently, there was a statement that was made about are we better off in some programs than others because we have been working at this longer? I could take HHS as an example. If you look at the reporting that is going on under Medicare, this process started back in 1996, when the IG began taking a sample.

And as recently as last year, you can see that they are still making refinements to it and that we have had the discussion today that the number dropped down because of better reporting of the documentation that is coming in from the medical providers.

So I think you would have to conclude that it does take time in some of these programs. That might be one of the reasons why some of these programs are showing not reporting instead of having an amount.

So I think with time, and I think we all would agree that people are working hard at trying to address this issue, and there are var-

ious things that are going on. Because as I read through their various performance and accountability reports, I saw numerous examples of various matching concepts that have been put into place and things along this line that should help reduce some of the improper payments that is occurring in the Federal Government today.

But in conclusion, I also want to point out that $38 billion is still $38 billion, and we still don't know today exactly what that number is in total based on the reporting that I have seen up through fiscal year 2005. Thank you.

Senator CARPER. Good. Thanks. You mentioned people are working hard. Are there any folks out there that aren't working hard enough that you know of?

Mr. WILLIAMS. None that I know of. [Laughter.]

Senator CARPER. All right. I was out on a phone call here for a minute, and I missed a part of the testimony of two of our witnesses. I was trying to watch it on TV in the anteroom here and do my phone call as well and probably didn't do a good job with either of them.

But I came in and I think I heard the Chairman talking about these programs where the Feds partner with the States and maybe the States administer the programs and where I think Medicaid might have been an example of one of those programs where we still haven't been able to get our arms around the improper payments problem.

I think I heard some discussion about incentivizing the States to cooperate more. It reminded me a little bit of a conversation we had in another hearing where I think we dealt with real property management, and we were looking at, I think, the Veterans Administration, where they are actually doing a much better job than some of our other agencies in handling their property management because they have an incentive to do so.

Let us come back to the issue and programs that either of you partner with the States, in other words, on UI or Medicaid. And just talk to us about, let us say you are a governor or a State legislator, what incentives are we providing the States to partner with us in reducing the improper payments? Why should the States want to help us on this, aside from being the right thing to do?

Mr. JOHNSON. Yes, and as a former governor, you know that States do want to do the right thing, and they do have a vested interest.

Senator CARPER. I know in Delaware and Oklahoma they sure felt that way. I can't speak for some of those other States.

Mr. JOHNSON. The issue then is whether or not the incentives just to do the right thing is all that it takes. And with respect to Medicaid, we think now that the States have entered into a contract, joint contract—they are paying their part, we are paying our part—and we do think we have a solution there.

We have just introduced these matching programs just recently. But our success factor then in getting States to sign up has been rather astounding. So they can see the benefit of using these matching programs to find errors because if you take TANF or the child care, the benefit comes right back to them, right back to the State.

But again, those work and those are dollar savers. It just doesn't get us to the technical statistically valid national error rate. And so, I look at it from a cost benefit, I think we are doing a lot of the right things. And getting to this, the technical, we are eliminating errors, and we are eliminating fraud and abuse, but we are missing somewhat getting this technical requirement down.

And I know we have to obey the law, and we intend to. But in the meantime, we are trying to save dollars.

Senator CARPER. For a State, their incentive on TANF, the large States don't have enough money in their Temporary Assistance for Needy Families. They have a waiting list for child care.

Mr. JOHNSON. Yes.

Senator CARPER. So what they need to do is to stretch the dollars. And so, the incentive for them is if we can ferret out an improper payment, then there is more money in their allocation to use for the needs that need to be met. That is a pretty good incentive.

Mr. JOHNSON. That is a very good incentive. Where it breaks down is if you say, "I would like you to spend some of your administrative dollars to do some statistical sampling that will give us a national error rate."

They are saying, "I like the matching program. I like that. I can see direct benefit of that." It gets a little more distant when you start asking them to get some statistical sampling so it will help the Federal Government get a national error rate. And so, I understand that.

Senator CARPER. All right. One more question, if I could, Mr. Williams, to ask you to talk about the controls, I guess I would say controls against waste along the Gulf Coast with respect to the recovery, and your confidence or lack of confidence that FEMA can set up a system to prevent waste during a disaster? Anything you could offer us on that?

Mr. WILLIAMS. Well, one of the things that I would like to point out, first of all, is that if you look at the event from a timing standpoint, if you are looking at the 2005 reports that the agencies have put out, the events took place very close toward the end of the fiscal year.

So from an improper payment standpoint, if there are several major impacts in the improper payments area, it will probably show up more in the 2006 financial reports than the 2005 because you only had about a month, month and a half.

We have always had concerns about internal controls, and when you look at audit reports in which an agency had 10 material internal control weaknesses, they had two reportable conditions, and they had seven noncompliance with laws and regulations. And one of those noncompliance issues related to not being compliant with the improper payments act.

So that raises an antenna right there, and I would suggest that in an environment like that, you would want to have every resource possible working in your favor to put internal controls in place so that you can prevent improper payments from occurring, as well as having procedures in place to detect improper payments.

I like to look at it from the standpoint of putting procedures in place to prevent the horse from getting out of the barn, but once

the horse gets out of the barn, you need to have something, and those are my detectable controls. So you would want to see as much of those in place as possible when you have an area that has that number of material weaknesses, noncompliance, reportable conditions.

It would be an area in which not only would you want to look close at it, but you would want to make sure that you have good oversight, good communications, and I think that was the thinking of the Congress when it passed the Department of Homeland Security Financial Accountability Act, was the Congress was trying to get involved in this process to make sure that there was a structure in place that would highlight some of these issues, would put strong management in place at the organization.

I think the statute had some specific requirements as far as the chief financial officer at the agency. That they would be confirmed by the Senate, that they would have certain experience, extensive experience in accounting, budgeting, financial systems. And I think that was the thinking along that line, and I would encourage anything that the Congress can do in going forward to assist the agency in any way possible to make sure that these procedures are put in place because there is a susceptibility to risk, based on the reporting that we have seen from the auditors at the agency over the years.

Senator CARPER. All right. Good. Thanks so much.

And Mr. Chairman, thanks for being so generous with the time.

Mr. WILLIAMS. Could I add one more point? Without going into any details, I would just like to make the both of you aware of the fact that I currently have an assignment under way in which I am basically looking at what things are going on in this area with the States, what needs to be done from a State perspective in order to try to address the issue of improper payments, given the fact that the States play such a large role in this particular issue with grants in the neighborhood of $400 billion a year.

And we are in the latter stage of gathering that information, but I just wanted to make you aware that we are looking at that, and we are looking at issues such as what can the Federal Government do? What can OMB do? And things along this line to address any communications issues, things that could be done to improve the link between the Federal Government and the States in some of these programs that we are talking about today.

Senator CARPER. I don't think we would be interested, do you?

Senator COBURN. I have a couple of other questions. One is, we started a brand-new program this year. It is called Medicare Part D.

Mr. JOHNSON. That is correct.

Senator COBURN. What aspects of Medicare Part D had in it so that we will know what the improper payment rate is? Is there a program in it?

Mr. JOHNSON. Well, I think the Medicare Integrity Program encompasses Part D. Part D, of course, will be a little bit different from the standpoint that we are now going through other insurance companies or, therefore, other providers. And so, it will have a little less risk on that side because someone else is setting premium rates.

Senator COBURN. I understand that. But here is my question.

Mr. JOHNSON. Yes.

Senator COBURN. With a brand-new program, knowing we have an improper payments law, was there a component of that program that said, here is this new multi-, multi-, multi-, multi-, multi-billion program, was part of the design of that program in its implementation a way to audit and report improper payments?

Mr. JOHNSON. I have been given a note that says starting next week, we are having discussions on that issue. But as of now, we don't have anything in place.

Senator COBURN. OK, but you would agree——

Mr. JOHNSON. Oh, absolutely.

Senator COBURN [CONTINUING]. That one of the things that should have been in that rather than after the fact, design it with the fact as a part of the program. And so, this is part of the management agenda the President has to get ahead of. I mean, if we have something new, then you have to meet the requirements.

The other point that I would make is the improper payments act may be hard, but it is the law. And I will tell you personally I am not going to rest until every agency is reporting on it accurately. And then if it cannot happen, then the President and the Administration has an obligation through OMB to come back to us and say this has to be changed, and here is why because it is not achievable.

But to say it isn't going to happen, and we can't get it done because it is hard to get done isn't an acceptable response. I know it is difficult, and I don't doubt dedication. I want to make sure you all understand that.

My communication to you is, I think, we have wonderfully dedicated people, but I think we have to be thinking down the road, and what the President is attempting to do through this difficult process of changing bureaucracy, I think we are seeing some good signs that we are seeing change. But one of the reasons we are having this hearing is the pressure is going to stay on, OK?

GAO reported that Department of Labor did not follow the required format for recovery auditing included in OMB's guidelines. Are you aware of that, Mr. Mok?

Mr. MOK. Yes, I am aware of that if you are talking about the recovery audit, where the auditor is allowed to keep certain percentage recovered. According to our internal analysis and study, we do not see the cost effectiveness of doing that because if you look at some of the programs that we can apply it to, the amount is not there.

Senator COBURN. Right. You also reported that no improper payments were noted from recovery auditing activities for 2005. Is that correct?

Mr. MOK. That is correct.

Senator COBURN. And that recovery audit effort was, therefore, unnecessary?

Mr. MOK. We do not see the need at this time. However, we are continuously looking at that, monitoring that.

Senator COBURN. Yes. What do you find on that, Mr. Williams?

Mr. WILLIAMS. That is consistent with your statement. You have made an accurate statement. What I would point out in this area

is that if that is the conclusion now, that you need to continue to monitor the process because things change as you go down the road.

Mr. MOK. And that is our intent.

Senator COBURN. Well, let me once again thank each of you. I am sorry for the late hour. I apologize for it. I thank you for your dedication and your service. We will be back here in about 6 months, doing this again, I will assure you.

You will have some additional questions. I would also ask that you give us recommendations from your agencies that you would like to see changed. I think Senator Carper and I have a good handle on improper payments, and we can work both sides of the aisle to try to get some of this stuff to happen.

You will be sent some additional questions, and we would like a prompt reply on that, if we could.

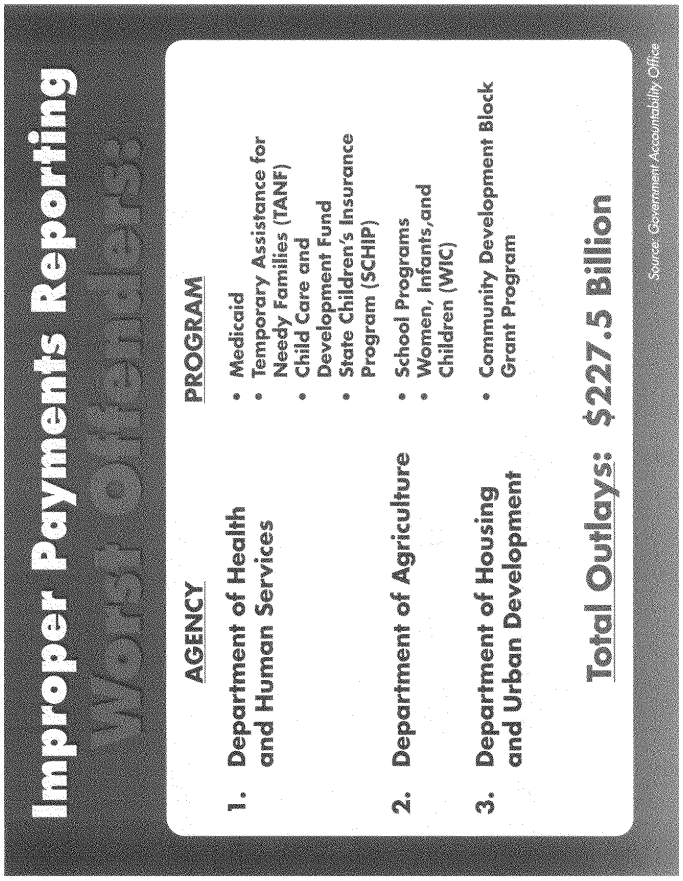
Thank you very much, and the hearing is adjourned.

Mr. MOK. Thank you very much.

Mr. JOHNSON. Thank you.

[Whereupon, at 4:52 p.m., the Subcommittee was adjourned.]

APPENDIX


Improper Payments Reporting
Worst Offenders
AGENCY
PROGRAM
1. Department of Health and Human Services
• Medicaid
• Temporary Assistance for Needy Families (TANF)
• Child Care and Development Fund
• State Children's Insurance Program (SCHIP)
2. Department of Agriculture
• School Programs
• Women, Infants, and Children (WIC)
3. Department of Housing and Urban Development
• Community Development Block Grant Program
Total Outlays: $227.5 Billion
Source: Government Accountability Office

Internal assessment found no programs susceptible to significant improper payments.

Hard to Believe?

- The Department of Commerce
- The General Services Administration (GSA)
- The Department of Homeland Security
- The Department of the Interior
- The Department of Justice
- NASA
- The Nuclear Regulatory Commission
- The Securities and Exchange Commission

Source: Government Accountability Office

Earned Income Tax Credit

28% Improper Payment Rate

> One Quarter Payments Made Are WRONG

Source: Office of Management and Budget

Improper Payments at HHS

Medicaid	NOT REPORTING
TANF	NOT REPORTING
State Children's	NOT REPORTING
Insurance Program	NOT REPORTING
Child Care and Development Fund	NOT REPORTING
Medicare	$12.1 Billion (5.2%)
Head Start	$110 Million (1.6%)
Foster Care Title IV-E	$182 Million (10.02%)

Source: Government Accountability Office

Agencies That Reported "INSUFFICIENT" Improper Payments Information in 2005

- Agency for International Development
- Export–Import Bank
- Pension Benefit Guaranty Corporation
- Postal Service
- Smithsonian Institution
- NASA

Source: Government Accountability Office

FY 2007 Budget Proposal
Improve the Administration of the Windfall Elimination Provision and Government Pension Offset Provision

Summary

- This proposal would improve the administration of the windfall elimination provision (WEP) and the government pension offset provision (GPO) by establishing a mandatory system for collecting data on pension income from non-covered State and local employment.

Background/Present Law

- The WEP and GPO were enacted in order to provide more equal treatment of workers in jobs not covered by Social Security and workers in jobs covered by Social Security—i.e. to reduce the advantage that workers eligible for a pension on the basis of noncovered earnings may have relative to other workers.

  - Under the WEP provision, a person's own Social Security retirement or disability benefit may be reduced, but not eliminated, if he/she receives a pension from employment not covered by Social Security. The amount of the reduction, if any, depends on the number of years in jobs with substantial Social Security-covered earnings and the year in which the person attains age 62.

  - Under the GPO provision, a person's Social Security benefit as a spouse or surviving spouse is reduced by two-thirds of any pension that person receives based on his/her own work in Federal, State or local government employment that is not covered by Social Security.

- The WEP generally applies to a worker who receives a pension based on **any work** not covered by Social Security while the GPO reduces the Social Security spousal and/or survivor benefit payable to someone receiving a pension based on **government employment** not covered under Social Security.

- Individuals who apply for Social Security benefits, are asked if they are receiving a pension based upon noncovered employment. The Social Security Administration (SSA) then obtains verification of the pension and applies the WEP and/or GPO accordingly. SSA largely relies on the person to correctly inform SSA of his/her pension receipt.

FY 2007 Proposal

- To permit SSA to better administer the WEP and the GPO provision, this proposal would require State and local governments to provide data, in an electronic format, directly to SSA regarding the receipt of government pensions based on employment not covered by Social Security. SSA could then compare the reports with the beneficiary payment records and examine cases that indicate the possibility that WEP or GPO applies.

- If a State or local government fails to comply with SSA's request for this information, a penalty may be imposed on the State by denying the State access to IRS tax information the State may need to administer State tax provisions.

Rationale/Discussion

- Access to noncovered pension data from State and local governments would improve SSA's ability to determine, in a timely manner, whether a beneficiary should be subject to the WEP or GPO. This would reduce overpayments that currently occur when SSA determines that a beneficiary should have been subject to WEP or GPO but was not. The proposal would thereby improve SSA's stewardship over the program and the Social Security trust funds.

- SSA currently has a matching agreement with the Office of Personnel Management to obtain information on Federal government retirees who receive a pension from work not covered by Social Security. However, SSA generally lacks similar information from State and local governments and many of these pensions go unreported.

- This change would improve the equity in the application of these provisions because it would improve SSA's ability to identify State and local government retirees receiving pensions based on noncovered work in a manner similar to SSA's present ability to identify persons receiving Federal pensions based on noncovered work.

- Presently, State and local governments already provide annual reports of pensions to IRS on Form 1099R so much of the information SSA needs is available to the State and local governments. Therefore, the proposal should not pose a severe administrative problem to the pension administrators that will have to report.

OASDI Savings/Number Affected[1]

- Estimated OASDI program savings are shown below, in millions:

FY	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	Total
Savings	-	-	-	$133	$294	$396	$430	$405	$395	$378	$2,431

- Estimates of the number of individuals whose Social Security benefits would change as a result of information obtained through these reports are shown below, in thousands:

CY	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
Number	0	0	0	25	55	70	75	70	65	60

[1] These estimates assume that the provision would be effective after December 2006, but that full implementation would take several years.

FY 2007 Budget Proposal
Simplify Workers' Compensation Offset Computation

Summary

- Change the amount of workers' compensation (WC) offset to a percentage of the benefits paid to the disabled worker and the worker's family and limit the length of offset to 5 years. The effect of this change would be to make the provision more equitable and to simplify its administration.

Background/Present Law

- If an individual receives both a Social Security disability benefit and a WC payment, the disability benefit is offset so that the combined benefits (WC and the disability benefit payable to the worker and to the worker's family) do not exceed 80 percent of the individual's average earnings before he or she became disabled. Offset is applied first against benefits payable to family members (i.e., spouse and children) before it is applied against the worker's benefit.

- The purpose of the offset is to avoid excessive total benefits that could act as a disincentive to remain in the workforce or return to work.

FY 2007 Proposal

- For disabled workers who are receiving a workers' compensation payment [1], the proposal would reduce the worker's benefit (and those of entitled family members) by 37 percent.[2]

- The amount of offset could not exceed the monthly amount of the WC payment.

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[1] This change would also apply to the relatively small group of disabled workers who receive certain public disability benefits and whose Social Security benefits are offset under the same rules applicable to receipt of workers' compensation payments.
[2] This percentage was selected to make the proposal largely cost neutral in the short range.

- The offset would continue for only the first 5 years of concurrent receipt of Social Security benefits and WC payments. (The offset would end before the 5-year period if payment of the WC ends sooner.)

- Any lump sum WC payments received would be prorated and count as months of concurrent receipt.

- The offset would be extended beyond age 65 to the applicable full-benefit retirement age for workers whose full-benefit retirement age is after age 65. Apparently, this change was inadvertently omitted by Congress in 1983 when legislation was enacted to gradually raise the full-benefit retirement age -- ultimately to age 67.

Rationale/Discussion

- The WC offset is a complex aspect of the Social Security DI program, is difficult to administer, and is error-prone in terms of payment accuracy. Due to the complexity of the provision, SSA has devoted substantial staff time to reworking cases in which errors were made.

- This proposal would simplify the administration of the WC offset provision, thus allowing the Social Security Administration to improve its use of administrative resources. It is estimated that this change would reduce administrative costs by $30 million and save 375 work years over 5 years. These resources could be applied to other pressing workloads at SSA—e.g., the backlog for disability hearings.

- In addition, under current law, the offset falls disproportionately on lower earners. Because of relatively low State law limits on the amount of WC payments, it is common for higher earners to escape the offset because combined Social Security and WC benefits for these earners are below the present law cap (80 percent of their average pre-disability earnings) that triggers the offset. By replacing the existing complicated offset with a uniform

offset, the proposal would more evenly distribute the offset among higher and lower earners.

- Further, the proposal would address an inequity in present law that applies the offset first against benefits paid to the worker's family members before applying any offset to the worker. Under the proposal, the same percentage of offset would apply to both the worker and to the worker's family members.

OASDI Savings

- Estimated OASDI program savings are shown below, in millions:[3]

FY	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	Total
Savings	$ 8	$ 35	$ 50	$ 63	$ 72	$ 55	$ 42	$ 35	$ 26	$ 16	$ 402

[3] This cost estimate assumes the change is effective for new concurrent receipt cases after September 2006; however, depending on the date of enactment, a later effective date may be necessary.

Statement of The Honorable Linda M. Combs
Controller, Office of Federal Financial Management
Office of Management and Budget

Before the
Subcommittee on Federal Financial Management, Government Information, and International Security
Committee on Homeland Security and Governmental Affairs
United States Senate
March 9, 2006

Thank you, Dr. Coburn, Senator Carper, and Members of the Committee.

I am pleased to be here today to discuss the Administration's efforts to improve the accuracy and integrity of Federal payments. As there is no more important undertaking than the effective and efficient stewardship of taxpayer dollars, the President has made the elimination of improper payments one of his highest management priorities. Through the government-wide effort to improve financial management under the President's Management Agenda (PMA), as well as through the "Eliminating Improper Payments" PMA initiative, the Federal financial community is mobilizing people, resources, and technology to identify improper payments in all high risk programs, establish aggressive improvement targets, and implement corrective actions to meet those targets expeditiously. I appreciate this opportunity to share some recent success stories on agency efforts, to discuss steps we are taking to address ongoing challenges, and to provide you with highlights from OMB's second annual report on government-wide improper payments.

During fiscal year (FY) 2005, the Federal Government made substantial progress in meeting the President's goal to eliminate improper payments. Most significantly, the government-wide improper payment total reported for FY 2004 decreased from $45.1 billion to $37.3 billion, a reduction of approximately $7.8 billion (or 17%.) With this result, the Federal Government exceeded its FY 2005 strategic goal for improper payment eliminations by $5 billion.

Much of this success can be attributed to the Improper Payments Information Act of 2002 (IPIA) and the PMA, each of which provide an effective accountability framework for ensuring the Federal agencies take all the necessary steps to ensure payment accuracy. Notable accomplishments from this past year include:

- The Department of Health and Human Services (HHS) dramatically improved its stewardship of Medicare funds by taking aggressive steps to ensure that the necessary documentation was in place to support payment claims. As a result, Medicare's reported improper payments decreased by more than $9 billion or 44%.

- The Department of Agriculture (USDA) continued efforts to reduce improper payments in the Food Stamp program by simplifying program administration and working with States to ensure that quality control checks are in place. As a result, USDA reported an error rate of less than 6% in the Food Stamp program, the lowest error rate in the program's history.

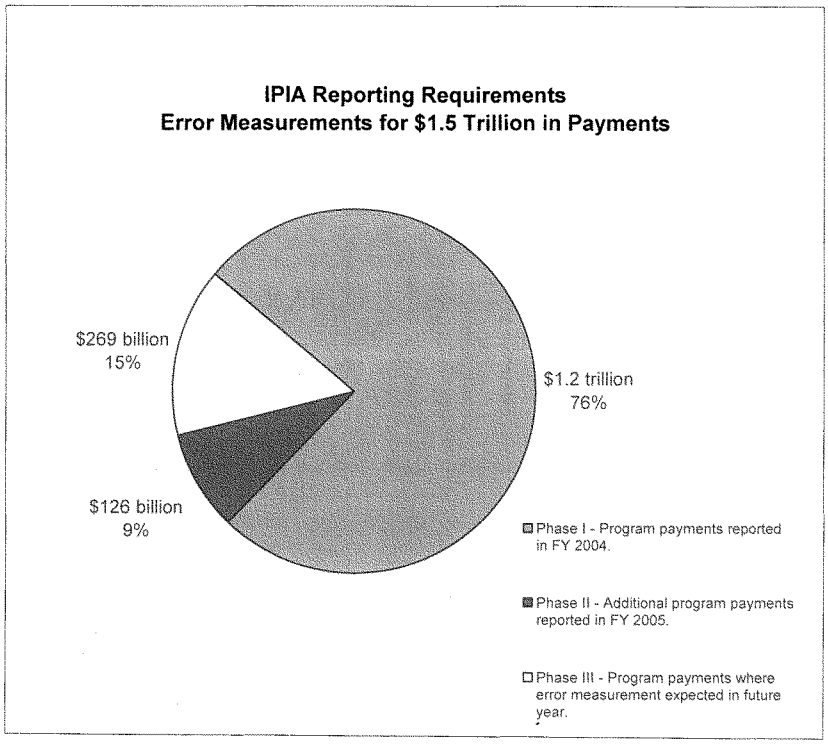
- The Department of Labor (DOL) reduced improper UI payments by approximately $600 million in FY 2005. This represents a greater than 15% decrease in the level of improper payments for this program since last year's reporting. To continue this success, DOL has undertaken several initiatives, including an expansion of its data matching program for the Unemployment Insurance (UI) program, ensuring that individuals who have returned to work do not continue to receive benefits they are no longer eligible to receive.

- The Department of Housing and Urban Development (HUD) continued to expand and strengthen its income verification program for the Public Housing/Rental Assistance program. As a result, HUD has reduced improper payments in this program by more than $1.8 billion since 2000, with an additional $200 million in reductions reported in FY 2005.

Although several important programs such as the Earned Income Tax Credit and Old-Age and Survivors Disability Insurance (OASDI) reported increases in improper payments in FY 2005, the government-wide improper payment total is trending significantly downward. It is important to note that a large portion of the increases for these programs is due to outlay growth. In fact, the error rates for these programs have remained stable over time. It should also be noted that the OASDI overpayment rate is still a very low 0.5%.

Working together with Congress and the Federal financial management community, it is my charge to ensure that effective approaches, such as those employed at HUD, HHS, DOL, and USDA, are implemented at more agencies and with similar results. The Chief Financial Officers Council will continue to play a critical role in our efforts by providing a forum for sharing best practices and by exploring partnerships with the private sector and states to leverage new technologies and generate more cost efficient methods for measuring and eliminating improper payments.

Another critical accomplishment in FY 2005 was that Federal agencies reported error measurements on an additional 17 programs. As noted in the figure below, we are referring to this new reporting as Phase II, with Phase I covering the programs originally reported in OMB's FY 2004 report. A third phase of the government's effort will be defined when improper payment measurements are available for remaining programs where measurements are currently under development.



With agencies now reporting on all Phase 1 and Phase 2 activities, we have an error measurement in place for approximately 85% of all payments deemed risk susceptible by Federal agencies. Although we are proud of this result, we are not satisfied with it. As I have stated in previous testimony before this Subcommittee, until all high risk programs report an error rate measurement, the totality of the problem will not be known. Therefore, through the PMA, we have asked agencies to develop and implement aggressive plans to develop error measurements in remaining programs where

an error measurement is needed. Based on agency plans, we expect to narrow the reporting gap to less than 5% by FY 2007 as measurements are established for programs such as Medicaid and School Lunch.

Also of note, and in direct response to suggestions made by this Subcommittee at a previous hearing, agency reporting on improper payments to vendors is now included in our government-wide reporting, providing a more complete picture on government-wide improper payments. Specifically, Federal agencies reviewed $365 billion in vendor payments in FY 2005, identified $557 million in improper payments, of which $467 million (or 84%) has been recovered to date.[1]

With agencies working to deploy more innovative and sophisticated approaches for addressing improper payments, the prospects for additional and significant improper payment reductions in the coming years are promising. For the programs reported in Phase I, the overall error rate dropped from 3.9% in FY 2004 to 3.1% for FY 2005. If these agencies continue to meet their expected reduction targets, we are projecting a 3% error rate for FY 2006 and a 2.9% rate for FY 2007. We also expect agencies to expand and enhance their recovery audit activities to cover more vendor payments and to improve recovery rates.

Because 95% of the reported improper payment total continues to reside within seven programs, OMB continues to focus on these agencies. In addition, we will continue to provide close scrutiny of the Department of Defense (DOD) efforts to identify and recover improper payments to vendors. To date, we have been impressed by DOD's commitment to improving recovery audit results and maintaining low error rates in other major programs, such as Military Health and Retirement benefits. Specifically, Military Health reported a 0.1% error rate, Military Retirement reported a .14% error rate, and DOD achieved an 88% recovery rate from internal reviews of vendor payments and external recovery auditing efforts. In addition, DOD identified and reported on an additional program in their FY 2005 PAR, Military Pay. We have found it very encouraging that DOD has carried on its efforts to risk assess it program inventory, and determine additional programs to track if warranted. It is our commitment to ensure that DOD continues to improve on results to date and that they enhance and expand the significant due diligence efforts underway to identify all relevant program areas at risk for improper payments.

Finally, the Administration continues to pursue an aggressive legislative agenda in the improper payments arena, with a series of program integrity reforms included in the President's FY 2007 Budget. If enacted, these proposals are projected to generate more

[1] These results reflect updated information from Federal agencies received after all PARs were published in final. To reflect these new totals, OMB recently updated the annual improper payment report and re-posted it on our website.

than $12 billion in savings over 10 years, leading to significant decreases in the government-wide improper payment total.

With the tools of the IPIA and this Administration's management initiatives in effect, the Federal Government is in a strong position to build on the dramatic reduction in improper payments achieved this year and to ensure that an error measurement is provided for all higher risk programs. With the goal of ensuring that each taxpayer dollar is spent wisely, efficiently, and for the purpose for which it was originally intended, we remain committed to eliminating Federal improper payments. We look forward to continuing to work with the Congress to see this objective accomplished.

Thank you, Mr. Chairman, for the opportunity to speak before you today. I am pleased to address any questions.

United States Government Accountability Office

GAO

Testimony

Before the Subcommittee on Federal Financial Management, Government Information, and International Security, Committee on Homeland Security and Governmental Affairs, U.S. Senate

For Release on Delivery
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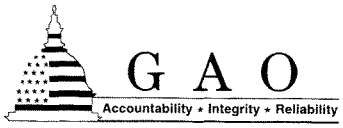
FINANCIAL MANAGEMENT

Challenges Remain in Meeting Requirments of the Improper Payments Information Act

Statement of McCoy Williams, Director
Financial Management and Assurance



GAO-06-482T

March 9, 2006

GAO
Accountability · Integrity · Reliability

Highlights

Highlights of GAO-06-482T, a testimony before the Subcommittee on Federal Financial Management, Government Information, and International Security, Committee on Homeland Security and Governmental Affairs, U.S. Senate

FINANCIAL MANAGEMENT

Challenges Remain in Meeting Requirements of the Improper Payments Information Act

Why GAO Did This Study

Improper payments are a long-standing, widespread, and significant problem in the federal government. The Congress enacted the Improper Payments Information Act of 2002 (IPIA) to address this issue. Fiscal year 2005 marked the second year that federal agencies governmentwide were required to report improper payment information under IPIA. One result of IPIA has been increased visibility over improper payments by requiring federal agencies to identify programs and activities susceptible to improper payments, estimate the amount of their improper payments, and report on the amounts of improper payments and their actions to reduce them in their annual performance and accountability reports (PAR).

GAO was asked to testify on the progress being made by agencies in complying with requirements of IPIA and the magnitude of improper payments. As part of the review, GAO looked at (1) the extent to which agencies have performed risk assessments, (2) the annual amount of improper payments estimated, and (3) the amount of improper payments recouped through recovery audits.

www.gao.gov/cgi-bin/getrpt?GAO-06-482T.

To view the full product, including the scope and methodology, click on the link above. For more information, contact McCoy Williams at (202) 512-9095 or williamsm1@gao.gov.

What GAO Found

The federal government continues to make progress in identifying programs susceptible to the risk of improper payments in addressing the new IPIA requirements. At the same time, significant challenges remain to effectively achieve the goals of IPIA. The 32 fiscal year 2005 PARs GAO reviewed show that some agencies still have not instituted systematic methods of reviewing all programs and activities, have not identified all programs susceptible to significant improper payments, or have not annually estimated improper payments for their high-risk programs as required by the act.

The full magnitude of the problem remains unknown because some agencies have not yet prepared estimates of improper payments for all of their programs. Of the 32 agencies reviewed, 18 reported over $38 billion of improper payments in 57 programs. This represented almost a $7 billion, or 16 percent, decrease in the amount of improper payments reported by 17 agencies in fiscal year 2004. However, as shown in the table below, the governmentwide improper payments estimate does not include 7 major agency programs with outlays totaling about $228 billion.

Major Programs That Have Not Reported Improper Payment Estimates

Dollars in billions

Agency	Program	Fiscal year 2005 outlays	Target fiscal year for estimating
Department of Agriculture	School Programs	$8.2	2007
Department of Health and Human Services	State Children's Insurance Program	5.1	2007
Department of Agriculture	Women, Infants, and Children	4 8	2008
Department of Health and Human Services	Medicaid	181.7	2008
Department of Health and Human Services	Child Care and Development Fund	4 9	Did not report
Department of Health and Human Services	Temporary Assistance for Needy Families	17.4	Did not report
Department of Housing and Urban Development	Community Development Block Grant	5.4	Did not report
Total		**$227.5**	

Sources Office of Management and Budget and cited agencies' fiscal year 2005 PARs

Further, agency auditors have identified major management challenges related to agencies' improper payment estimating methodologies and significant internal control weaknesses for programs susceptible to significant improper payments. In addition, two agency auditors cited noncompliance with IPIA in their annual audit reports.

For fiscal year 2005 PARs, agencies that entered into contracts with a total value exceeding $500 million annually were required to report additional information on their recovery audit efforts. Nineteen agencies reported reviewing over $300 billion in vendor payments, identifying approximately $557 million to be recovered, and actually recovering about $467 million.

Mr. Chairman and Members of the Subcommittee:

I am pleased to be here today to discuss the governmentwide problem of improper payments in federal programs and activities.[1] Our work over the past several years has demonstrated that improper payments are a long-standing, widespread, and significant problem in the federal government. The extent of the problem initially had been masked because only a limited number of agencies reported their annual payment accuracy rates and estimated improper payment amounts prior to the passage of the Improper Payments Information Act of 2002 (IPIA).[2]

Fiscal year 2005 marked the second year that federal agencies governmentwide were required to report improper payment information under IPIA in their performance and accountability reports (PAR). IPIA has increased visibility over improper payments to a higher, more appropriate level of importance by requiring executive agency heads, based on guidance from the Office of Management and Budget (OMB),[3] to identify programs and activities susceptible to significant improper payments, estimate amounts improperly paid, and report on the amounts of improper payments and their actions to reduce them. Further, in fiscal year 2005, OMB began to separately track the elimination of improper payments under the President's Management Agenda (PMA).

As reported in agencies' fiscal year 2005 PARs, the governmentwide improper payments estimate for fiscal year 2005 exceeded $38 billion, but did not include some of the highest risk programs, such as Medicaid with outlays exceeding $181 billion for fiscal year 2005. I highlight these omissions later in my testimony. From our review, we noted that federal agencies made progress in addressing improper payments by implementing processes and controls to identify, estimate, and reduce improper payments. For example, agencies demonstrated improved error detection and measurement by reporting improper payment estimates for 17 newly

[1]Improper 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 fraud and abuse by program participants, federal employees, or both.

[2]Pub. L. No. 107-300, 116 Stat. 2350 (Nov. 26, 2002).

[3]OMB Memorandum M-03-13, "Improper Payments Information Act of 2002 (Public Law 107-300)," May 21, 2003.

reported programs[4] totaling about $1.2 billion, which are included in the governmentwide improper payments estimate totaling over $38 billion. However, we noted that some agencies still have not instituted systematic methods of reviewing all programs and activities, have not identified all programs susceptible to significant improper payments, or have not annually estimated improper payments for their high-risk programs.

Because of ongoing interest in addressing the governmentwide improper payments issue, we continue to report on the progress being made by agencies in complying with certain requirements of IPIA. A list of related GAO products is provided at the end of this testimony. As you requested, in my testimony today, I will discuss (1) the extent to which agencies have performed the required assessments to identify programs and activities that are susceptible to significant improper payments, (2) the annual amount of improper payments estimated by the reporting agencies, and (3) the amount of improper payments recouped through recovery audits.

The scope of our review included the 35 federal agencies[5] that the Department of the Treasury (Treasury) determined to be significant to the U.S. government's consolidated financial statements. Based on available information, we reviewed improper payment information reported by 32 agencies[6] in their fiscal year 2005 PARs or annual reports. We further reviewed OMB guidance on implementation of IPIA and its report on the results of agency-specific reports, significant findings, agency accomplishments, and remaining challenges. We did not independently validate the data that agencies reported in their PARs or annual reports or that OMB reported. However, we are reporting it in order to provide descriptive information that will inform interested parties about the magnitude of governmentwide improper payments and other improper payments related information. We believe the data to be sufficiently reliable for this purpose. We provided the major findings discussed in this statement to OMB; however, they had not provided official comments by the date of this hearing. We conducted our work in February 2006 in accordance with generally accepted government auditing standards.

[4]Fiscal year 2005 was the first time that these agency programs reported under the governmentwide reporting requirements of IPIA.

[5]See *Treasury Financial Manual*, vol. 1, part 2, ch. 4700. A list of the 35 agencies is included in app. II.

[6]Three agencies' annual reports were not available prior to the end of our fieldwork.

Background

Before I discuss our review of agencies' fiscal year 2005 PARs, I would like to summarize IPIA, related OMB initiatives, and statutory requirements for recovery audits. The act, passed in November 2002, requires agency heads to review their programs and activities annually and identify those that may be susceptible to significant improper payments. For each program and activity agencies identify as susceptible, the act requires them to estimate the annual amount of improper payments and submit those estimates to the Congress. The act further requires that for programs for which estimated improper payments exceed $10 million, agencies are to report annually to the Congress on the actions they are taking to reduce those payments.

The act requires the Director of OMB to prescribe guidance for federal agencies to use in implementing IPIA. OMB issued guidance in May 2003[7] requiring the use of a systematic method for the annual review and identification of programs and activities that are susceptible to significant improper payments. The guidance defines significant improper payments as those in any particular program that exceed both 2.5 percent of program payments and $10 million annually. It requires agencies to estimate improper payments annually using statistically valid techniques for each susceptible program or activity. For those agency programs determined to be susceptible to significant improper payments and with estimated annual improper payments greater than $10 million, IPIA and related OMB guidance require each agency to report the results of its improper payment efforts for fiscal years ending on or after September 30, 2004. OMB guidance requires the results to be reported in the Management Discussion and Analysis section of the agency's PAR.

In August 2004, OMB established Eliminating Improper Payments as a new program-specific initiative under the PMA. This separate improper payments PMA program initiative began in the first quarter of fiscal year 2005. Previously, agency efforts related to improper payments were tracked along with other financial management activities as part of the Improving Financial Performance initiative of the PMA. The objective of establishing a separate initiative for improper payments was to ensure that agency managers are held accountable for meeting the goals of IPIA and are therefore dedicating the necessary attention and resources to meeting IPIA requirements. With this new initiative, 15 agencies are to measure their improper payments annually, develop improvement targets and corrective

[7]OMB Memorandum M-03-13.

actions, and track the results annually to ensure the corrective actions are effective.

In August 2005, OMB revised Circular No. A-136, *Financial Reporting Requirements,* and incorporated IPIA reporting details from its May 2003 IPIA implementing guidance. Among other things, OMB Circular No. A-136 includes requirements for agencies to report on their risk assessments; annual improper payment estimates; corrective action plans; and recovery auditing efforts, including the amounts recovered in the current year. Section 831 of the National Defense Authorization Act for Fiscal Year 2002[8] contains a provision that requires all executive branch agencies entering into contracts with a total value exceeding $500 million in a fiscal year to have cost-effective programs for identifying errors in paying contractors and for recovering amounts erroneously paid. The legislation further states that a required element of such a program is the use of recovery audits and recovery activities. The law authorizes federal agencies to retain recovered funds to cover in-house administrative costs as well as to pay contractors, such as collection agencies. Agencies that are required to undertake recovery audit programs were directed by OMB to provide annual reports on their recovery audit efforts, along with improper payment reporting details[9] in an appendix to their PARs.

The fiscal year 2005 PARs, the second set of reports representing the results of agency assessments of improper payments for all federal programs, were due November 15, 2005. In our December 2005 report[10] on the U.S. government's consolidated financial statements for the fiscal years ended September 30, 2005 and 2004, which includes our associated opinion on internal control, we reported improper payments as a material weakness in internal control. Specifically, we reported that while progress

[8]Pub. L. No. 107-107, § 831, 115 Stat.1012, 1186 (Dec. 28, 2001) (codified at 31 U.S.C. §§ 3561-3567).

[9]In November 2005, OMB issued draft revisions to its IPIA implementing guidance. This implementing guidance together with recovery auditing guidance is to be consolidated into Parts I and II of Appendix C to OMB Circular No. A-123, *Management's Responsibility for Internal Controls* (Dec. 21, 2004).

[10]For GAO's audit report on the U.S. government's consolidated financial statements for fiscal year 2005, see Department of the Treasury, *Financial Report of the United States Government* (Washington, D.C.: December 2005), 135-154, which can be found on GAO's Internet site at www.gao.gov.

had been made to reduce improper payments, significant challenges remain to effectively achieve the goals of IPIA.

Some Agencies Still Have Not Assessed All Programs and Activities for Risk of Improper Payments

We reviewed the fiscal year 2005 PARs or annual reports for 32 of the 35 federal agencies that the Treasury determined to be significant to the U.S. government's consolidated financial statements. Of those 32 agencies, 23 reported that they had completed risk assessments for all programs and activities. See appendix II for detailed information on each agency. This was the same number of agencies that reported having completed risk assessments in our prior year review.[11] The remaining 9 agencies either were silent on IPIA reporting details in their PARs or annual reports or had not yet assessed the risk of improper payments for all their programs.

In addition, we noted that selected agency auditors reviewed agencies' risk assessment methodologies and identified issues of noncompliance or other deficiencies. For example, auditors for the Departments of Justice and Homeland Security cited agency noncompliance with IPIA in their fiscal year 2005 annual audit reports, primarily caused by inadequate risk assessments. The Department of Justice auditor stated that one agency component had not established a program to assess, identify, and track improper payments. The agency acknowledged this noncompliance in its PAR as well. The Department of Homeland Security (DHS) auditor reported that the department did not institute a systematic method of reviewing all programs and identifying those it believed were susceptible to significant erroneous payments. This was the second consecutive year that the auditor reported IPIA noncompliance for DHS. Although the auditors identified the agency's risk assessment methodology as inadequate, DHS reported in its PAR that it had assessed all of its programs for risk. A third agency auditor reported that the Department of Agriculture needed to strengthen its program risk assessment methodology to identify and test critical internal controls over program payments totaling over $100 million.

[11]GAO, *Financial Management: Challenges in Meeting Requirements of the Improper Payments Information Act*, GAO-05-417 (Washington, D.C.: Mar. 31, 2005).

Magnitude of Improper Payments Is Still Unknown

As I highlighted in my introduction, federal agencies' reported estimates of improper payments for fiscal year 2005 exceeded $38 billion. This represents almost a $7 billion, or 16 percent, decrease in the amount of improper payments reported by 17 agencies in fiscal year 2004.[12] On the surface, this appears to be good news. However, the magnitude of the governmentwide improper payment problem remains unknown. This is because, in addition to not assessing all programs, some agencies had not yet prepared estimates of significant improper payments for all programs determined to be at risk. Specifically, of the 32 agency PARs included in our review, 18 agencies reported improper payment estimates totaling in excess of $38 billion for some or all of their high-risk programs. The $38 billion represents estimates for 57 programs. Of the remaining 14 agencies that did not report estimates, 8 said they did not have any programs susceptible to significant improper payments, 5 were silent about whether they had programs susceptible to significant improper payments, and the remaining 1 identified programs susceptible to significant improper payments and said it plans to report an estimate by fiscal year 2007. Further details are included in appendix I.

Regarding the reported $7 billion decrease in the governmentwide improper payment estimate for fiscal year 2005, we determined that this decrease was primarily due to a $9.6 billion reduction in the Department of Health and Human Services's (HHS) Medicare program improper payment estimate, which was partially offset by more programs reporting estimates of improper payments, resulting in a net decrease of $7 billion. Based on our review, HHS's $9.6 billion decrease[13] in its Medicare program improper payment estimate was principally due to its efforts to educate health care providers about its Medicare error rate testing program and the importance of responding to its requests for medical records to perform detailed statistical reviews of Medicare payments. HHS reported that these more intensive efforts had dramatically reduced the number of "no documentation" errors in its medical reviews. The relevance of this significant decrease is that when providers do not submit documentation to

[12]In their fiscal year 2005 PARs, selected agencies updated their fiscal year 2004 improper payment estimates to reflect changes since issuance of their fiscal year 2004 PARs. These updates increased the governmentwide improper payment estimate for fiscal year 2004 from $45 billion to $46 billion.

[13]HHS reported an improper payment estimate for its Medicare program of $12.1 billion for fiscal year 2005 and $21.7 billion for fiscal year 2004.

justify payments, these payments are counted as erroneous for purposes of calculating an annual improper payment estimate for the Medicare program. HHS reported marked reductions in its error rate attributable to (1) nonresponses to requests for medical records and (2) insufficient documentation submitted by the provider. We noted that these improvements partially resulted from HHS extending the time that providers have for responding to documentation requests from 55 days to 90 days.

These changes primarily affected HHS's processes related to its efforts to perform detailed statistical reviews for the purposes of calculating an annual improper payment estimate for the Medicare program. While this may represent a refinement in the program's improper payment estimate, the reported reduction may not reflect improved accountability over program dollars. Our work did not include an overall assessment of HHS's estimating methodology. However, we noted that the changes made for the fiscal year 2005 estimate were not related to improvements in prepayment processes, and we did not find any evidence that HHS had significantly enhanced its preventive controls in the Medicare payment process to prevent future improper payments. Therefore, the federal government's progress in reducing improper payments may be exaggerated because the reported improper payments decrease in the Medicare program accounts for the bulk of the overall reduction in the governmentwide improper payments estimate. Mr. Chairman, I think the only valid observation at this time is that improper payments are a serious problem, agencies are working on this issue at different paces, and the extent of the problem and the level of effort necessary to control these losses is as yet unknown.

What is clear is that there is a lot of work to do in this area. Agency auditors have reported major management challenges related to agencies' improper payment estimating methodologies and highlighted internal control weaknesses that continue to plague programs susceptible to significant improper payments. For example, the Department of Labor's agency auditor reported that inadequate controls existed in the processing of medical bill payments for its Federal Employee Compensation Act program. As a result, medical providers were both overpaid and underpaid. Internal control weaknesses were also identified in the Small Business Administration's (SBA) 7(a) Business Loan program. SBA did not consistently identify instances of noncompliance with its own requirements, resulting in improper payments. In another example, agency auditors for the Department of Education (Education) raised concerns about the methodology Education used to estimate improper payments for

its Federal Student Aid program. The auditors reported that the methodology used did not provide a true reflection of the magnitude of improper payments in the student loan programs. To overcome these major management challenges, agencies will need to aggressively deploy more innovative and sophisticated approaches to correct such deficiencies and identify and reduce improper payments.

Also, I would like to point out that the fiscal year 2005 governmentwide improper payments estimate of $38 billion did not include seven major programs, with outlays totaling over $227 billion for fiscal year 2005. OMB had specifically required these seven programs to report selected improper payment information for several years before IPIA reporting requirements became effective.[14] After passage of IPIA, OMB's implementing guidance required that these programs continue to report improper payment information under IPIA. As shown in table 1, the fiscal year 2005 governmentwide improper payment estimate does not include one of the largest federal programs determined to be susceptible to risk, HHS's Medicaid program, with outlays exceeding $181 billion annually.

[14]Prior to the governmentwide IPIA reporting requirements beginning with fiscal year 2004, former Section 57 of OMB Circular No. A-11, required certain agencies to submit similar information, including estimated improper payment target rates, target rates for future reductions in these payments, the types and causes of these payments, and variances from targets and goals established. In addition, these agencies were to provide a description and assessment of the current methods for measuring the rate of improper payments and the quality of data resulting from these methods.

Table 1: Major Programs That Did Not Report Improper Payment Estimates as Previously Required by OMB and Target Dates for Estimates

Dollars in billions

Agency/program	Fiscal year 2005 outlays	Target date for improper payment estimates: Fiscal year 2007	Fiscal year 2008	Did not report target date
Department of Agriculture—School Programs	$8.2	X		
Department of Health and Human Services—State Children's Insurance Program	5.1	X		
Department of Agriculture—Women, Infants, and Children	4.8		X	
Department of Health and Human Services—Medicaid	181.7		X	
Department of Health and Human Services—Child Care and Development Fund	4.9			X
Department of Health and Human Services—Temporary Assistance for Needy Families	17.4			X
Department of Housing and Urban Development—Community Development Block Grant	5.4			X
Total	**$227.5**	**2**	**2**	**3**

Sources: OMB and cited agencies' fiscal year 2005 PARs

Of these seven programs, four programs reported that they would be able to estimate and report on improper payments sometime within the next 3 fiscal years, but could not do so for fiscal year 2005. For the remaining three programs, the agencies did not estimate improper payment amounts in their fiscal year 2005 PARs and were silent about whether they would report estimates in the future. As a result, improper payments for these programs susceptible to risk will not be known for at least several years, even though these agencies had been required to report this information since 2002, with their fiscal year 2003 budget submissions under previous OMB Circular No. A-11 requirements. OMB reported that some of the agencies were unable to determine the rate or amount of improper payments because of measurement challenges or time and resource constraints, which OMB expects to be resolved in future reporting years. However, in the case of the HHS programs, the agency auditor recognized this lack of reporting as a reportable condition. In its fiscal year 2005 audit report on compliance with laws and regulations, the auditor reported that HHS potentially had not fully complied with IPIA because nationwide improper payment estimates and rates for significant health programs were

under development and the agency did not expect to complete the estimation process until fiscal year 2007.

Another factor which may affect the magnitude of improper payments is Hurricane Katrina, one of the largest natural disasters in our nation's history. In order to respond to the immediate needs of disaster victims and to rebuild the affected areas, government agencies streamlined eligibility verification requirements for delivery of benefits and expedited contracting methods in order to commit contractors to begin work immediately. These expedited processes can increase the potential for improper payments. For example, from our recent review of the Federal Emergency Management Agency's (FEMA) Individuals and Households Program[15] we identified significant flaws in the process for registering disaster victims for assistance payments. We found limited procedures in place designed to prevent, detect, and deter certain types of duplicate and potentially fraudulent disaster registrations. As a result, we determined that thousands of registrants provided incorrect Social Security numbers, dates of birth, and addresses to obtain assistance and found that FEMA made duplicate assistance payments to about 5,000 of the nearly 11,000 debit card recipients.

In one example of expedited contracting, the Department of Transportation (DOT) Office of Inspector General (OIG)[16] determined that DOT had overpaid a contractor by approximately $32 million for services to provide buses for evacuating hurricane victims from the New Orleans area. According to the OIG, the overpayment occurred because DOT had made partial payments based on initial task estimates and without documentation that substantiated the dollar amount of services actually provided to date. Although DOT promptly recovered the funds, the nature of these types of exigencies to adequately respond to the hurricane victims illustrates that future improper payments are likely to occur. As a result, selected agencies, such as DHS and DOT, have said they plan to perform concentrated reviews of payments related to relief efforts to identify the

[15]GAO, *Expedited Assistance for Victims of Hurricanes Katrina and Rita: FEMA's Control Weaknesses Exposed the Government to Significant Fraud and Abuse*, GAO-06-403T (Washington, D.C.: Feb. 13, 2006).

[16]Department of Transportation Office of Inspector General, *Internal Controls Over the Emergency Disaster Relief Transportation Services Contract*, AV-2006-032 (Washington, D.C.: Jan. 20, 2006).

extent of improper payments, develop actions to reduce these types of payments, and enhance internal controls for future relief efforts.

Additional Reporting Requirements for Recovery Auditing Information

Section 831 of the National Defense Authorization Act for Fiscal Year 2002 provides an impetus for applicable agencies to systematically identify and recover contract overpayments. Recovery auditing is another method that agencies can use to recoup detected improper payments. Recovery auditing focuses on the identification of erroneous invoices, discounts offered but not received, improper late penalty payments, incorrect shipping costs, and multiple payments for single invoices. Recovery auditing can be conducted in-house or contracted out to recovery audit firms. The law authorizes federal agencies to retain recovered funds to cover in-house administrative costs as well as to pay contractors, such as collection agencies. Any residual recoveries, net of these program costs, shall be credited back to the original appropriation from which the improper payment was made, subject to restrictions as described in legislation. As we previously reported,[17] with the passage of this law, the Congress has provided agencies a much needed incentive for identifying and reducing their improper payments that slip through agency prepayment controls. The techniques used in recovery auditing offer the opportunity for identifying weaknesses in agency internal controls, which can be modified or upgraded to be more effective in preventing improper payments before they occur.

For fiscal year 2005, OMB clarified the type of recovery auditing information that applicable agencies are to report in their annual PARs. Prior to fiscal year 2005, applicable agencies were only required to report on the amount of recoveries expected, the actions taken to recover them, and the business process changes and internal controls instituted or strengthened to prevent further occurrences. In addition, OMB was not reporting on a governmentwide basis agencies' recovery audit activities in its annual report on agencies' efforts to improve the accuracy and integrity of federal payments.

In fiscal year 2005, OMB revised its recovery auditing reporting requirements and required applicable agencies to provide more detailed information on their recovery auditing activities. Specifically, in addition to

[17]GAO, *Financial Management: Challenges Remain in Addressing the Government's Improper Payments*, GAO-03-750T (Washington, D.C.: May 13, 2003).

the prior year requirements, agencies that entered into contracts with a total value exceeding $500 million annually were required to discuss any contract types excluded from review and justification for doing so. In addition, agencies were required to report, in table format, various amounts related to contracts subject to review and actually reviewed, contract amounts identified for recovery and actually recovered, and prior year amounts. For fiscal year 2005, 19 agencies[18] reported entering into contracts with a total value in excess of the $500 million reporting threshold. These 19 agencies reported reviewing more than $300 billion in contract payments to vendors. From these reviews, agencies reported identifying about $557 million in improper payments for recovery and reported actually recovering about $467 million, as shown in table 2.

Table 2: Improper Payment Amounts Recovered in Fiscal Year 2005

	Department or agency	Amount identified for recovery in fiscal year 2005	Amount recovered in fiscal year 2005
1	Agency for International Development	$5,900,000	$5,782,000
2	Department of Agriculture	333,000	189,000
3	Department of Defense	473,000,000	418,500,000
4	Department of Education	274,367	112,506
5	Department of Energy	10,600,000	9,500,000
6	Department of Health and Human Services	2,100,000	14,430
7	Department of Homeland Security	2,191,000	1,207,000
8	Department of Housing and Urban Development[a]	0	0
9	Department of the Interior	1,548,620	195,479
10	Department of Justice	1,044,320	765,086
11	National Aeronautics and Space Administration	617,442	617,442
12	Department of State	5,350,000	5,190,000

[18]We identified one additional agency—the Department of Commerce—that should have reported recovery auditing amounts in its PAR. OMB was unable to provide further information on this omission prior to the hearing date. We also noted that the Department of Labor did not follow the required reporting format included in OMB's guidance. Labor reported that no improper payments were noted from its recovery auditing activities for fiscal year 2005 and that recovery audit efforts were not necessary.

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	Department or agency	Amount identified for recovery in fiscal year 2005	Amount recovered in fiscal year 2005
13	Department of Transportation	2,663,984	2,663,984
14	Department of the Treasury	428,977	364,680
15	Department of Veterans Affairs	23,001,137	12,957,264
16	Environmental Protection Agency	130,000	130,000
17	General Services Administration	26,638,654	8,317,187
18	Social Security Administration	317,000	50,000
19	Tennessee Valley Authority	909,573	443,763
	Total	**$557,048,074**	**$466,999,821**

Sources: OMB and cited agencies' fiscal year 2005 PARs

[a]For fiscal year 2005, the Department of Housing and Urban Development (HUD) reported that contracts subject to review totaled about $2.3 billion. Of this amount, HUD reported reviewing about $207 million in contract payments, but identified no improper payments for recovery.

Concluding Observations

In closing, I want to say that we recognize that measuring improper payments and designing and implementing actions to reduce them are not simple tasks and will not be easily accomplished. The ultimate success of the governmentwide effort to reduce improper payments depends, in part, on each federal agency's continuing diligence and commitment to meeting the requirements of IPIA and the related OMB guidance. The level of importance each agency, the administration, and the Congress place on the efforts to implement the act will determine its overall effectiveness and the level to which agencies reduce improper payments and ensure that federal funds are used efficiently and for their intended purposes. With budgetary pressures rising across the federal government, and the Congress's and the American public's increasing demands for accountability over taxpayer funds, identifying, reducing, and recovering improper payments become even more critical. Fulfilling the requirements of IPIA will require sustained attention to implementation and oversight to monitor whether desired results are being achieved.

Mr. Chairman, this concludes my statement. I would be pleased to respond to any questions that you or other members of the Subcommittee may have.

Contacts and Acknowledgments

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Federal Agency Improper Payment Estimate Reporting in Fiscal Year 2005

	Department or agency	Agency reported estimate for one or more programs	Agency did not report estimate: Agency reported that no programs were susceptible to significant improper payments	Agency did not report estimate: Agency silent as to whether it had programs susceptible to significant improper payments	Agency reported future date to report estimate
1	Agency for International Development			X	
2	Department of Agriculture	X			
3	Department of Commerce		X		
4	Department of Defense	X			
5	Department of Education	X			
6	Department of Energy	X			
7	Environmental Protection Agency	X			
8	Export-Import Bank of the United States			X	
9	Federal Communications Commission				X
10	General Services Administration		X		
11	Department of Health and Human Services	X			
12	Department of Homeland Security		X		
13	Department of Housing and Urban Development	X			
14	Department of the Interior		X		
15	Department of Justice		X		
16	Department of Labor	X			
17	National Aeronautics and Space Administration		X		
18	National Science Foundation	X			
19	Nuclear Regulatory Commission		X		
20	Office of Personnel Management	X			
21	Pension Benefit Guaranty Corporation			X	
22	Postal Service			X	
23	Railroad Retirement Board	X			
24	Securities and Exchange Commission		X		

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			Agency did not report estimate		
	Department or agency	**Agency reported estimate for one or more programs**	**Agency reported that no programs were susceptible to significant improper payments**	**Agency silent as to whether it had programs susceptible to significant improper payments**	**Agency reported future date to report estimate**
25	Small Business Administration	X			
26	Smithsonian Institution			X	
27	Social Security Administration	X			
28	Department of State	X			
29	Tennessee Valley Authority	X			
30	Department of Transportation	X			
31	Department of the Treasury	X			
32	Department of Veterans Affairs	X			
	Total	**18**	**8**	**5**	**1**

Source: GAO's analysis of cited agencies' fiscal year 2005 PARs.

Appendix II

Improper Payment Estimates Reported in Agency Fiscal Years 2004 and 2005 PARs or Annual Reports

Dollars in millions

	Department or agency		Program or activity	Improper payment estimates reported 2004	Improper payment estimates reported 2005	Previous OMB Circular No. A-11 reporting requirements	Agency reported it had assessed all programs	Programs that the agency reported were not susceptible to significant improper payments
1.	Agency for International Development	1.	All programs and activities	0.0[a]	0.0[a]			
2.	Department of Agriculture		All programs and activities				X	
		2.	Marketing Assistance Loan Program (previously Commodity Loan Programs)	0.0[a]	$45.0	X		
		3.	Food Stamp Program	$1,400.0[b]	1,432.0	X		
		4.	School Programs[c]	0.0	0.0	X		
		5.	Women, Infants, and Children[c]	0.0	0.0	X		
		6.	Child and Adult Care Food Program	0.0[a]	0.0[a]			
		7.	Wildland Fire Suppression Management	0.0[a]	73.0			
		8.	Rental Assistance Program	20.0[b]	27.0			
		9.	Federal Crop Insurance Corporation	125.0	28.0			
		10.	Farm Security and Rural Investment	0.0[a]	16.0			
		11.	Milk Income Loss Contract Program	0.0[a]	0.2			
		12.	Loan Deficiency Payments	0.0[a]	5.0			
3.	Department of Commerce	13.	All programs and activities	0.0	0.0		X	X

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Dollars in millions

	Department or agency		Program or activity	Improper payment estimates reported 2004	Improper payment estimates reported 2005	Previous OMB Circular No. A-11 reporting requirements	Agency reported it had assessed all programs	Programs that the agency reported were not susceptible to significant improper payments
4.	Department of Defense		All programs and activities				X	
		14.	Military Retirement Fund	66.0[b]	49.3	X		X[d]
		15.	Military Health Benefits	99.6[b]	150.0	X		X[d]
		16.	Military Pay	0.0[a]	432.0			
5.	Department of Education		All programs and activities				X	
		17.	Student Financial Assistance—Pell Grants[e]	571.0[b]	617.0	X		
		18.	Student Financial Assistance—Federal Family Education Loan[e]	10.0[b]	16.0			
		19.	Title I	0.0[a]	149.0	X		X[d]
6.	Department of Energy	20.	Payment programs	20.3	14.5		X	X[d]
7.	Environmental Protection Agency	21.	Clean Water State Revolving Funds	10.3	3.1	X		X
		22.	Drinking Water State Revolving Fund	0.0[f]	0.0[f]	X		X
8.	Export-Import Bank of the United States[i]	23.	All programs and activities	0.0	0.0			
9.	Farm Credit System Insurance Corporation[h]	24.	All programs and activities	0.0	0.0			

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Dollars in millions

	Department or agency		Program or activity	Improper payment estimates reported 2004	Improper payment estimates reported 2005	Previous OMB Circular No. A-11 reporting requirements	Agency reported it had assessed all programs	Programs that the agency reported were not susceptible to significant improper payments
10.	Federal Communications Commission		All programs and activities				X	
		25.	Universal Service Fund's Schools and Libraries	0.0[a]	0.0[a]			
		26.	High Cost Support Program	0.0[a]	0.0[a]			
11.	Federal Deposit Insurance Corporation[h]	27.	All programs and activities	0.0	0.0			
12.	General Services Administration	28.	All programs and activities	0.0	0.0		X	X
13.	Department of Health and Human Services		All programs and activities				X	
		29.	Medicaid[c]	0.0	0.0	X		X
		30.	Medicare	21,700.0	12,100.0	X		X
		31.	Head Start	255.0	110.0	X		X[d]
		32.	Temporary Assistance for Needy Families[c]	0.0	0.0	X		X
		33.	Foster Care—Title IV-E	186.0[b]	182.0	X		X
		34.	State Children's Insurance Program[c]	0.0	0.0	X		X
		35.	Child Care and Development Fund[c]	0.0	0.0	X		X
14.	Department of Homeland Security	36.	All programs and activities	0.0	0.0		X	X

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Dollars in millions

	Department or agency		Program or activity	Improper payment estimates reported 2004	Improper payment estimates reported 2005	Previous OMB Circular No. A-11 reporting requirements	Agency reported it had assessed all programs	Programs that the agency reported were not susceptible to significant improper payments
15.	Department of Housing and Urban Development		All programs and activities				X	
		37.	Low Income Public Housing	356.0	326.0[g]	X		
		38.	Section 8 Tenant Based	840.0	551.0[g]	X		
		39.	Section 8 Project Based	511.0	324.0[g]	X		
		40.	Community Development Block Grant (Entitlement Grants, States/Small Cities)[c]	0.0	0.0	X		X
		41.	Federal Housing Administration's Single Family Acquired Asset Management System	26.1	2.2			X
		42.	Public Housing Capital Fund	0.0[a]	133.5			
16.	Department of the Interior	43.	All programs and activities	0.0	0.0		X	X
17.	Department of Justice	44.	All programs and activities	0.0	0.0			X
18.	Department of Labor		All programs and activities				X	
		45.	Unemployment Insurance	3,861.0	3,267.0	X		
		46.	Federal Employees' Compensation Act	6.4	3.3	X		X
		47.	Workforce Investment Act	0.0[a]	7.9	X		X

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Dollars in millions

	Department or agency		Program or activity	Improper payment estimates reported 2004	Improper payment estimates reported 2005	Previous OMB Circular No. A-11 reporting requirements	Agency reported it had assessed all programs	Programs that the agency reported were not susceptible to significant improper payments
19.	National Aeronautics and Space Administration	48.	All programs and activities	0.0	0.0		X	X
20.	National Credit Union Administration[h]	49.	All programs and activities	0.0	0.0			
21.	National Science Foundation	50.	Research and Education Grants and Cooperative Agreements	4.4	1.1	X	X	X
22.	Nuclear Regulatory Commission	51.	All programs and activities	0.0	0.0		X	X
23.	Office of Personnel Management		All programs and activities				X	
		52.	Retirement Program (Civil Service Retirement System and Federal Employees Retirement System)	197.7	152.2	X		X
		53.	Federal Employees Health Benefits Program	86.1	196.5	X		X
		54.	Federal Employees Group Life Insurance	2.1	2.0	X		X
24.	Pension Benefit Guaranty Corporation[i]	55.	All programs and activities	0.0	0.0			
25.	Postal Service[i]	56.	All programs and activities	0.0	0.0			
26.	Railroad Retirement Board		All programs and activities				X	
		57.	Retirement and Survivors Benefits	147.9[b]	150.6	X		X[d]

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Dollars in millions

	Department or agency		Program or activity	Improper payment estimates reported 2004	Improper payment estimates reported 2005	Previous OMB Circular No. A-11 reporting requirements	Agency reported it had assessed all programs	Programs that the agency reported were not susceptible to significant improper payments
		58.	Railroad Unemployment Insurance Benefits	2.6[b]	2.3	X		X
27.	Securities and Exchange Commission	59.	All programs and activities	0.0	0.0			X
28.	Small Business Administration		All programs and activities				X	
		60.	7(a) Business Loan Program	0.0[a]	31.4	X		
		61.	504 Certified Development Companies	0.0	0.0	X		X
		62.	Disaster Assistance	1.1	1.6	X		X
		63.	Small Business Investment Companies	129.0	10.5	X		X[d]
29.	Smithsonian Institution[c]	64.	All programs and activities	0.0	0.0			
30.	Social Security Administration		All programs and activities				X	
		65.	Old Age and Survivors' Insurance	1,707.0	3,681.0	X		X[d]
		66.	Disability Insurance	0.0[f]	0.0[f]	X		
		67.	Supplemental Security Income Program	2,639.0	2,910.0	X		
31.	Department of State		All programs and activities				X	
		68.	International Narcotic and Law Enforcement Affairs-Narcotics Program	1.7	0.6			

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Dollars in millions

Department or agency		Program or activity	Improper payment estimates reported 2004	Improper payment estimates reported 2005	Previous OMB Circular No. A-11 reporting requirements	Agency reported it had assessed all programs	Programs that the agency reported were not susceptible to significant improper payments
	69.	International Information Program-U.S. Speaker and Specialist Program	1.4	1.9			
	70.	Vendor payments	0.8	0.4			X
	71.	Structures and Equipment	0.3[b]	0.2			X
32. Tennessee Valley Authority	72.	Payment programs	8.1	36.3			
33. Department of Transportation		All programs and activities				X	
	73.	Airport Improvement Program	0.0[j]	0.0[j]	X		X
	74.	Highway Planning and Construction	0.0[j]	0.0[j]	X		X
	75.	Federal Transit—Capital Investment Grants	0.0[j]	0.0[j]	X		X
	76.	Federal Transit—Formula Grants	0.0[j]	0.0[j]	X		X
34. Department of the Treasury		All programs and activities				X	
	77.	Earned Income Tax Credit	10,300.0[b]	10,500.0	X		
35. Department of Veterans Affairs		All programs and activities				X	
	78.	Compensation	302.4[b]	322.9	X		
	79.	Dependency and Indemnity Compensation	0.0[f]	0.0[f]	X		
	80.	Education programs	70.0[b]	64.0			
	81.	Pension	280.7[b]	261.0	X		

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Dollars in millions

Department or agency		Program or activity	Improper payment estimates reported 2004	Improper payment estimates reported 2005	Previous OMB Circular No. A-11 reporting requirements	Agency reported it had assessed all programs	Programs that the agency reported were not susceptible to significant improper payments
	82.	Insurance programs	0.3[b]	0.3	X		X
	83.	Loan Guaranty	6 3	4.2			
	84.	Vocational Rehabilitation	9.5	9.8			
Total			**$45,962.1**	**$38,404.8**	**46**	**23**	**42**

Source GAO's analysis of cited agencies' fiscal year 2005 performance and accountability reports (PAR) or annual reports

[a]Agency did not report an annual improper payment estimate.

[b]Fiscal year 2004 estimates were updated to the revised estimates reported in the fiscal year 2005 PARs.

[c]See table 1 of this testimony.

[d]The agency reported that this program was not high risk, meaning not susceptible to significant improper payments because it did not meet the Office of Management and Budget (OMB) reporting threshold of exceeding both $10 million and 2 5 percent of program payments.

[e]Student Financial Assistance—Pell Grants and Federal Family Education Loan are combined together as Student Financial Assistance in OMB Circular No. A-11, Section 57.

[f]Agency combined with the above program.

[g]An additional $266 million of improper payments exist for these three programs. In its PAR, HUD did not provide a breakout of this amount among the three programs.

[h]Agency fiscal year 2005 PAR or annual report information not available as of the end of our fieldwork.

[i]Agency did not address improper payments or the Improper Payments Information Act (IPIA) requirements for this program in its fiscal year 2005 PAR or annual report.

[j]Agency reported that the annual improper payment amount was zero.

Related GAO Products

Financial Management: Challenges in Meeting Governmentwide Improper Payment Requirements. GAO-05-907T. Washington, D.C.: July 20, 2005.

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WRITTEN TESTIMONY OF THE COMMISSIONER OF INTERNAL REVENUE SERVICE MARK EVERSON BEFORE SENATE HOMELAND SECURITY AND GOVERNMENTAL AFFAIRS COMMITTEE SUBCOMMITTEE ON FEDERAL FINANCIAL MANAGEMENT, GOVERNMENTAL INFORMATION AND INTERNATIONAL SECURITY ON REPORTING IMPROPER PAYMENTS: A REPORT CARD ON AGENCIES' PROGRESS

MARCH 9, 2006

Good afternoon, Chairman Coburn, ranking member Carper and members of the Subcommittee. I am pleased to be with you again this afternoon to discuss IRS's compliance with the Improper Payments Information Act (IPIA) of 2002.

Before turning to today's subject, I would like to briefly update you on the subject of your hearing last October --- the tax gap.

You will remember that when I appeared before this Subcommittee last October to discuss the tax gap, we were in the process of updating our preliminary estimates for the extent of the gap. As you know, the tax gap is the difference between the amount of tax imposed on taxpayers for a given year and the amount that is paid voluntarily and timely. The tax gap represents, in dollar terms, the annual amount of noncompliance with our tax laws. Based on our updated numbers from the National Research Program's (NRP) analysis of Tax Year (TY) 2001 returns, our best estimate of the gross tax gap is $345 billion. The net tax gap, after enforcement and the collection of late payments, is $290 billion.

One of the advantages derived from the NRP study, other than to get a reliable estimate of the tax gap, is the opportunity to update our method of determining which returns merit further examination and to avoid examining compliant taxpayers. Using the recent NRP study data, we have developed new formulas for several examination classes. IRS implemented these new formulas in January 2006 to evaluate TY 2005 returns. We will begin examining returns selected using these new formulas in October 2006. We believe using the new formulas will allow us to improve productivity and reduce taxpayer burden by reducing significantly the number of examinations resulting in little or no change to the taxpayer's tax liability.

One of the best ways to reduce the tax gap is to fully fund the President's FY 2007 proposed budget for the IRS. This committee has long been a supporter of our budget

and we appreciate the fact that last year we received full funding. This has allowed us to pursue several new enforcement initiatives. The FY 2007 budget, if fully funded, will allow us to continue the progress on those enforcement priorities while maintaining our strong focus on service. In 2006, Congress provided a significant enforcement increase through a program integrity cap adjustment to continue these enforcement improvements. The 2007 Budget again proposes a cap adjustment to maintain this increase.

The President's proposed FY 2007 Budget also requested enactment of five legislative initiatives that will assist us further in reducing the tax gap. These include:

- Information reporting on payment card transactions. We know that compliance is significantly higher when information is reported to the IRS. Currently, more than 150 million wage earners have their wage information reported to the IRS by their employers.

- Clarification of the circumstances in which employee leasing companies and their clients can be held jointly liable for Federal employment taxes;

- Amended Collection Due Process procedures for employment tax liabilities;

- Expanded information reporting on certain payments made by federal, state, and local governments to procure property and services;

- Expansion to non-income tax returns the requirement that paid return preparers identify themselves on such returns and expansion of the related penalty provisions as well.

These changes strategically target areas where (1) research reveals the existence of significant compliance problems, (2) improvements will burden taxpayers as little as possible, and (3) the changes support the Administration's broader focus on identifying legislative and administrative changes to reduce the tax gap.

The IPIA and the IRS

The IPIA requires agencies annually to review their programs and activities to identify those that are susceptible to significant erroneous payments. "Significant" means that an estimated error rate and a dollar amount exceed the threshold of 2.5 percent and $10 million. Once high-risk programs are identified, a method for systematically reviewing them must be developed and statistically valid samples must be conducted to determine annual error rates. If those error rates, when applied to all program funding, result in a level of improper payments that meet the significant criteria, a Corrective Action Plan must be developed to resolve the underlying causes and reduce the improper payments.

Some Federal programs are so complex that developing an annual error rate is not feasible. The government-wide Chief Financial Officers Council developed an alternative for such programs to assist them in meeting the IPIA requirements. Agencies may establish an annual estimate for a high-risk component of a complex program with Office of Management and Budget (OMB) approval. Agencies must also perform trend analyses to update the program's baseline error in the interim years between detailed program studies. When development of a statistically valid error rate is possible, the reduction targets are revised and become the basis for future trend analyses.

The risk assessments performed across all Treasury programs in FY 2005 resulted in all programs and activities being rated as having low or medium risk susceptibility to improper payments except one, the Earned Income Tax Credit (EITC).

The Earned Income Tax Credit

The EITC is one of the government's most successful anti-poverty programs. In 2003, 4.3 million people were lifted above the poverty line because of the EITC In FY 2005, 22 million taxpayers received nearly $40 billion in payments through the EITC.

Taxpayers eligible for the EITC receive a refundable federal tax credit that offsets taxes owed through the income tax system. If the credit exceeds the amount of taxes owed, a lump sum payment is provided to those who qualify.

When I became the Commissioner of the IRS in 2003, one of my priorities was to develop a program strategy for the EITC around a very simple philosophy that everyone who qualifies for the EITC should receive it, but only those who qualify.

That simple philosophy led us to a five point plan around which the EITC program is currently organized. The essential tenets of that plan are as follows:

1. Reduce the backlog of pending EITC examinations to ensure that eligible taxpayers whose returns are being examined receive their refunds quickly.

2. Minimize burden and enhance the quality of communications with taxpayers by improving the existing audit process.

3. Encourage eligible taxpayers to claim the EITC by increasing outreach efforts and making requirements for claiming the credit easier to understand.

4. Ensure fairness by refocusing compliance efforts on taxpayers who claimed the credit but were ineligible because their incomes were too high.

5. Pilot a certification effort to substantiate qualifying child residency eligibility for claimants whose returns are associated with a high risk of error.

I am pleased to report that we have made significant progress in each of these areas in the last three years. Since 2003, our backlog of cases has fallen 77 percent. Audit cycle times from 2003 until the end of 2005 declined from 206 days to 180 days.

Our outreach efforts also appear to be succeeding. In the 2005 filing season, over 7.7 million people reviewed our EITC pages on IRS.gov, nearly a million used the EITC Assistant, approximately 75,000 professionals accessed our electronic toolkits, 220,000 information emails went to paid tax preparers, and we provided answers to more than160,000 EITC questions from our call site to illustrate a few of our methods.

We have been able to refocus our compliance efforts on those most likely to be in non-compliance by utilizing some new methodologies under the automated under-reporter program. We completed our initial test of certification which showed that it does reduce erroneous EITC payments and claims, but it also deters some eligible taxpayers from claiming the credit. We have launched subsequent tests to refine our selection methodology and to evaluate the effect of a certification requirement on the institutions that provide assistance to these taxpayers.

We have a robust research program. We take the data from that research, analyze it, and based on that analysis, we make decisions. The certification program is a good example. We have reached no conclusion on whether to implement it, and we'll rely on the data and analysis to determine how to proceed.

On our web site, IRS.gov, taxpayers can now go to the *EITC Assistant* to determine if they may qualify for the EITC and, if they do, to determine estimate the amount of their refund. This year, we significantly revised this feature to reflect changes in the law as a result of Hurricane Katrina. This *EITC Assistant* is available in both English and Spanish.

Some have suggested that the *EITC Assistant* might not be that useful since many of those eligible may lack access to a computer. Even if they do not have a computer in their homes, they may have access through other means, such as public libraries. Nearly three-quarters of all EITC returns are done by paid preparers and the *EITC Assistant* can help them better assist taxpayers. In TY 2005 we had nearly 1 million hits on this feature of our web site.

A key service offered by the IRS to assist EITC claimants in the preparation of their returns are the Volunteer Income Tax Assistance (VITA) and Tax Counseling for the Elderly (TCE) centers. These sites are not limited to EITC claimants, but serve low-income and elderly taxpayers, who are often eligible for the EITC. In the 2005 filing season, these centers processed over 2.1 million returns and we anticipate that this number will grow again this year.

I have visited two VITA sites in recent weeks. The first was in Harlem. Mayor Bloomberg and I toured the FoodChange Food and Finance Center, the largest VITA site in the country. Despite the high volume of returns processed, it has one of the lowest

processing error rates of any such site. I have also visited the Employment and Family Services Southgate VITA site in Cleveland. I can't begin to tell you how impressed I was with the competence, professionalism, and dedication of all the volunteers who staff these sites.

These sites serve several important purposes. First and foremost, they allow low income taxpayers to have their income taxes done reliably, at no cost. Second, they often allow taxpayers to have their returns filed electronically, meaning that the taxpayers will get their refunds in two weeks or less. This should reduce the demand for refund anticipation loans (RALs). These RALs are used by banks, tax preparation companies and others to give the taxpayer his or her refund immediately. However, the cost of the RALs are significant and as a result they have become a scourge, preying on those people least able to afford turning over a healthy portion of their EITC refund just to get their money a few days sooner. Third, the sites help educate the taxpayers about their eligibility for not only EITC, but other tax credits as well.

Reducing EITC Improper Payments

As much success as we have had in meeting our objective of having every taxpayer who is eligible, applies for the EITC, there remains a significant problem with erroneous payments under the program. Our latest estimates for TY 2005 are that $9.6-11.4 billion (23-28 percent) is paid out erroneously.

The primary source for this estimate of erroneous payments is the NRP study results for the EITC claimant subset of NRP returns (approximately 6,400 of about 44,000 total returns analyzed). Other data and information sources used for the estimates included IRS Enforcement Revenue Information System data, Treasury Department estimates of the effect of the EITC provisions in the Economic Growth and Tax Relief Reconciliation Act of 2001 on EITC erroneous claims, and FY 2006 budget estimates.

The IRS has in place a robust, balanced, and comprehensive plan to help reduce improper payments. First, we wanted to make the base program better by increasing program efficiency within existing resources. Second, we wanted to test potential business process enhancements to reduce error.

Base Program

In 2005, the IRS spent approximately $165 million on EITC activities, the bulk of which was used in three key areas:

- *Examinations* --- We identify and examine selected tax returns;
- *Math Error* --- This refers to an automated process in which IRS identifies math or other statistical irregularities and automatically prepares an adjusted return; and
- *Document Matching* --- This involves comparing income information provided by the taxpayer with document matching information (e.g. W-2s, 1099s) from employers to identify discrepancies.

Collectively, these three enforcement initiatives prevented nearly $2 billion from being paid out erroneously. The bulk of that was saved through examinations ($1.34 billion). Math error corrections saved $330 million. Under both examinations and math error, the IRS identifies the mistake before the refund check is mailed. The taxpayer is sent a letter notifying him or her of the correction and provided an opportunity to offer evidence to support the original claim. With document matching, the check is sent and any overpayment is recaptured generally against future claims.

We estimate that these EITC enforcement efforts have directly protected an estimated $6.52 billion in revenue from FY 2002 through FY 2005. In addition, we project that continued enforcement efforts will protect a total of $12.21 billion in revenue through FY 2008.

Business Process Enhancements

In 2003 and 2004, we received a total of $75 million to fund a number of EITC business process improvement initiatives. The initiatives included the use of private sector solutions to better identify egregious cases, apply appropriate collection methods, assign and manage case inventory more efficiently, catch problems with amended returns, improve communications with taxpayers, better focus on under-reported income, and explore use of new notices to improve taxpayer response.

We used several private sector solutions to implement these initiatives and improve error detection and prevention. I have talked about the *EITC Assistant* as one means of prevention. We also have *EITC CERT*, a web and phone self-service application that allows participants in the qualifying child certification test to determine the status of the documentation they have provided to establish eligibility.

For error detection, we have a risk-based scoring system that helps the IRS work high-risk cases more effectively by scoring potential errors and determining the best treatment based on the characteristics of the claim.

We have also completed the first test of an initiative to address egregious EITC return preparers. We have opened discussions with several states having an interest in sharing information to prevent erroneous payments and we are evaluating potential new ways to share data to improve our revenue protection activities. These include a review of external databases that could help identify taxpayers who are not eligible for the EITC as well as developing possible new candidates for math error authority.

In addition, we have initiated a longitudinal study to determine the characteristics of EITC claimants and EITC filing trends/patterns over time. This study will enable us to make data driven decisions on how to better target areas of non-compliance. The IRS has also begun the final phase of testing of certification as a means of reducing EITC errors.

This year, we are launching the second phase of the EITC return preparer strategy. We will incorporate new selection tools to determine more effective compliance treatments for return preparers. We also plan to test new solutions to reduce duplicate claims of qualifying children in 2007.

Challenges with the EITC Program

A number of factors serve as barriers to reducing erroneous claims in the EITC program. These include:

- The complexity of the tax law;
- The structure of the earned income credit;
- Confusion among eligible claimants;
- High program turnover;
- Unscrupulous preparers; and
- Fraud

No one of these factors can be considered the primary driver of program error. Furthermore, the interaction among the factors makes addressing the credit's erroneous claims rate problematic.

Under the IPIA requirements, the EITC program must establish annual targets for error reduction and develop action plans to achieve these targets. While this approach works conceptually, there are several concerns and issues that should be taken into consideration.

First, the EITC program expenditures are such a small fraction of program benefits and program error that a very large increase in expenditures would be needed to make a noticeable change in the EITC error rate using current strategies. Current administration costs are less than 1 percent of the benefits delivered. These costs appear quite low compared to other non-tax benefit programs, in which administrative costs can run as high as 20 percent of program expenditures.

Second, new error reduction strategies require multiple years to take effect and, therefore, will not be reflected in annual estimates.

Third, current improper EITC estimating technologies are too imprecise to capture the effects of annual program changes in EITC. Due to this lack of precision and because the incremental improvements the IRS is able to achieve with its current approach are relatively small, any reduction in the EITC error rate is unlikely to be significant or measurable.

As a result, we expect audit rates for the EITC to flatten out in terms of actual numbers and to decline as a percentage of our overall audits. We believe we are devoting an appropriate amount of resources to the EITC program.

Possible Legislative Changes

There are two legislative proposals contained in the President's FY 2007 budget that will serve to simplify eligibility criteria, improve enforcement for the EITC, and allow us to access important information from other Federal agencies.

- *Simplify EITC Eligibility Requirements:* To qualify for the EITC, taxpayers must satisfy requirements regarding filing status, the presence of children within their households, and their work and immigration status in the United States. These rules are confusing, require significant record keeping, and are costly to administer. The President's FY 2007 budget proposes to make certain changes simplifying these rules.

- *Reduce Computational Complexity of Refundable Child Tax Credit:* Taxpayers with earned income in excess of $11,300 may qualify for a refundable (or "additional") child tax credit even if they do not have any income tax liability. About 70 percent of additional child tax credit claimants also claim the EITC. However, the two credits have a different definition of earned income and different U.S. residency requirements. In addition, some taxpayers have to perform multiple computations to determine the amount of their additional child tax credit. The President's budget proposal proposes certain changes to the additional child tax credit rules to address these issues.

Questionable Refund Program

In its annual report to Congress, the Taxpayer Advocate Service (TAS) called the IRS to task for its Questionable Refund Program (QRP). The QRP is a program administered out of our Criminal Investigation (CI) division. CI places a freeze on refund claims each year that it believes may contain indicia of fraud. Many of these returns involve claims for the EITC.

Shortly after the TAS report was issued, I requested a review of the program and pledged to send notices to taxpayers if their refunds were frozen. As a result of that review, we are implementing new procedures for this filing season, in partnership with the National Taxpayer Advocate, to notify taxpayers that we are freezing their refunds at the time we initiate the freeze. We will also automatically release refunds after an established time period if CI has not determined a particular return requires additional verification, and will minimize automatic freezes on taxpayers' accounts in future years.

In addition, we will refine our identification and selection criteria and review refunds frozen from 2004 and prior tax years. Determining the proper disposition of these cases will require additional time and resources. We will either process the refund or notify the taxpayer to give him or her opportunity to substantiate the claim. We hope to have these completed by the end of the year.

Conclusions

In summary, Mr. Chairman, I would like to emphasize the following points:

- The EITC is one of the largest Federal anti-poverty programs paying out $40 billion to 22 million taxpayers;
- We have a balanced approach to the EITC. We want everyone who qualifies to receive the credit, but only those who qualify.
- We plan to continue the growth of the VITA and TCE sites so low income families can have their returns done accurately, at no cost, and without the need for refund anticipation loans.
- Adoption of the President's FY 2007 proposed budget, including adoption of proposed legislative changes, remains the most important step that Congress can take to improve the EITC program.

Thank you and I will be happy to respond to any questions that you may have.

Statement of James B. Lockhart
The Deputy Commissioner of Social Security

Testimony before the Senate Committee on
Homeland Security and Governmental Affairs

Subcommittee on Federal Financial Management,
Government Information, and International Security
March 9, 2006

Mr. Chairman and Members of the Subcommittee:

Thank you for inviting me here today to discuss the efforts the Social Security Administration (SSA) is undertaking to strengthen and maintain the integrity of the Old-Age, Survivors and Disability Insurance (Social Security) and Supplemental Security Income (SSI) programs, and to prevent, detect, and collect improper payments. This issue is crucially important to the Social Security Administration and is essential to insure public confidence in our programs. To that end, I will today describe the scope and magnitude of our Agency's activities.

Administration of Our Programs

SSA's programs promote the nation's economic security by administering America's major income support programs for the elderly, disabled, and their dependents and survivors through the Old-Age and Survivors Insurance (OASI) program, the Disability Insurance (DI) program, and the SSI program. These programs touch the lives of over 95 percent of the American public and improve the economic well being of the nation.

The combined Social Security programs provide a comprehensive package of protection against loss of earnings due to retirement, disability, and death. Cash benefits are financed through payroll taxes paid by workers, their employers, and self employed individuals. SSI, on the other hand, is a needs-based program

funded by general revenues designed to provide assistance to disabled and aged individuals with limited income and resources.

In 2005, SSA paid over $520 billion to over 48 million individuals in Social Security benefits, and over $38 billion to over 7 million individuals in SSI payments. Our beneficiary rolls continue to grow. Over the 10-year period beginning October 1996 through the end of September 2005, the number of OASI beneficiaries has increased by 6 percent, DI beneficiaries by 37 percent, and SSI recipients by 10 percent.

As you can see, SSA pays out a large amount of money to a growing beneficiary population. We are proud of the work we do to maintain and improve our high level of payment accuracy. In FY 2004, our combined Social Security/SSI payment accuracy was 99.1 percent with respect to overpayments, and 99.7 percent with respect to underpayments. Even with this high level of performance, we believe we can do better. We are committed to improving our payment accuracy and reducing the volume and magnitude of improper payments we make.

SSA has a well-deserved reputation for providing sound, excellent financial management. We take our reputation, and the stewardship responsibility that comes with it, very seriously. We have made improving the financial integrity and management of all the programs we administer one of our top priorities.

SSA's Stewardship Responsibility

The Social Security Administration faces great challenges: giving the American people the service they expect and deserve, particularly as the number of beneficiaries increases each year with the aging of the baby boomers; improving program integrity through sound fiscal stewardship; ensuring the program's solvency for future generations and maintaining the high quality staff the Social Security Administration needs to meet these challenges. The Agency's strategic goals -- Service, Stewardship, Solvency and Staff -- directly address these challenges. To achieve these goals, we established nine strategic objectives.

One of our strategic objectives is to detect and "Prevent fraudulent and improper payments and improve debt management." To support this objective, we established individual performance measures aimed at preventing and detecting improper payments and collecting debt efficiently. This goal aligns directly with the President's Management Agenda (PMA) program initiative to eliminate improper payments. We work closely with OMB on this initiative.

We also work closely with our Inspector General to detect, prevent, and resolve improper payments. For example, the Cooperative Disability Investigations (CDI) program is a joint effort among Federal and state agencies to effectively pool resources to prevent fraud in SSA's Social Security and SSI disability programs and related Federal and state programs. SSA's Office of Operations, Office of Disability Programs, and the OIG manage the CDI Program. In the field, CDI Units are typically comprised of one OIG Special Agent, two Investigators on detail from state or local law enforcement agencies, and two experienced SSA and/or DDS employees.

The mission of the CDI program is to obtain evidence of material fact sufficient to resolve questions of fraud in SSA's Social Security and SSI disability programs. Last year CDI units saved $123 million related to overpayments caused by fraud.

Definition of Improper Payments

The Improper Payments Information Act of 2002 (IPIA) and OMB implementation guidance define programs whose estimated improper over and underpayments exceed 2.5 percent of program outlays and $10 million as susceptible to improper payments. SSI has been identified as such a program, and, while improper payments in our retirement, survivors, and disability, programs are well below that threshold, we are part of the "Eliminating Improper Payments" program initiative and are committed to eliminating improper payments in all our programs.

In measuring payment accuracy SSA considers as proper those payments it is required to make under statute or court order, even though some of those payments may later be determined to be overpayments. Both OMB and GAO have affirmed this to be a correct interpretation of IPIA. However, OMB and SSA have agreed that once it is known that these payments are determined to be overpayments and thereby subject to recovery, SSA initiates collection efforts immediately to increase the chances that they will be recaptured. All overpayments, whether improper payments or the result of a statute or court order, are pursued aggressively using all recovery tools available to SSA.

An example of this type of payment occurs when an individual is determined to no longer be disabled, but files an appeal of SSA's decision. Under section 223 (g) of the Social Security Act and pursuant to the 1970 U.S. Supreme Court decision in *Goldberg v. Kelly*, while the appeal is being adjudicated SSA is required to continue to pay disability benefits to the individual if requested to do so. This requirement was extended to SSI payments by the U.S. District Court order in *Cardinale v. Matthews* in August 1975. If the appeal decision upholds the Agency's determination, the individual is considered overpaid as of the date of the original decision. While this results in an overpayment that must be resolved, the payments issued are not considered improper since they were required. It is important to note that, while these payments are not defined as improper, SSA makes every effort to collect the resulting overpayment.

Management Plans Addressing Improper Payments

We have plans in place to reduce improper payments and are implementing them. Our Social Security improper payment rate is extremely low -- one-half of a percent with respect to overpayments and two-tenths of a percent with respect to underpayments in FY 2004. Despite these low percentages, we are committed to taking the steps needed to lower them further because in a program the size of Social Security, each one-half of a percent increase in payment accuracy equates to $2.6 billion of error prevented.

As of the first quarter in FY 2005, OMB implemented a President's Management Agenda program initiative on Eliminating Improper Payments. Prior to this time, activities in this area were highlighted in the Financial Performance PMA Initiative. We report to OMB every quarter on our accomplishments for the prior three months as well as actions we plan for the next quarter. OMB reviews the quarterly report, and rates the agency both on progress and status using a scorecard with the possible grades of green, yellow, and red. In its most recent scorecard report, OMB scored this initiative as a "green" in progress and a "yellow" in status. We are pleased with this score, but plan to implement additional improper payment safeguards to reach our goal of green in both status and progress.

GAO designated SSI as a high-risk program in 1997. Shortly after Commissioner Barnhart and I came to SSA, we released the SSI Corrective Action Plan in June 2002. This plan outlined a multi-faceted approach to improved stewardship through increased overpayment detection and prevention, improved debt collection, new measurement strategies, potential changes in SSI policies, and Agency accountability. GAO recognized SSA's progress in improving the management of the SSI program by removing it from the high-risk list in January 2003. In FY 2004, our error rates were 6.4 percent with respect to overpayments and 1.3 percent with respect to underpayments. We are pleased with our progress and continue to improve our management of the SSI program. The SSI Corrective Action Plan is updated monthly, and I meet with the SSA accountable executives each month.

As you can see from the attached charts, SSA has been able to keep its error rates at low levels over the last several years. For Social Security benefits, the error rate for both over and underpayments have been less than 1 percent in every year during this period. The SSI program is more error-prone. Over the same period the overpayment error rate ranged from a low of 5.3 percent in 2000 to a high of 6.7 percent in 2001. For the same period, the SSI underpayment error rate has been consistently below 2 percent. The combined rate for all programs, for both over and underpayments,

has been under 1 percent each year. But we can and must do better, especially in the very complex SSI program.

Challenges in Eliminating Improper Payments

The complexity of the programs we administer presents unique challenges in our ability to control improper payments. The risk of improper payments increases in programs with a significant volume of transactions or complex criteria for computing payment. For example, application of provisions relating to the effect of workers' compensation payments on DI benefits varies based on differences in state laws. In addition, we are sometimes unable to get timely information on the amount and payment of workers' compensation from the beneficiaries and payers.

Another error-prone area involves substantial gainful activity (SGA), which is the determination as to whether a DI beneficiary's work activity indicates he/she is no longer eligible for benefits. One issue in this area is the accuracy and timeliness of work reports. Another is the complex nature of the determination, which involves consideration and development of work related income exclusions, subsidy, application of trial work period months, and extended periods of eligibility.

The rules for determining initial and continuing eligibility for SSI are even more complex. Our ability to get timely, accurate information to support payment determinations, especially where wages are concerned, sometimes adversely impacts our ability to effectuate accurate, timely benefits. While we continue to pursue data matches and other initiatives to get the information we need, we must still rely heavily on reports from recipients or their payees to get information timely.

Computing an SSI payment involves developing complex issues such as living arrangements, in-kind support and maintenance, cash income, and ownership and valuation of resources. Resource limits, which exclude a house and one car, are $2000 for individuals and $3000 for couples.

Some types of income are subject to specific exclusions. Others, such as some child support payments, do not count dollar for dollar. In addition, many individuals who are eligible for both Social Security and SSI are subject to a complex adjustment of their retroactive payment.

We build accuracy controls into every payment decision we make. Further, SSA has a number of very cost effective processes to prevent and detect improper payments. Prominent among these are continuing disability reviews (CDRs) for assuring ongoing entitlement to disability benefits, and redeterminations of eligibility for SSI recipients to assure that payments reflect any changes in circumstances that affect eligibility. The administrative cost of those types of workloads is more than offset by the savings that result -- by a factor of about eight program dollars saved for every one administrative dollar spent. We use sophisticated profiling techniques to select cases for those reviews and to maximize the resulting savings.

This year the Congress did not fully fund the President's administrative funding request and it is important to acknowledge that budget limitations will impact our ability to pursue as many of those cases as we know would be productive. In his FY '07 the President is asking for special funding and a discretionary cap adjustment to assure that the resources will be available to conduct CDRs.

What We Are Doing

SSA has made great strides in preventing improper payments by obtaining beneficiary information from independent sources sooner and by using technology more effectively. For example, SSA has data matches with a number of Federal and state agencies. These include matches with the Internal Revenue Service, Department of Labor, Office of Personnel Management, and the Department of Veterans Affairs. With the states, we also have developed and are using Electronic Death Registration information to prevent improper payments after an individual's death.

We are in the process of developing automated capabilities that will further prevent, identify, and correct computation errors. For example, we recently entered into an agreement with the Office of Child Support Enforcement (OCSE) to access the database of new hires to detect work activity of DI beneficiaries. We have implemented a system known as eWork, which allows field office staff to record work reports and issue receipts for reported work, and allows managers to track and prioritize our nonmedical CDR workload. We are improving the accuracy of earnings records by encouraging employers to file wage reports electronically. Last year, 66 percent of W-2s were filed electronically, up from less than 10 percent in 1999.

One of our most effective tools to prevent DI overpayments is the Pre-Effectuation Review (PER) of samples of favorable DI awards. During FY 2004, we reviewed over 330,000 cases. An estimated $13 was saved for every $1 spent on these reviews.

We are also involved in initiatives specific to controlling SSI improper payments. For example, we are testing an automated telephone process for SSI recipients and their payees to report monthly wages. We are also conducting a test in Kansas City that utilizes a centralized unit to process mailed-in wage reports. During the interview process we use online queries during interviews to access the OCSE online wage and new hire files to help avoid and detect SSI wage overpayments. In addition, we are exploring the usefulness of matching all receipents against the new hires file to learn quickly about unreported work.

To address improper payments caused by unreported financial accounts held by SSI beneficiaries, we initiated a study in our New York region to gather information electronically about account balances directly from financial institutions and ascertain the characteristics of cases that are likely to have unreported resources. We plan to expand this successful pilot.

The redetermination process is one of our most powerful tools for preventing and detecting SSI overpayments. In this process, we review cases to ensure that nondisability factors of eligibility continue to be met and payment amounts are correct. In FY 2004, this process enabled SSA to collect or prevent $2.4 billion in overpayments and $1.3 billion in underpayments.

To support our strategic objective to "Prevent fraudulent and improper payments and improve debt management", SSA established performance goals for processing redeterminations, processing CDRs and for the percentage of outstanding debt in a collection arrangement. I am pleased to report that, in FY 2005, we met each of these goals. We also have very aggressive goals to maintain our Social Security improper payments at 0.4 percent and reduce SSI improper payments to 5.2 percent by 2008.

In addition to our efforts to prevent and detect improper payments, SSA also has a comprehensive debt collection program. We use both internal and authorized external collection tools to collect what we are owed. Internal methods include benefit withholding for persons who are on our rolls, and our own billing and follow-up system to collect overpayments from individuals who are no longer receiving benefits. Other authorized external debt collection methods include:

- Tax Refund Offset (as authorized under IRC section 6402(d));
- Administrative Offset (collection of a delinquent debt from a Federal payment other than a tax refund);
- Mandatory Cross-Program Recovery;
- Credit Bureau Reporting; and
- Administrative Wage Garnishment (AWG);

We plan to expand the use of the AWG program, and are working towards implementing programs involving federal salary offset, non-entitled debtors, interest charging, and private collection agencies.

Legislation

SSA continuously develops legislative proposals to improve administration of our programs and to support the President's annual budget. The Social Security Protection Act of 2004 (SSPA) contained several provisions that simplify administration of the SSI program. These include changing the way we calculate certain income exclusions, making uniform the time period for excluding from countable resources certain payments, and simplifying how we count one-time receipt of income.

SSPA also expanded our ability to use cross-program recovery to collect overpayments. We can now recover overpayments paid under one program from benefits payable under another. We can also withhold up to 100 percent of any underpayment and 10 percent of ongoing monthly income to recover an overpayment.

On February 8, 2006, the President signed S. 1932, the Deficit Reduction Act of 2005. It requires the Commissioner of Social Security to conduct reviews of a specific percentage of SSI initial disability and blindness cases of individuals aged 18 and older that are allowed by state disability determination service agencies (DDS). The provision will be phased in beginning in April of this year. In fiscal year 2007, the review requirement is 40 percent. And, for fiscal years 2008 and thereafter, 50 percent of all DDS allowances will be reviewed. We project these pre-effectuation reviews will save approximately $490 million over 10 years. By the tenth year, these reviews will have identified and prevented improper payments in an estimated 25,000 incorrect SSI disability and blindness determinations. As I said earlier, we already conduct PER reviews on DI cases and have found them to be an extremely effective improper payment prevention tool.

The President's FY 2007 budget request includes a proposal that would simplify the administration of our workers' compensation offset provisions. Enactment of this proposal would establish a uniform amount of reduction and would limit the duration of the offset imposed to five years.

The budget request also includes a proposal that would improve the administration of provisions that reduce the Social Security benefits of beneficiaries who receive government pensions from work not covered by Social Security. The proposal would establish a mandatory electronic system for collecting data on pension income from non-covered state and local employment. This proposal and the workers' compensation proposal will prevent $2.8 billion in improper payments over the next 10 years.

As mentioned in the 2007 budget and as part of our SSI Corrective Action Plan, SSA is working on a plan to restructure and simplify the SSI program, including the complicated in-kind support and maintenance rules I mentioned earlier. Our challenge is to do this in a fair and equitable manner while being budget neutral regarding program costs.

This budget also helps SSA to fulfill its fiscal stewardship responsibility by providing funding to conduct CDRs, which ensure proper benefit payments. Funding for CDRs is included in the $9.5 billion budget for SSA's Limitation on Administrative Expenses (LAE) account. As I mentioned before, the FY 2007 President's budget proposes to finance the increase in SSA's CDR funding through a discretionary cap adjustment of $201 million. We estimate we will save $2 billion in program costs through this additional funding.

Conclusion

SSA is committed to ensuring that the public receives the benefits they are due and assuring taxpayers that Trust Fund money and general revenue funds are accurately and efficiently paid. We are responsible for nearly $560 billion in benefit payments annually, and we take our stewardship responsibility very seriously. Every year, we target initiatives that will have the most potential to improve the integrity of the Agency's programs by improving debt prevention, detection, and collection.

We will continue to work with Congress, OMB, and other stakeholders to achieve the PMA goal of eliminating improper payments. I appreciate the opportunity to discuss our efforts, and I would be happy to answer any questions you may have.

Statement of Samuel T. Mok

Chief Financial Officer

U.S. Department of Labor

Before the

Subcommittee on Federal Financial Management, Government Information, and International Security

Committee on Homeland Security and Governmental Affairs

United States Senate

March 9, 2006

Thank you, Mr. Chairman, Senator Carper, and Members of the Committee.

I appreciate the opportunity to testify before this Subcommittee to discuss the U.S. Department of Labor's (DOL) compliance with the Improper Payments Information Act of 2002 (IPIA), ways in which we measure improper payments to determine their magnitude, and suggestions for legislative changes that would enhance our efforts to eliminate improper payments. Developing strategies and the means to reduce improper payments is a matter of good stewardship for us: accurate payments lower program costs.

In fiscal year (FY) 2005, the Department had two benefit programs and one grant program classified at high risk for improper payments. All three of these programs—Unemployment Insurance (UI), the Federal Employees Compensation Act (FECA), and the Workforce Investment Act (WIA)—are designated as high risk under former Section 57 of OMB Circular A-11 because each program makes annual payments in excess of $2 billion. As such, the Department must report on each regardless of the estimated improper payment amount. Of

the three programs, our analysis indicates that only the Unemployment Insurance program has an improper payment rate above threshold for reporting. In FY 2005, the estimated improper payments for these programs were as follows: Unemployment Insurance benefits—$3.3 billion, Federal Employees Compensation Act benefits—$3 million, and Workforce Investment Act grants—$8 million. The UI program had an estimated overpayment rate of 9.46%. For comparison, the FECA program had an estimated error rate of 0.13% and the WIA program had an estimated error rate of 0.21%.

I am pleased to report that in FY 2005 the Department met its improper payments reduction and recovery targets for each of these programs using the criteria established under guidance from the Office of Management and Budget (OMB). Improper UI payments fell by approximately $600 million in FY 2005. This represents a greater than 15% decrease in the dollar amount of improper payments for this program since last year's reporting.

We developed our FY 2005 IPIA analysis by establishing criteria for determining levels of risk and evaluating our programs against these criteria. We found it necessary to use different methodologies for assessing the risks of improper payments for our benefit programs and grant programs because of the differences in the administration of these two different types of programs and the availability of data.

The Department of Labor's analytical methodologies for determining improper payments are discussed in detail in our FY 2005 Performance and Accountability Report. But, I would take a moment to highlight our efforts regarding Workforce Investment Act improper payments, which pose unique challenges to quantify. The WIA program is the only DOL Section 57 program for which data is not readily available to develop a statistically valid estimate of improper payments. WIA's complex funding stream makes it very difficult to assess the improper payment rate at the terminal dollar level.

Because the Department provides grants to States, cities, counties, private non-profits, and other organizations to operate programs, we must rely significantly on single audits as required under the Single Audit Act to monitor funding to grant recipients. For the WIA program, we analyzed all available single audit reports to determine the improper payment rate and were able to validate information on "questioned costs" as a proxy for improper payments. We found the total questioned costs for the WIA program as identified in single audit reports to be very low—approximately $8 million for $3.7 billion in outlays in FY 2005.

In summation, our improper payment analysis disclosed only one program, Unemployment Insurance, to be high risk for improper payments. Two other programs, FECA and WIA, were reported as high risk because they are designated as such in Section 57, although our internal risk assessments indicate a low level of risk.

The Department seeks to be proactive in addressing improper payments. Therefore, we will continue to sample and test other DOL programs in order to detect and mitigate unexpected increases in improper payments.

Let me take a few minutes to focus on the Department's program with the highest dollar outlays and with the highest rate of improper payments—Unemployment Insurance. Unemployment benefits serve as our first line of economic defense against the ripple effects of unemployment by providing temporary, partial wage replacement to laid-off workers to maintain their purchasing power and helping to stabilize local economies. The UI program is a Federal-State partnership based upon Federal law, but is administered by State employees under State law. Federal law established the broad coverage provisions and certain minimum requirements for State UI laws. Within this framework, each State designs and administers its own UI program. Key State functions include taking claims from individuals, determining benefit

eligibility, ensuring timely and accurate payments of benefits to jobless workers, and determining employer liability and assessing and collecting State UI taxes.

The Federal government's primary role is one of oversight. The Department of Labor's key functions are ensuring State law and practice meet Federal requirements, setting broad overall policy for administration of the UI program, monitoring State performance, providing technical assistance, and providing funds for administration of State programs. However, in our efforts to reduce improper payments in the UI program, the Department acknowledges the efforts of States to balance the need for accuracy against the need to pay benefits in a timely fashion.

Since 1987, the Department has required States to investigate a small but statistically valid sample of UI payments each week. These investigations determine whether the individual beneficiary met all State requirements for eligibility such as being able to work, available for work, and searching for work during the week being examined. The data resulting from these investigations are used to estimate the total level of improper payments in each State. Some improper payments, for example, those resulting from failure to make a certain number of job search contacts, can be found by these lengthy investigations but are not cost effective to detect on an operational basis. These "benefit accuracy measurement" data are used by the States and the Department to determine the causes of payment errors and points in the claims process where errors occur.

Reducing improper UI payments is a major focus of the Department. The number one cause of overpayments is individuals who are working and claiming benefits at the same time—about one quarter of all overpayments Other top causes are incorrect eligibility decisions by the State agency (sometimes due to lack of information from employers) and beneficiaries' failure to meet weekly work search requirements.

Prevention and early detection of overpayments are essential. The sooner a State finds out about an improper payment, the sooner it can cut off benefits and start the collection process. The Department has undertaken a number of initiatives to help States reduce improper payments of UI benefits. In March 2004, the Department entered into an agreement with the Social Security Administration to exchange data. This agreement enables State UI agencies to crossmatch UI claims information against social security records to verify a claimant's name, social security number, age, and amount of any pension received. This helps prevent UI payments to persons working under stolen social security numbers and helps determine the correct benefit amount for individuals receiving pensions. The Department provided funds to 39 States to implement this data exchange, and 29 States have already begun this crossmatch.

The Department has funded States to use data in the State Directories of New Hires (SDNH) to detect and prevent improper payments to beneficiaries who continue to collect despite having returned to work. Forty-two States are currently using the SDNH crossmatch for UI purposes. By enabling the States to learn about beneficiaries who still collect while working, the SDNH crossmatch is estimated to have saved at least $150 million over the last two calendar years.

State UI agencies were recently granted access to the National Directory of New Hires (NDNH), which promises to be even more helpful in reducing this type of overpayment as it is a more comprehensive database than the SDNH. The NDNH allows States access to a wider universe of employers, including Federal agencies and multi-state employers who report all of their new hires to a single State. The Department provided States with funds to implement crossmatches with the NDNH. We expect 29 States to be using the NDNH crossmatch by the end of this fiscal year.

We are also pursuing new initiatives to promote UI payment integrity. As an important part of the Department's continuing commitment to reducing improper UI payments, the FY 2007 budget includes a set of legislative proposals and funding requests that would help States deter, detect, and collect UI overpayments. The following legislative proposals would give States access to new funding sources for paying costs of benefit payment control (BPC) activities—that is for preventing, detecting, and recovering UI overpayments.

Allow States to use a percentage of all recovered overpayments for BPC activities. Under current Federal law, all overpayments collected by a State must be deposited in the State's unemployment fund where they may be used only for the payment of UI benefits. The Department proposes to amend Federal law to *permit* States to use up to 5% of all overpayments recovered to augment administrative funding for BPC activities.

Require States to impose at least a 15% penalty on fraud overpayments. Currently, all States impose penalties on employers who are delinquent in paying contributions. It makes sense to require States to impose a similar fine on individuals who have defrauded the system. Under this proposal, Federal law would be amended to *require* States to impose a penalty of not less than 15% on fraud overpayments and to use these penalties only for BPC activities.

Allow States to permit collection agencies to retain a percentage of fraud overpayments recovered. Several States have explored using private collection agencies to collect certain overpayments. One of the problems States have encountered is finding a way to pay the private agency's costs of collection, which can be up to 25% of the amount collected. To overcome this barrier to collections, Federal law would be amended to *permit* up to 25% of any amount collected by the collection agency on fraud overpayments to be retained by that agency. This would be permitted only when the State UI agency has (1) made its own collection efforts, (2)

declared the amount uncollectible, and (3) one year has elapsed since the debt was established. Thus, the proposal only applies to hard-to-collect fraud debt that would not otherwise be collected.

In addition, we would like to see the following legislative amendments to support the Department's integrity activities by providing States with new tools to identify and recover overpayments:

Require employers to report "start work date" to the Directory of New Hires. State UI agencies have found directories of new hires to be extremely useful in identifying individuals who fraudulently claim UI benefits after they have returned to work. However, the effectiveness of these data is limited because not all employers report the date when an individual started work. Following the Office of Inspector General (OIG) recommendation, the Department proposes amending Federal law to require employers to report a new hire's first day of earnings (work) to the directory of new hires.

Authorize the U.S. Department of the Treasury to intercept Federal income tax refunds for certain UI purposes. This proposal would authorize the U.S. Department of the Treasury to recover overpayments of UI benefits paid by State agencies through offset from an individual's Federal income tax refunds via the Treasury Offset Program (TOP)—a government-wide debt matching and payment offset system that matches delinquent debts owed to various government agencies to Federal income tax refunds. This amendment would increase overpayment recoveries thereby contributing to the solvency of State accounts in the Unemployment Trust Fund and lower employer taxes.

Together, these legislative proposals—along with a few complementary proposals to collect delinquent employer taxes and augment tax integrity activities—would reduce

overpayments and increase overpayment recoveries by roughly $2.2 billion over 5 years and $5.0 billion over 10 years.

Combatting identity theft. The President's FY 2007 budget requests $10 million to prevent and detect fraudulent UI claims filed using personal information stolen from unsuspecting workers. As most unemployment claims are now filed by telephone or the Internet—a convenience for unemployed workers and an efficiency for States—new opportunities for schemes to obtain benefits fraudulently have been created. The Department's OIG has cited identity theft schemes in the UI program as a top management challenge since they are now being conducted by "nontraditional organized crime groups" and result in "more costly, complex, and far reaching" fraud schemes than previously seen within the UI program. The OIG reported that two schemes, one involving four States, were responsible for over $11 million in fraudulent payments. The proposed safeguards would more than pay for themselves as these activities are expected to prevent an estimated $77 million in overpayments.

Reemployment and Eligibility Assessments (REAs). A number of studies found that attention to eligibility and reemployment service needs assessments resulted in relatively shorter periods of benefit receipt by speeding reemployment and reducing overpayments. In FY 2005, the Department began the REA initiative by giving about $17 million to 21 States to review the eligibility of beneficiaries and provide job search assistance in person. In the current fiscal year, the Department will be providing these States with additional resources to continue their efforts. The FY 2007 budget requests $30 million to expand the scope of this initiative to include more States. It is estimated that this $30 million expansion of current REA efforts would reap as much as $151 million.

In closing, I would like to say that while the Department of Labor was one of the first cabinet-level agencies to receive a "green" rating under the President's Management Agenda for eliminating improper payments, we recognize that there is no finish line to this endeavor. We are acutely aware that we must continually refine our efforts to ensure that the funds entrusted to our stewardship go to their intended purpose while exercising the greatest diligence to ensure that improper payments are not made.

Statement of Charles Johnson

Assistant Secretary for Budget, Technology and Finance

U.S. Department of Health and Human Services

Before the

Subcommittee on Federal Financial Management,

Government Information, and International Security

Committee on Homeland Security and Governmental Affairs

United States Senate

Good afternoon Dr. Coburn and distinguished Subcommittee members. Thank you for inviting me before you today. It is a pleasure and honor for me to have the opportunity to speak on the U.S. Department of Health and Human Services (HHS or the Department) improper payment initiatives.

The Department is firmly committed to ensuring the highest measure of accountability to the American people. With the size and scope of HHS programs, we know that it is critical to prioritize, and be aggressive in our activities to identify and take action to reduce improper payments. Over the past several years, we have had many successes and accomplishments in this area. I am pleased to share some of these with you today as well as some of the challenges we face.

As required under the Improper Payments Information Act of 2002 (IPIA) and related guidance issued by the Office of Management and Budget (OMB), the Department is estimating, or in the process of developing or implementing methodologies to estimate improper payments, for seven of its programs: Medicare, Medicaid, State Children's Health Insurance Program (SCHIP), Temporary Assistance for Needy Families (TANF), Foster Care, Head Start and Child Care. These seven programs account for close to 90 percent of HHS' $640 billion total estimated FY 2006 outlays. In terms of both size and potential for growth, the risk and impact of improper payments is greatest for the two HHS programs which account for 80 percent of the total outlays – Medicare and Medicaid. My testimony here today is focused on improper payments. Those cases involving fraud are referred to the HHS Office of the Inspector General (OIG) and

prosecuted by the Department of Justice which provides an important deterrent to fraudulent payment schemes.

MEDICARE

The Department's largest program, Medicare, accounts for close to 50 percent of the Department's outlays. Medicare is a Federal health insurance program administered by HHS that provides medical insurance to 42 million people. The majority of Medicare spending is for fee-for-service (FFS) hospital and physician services. The FFS component of Medicare covers a wide range of other items and services, including home health care, ambulance services, medical equipment, and preventive services. The HHS Centers for Medicare and Medicaid Services (CMS) administers the Medicare FFS claims processing and payment systems through contracts with Carriers, Durable Medical Equipment Medicare Administrative Contractors (formerly called Regional Carriers (DMERCs)), Fiscal Intermediaries (FI), and Quality Improvement Organizations (QIOs). These entities review claims submitted by providers to ensure payments are made only for medically necessary services covered by Medicare for eligible individuals. HHS estimates that the contractors processed over one billion claims (1.156 billion claims) from providers, physicians, and suppliers for items and services that Medicare covers.

In 1996, HHS' Office of the Inspector General (OIG) began estimating improper payments in the Medicare FFS program as part of the financial statement audit required by the Chief Financial Officer's Act of 1990. The OIG produced FFS error rates from FYs 1996 - 2002. Beginning in FY 2003, CMS, working with the OIG, implemented a more robust process – the Comprehensive Error Rate Testing (CERT) program – to assess and measure improper payments in the Medicare

FFS program. The CERT program not only produces a national paid claims error rate but also provides very specific improper payment rates, including contractor-specific improper payment rates which measure the accuracy of our claims processors; provider-type specific improper payment rates which measure how well the providers who care for our beneficiaries are preparing and submitting claims to the Program; and other management related information which provides insight into payment errors by region and reason. The Medicaid FFS improper payment estimate is derived from two programs; the Comprehensive Error Rate Testing (CERT) Program and Hospital Payment Monitoring Program (HPMP). Each component represents about 50 percent of the total FFS Medicare payments. The CERT Program has provided HHS with a powerful tool to identify problems in the claims process and address these problems through specific corrective action plans.

In FY 2005, HHS reported a Medicare FFS paid claims error rate of 5.2 percent; a rate that is significantly lower than the 10.1 percent rate reported in FY 2004. The significant drop in the rate is primarily attributable to the aggressive measures that were taken by the Department to ensure that necessary documentation was in place to support payment claims.

The CERT and HPMP statistical methodologies that HHS uses to calculate the Medicare national FFS error rate were reviewed by PricewaterhouseCoopers, LLP (PwC) in FY 2004. As a result of the review, PwC reported the "fee-for-service error rate to be statistically valid." In addition, reviews were done by the Department's OIG in FY 2005 and GAO is in the process of completing a review of the methodology as required under the Medicare Prescription Drug, Improvement, and Modernization Act of 2003 (MMA).

HHS program integrity activities are primarily funded through the Medicare Integrity Program (MIP), established by the Health Insurance Portability and Accountability Act of 1996. The MIP includes medical review and benefit integrity activities, provider education and training, Medicare Secondary Payer, and provider audits. HHS overall program integrity efforts were supplemented by funding from HHS program management account and other funds made available from the Health Care Fraud and Abuse Control (HCFAC) account. Additionally, new Medicare contractor reform legislation enacted through the Medicare Prescription Drug, Improvement, and Modernization Act of 2003 (MMA), will further enhance MIP's effectiveness.

The Administration's budget request for FY 2007 provides new resources for reducing improper payments. The budget includes $1.1 billion from the Health Care Fraud and Abuse Control account to fight improper Medicare and Medicaid payments. To supplement these efforts, the Budget requests $118 million for efforts to protect the new Medicare prescription drug benefit and the MA program against fraud, waste, and error, as well as reduce errors in Medicaid. These funds are part of a Government-wide proposal to fund program integrity activities through a discretionary cap adjustment.

While CERT and HPMP have been useful for guiding our efforts in the Medicare FFS program, they do not provide a measure for payments in Medicare Advantage or the Medicare Prescription Drug Benefit Program. These programs added by the MMA represent about 18% of Medicare benefits outlays in FY 2006, and will grow in future years. The Department is in the process of evaluating how to best address improper payments in these programs.

In 2001, using HCFAC funding, HHS embarked on its first Medi-Medi project with the State of California. This project allowed HHS to match Medicare and Medicaid data to detect fraudulent patterns that may not be evident when billings for either program are viewed in isolation. Since that time, nine States have participated. Since inception, the Medi-Medi projects have yielded 335 investigations with an estimated $182 million dollars at risk.

MEDICAID AND SCHIP

The Department's second largest program, Medicaid, accounts for over 30 percent of Department outlays. Unlike Medicare, it is administered primarily by State Governments. While the Federal Government provides financial matching payments to the States, each State is responsible for overseeing its Medicaid Program, and each State essentially designs and runs its own program within the Federal structure. The Federal Government pays the States a portion of their costs through a statutorily determined matching rate called the Federal Medical Assistance Percentage, or FMAP, that currently ranges between 50 and 77 percent. In FY 2006, total Medicaid expenditures – those that include both Federal and State contributions – are estimated to be approximately $340 billion.

In FY 2000, HHS adopted a Government Performance and Results Act (GPRA) goal to explore the feasibility of developing a methodology to estimate improper payments in the Medicaid Program. Beginning in 2001, HHS formally solicited States to participate in the development of a model to estimate payment accuracy. Only three States, Illinois, Texas, and Kansas, had

attempted to estimate payment error in their respective State Medicaid Programs prior to HHS initiating pilot projects.

From FYs 2002-2005, HHS conducted the Payment Accuracy Measurement (PAM) and Payment Error Rate Measurement (PERM) pilot projects with extensive collaboration from participating States to determine a systematic means of measuring payment errors at the State and national levels. From these pilot projects, HHS was able to develop a methodology to estimate a State-specific payment error rate that would be the basis for the national Medicaid error rate as well as the State Children's Health Insurance Program (SCHIP).

In FY 2006, contractors will measure a national Medicaid FFS error rate in 17 States based on medical reviews and data processing reviews. In FYs 2007 and 2008, contractors will measure national Medicaid and SCHIP FFS and managed care (MC) payments in 17 randomly selected States, and the States will measure eligibility payment errors. Comprehensive Medicaid and SCHIP error rates (MC, FFS and eligibility) will be reported in the FY 2008 PAR.

TANF

The TANF program provides a capped pre-appropriated annual block grant of approximately $16.7 billion to States, Territories and eligible Tribal programs to help families transition from welfare to self-sufficiency. In the past several years, HHS has worked toward identifying strategies for estimating payment errors in the TANF Program. Four different activities were

identified to assist in efforts to reduce the occurrence of improper payments in the TANF Program. These activities and related actions taken include:

- HHS is soliciting information from States on their practices for identifying and reducing improper payments in the TANF Program. HHS developed a survey instrument to solicit information on State systems and practices for identifying and reducing improper payments in the TANF Program that will be placed on a website for information sharing among the States;

- HHS is conducting an improper payments demonstration project with volunteer States in which the States undergo a more in-depth review of TANF expenditures during the OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations,* audit process. The objective of the pilot is to explore the viability of estimating improper payments using the A-133 audit process. HHS obtained agreement from one State (Alabama) to participate in the A-133 audit pilot project. In the expanded audit, the auditors used a statistical sample of a fixed size for a test of controls (attribute sampling method). The auditors reviewed 208 TANF cases to achieve a 95 percent confidence level with an expected deviation rate of 2.25 percent. The auditors reported an overall case error rate of 20 percent and a payment error rate of 3.9 percent. HHS contacted six States to increase the number of States participating in the A-133 pilot in FY 2006. Of the six States contacted, only three States agreed to participate. HHS will report on the results of the audits in these three states in the FY 2006 PAR;

- HHS initiated various activities to improve data match capability and increase State utilization of the Public Assistance Reporting Information System (PARIS). PARIS provides a Federal computer matching capability to assist State Public Assistance Agency (SPAA) efforts to validate client-reported information and identify potential improper payments (using client social security numbers) in the Medicaid, TANF and Food Stamps Programs. PARIS includes the Veterans Administration (VA) match and a VA spousal match; a Department of

- Defense/Office of Personnel Management match (active and retired military personnel and Federal employees); and an interstate match (duplicate payments made to the same client in more than one State). Every quarter, PARIS member States voluntarily choose whether, and in which match to participate (at no charge to them). The more States that join and conduct matches under PARIS, the wider the net of potential matches of information becomes available to PARIS member States to validate public assistance program client-reported information and identify potential improper payments – especially under the interstate match. HHS also engaged in a number of activities to improve data match capability and usefulness and increase State utilization of PARIS and will be continuing to work on expanding State participation and improving PARIS capability in FY 2006; and

- HHS is continuing to expand State access to the National Directory of New Hires (NDNH). The NDNH offers solutions to the prevalent under-detection by States and reporting of employment of TANF recipients. The NDNH was authorized under the

welfare reform legislation to provide a national database of employment information for the purpose of collecting child support payments. The NDNH contains three database components: 1) new hires – information on new employees (filled out W-4 data); 2) quarterly wage data which includes information on individual employees from the records of State workforce and Federal agencies; and 3) unemployment compensation. HHS has initiated a demonstration project to provide State TANF agencies direct access to match their TANF caseloads against the databases. This effort began with a pilot effort in the District of Columbia (DC). In the DC pilot, 33 percent of the individuals submitted were identified as employed by the match, and over 81 percent of those identified were verified as actually being employed. The vast majority of these recipients were not known to be employed by the State TANF agency. In FY 2005, all State TANF agencies were given access to the NDNH. To encourage use of the NDNH to carry out program responsibilities, HHS has provided States access to conduct up to 12 matches (one per month) against the New Hires (W-4 data) database in FY 2006. Since July 2005, 30 States, DC and Puerto Rico have conducted matches. Together, these States and Territories account for 82 percent of the TANF caseload. During FY 2006, HHS will continue working with the States.

Although HHS is engaging in many activities which have been quite successful in identifying improper payments, HHS has not yet identified an efficient and effective approach for determining an estimate of improper payments in the TANF Program. One of our most significant challenges has been the flexibility that States have in the design and administration of the program. Also, there are statutory limitations with regard to the information that HHS can

request of States. HHS is in the process of considering the work that has been done thus far and will continue to work toward formulating a feasible and detailed plan for estimating payment errors in TANF.

HEAD START

The Head Start Program provides grants to local public and non-profit agencies to provide comprehensive child development services to children and families, primarily preschoolers from low-income families. Head Start regulations allow Head Start programs to serve up to 10 percent of their enrolled children (49 percent in certain situations for tribal Head Start programs) from families who do not meet Head Start income requirements. Under Head Start legislation, grantees are required to be monitored at least once every three years. In FY 2004, HHS developed a methodology for estimating a national Head Start payment error rate building on the required review process. HHS has reported Head Start payment error rates in FY 2004 (3.9 percent) and FY 2005 (1.6 percent).

FOSTER CARE

The Foster Care Program is designed to help States provide safe, appropriate, 24-hour, substitute care for children who are under the jurisdiction of the administering State agency and who need temporary placement and care outside their homes. Under the regulatory review promulgated at 45 CFR 1356.71, primary reviews are conducted in each State every three years by teams who review 80 cases selected from the State's title IV-E foster care population. These reviews are intended to recover title IV-E funds claimed by States for ineligible cases and, in conjunction

with the required program improvement plan (PIP) for those States determined to be non-compliant, to help change their behavior so that subsequent reviews will result in lower error rates.

HHS developed a methodology for estimating a national payment error rate for the title IV-E Foster Care Program using data gathered in the eligibility reviews conducted in FY 2001 - 2004. The FY 2004 error rate was 10.33 percent and the FY 2005 final error rate was 8.6 percent.

HHS has begun measuring underpayments in the reviews that are being conducted in FY 2006. In the coming year, HHS will continue to measure error cases and begin implementing its plan to measure Foster Care administrative cost payment errors.

CHILD CARE

The Child Care and Development Fund (CCDF) is a block grant composed of three distinct funding elements (mandatory, discretionary and matching) authorized in two different statutes. During FY 2003, HHS began to work toward identifying strategies for estimating payment errors in CCDF . In FY 2004, HHS initiated an improper payment pilot project to assess the efforts of eleven States to prevent and reduce improper payments in their child care programs and to explore feasible strategies to measure and estimate improper payments for the program. HHS expanded State participation in the pilot project from eleven to eighteen States in FY 2005 and continued to work on a strategy for determining a payment error rate in the CCDF. Further, HHS partnered with Regional and State staff to test an error rate methodology in four States focused on the client eligibility process.

HHS drafted a report of the findings which includes a preliminary error rate calculated for each of the four States and an estimated analysis of the cost incurred by each State. HHS also developed a survey instrument to solicit information on a voluntary basis from States on State systems and practices for identifying and reducing improper payments in the CCDF.

CCDF gives the States flexibility in the design and administration of the Program which has presented challenges in developing a model or methodology that can be used by all States. HHS is developing a plan for applying the error rate methodology that was tested in the four States in FY 2005, to all the States over time. This methodology focuses on client eligibility and involves an intensive case review process to identify cases with errors, cases with improper payments, percentages of payments made in error, average amounts of improper payments, and minimum and maximum amounts of improper payments. The field work also raised questions about the need for regulatory or other policy changes to support the State-by-State error rate strategy. These policy questions are currently being considered within the Department.

CONCLUSION

Dr. Coburn, and Subcommittee member, in conclusion, HHS has had numerous accomplishments and successes in its improper payment activities. In our largest program, Medicare, we are estimating improper payments and seeing the results of the corrective actions we have taken in seeing the rate drop significantly. In Medicare, Head Start and Foster Care Programs we experienced a decrease in improper payments through identification and implementation of appropriate corrective action. In two other programs, Head Start and Foster

Care, we have achieved efficiencies in utilizing reviews required by legislation or regulation in developing our methodologies for determining estimates in these programs. In our second largest, Medicaid, we have developed and are working on implementing a plan for estimating improper payments. In the two programs where we have not been able to develop methodologies for estimating improper payments, TANF and Child Care, we are engaging in activities that comply with the intent of the IPIA in identifying and reducing improper payments. Our data matches and pilot activities have not only been successful in identifying and reducing improper payments, they have allowed us to build strong partnerships with the States in our endeavors to reduce improper payments. In the coming months, we will continue to work toward achieving compliance with the IPIA in overcoming the challenges we face in our TANF and CCDF and in implementing our plans for estimating improper payments in the Medicaid and SCHIP Programs.

Thank you again for this opportunity to talk about the Department's improper payment initiatives. At this time, I will be pleased to answer any questions.

The Honorable Dr. Tom Coburn
Chairman
Subcommittee on Financial Management, Government, and International Security
Committee on Homeland Security and Governmental Affairs
439 Hart Senate Office Building
Washington, DC 20510

Questions for the Record for Linda Combs on March 9, 2006 hearing entitled, "Reporting Improper Payments: A Report Card on Agencies' Progress."

1. The Improper Payments Information Act of 2002 (IPIA) states that all Executive Branch Agencies are required to report improper payment information. It is still unclear on who exactly is included in the list of Executive Branch agencies.

   a. Can you please clarify which specific agencies are included in this list?

   OMB believes that all executive agencies are covered by the IPIA. Thus, all agencies are required to review their activities and identify any programs with significant risk of improper payments. If a program with significant risk of improper payments is identified, the agency is required to develop an annual measurement and report it publicly in its Performance and Accountability Report (PAR).

   b. What were the criteria for deeming these agencies, "Executive Branch Agencies?"

   OMB uses the definition for executive agency as referenced in 31 U.S.C., Section 102.

2. As you know, critics -including myself- argue that OMB's definition of "significant" could hide major problems. OMB defines a "significant" improper payment problem as: A program where at least 2.5% of all payments are improper and where the absolute dollar figure associated with that 2.5% or more totals at least $10M. The definition matters because agencies only have to report on "significant" improper payments.

   In our hearing last July, it became evident that some federal programs are so large that even a small improper payment rate (lower than 2.5%) would constitute a massive amount of money.

   In a post hearing question about programs that might go unchecked because they fail to meet both criteria, you responded that "OMB will work closely with agencies that report on programs with more than $10 million in improper payments, but that fall below the 2.5 % error rate threshold, to ensure proper monitoring.

   a. Which agencies have programs that report more than $10 million in improper payments, but fall below the 2.5% threshold? What programs are they?

At the current time, the agencies and programs that report more than $10 million in improper payments, but fall below the 2.5% threshold, are included in the following table.

Agency	Program	Improper Payment Rate	Improper Payment Amount
Department of Agriculture	Marketing Assistance Loan Program	0.70%	$45 million
	Federal Crop Insurance Program	.9%	$28 million
	Farm Security & Rural Investment Programs	1.55%	$16 million
Department of Defense	Military Health	2.00%	$150 million
	Military Retirement	.14%	$49.3 million
	Military Pay	.63%	$432 million
Department of Education	Federal Family Education Loans	.16%	$16 million
	Title I	1.19%	$139 million
Department of Veterans Affairs	Compensation/Dependency & Indemnity	.9%	$239 million
	Education	2.4%	$55 million
Department of Health & Human Services	HeadStart	1.6%	$110 million
Office of Personnel Management	Federal Retirement Programs	.28%	$152.2 million
	Federal Health Benefit Program	.67%	$196.5 million
Railroad Retirement Board	Retirement and Survivor Benefits	1.9%	$172.8 million
Small Business Administration	Small Business Investment Centers	.67%	$10.5 million
Social Security Administration	Old Age, Survivors and Disability Insurance Programs	.74%	$3,681 million

b. What actions has OMB taken to work with those specific agencies and programs to assist them in monitoring and reducing improper payments?

OMB's implementing guidance for the IPIA requires that agencies report on these programs annually and develop improper payment reduction targets and associated corrective actions. This is because OMB's implementing guidance currently mandates that, absent specific waivers, agencies deem all programs listed in the original Section 57 of OMB Circular A-11 as high risk.

As a complement to these requirements, for each program listed in the table above (excluding the Railroad Retirement Board), OMB uses the Eliminating Improper Payment initiative under the President's Management Agenda (PMA) to hold agencies accountable for specific activities intended to improve improper payment results (e.g., enhanced measurement, achievement of reduction targets.) In addition, the Chief Financial Officer (CFO) Council's Improper Payment Transformation Team sponsors best practice forums where agencies can share approaches in activities such as measurement and prevention. The CFO Council is also collaborating with States and the private sector to identify more cost effective approaches for addressing improper payments.

OMB is also in the process of developing revisions to IPIA implementing guidance to include additional safeguards for ensuring that all high risk programs are identified and tracked by Federal agencies.

3. The Department of Homeland Security reported in its PAR that it had assessed all programs and activities and found none to be susceptible to making significant improper payments. Their independent auditor reported that the Department did not institute a systematic method of reviewing all programs and identifying those it believed were susceptible to significant improper payments. This was the second year in a row that the auditor reported IPIA noncompliance for DHS.

   a. Isn't the purpose of the report to provide a way for Congress and the President to hold agencies accountable? How can Congress trust the information in an agency's Performance and Accountability Report?

OMB also wants to ensure that information reported in the PAR is both accurate and complete. For fiscal year 2006 reporting, we asked DHS to perform a more rigorous risk assessment to validate its fiscal year 2005 reporting. In response, DHS changed its risk assessment methodology to be more inclusive of all major agency programs. This revised measurement strategy will permit DHS to report an error measurement for all programs. In addition, this fiscal year we also requested that DHS perform a more thorough sampling methodology in its Individual Household grant program given the additional risks brought on by Hurricanes Katrina and Rita.

The independent financial statement auditor for DHS identified significant flaws in the risk assessment process that the agency used in fiscal year 2005. As a result, DHS recently awarded a contract for developing and implementing a new and enhanced risk assessment methodology. This methodology will apply to FEMA's disaster relief efforts as well as other DHS programs, and should provide a more rigorous review of program payments.

4. Isn't it true that DHS has decided to cancel its BearingPoint contract for integrating all its diverse financial reporting systems because the project has been a total failure? How do we know that the proposed "do-over" in the President's budget request for 2007 will avoid the same pitfalls?

DHS has made several changes to their financial system implementation project, known as eMerge^2, including making changes to the eMerge^2 contracts. I share your concern about this investment, and OMB is working closely with DHS on its revised implementation approach and meets with DHS routinely to discuss its efforts to avoid similar problems.

5. Can you explain how the Social Security Administration uses supplemental guidance regarding "avoidable v. unavoidable" improper payments?

   a. Was this guidance developed by the Office of Management and Budget, or by the Social Security Administration?

   Section 223(g) (1) of the Social Security Act as well as various court rulings compel SSA to continue to make certain benefit payments until a settlement has been reached, whether they are known to be in error or not. SSA makes a distinction between "avoidable v. unavoidable" payments because these payments occur as a result of due process requirements or court orders when beneficiaries appeal their disability determination or termination of their benefits. Once adjudication has been reached, and the payment can be determined to be an overpayment, SSA immediately establishes a receivable and starts recovery action.

   b. Can you explain the reason for coming up with this supplemental guidance?

   SSA raised this issue with OMB after the issuance of OMB Memorandum M-03-13, Improper Payments Information Act of 2002 (Public Law No: 107-300), our implementation guidance for the IPIA. Because there is no specific internal control or process improvement that SSA can implement to avoid payments, we concur with SSA's approach to categorizing these payments. The Government Accountability Office (GAO) also reviewed SSA's unavoidable designation, and agreed that these were not improper payments.

c. Do other agencies use similar supplemental guidance?

We are not aware of other agencies that are similarly compelled by due process to make similar payments that are known to be improper at the time of payment.

d. Is there a concern that other agencies will adopt this type of distinction between "avoidable" and "unavoidable" errors?

OMB works closely with agencies to understand their programs and the types of improper payments that could be made. We are not aware of any other agencies making a similar distinction. However, we will continually review all programs to determine if such a distinction is being made and understand whether it is appropriate.

e. Are "avoidable overpayment" statistics reported to OMB?

SSA does not report the breakdown of which payments are "avoidable" or "unavoidable".

6. The Department of Defense (DoD) has reported in both fiscal year 2004 and 2005 that it had assessed all programs and activities for susceptibility to significant improper payments.

In both fiscal years 2004 and 2005 the Military Retirement Fund and Military Health Benefits reported improper payment information, even though these two programs were not susceptible to significant improper payments. Their improper payment amounts for fiscal year 2005 were $49.3 million and $150 million, respectively.

In response to a post hearing question, you stated that "DoD will report on all programs that meet the guidance standards in the upcoming fiscal year 2005 Performance and Accountability Report. While not publicly reported, DoD actively tracks all programs with improper payments that exceed $10 million, regardless of the improper payment rate."

a. What is OMB doing to ensure that DoD tracks these programs?

OMB uses the Eliminating Improper Payment initiative under the PMA to hold DoD accountable for specific activities intended to improve improper payment results (e.g., enhanced measurement, achievement of reduction targets). In addition, we continue to work with DOD to ensure that it continually reviews all programs to identify any that may be of significant risk to improper payments.

Currently, DoD efforts fall under both IPIA and the Recovery Auditing Act. For IPIA, DoD annually tracks three major programs (i.e., Military Pay, Retirement, and Health) accounting for $112 billion in outlays. Under its recover auditing efforts,

DoD reviews $223 billion in contract payments. Adding together the IPIA and recovery auditing efforts, DoD tracks and reports $335 billion out of $474 billion (or 71%) in DOD outlays.

Notable is the performance of DOD's recovery auditing efforts. Of the nearly $223 billion in contract payments that DoD reviewed during fiscal year 2005, $473 million was identified for recovery, and $418.5 million has in fact been recovered as of September 30, 2005. This represents a recovery rate of 88%.

7. For fiscal year 2005, Military Pay began reporting improper payments of $432 million. Because this amount does not exceed 2.5% of program payments, DoD is not required to report improper payment information.

   GAO has reported concerns with financial management at DoD with activities related to military pay, travel, property, contract payments and automated systems.

   a. Has OMB taken a closer look at some of these areas?

   DoD and OMB are monitoring all of these areas. In regards to improper payments, DoD currently reports an error rate and amount for Military Pay, performs an annual risk assessment for travel payments, and reviews contracts payments as part of its recovery auditing efforts and commercial pay reviews.

   b. What is OMB doing to improve the integrity of payments in these programs?

   OMB is working with DoD on all of the areas mentioned either through the PMA's Eliminating Improper Payment initiative or as part of our oversight for the PMA's Improved Financial Performance and Real Property Management initiatives. We meet with DoD frequently for all of these initiatives where we monitor milestones and review results.

8. As you may know, this Subcommittee is committed to rigorously overseeing USAID and some of its programs. In a written question following last July's improper payments hearing, I asked whether or not OMB supported USAID's internal assessment that none of their programs were considered to be at risk for "significant" improper payments.

   Your response said you deemed their documentation for fiscal year 2004 as acceptable, and would re-evaluate their risk assessments in the fiscal year 2005 Performance and Accountability Report to determine their acceptability.

   a. Dr. Combs, has OMB re-evaluated USAID's risk assessment yet to determine its acceptability?

   USAID's PAR fiscal year 2005 reporting improved from fiscal year 2004. However, due to the sharp increase of grant and contract dollars as a result of the Global War on

Terror, we are working with USAID to improve and enhance its approach for assessing whether there is significant risk of improper payments in any of its programs.

b. According to GAO, USAID was silent as to whether it had programs that are susceptible to making significant improper payments. In other words, USAID did not even mention compliance with the Improper Payments Information Act in their fiscal year 2005 Performance and Accountability Report. Is OMB aware of this?

USAID reported its annual improper payment information on page 62 of its fiscal year 2005 Performance and Accountability Report (PAR). However, we will follow-up with USAID to ensure that it is taking appropriate actions to comply with the requirements of IPIA.

c. Does OMB penalize agencies that do not even mention the Improper Payments Information Act in its Performance and Accountability Report?

OMB works with all agencies to ensure that they meet the reporting requirements of IPIA in their annual PARs and would contact any agency that fails to report. In addition, we review draft PARs for the 24 CFO Act agencies and work with each agency to address any discrepancies before the November 15 reporting deadline. OMB uses the Eliminating Improper Payment initiative under the PMA to hold agencies accountable for specific activities intended to improve improper payment results (e.g., enhanced measurement, achievement of reduction targets).

9. In fact, there were five programs that did not provide sufficient reporting on improper payments in their fiscal year 2005 Performance and Accountability Report: USAID, the Export-Import Bank, the Pension Benefit Guarantee Corporation, the Postal Service, and the Smithsonian.

   a) How can Congress hold agencies accountable when getting improper payment information can be like pulling teeth? How will OMB deal with these agencies?

   OMB is not aware of any high risk program areas within the Export Import Bank, the Pension Benefit Guarantee Corporation, the Postal Service, or the Smithsonian. However, we will follow-up with them to ensure that they are taking appropriate action to comply with the requirements of IPIA. If any of the agencies that we require to report under the IPIA fail to report, we will contact them immediately. In addition, all agencies that we track under the IPIA provide draft reporting in the October. This helps to ensure that any large discrepancies or reporting gaps can be addressed before the final PAR publication date.

10. The Department of Health and Human Services currently has a red rating on the Executive Branch Management Scorecard.

a) What are the main reasons for this rating?

All agencies subject to the PMA's Elimination Improper Payment's initiative remain red on status until they complete three steps: (1) risk assess their inventory of programs; (2) develop a statistically valid, OMB-approved measurement plan for the high risk programs identified in Step 1; and, (3) implement a corrective action plan to address root causes of payment error and set OMB-approved reduction targets for a minimum of three fiscal years hence. HHS remains red on status because it has not been able to complete steps 2 and 3 for Medicaid, State Children's Health Insurance Program, Temporary Assistance for Needy Families, and Child Care and Development Fund.

b) What is OMB's role in working with them to implement procedures to strengthen internal controls relating to the accuracy and integrity of payments they make?

OMB works closely with all agencies to strengthen internal controls not only through implementation of the IPIA, but also through the implementation of OMB Circular A-123, Appendix A, Management's Responsibility for Internal Controls. Circular A-123, Appendix A, requires that management of the CFO Act agencies identify material line items from significant financial reports and document the key business processes that support those material line items. Management must also document and test the internal controls related to those processes and related transactions. The results of the testing will support the management assurance as to the effectiveness of the internal control over the financial reporting. For agencies that provide significant benefit payments to the public, such processes and related controls may fall within the scope of the Circular A-123, Appendix A assessment process, and therefore, would have to be documented, tested, and assessed for their effectiveness. OMB is currently reviewing plans submitted by the CFO Act agencies regarding their implementation of the Circular A-123, Appendix A.

11. As part of the President's Management Agenda, OMB Circular A-11 has required major programs to report improper payment information since 2001. At the Department of Health and Human Services, the State Children's Health Insurance Program (SCHIP), Medicaid, Child Care and Development Fund, and Temporary Assistance for Needy Families (TANF) are still not reporting improper payments estimates, five years later.

a) Can you tell me what OMB is doing to get these programs reporting their improper payments estimates? When will we see reporting?

OMB is working with HHS to ensure that improper payment estimates are developed for all of these programs. Medicaid and SCHIP will report comprehensive error rates in time to include in the fiscal year 2008 PAR.

Medicaid will report an error measurement for the fee-for-service component of the program (that includes medical and data processing reviews) in the fiscal year 2007 PAR.

Data collection for the TANF program is limited to the items specified in the TANF statute. HHS has submitted a TANF Improper Payment plan, which lays out the steps that the Department will take to work around the limitations of the statute and to meet the IPIA requirements. Specifically, HHS is determining whether it can tap into the pilot authority under the Single Audit Act Amendments of 1996 or TANF research authority.

b) What are the biggest challenges in getting these programs to begin reporting?

We are working with HHS to form partnerships with the States to identify cost effective approaches for developing an error rate for the TANF program. HHS currently has several State pilots ongoing to develop a methodology for measuring errors in the Child Care Development Fund program. The challenge lies in balancing the Federal need for information with minimizing burden placed on State and local stakeholders.

12. In Appendix C of HHS' FY 2005 Performance and Accountability Report, HHS said, and I quote, "Program risk assessments were completed for FY 2005. WHILE HHS DID NOT IDENTIFY ANY HIGH-RISK PROGRAMS IN ITS FY 2005 RISK ASSESSMENT WORK, SEVEN HHS PROGRAMS WERE PREVIOUSLY IDENTIFIED AS HIGH RISH PROGRAMS IN OMB CIRCULAR A-11."

    a) If HHS, who of all agencies makes by far the most amount of improper payments, denies in their own report that they have programs at high risk for making improper payments, then how can we trust anything else that agencies report in their Performance and Accountability Report?

    We believe that HHS' intent was to state that outside of the seven programs enumerated in the former Section 57 of OMB Circular A-11, that it had no high risk programs. Nonetheless, OMB has reviewed HHS' risk assessments each year very closely. Based on their latest risk assessments, we accept the HHS determination that only the seven programs previously identified are risk susceptible. However, OMB will continue to review agency risk assessments to ensure all high risk programs are identified when appropriate.

13. The Department of Labor has reduced improper payments in its Unemployment Insurance program by about $600 million between 2004 and 2005. OMB reports that this is more than a 15 percent decrease in the error rate for this program since last year's reporting. A 15 percent reduction is a significant accomplishment.

    a) How can the Department of Labor's successes be carried over to other agencies? Wouldn't you agree that their success in implementing a rigorous

improper payment tracking system provides proof that other agencies should be able to do the same?

Several factors contribute to the success that the Department of Labor (DOL) has achieved in reducing the improper payments in the Unemployment Insurance (UI) program. A large portion of the reduction in improper payments can be attributed to the strong economic recovery that reduced benefit outlays. In addition, the error rate fell due to the cooperative efforts between DOL and States.

Under the Social Security Act, DOL has a different financial relationship with the States than other benefit programs. By law, DOL pays the administrative costs of running the UI program as well as the maintenance and support of each State's Benefit Accuracy Measurement (BAM) program. Because of this relationship, DOL has been partnering with States in eliminating improper payments for nearly 20 years. This long-term relationship has allowed DOL and the States to structure the program to maximize program integrity results. Specifically:

- Within each State, a single entity is responsible for administering the UI program, as well as maintaining and controlling all benefit payment records. This arrangement provides for a narrow span of control thus allowing for better internal control.
- DOL funds dedicated staff in each State to operate the BAM program. DOL also funds States to match data both in the State Directories of New Hires as well as the National Directory of New Hires. These data matches are an effective tool for identifying when claimants have gone back to work while still receiving UI, which is the primary cause of improper payments in the UI program.
- States have the appropriate incentives under the UI program - regular UI benefits are paid out of State-levied UI taxes, with Federal funds covering administrative costs only. Since the benefit payments are paid from State taxes, with no Federal matching funds, the States have an incentive to ensure they are correct.

14. It seems there is some confusion on whether or not the Community Development Block Grant Program is required to report improper payments. It was one of the original programs on the President's Management Agenda, so it's been required to report since 2001. It is also required to report under the Improper Payments Information Act, but is not reporting under both requirements.

    In other hearings held by this Subcommittee as well as in written responses to letters sent by me and Senator Carper, HUD has denied that they are out of compliance with the Improper Payments Information Act.

    a) Has OMB issued the Community Development Block Grant program a waiver from reporting under the President's Management Agenda?

b) Their outlays are $5.4 billion in outlays, yet they not reporting improper payments information. What is OMB doing to see that they comply with IPIA?

HUD has determined that the Community Development Block Grant is not a high risk program. Its average annual outlay total is approximately $4 billion, with $2 billion being an informal threshold for the former Section 57 programs delineated by OMB in Circular A-11 in 2001. In addition, HUD has formally risk assessed this program for the past three years, including a risk assessment by a private contractor. Each time, HUD determined that the program was low risk for improper payments. However, we are continuing to work with HUD to determine the best path going forward, given that a comprehensive error rate measurement will necessitate considerable resources.

15. Please provide the Subcommittee with a list of legislative changes that need to be made in order to allow state-federal programs at HHS to be able to have the flexibility to measure improper payments that the Department of Labor has.

The Administration's proposed legislative reforms related to the improper payments initiative are outlined in OMB's annual improper payment report as well as the President's fiscal year 2007 Budget. These legislative changes will provide needed flexibilities and resources to address improper payments in many of our highest risk programs.

With respect to challenges in "State-Federal programs at HHS," OMB is actively working with HHS and State and local officials to develop and implement strategies that will provide for measurements and corrective action plans, with similar reliability and effectiveness as DOL has achieved in the UI program. As part of this strategy development, we will take a close look at any possible legislative reforms and report back to the Subcommittee.

Medicaid and TANF are programs that will receive special focus in our State-Federal partnership activities.

- Medicaid: HHS is making great strides in measuring improper payments and detecting fraudulent and abusive practices under current law. Per IPIA, the agency will release a regulation at the end of the summer outlining its approach to collecting information from States regarding improper payments attributable to medical, data processing, and eligibility-determination errors. Additionally, the Deficit Reduction Act created the Medicaid Integrity Program, which provided additional funds to HHS and CMS to augment efforts to curb fraud and abuse within Medicaid.

- TANF: At the current time, data collection for this program is limited to the items specified in the TANF statute. HHS has submitted a TANF Improper Payment plan, which lays out the steps that the Department will take to work

around the limitations of the statute and to meet the IPIA requirements. Specifically, HHS is exploring whether it can tap into the pilot authority under the Single Audit Act Amendments of 1996 (SAA) or TANF research authority.

In a broader context, OMB is awaiting the results of the interagency research project led by the Department of Education regarding quality of audits performed under the SAA. We believe that the SAA can be improved to allow Federal agencies to obtain critical information on improper payments, with reduced burden on State and local officials.

The Honorable Mr. Thomas R. Carper
Subcommittee on Financial Management, Government, and International Security
Committee on Homeland Security and Governmental Affairs
439 Hart Senate Office Building
Washington, DC 20510

Questions for the Record for Linda Combs on March 9, 2006 hearing entitled, "Reporting Improper Payments: A Report Card on Agencies' Progress."

1. At one point in your testimony you seem to excuse increases we see in certain programs' improper payment estimates by pointing out that they're due to outlay growth. If a program's improper payment estimate goes up along with outlay growth each year, however, we'll never be able to get our arms around this problem. Are you satisfied with the progress, or, in some cases, the lack of progress, we've seen this year in reducing improper payments rates?

I am proud of the progress that we've seen this year in reducing improper payments, but I am not satisfied with it. The government-wide improper payment total reported for fiscal year 2004 decreased from $45.1 billion to $37.3 billion, a reduction of approximately $7.8 billion (or 17 percent). With this result, the Federal Government exceeded its fiscal year 2005 strategic goal for improper payment eliminations by $5 billion. In addition, Federal agencies reported error measurements on an additional 17 programs in fiscal year 2005. Moving forward, however, we need to ensure that we make progress in reducing the dollar amount and rate of improper payment rate in all programs, regardless of whether outlays are increasing or decreasing.

2. I know that OMB has conducted seminars in which agency Chief Financial Officers have heard from their counterparts in the private sector about how to control improper payments. What did you learn in those sessions about what's deemed acceptable in the business world with respect to improper payments? Is it possible to hold federal agencies to a similar standard?

Over the past several years, the Improper Payment Working Group (a committee under the Chief Financial Officer's (CFO) Council) held discussions with various private sector firms who presented their capabilities to identify, prevent and recover improper payments. In many cases, Federal agencies are actively leveraging tools utilized by the commercial sector, such as data mining and card-based technology. The CFO Council will continue to facilitate additional communications between the private and public sector so that additional synergies for identifying and eliminating improper payments can be further explored.

3. It's clear to me when you look at who's reporting improper payments estimates and who's not that not all agencies are doing as rigorous a job as they need to be in assessing programs to determine whether they're at risk for improper payments. I know from our conversations that you and your staff have worked closely with some of these agencies. What kinds of problems are they running into? Do they not have

the resources or the expertise to do the risk assessments? Is it possible that some of them just aren't taking their requirements under the Improper Payments Information Act seriously?

I believe that every agency takes the requirements of the Improper Payments Information Act (IPIA) seriously and that each one is working hard to identify, prevent, and eliminate improper payments. Currently, the Federal government reports an improper payment measurement on 85% of all high risk outlays. For the remaining 15%, we have found that some agencies have run into challenges when attempting to estimate a national error rate for programs that are administered at the State and/or local level.

Most notably, the absence of an annual improper payment measurement in Medicaid is of major concern. I am pleased that the Department of Health and Human Services has worked closely with State and local officials to develop a measurement plan that appropriately balances the need for information with the burden imposed. As a result, a measurement for Medicaid and the State Children's Health Insurance Program (SCHIP) is expected by fiscal year 2008. Once the Medicaid rate is captured, the Federal government will report an improper payment measurement on more than 95% of all high risk outlays.

4. At one point in the testimony he gave during the hearing, Mr. Everson from the IRS mentions that EITC was the only program in his agency deemed at high enough risk to warrant reporting under the Improper Payments Information Act. He says that other programs were deemed at "low" or "medium" risk and, hence, were not reported on. What does this mean? What criteria are agencies using to classify a program as "low" or "medium" for making improper payments? Does OMB work with agencies on remediation plans for programs just below the reporting threshold?

Under the IPIA and OMB's implementing guidance, Federal agencies are required to identify programs as either high or low risk for improper payments. For those programs deemed high risk, agencies are required to develop annual improper payment measurements, reduction targets, and action plans for achieving those targets.

OMB has defined high risk programs as ones that the agency believes incur both $10 million in improper payments and have a 2.5% improper payment rate. Agencies use a variety of methods for assessing programs as low risk vs. high risk. For example, agencies can base their determination on the complexity of a program's statutory and regulatory requirements, the number of transactions that occur in the lifecycle of the Federal payment, evidence of error from the Government Accountability Office or Office of Inspectors General reports, and/or other evidence available to the agency.

To date, we have found that OMB's guidance has resulted in a majority of the government's payments being deemed as high risk. Specifically, of the $2.5 trillion in Federal outlays in fiscal year 2005, Federal agencies identified $1.5 trillion (or more than

60%) as high risk. Of the $1 trillion not identified as high risk, $659 billion are contract payments. More than half of the contract payments are tracked by agencies for improper payments under the Recovery Audit Act.

These statistics make it unlikely that there are significant dollars in high risk programs that Federal agencies are failing to identify. Nevertheless, OMB is in the process of revising our IPIA implementation guidance to include additional safeguards to ensure that all high risk programs are identified and tracked.

5. You mention in your testimony that, for the first time in FY05, agency improper payments reporting includes payments to vendors. How is this significant? What is included now that wasn't included before?

Agency reporting on improper payments to vendors is now included in our government-wide reporting. Previously, this was reported to Congress in a separate report. This is significant because our annual report now provides a more complete picture on government-wide improper payments. Specifically, Federal agencies reviewed $365 billion in vendor payments in fiscal year 2005, identified $557 million in improper payments, of which $467 million (or 84 percent) has been recovered to date.

6. We've heard numerous reports about poor financial controls at FEMA and about money being wasted during that agency's response to major disasters. Are FEMA's disaster response activities covered by the Improper Payments Information Act? If so, has the Department of Homeland Security performed the required risk assessments to determine whether they're at risk for improper payments? If it has, are you satisfied with the quality of those risk assessments?

Disaster response activities are covered by both IPIA and the Recovery Auditing Act. These statutes cover the activities performed by FEMA and the FEMA mission assignments given to other Federal agencies. The Department of Homeland Security (DHS) and other Federal agencies involved in disaster response have begun to perform risk assessments of disaster-related payments and we expect to see a full reporting of these activities in agency fiscal year 2006 Performance and Accountability Reports.

The independent financial statement auditor for DHS identified significant flaws in the risk assessment process that the agency used in fiscal year 2005. As a result, DHS recently awarded a contract for developing and implementing a new and enhanced risk assessment methodology. This methodology will apply to FEMA's disaster relief efforts as well as other DHS programs, and should provide a more rigorous review of program payments.

Therefore, I am satisfied that DHS is taking the necessary steps to improve its risk assessment process overall and to initiate the necessary focus on FEMA payments in disaster recovery settings.

United States Government Accountability Office
Washington, DC 20548

September 6, 2006

The Honorable Tom Coburn
Chairman, Subcommittee on Federal Financial Management, Government Information, and International Security
Committee on Homeland Security and Governmental Affairs
United States Senate

Subject: *Improper Payments: Posthearing Questions Related to Agencies Meeting the Requirements of the Improper Payments Information Act of 2002*

Dear Mr. Chairman:

On March 9, 2006, we testified[1] before your subcommittee at a hearing entitled, "Reporting Improper Payments: A Report Card on Agencies' Progress." At the hearing, we discussed our findings on federal agencies' challenges in meeting the requirements of the Improper Payments Information Act (IPIA) of 2002 based on our review of agencies' fiscal year 2005 performance and accountability reports (PAR) and annual reports. Our review focused on the extent to which agencies have performed the required assessments to identify programs and activities that were susceptible to significant improper payments, the annual amount estimated by the reporting agencies, and the amount of improper payments recouped through recovery audits.

This letter responds to your June 15, 2006, request that we provide answers to follow-up questions relating to our March 9, 2006, testimony. Your questions, along with our responses, follow.

1. *The Department of Homeland Security reported that it had assessed all programs and activities and found none to be susceptible to making significant improper payments. Their independent auditor reported that the Department did not institute a systematic method of reviewing all programs and*

[1]GAO. *Financial Management: Challenges Remain in Meeting Requirements of the Improper Payments Information Act*, GAO-06-482T (Washington, D.C.: Mar. 9, 2006).

identifying those it believed were susceptible to significant improper payments. This was the second year in a row that the auditor reported IPIA noncompliance for DHS. What concerns does GAO have regarding not only DHS' inability to comply with the Improper Payments Information Act; but on a greater scale with their overall financial management?

The Department of Homeland Security (DHS) continues to face challenges in meeting the requirements of IPIA as well as experience significant financial management weaknesses. For fiscal year 2005, DHS received a disclaimer of opinion[2] on its fiscal year 2005 balance sheet and fiscal year 2004 consolidated financial statements, primarily due to financial reporting problems.[3]

As context, DHS's auditors cited 10 material internal control weaknesses over areas such as financial management oversight; financial systems security; property, plant, and equipment; and accounts payable and disbursements. For example, agency auditors reported that DHS had not established sufficient controls to prevent duplicate payments to vendors related to prior year obligations or adopted policies to ensure receipt of goods and services prior to payment of invoices. In addition, DHS had not provided effective management and oversight to ensure corrective action plans were developed, implemented (with progress tracked), and successfully completed to support the elimination of material weaknesses and achieve consistent, timely, and reliable financial reporting departmentwide. Furthermore, the auditors found seven instances of noncompliance with applicable laws and regulations, one of those being noncompliance with IPIA. Specifically, for a second year in a row, its auditors found that DHS did not institute a systematic method of reviewing all programs and identifying those that are susceptible to significant erroneous payments.[4] The auditors also reported that DHS did not perform test work to evaluate improper payments for all material programs for fiscal year 2005. DHS's testing approach only included a review of its programs with total disbursements exceeding $100 million for each agency component. DHS reported that programs with fewer disbursements were assumed to be too small to exceed the Office of Management and Budget's (OMB) reporting threshold of $10 million in improper payments.

DHS, like other federal agencies, has a stewardship obligation to prevent fraud, waste, and abuse; to use tax dollars appropriately; and to ensure financial

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[2]A disclaimer of opinion means that the auditor does not express an opinion on the financial statements. This type of opinion is appropriate when the audit scope is not sufficient to enable the auditor to express such an opinion or when there are material uncertainties involving scope limitations.

[3]DHS's auditors reported that they were engaged to audit the accompanying consolidated balance sheets of DHS as of September 30, 2005 and 2004, and the related consolidated statements of net cost, changes in net position, and financing; combined statement of budgetary resources; and statement of custodial activity for the year ended September 30, 2004. The auditors were not engaged to audit the accompanying consolidated statements of net cost, changes in net position, and financing; combined statement of budgetary resources; and statement of custodial activity for the year ended September 30, 2005.

[4]We consider the terms "erroneous payments" and "improper payments" to be synonymous.

accountability to the President, Congress, and the American people. Management must establish effective internal controls to safeguard assets, protect revenue, and make authorized payments. Based on our previous work, the basic or root causes of improper payments can typically be traced to a lack of or breakdown in internal control. While DHS did not identify any of its programs or activities susceptible to significant improper payments, several of its inherited weaknesses clearly suggest risk for improper payments. These inherited weaknesses included financial accounting system design and operation limitations; lack of adequate accounting systems and processes to ensure property, plant, and equipment were properly recorded; and lack of policies and procedures to monitor contractor costs and performance.

Our recent testimonies[5] on select DHS programs further validate our position. Specifically, from our review of DHS's Individuals and Households program related to Hurricanes Katrina and Rita disaster relief efforts, we estimated that between $600 million and $1.4 billion in improper and potentially fraudulent individual assistance payments had been made. Similarly, our recent testimony on DHS's purchase card program identified a weak control environment and ineffective internal control activities that allowed potentially fraudulent, improper, and abusive or questionable transactions to occur. DHS must continue to focus on resolving weaknesses and developing strong internal controls to overcome its financial management challenges.

2. *The following agencies reported in their fiscal year 2005 Performance and Accountability Report that they had no programs susceptible to significant improper payments:*
   - *The Department of Commerce (Commerce)*
   - *The General Services Administration (GSA)*
   - *The Department of Homeland Security (DHS)*
   - *The Department of the Interior (Interior)*
   - *The Department of Justice (Justice)*
   - *National Aeronautics and Space Administration (NASA)*
   - *The Nuclear Regulatory Commission (NRC)*
   - *The Securities and Exchange Commission (SEC)*

   Please comment on any of the above agencies with which GAO has concerns.

   While we provided data on the above agencies' implementation efforts to annually review all programs and activities as required under IPIA, we have not analyzed their methodologies for conducting risk assessments to identify those programs and activities susceptible to significant improper payments. That said, noncompliance issues related to IPIA and agencies' existing financial management

[5]GAO, *Hurricanes Katrina and Rita Disaster Relief: Improper and Potentially Fraudulent Individual Assistance Payments Estimated to Be Between $600 Million and $1.4 Billion*, GAO-06-844T (Washington, D.C.: June 14, 2006) and *Purchase Cards: Control Weaknesses Leave DHS Highly Vulnerable to Fraudulent, Improper, and Abusive Activity*, GAO-06-957T (Washington, D.C.: July 19, 2006).

challenges raise questions regarding these agencies' assertions that they had no programs susceptible to significant improper payments. As we testified at the March 9 hearing, auditors for DHS and Justice cited agency noncompliance with IPIA, primarily caused by inadequate risk assessments.

In addition, other agency auditors have reported major management challenges that can hinder effective internal control. For example, at Interior, its auditor reported major management challenges in the agency's Workers Compensation Program. Specifically, the auditors found that (1) Interior's inefficient and ineffective management led to increases in the program's annual costs; (2) the program was understaffed, employees lacked training, and there was no uniform process for ensuring that costs are accurate; and (3) there was an overwhelming lack of awareness that workers' compensation fraud existed. The auditors also reported that, at best, the program was managed inconsistently and, at worst, was subject to abuse by managers seeking an easy way to deal with problem employees.

Internal control serves as the first line of defense in safeguarding assets and preventing and detecting errors, fraud, waste, abuse, and mismanagement. Strong systems of internal control provide reasonable assurance that programs are operating as intended and are achieving expected outcomes. A lack of strong internal control was evident in at least three of the eight agencies listed above that reported no programs were susceptible to significant improper payments. DHS, GSA, and NASA reported they have no risk susceptible programs, yet each of these agencies received a disclaimer of opinion on their fiscal year 2005 financial statement audits due to significant financial reporting deficiencies. In addition, agency auditors identified a total of 47 reportable conditions[6] related to internal control weaknesses found during the eight agencies' financial statement audits.[7] Weaknesses identified during a financial statement audit could materially affect an agency's program operations and thus, significantly increase the risk of making improper payments.

For example, at NRC, agency auditors identified four reportable conditions during their examination of the effectiveness of NRC's internal control over financial reporting. One of these reportable conditions related to financial controls over disbursements. Specifically, auditors found that NRC lacked verification controls to review the propriety of edits made to vendor tables which house information such as the vendor name, address, tax identification number, and bank routing numbers. Verifying such edits helps to ensure the existence of the vendor prior to payment, decreasing the risk of improper payments to phantom vendors. The auditors also reported that NRC does not have controls in place for review and approval of high-value payments to nonfederal entities, ranging from amounts in

[6]Reportable conditions are matters coming to an auditor's attention that, in their judgment, should be communicated because they represent significant deficiencies in the design or operation of internal control that could adversely affect the federal government's ability to meet the internal control objectives described in the audit report.

[7]The number of reportable conditions for each of the eight agencies ranged from 2 to 14.

excess of $250,000 to $300,000. Payments in the high-value category are not reviewed any differently than payments with lower dollar values. During their internal control testing, the auditors identified one improper payment in excess of $1 million, which had not been detected by NRC. The auditors made four recommendations to NRC to strengthen controls over its disbursements. Going forward, agency management at this agency and the other seven agencies listed above will need to ensure their risk assessment methodologies measure the potential or actual effect of major management challenges and internal control weaknesses identified from financial statement audits in order to assist in identifying programs and activities susceptible to significant improper payments.

3. *Should "unavoidable overpayment" statistics at the Social Security Administration be reported to the Office of Management and Budget? Why would this be important, and how could the Social Security Administration implement such a process?*

As we previously reported to your subcommittee,[8] OMB has allowed the Social Security Administration (SSA) to exclude from its estimate of improper payments those payments that it had to make following constitutional, statutory, or judicial requirements even though those payments are subsequently determined to be incorrect.[9] OMB deemed these types of payments to be "unavoidable" improper payments,[10] as there are no administrative changes SSA could implement that would eliminate the requirement to make such payments. Although the definition of improper payments does not use the terms "avoidable"[11] or "unavoidable," we agree with OMB that a payment that was made because of a legal requirement to make the payment, subject to subsequent determinations that the payment is not due, should not be included in an agency's estimate of its improper payments because it does not meet the definition of an improper payment under the act.

Currently, SSA does not track or publicly report on these types of payments. In addition, OMB has reported that it is not aware of other agencies that are similarly legislatively mandated to make these types of payments nor does OMB require governmentwide reporting of these types of payments. Because agencies are not currently required to track, monitor, and report these types of payments on a governmentwide basis, the magnitude of this issue is unknown.

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[8]GAO, *Post-Hearing Questions Related to Agency Implementation of the Improper Payments Information Act*, GAO-05-1029R (Washington, D.C.: Sept. 16, 2005).

[9]IPIA defines an improper payment as a payment that should not have been made or that was made in an incorrect amount (including overpayments and underpayments) under statutory, contractual, administrative, or other legally applicable requirements, and includes any payment to an ineligible recipient, any payment for an ineligible service, any duplicate payment, any payment for services not received, and any payment that does not account for credit for applicable discounts.

[10]OMB defines "unavoidable" payments as payments resulting from legal or policy requirements.

[11]OMB defines "avoidable" payments as payments that could be reduced through changes in administrative actions.

4. *As you know, the Subcommittee is committed to rigorously overseeing USAID and some of its programs. In a written question to Linda Combs following last July's improper payments hearing, I asked whether or not OMB supported USAID's internal assessment that none of their programs were considered to be at risk for "significant" improper payments. Her response deemed USAID's documentation for fiscal year 2004 as acceptable, and stated their intentions to re-evaluate their risk assessments in the fiscal year 2005 Performance and Accountability Report to determine their acceptability. According to GAO's report, USAID was silent as to whether it had programs that are susceptible to making significant improper payments.*

   a) What concerns does GAO have with the Agency for International Development's (USAID) reporting on improper payments?

   As with other agencies, it is important for USAID to fulfill the requirements of IPIA and report the applicable improper payments information in its PAR. As stated in IPIA and OMB's implementing guidance, each agency shall annually review all programs and activities that it administers and identify all such programs and activities that may be susceptible to significant improper payments. For fiscal year 2005, USAID reported limited improper payment information in its PAR. From our review, we found no assertions from USAID that it had assessed all programs and activities for susceptibility to significant improper payments. A risk assessment is a key step in gaining assurance that programs are operating as intended and that they are achieving their expected outcomes. It entails a comprehensive review and analysis of program operations to determine where risks exist, what those risks are, and the potential or actual effect of those risks on program operations. The information developed during a risk assessment forms the foundation or basis upon which management can determine the nature and type of corrective actions needed. It also gives management baseline information for measuring progress in reducing improper payments. USAID only reported that it continues to monitor all its programs and payment activities. Because USAID's PAR lacks details about the monitoring activities it reportedly performed, we are uncertain as to whether this meets the above requirement to perform a risk assessment.

   In fact, there were five programs that did not provide sufficient reporting on improper payments in their fiscal year 2005 Performance and Accountability Report: USAID, the Export-Import Bank, the Pension Benefit Guarantee Corporation, the Postal Service, and the Smithsonian.

   b) Does GAO have any concerns with the rest of these agencies and their failure to report improper payment information?

   Any agencies' failure to report improper payment information as required by the act is of great concern. For example, the Postal Service's Office of Inspector General (OIG) reported that for fiscal year 2005 it had identified $75 million in questioned costs, $261 million in funds that could have been put to better use, and $11 million in unrecoverable costs. The OIG further reported fines, restitutions, and recoveries of $66 million. These OIG findings suggest that the agency may not be adequately assessing all of its programs and activities for significant improper

payments. In meeting the requirements of the act, the Postal Service, as well as other agencies, should report on their risk assessment activities and explicitly state whether the results of the risk assessment identified programs and activities susceptible to significant improper payments.

Since fiscal year 2000, our work has demonstrated that improper payments are a long-standing, widespread, and significant problem in the federal government. Transparency in reporting improper payments is crucial at both the federal agency and governmentwide levels. Public reporting helps establish accountability as well as expectations for improvements. This includes holding agencies accountable for achieving target rates or otherwise implementing specifically planned actions. Annually identifying, estimating, and publicly reporting progress made to reduce improper payments enables agencies and others with oversight and monitoring responsibilities to measure this progress and determine whether further action is needed to minimize future improper payments.

5. *As you know, the improper payments made in the Earned Income Tax Credit makes up the second largest portion of government-wide improper payments for fiscal year 2005, estimating $9.6 to $11.4 billion dollars paid improperly.*

   In fiscal year 2004 EITC had an improper payment rate of 25 percent. For fiscal year 2005, it was 28 percent and this is on the low side, because it's just an estimate. This program does not just need help, it needs a complete overhaul, with an improper payment rate that high.

   I am familiar with the legislative proposals in the President's fiscal year 2007 Budget. OMB believes that if enacted, this proposal would save $232 million in the first year and $5 billion over ten years. That seems a bit under-ambitious when EITC is making at least $10 billion in improper payments every year. In other words, with improper payments of $100 billion over 10 years, why are you [OMB] projecting only to reduce that number by 5 percent? Mr. Williams, has GAO done any analysis of the President's proposals? If so, what is the GAO's assessment? Has GAO made any recommendations regarding the administration and financial controls in the EITC program?

   To date, we have not performed an analysis or an assessment of the President's legislative proposals as they relate to the Earned Income Tax Credit (EITC) program. Regarding any recommendations made, since fiscal year 2001, we have issued three reports that included seven recommendations related to the administration and financial controls in the EITC program. (See table 1.)

Table 1: GAO Recommendations since Fiscal Year 2001 Related to the EITC Program

GAO report number	GAO findings	GAO recommendations related to the EITC program	Status of recommendations
GAO-05-221[a]	Of the 12 federal means-tested programs reviewed, including the EITC program, we found that information on participants' eligibility and particular recipient groups can help program managers more effectively address issues related to program access. With regard to the EITC program, we found that the Internal Revenue Service (IRS) does not: (1) use rate information as a performance measure or (2) include rate information in its performance report or other key program reports.	As participation rate estimates are developed to use as program performance measures for the EITC program, we recommended that steps be taken to quantify errors that may result from estimating EITC participation rate estimates to help users better understand the accuracy of the data and ensure that estimates will be comparable over time.	The recommendation is open.
GAO-05-92[b]	We found that IRS's implementation of tests to address the leading sources of EITC errors was not well documented and the level and quality of some services provided to test participants were not measured.	We made four recommendations to (1) ensure the rationale for key decisions is documented, (2) obtain information on the quality and use of all types of taxpayer assistance, (3) clearly state limitations when disseminating results, and (4) complete development of detailed evaluation plans for the 2005 tests.	The first two recommendations are closed. The remaining two recommendations are open.
GAO-01-42[c]	While IRS has made improvements since we began auditing its financial statements in fiscal year 1992, serious internal control and financial and operational system weaknesses continued to affect the agency's ability to effectively manage its operations and produce reliable financial statement information during fiscal year 1999.	We made two recommendations to (1) determine why service centers have been ineffective in stopping refunds associated with questionable EITCs, and (2) develop reliable cost/benefit data, using the best available information from the screening and examination of EITC claims, to estimate the tax revenue collected by, and the amount of improper refunds returned to, IRS for each dollar spent pursuing these outstanding amounts.	The first recommendation is closed. The second recommendation is open.

Source: GAO.

[a]GAO, *Means-Tested Programs: Information on Program Access Can Be an Important Management Tool*, GAO-05-221 (Washington, D.C.: Mar. 11, 2005).

[b]GAO, *Earned Income Tax Credit: Implementation of Three New Tests Proceeded Smoothly, But Tests and Evaluation Plans Were Not Fully Documented*, GAO-05-92 (Washington, D.C.: Dec. 30, 2004).

[c]GAO, *Internal Revenue Service: Recommendations to Improve Financial and Operational Management*, GAO-01-42 (Washington, D.C.: Nov. 17, 2000).

6. *The Department of Labor has reduced improper payments in its Unemployment Insurance program by about $600 million between 2004 and 2005. OMB reports that this is more than a 15 percent decrease in the error rate for this program since last year's reporting. A 15 percent reduction is a significant accomplishment.*

   a) How can the Department of Labor's successes be carried over to other agencies? b) If the Department of Labor has had this much success in reporting and reducing improper payments, shouldn't other federal-state partnered programs like Temporary Assistance for Needy Families (TANF), Medicaid,

Foster Care, Child Care, State Children's Health Insurance Program (SCHIP), School Programs and Women, Infants and Children (WIC) be able to coordinate between the federal and state authorities to develop an improper payment estimate?

In our April 2006 report,[12] we highlighted that federal and state coordination was needed to develop improper payment estimates for federal programs administered at the state level, including some of the programs included in your question. State-administered programs and other nonfederal entities receive over $400 billion annually in federal funds. Thus, federal agencies and states share a responsibility for the prudent use of these funds. One of the reasons the Department of Labor (Labor) has been able to report an improper payment estimate for its Unemployment Insurance (UI) program is because of a federal requirement[13] in place that mandates that Labor measure each state's payment accuracy rate. To address this requirement, Labor implemented the Benefit Accuracy Measurement (BAM) program, which is designed to determine the accuracy of paid and denied claims in the UI program. It does this by reconstructing the UI claims process from samples of weekly payments and denied claims using data verified by trained investigators. For claims that were overpaid, underpaid, or improperly denied, the BAM program determines the cause of and the party responsible for the error, the point in the UI claims process at which the error was detected, and actions taken by the agency and employers prior to the error. For erroneously paid claims, the BAM program determines the amount of benefits the claimants should have received, which becomes the basis for subsequent recovery efforts. In addition to the federal requirement[14] in place that states must adhere to for estimating improper payments, Labor has attributed its successes to the support and commitment from top management to facilitate successful implementation of IPIA and excellent working relationships with the states.

There are several key initiatives that federal agencies with state-administered programs should employ to fulfill the requirements of IPIA, such as establishing a culture of accountability, developing a system to collect program information at the state level for estimating improper payments, and monitoring program performance to determine if desired program outcomes have been achieved. These key initiatives are aligned with our *Standards of Internal Control*[15] and executive guide[16] on strategies to manage improper payments. Among the standards that are directly linked to the above key initiatives are the following:

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[12]GAO, *Improper Payments: Federal and State Coordination Needed to Report National Improper Payment Estimates on Federal Programs*, GAO-06-347 (Washington, D.C.: Apr. 14, 2006).

[13]Part 602 of Title 20, *U.S. Code of Federal Regulations*.

[14]We have previously reported that only the Food Stamps and Unemployment Insurance programs had federal requirements for all states to annually estimate improper payments. See GAO-06-347.

[15]GAO, *Standards for Internal Control in the Federal Government*, GAO/AIMD-00-21.3.1 (Washington, D.C.: November 1999).

[16]GAO, *Strategies to Manage Improper Payments: Learning From Public and Private Sector Organizations*, GAO-02-69G (Washington, D.C.: October 2001).

- Control environment—creating a culture of accountability by establishing a positive and supportive attitude toward improvement and the achievement of established program outcomes.

- Information and communication—using and sharing relevant, reliable, and timely financial and nonfinancial information in managing activities related to improper payments.

- Monitoring—tracking improvement initiatives over time, and identifying additional actions needed to further improve program efficiency and effectiveness.

As we previously reported,[17] measuring improper payments and designing and implementing actions to reduce or eliminate them are not easy tasks, particularly for grant programs that rely on high-quality administration efforts at the state, grantee, or subgrantee level. Given states' involvement in determining eligibility and distributing benefits, states are in a position to assist federal agencies in reporting on IPIA requirements. Communication, coordination, and cooperation among federal agencies and the states will be critical factors in estimating improper payment rates and meeting IPIA reporting requirements for state-administered programs.

7. *There is some confusion on whether or not the Community Development Block Grant Program (CDBG) is required to report improper payments. It was one of the original programs on the President's Management Agenda, so it's been required to report since 2001. It is also required to report under the Improper Payments Information Act, but is not reporting under [either] requirements. In other hearings held by this Subcommittee as well as in written responses to letters sent by me and Senator Carper, the Department of Housing and Urban Development (HUD) has denied that they are out of compliance with the Improper Payments Information Act. The CDBG program is required to report under IPIA. Is GAO concerned that CDBG's outlays are $5.4 billion, and not only are they not reporting, they have claimed that they are in compliance?*

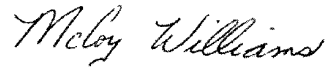
In its fiscal year 2005 PAR, HUD reported that based on completed testing of fiscal year 2003 payments, the CDBG program was below OMB's threshold for significant improper payments and, therefore, was removed from HUD's at-risk inventory. As such, HUD stated that this program was not subject to retesting unless there was a significant change in the nature of activity or internal control structure. We have several problems with HUD's position. First, CDBG was

[17]GAO-05-1029R.

subject to the previous OMB Circular No. A-11 requirements[18] and thus was required by OMB's guidance to continue to report improper payment information under IPIA, regardless of the agency-determined risk level. Second, during a June 2006 hearing before your subcommittee[19] on the CDBG program, HUD's OIG reported on numerous instances of fraudulent, improper, and abusive use of program funds identified over a 2-½ year period based on 35 audits. The HUD OIG reported that its office has recovered over $120 million in program funds, identified over $100 million in questioned costs, indicted 159 individuals, initiated administrative actions against 143 individuals, and took 5 civil actions and 39 personnel actions. As evident by the HUD OIG reviews, the CDBG program may be at risk of making improper payments.

We are sending a copy of this report to the Director of OMB and other interested parties. This report is also available on GAO's home page at http://www.gao.gov. Should you have any questions on matters discussed in this report or need additional information, please contact me at (202) 512-9095 or at williamsm1@gao.gov. Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this report. Major contributors to this report include Carla Lewis, Assistant Director; James Maziasz, and Donell Ries.

Sincerely yours,



McCoy Williams
Director, Financial Management and Assurance

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[18]Prior to the governmentwide IPIA reporting requirements beginning with fiscal year 2004, former section 57 of OMB Circular No. A-11, required certain agencies to submit similar information, including estimated improper payment target rates, target rates for future reductions in these payments, the types and causes of these payments, and variances from targets and goals established. In addition, these agencies were to provide a description and assessment of the current methods for measuring the rate of improper payments and the quality of data resulting from these methods.

[19]June 29, 2006 hearing before the Senate Subcommittee on Federal Financial Management, Government Information, and International Security, Committee on Homeland Security and Governmental Affairs.