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AND THE BROADCASTING BOARD OF GOVERNORS
OFFICE OF INSPECTOR GENERAL

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Office of Audits

April 2014

Audit of Department of State FY 2013 Compliance With Improper Payments Requirements

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United States Department of State
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Office of Inspector General

PREFACE

This report is being transmitted pursuant to the Inspector General Act of 1978, as amended, and Section 209 of the Foreign Service Act of 1980, as amended. It is one of a series of audit, inspection, investigative, and special reports prepared as part of the Office of Inspector General's (OIG) responsibility to promote effective management, accountability, and positive change in the Department of State and the Broadcasting Board of Governors.

This report addresses the Department of State's (Department) FY 2013 compliance with improper payments requirements. The report is based on interviews with employees and officials of relevant agencies and institutions, direct observation, and a review of applicable documents.

OIG contracted with the independent public accountant Kearney & Company, P.C. (Kearney), to perform this audit. The contract required that Kearney perform its audit in accordance with guidance contained in the *Government Auditing Standards*, issued by the Comptroller General of the United States. Kearney's report is included.

Kearney determined that the Department was in substantial compliance with improper payments requirements. However, Kearney identified two areas in which improvements could be made: payment recapture audit activities and improper payments reporting.

OIG evaluated the nature, extent, and timing of Kearney's work; monitored progress throughout the audit; reviewed Kearney's supporting documentation; evaluated key judgments; and performed other procedures as appropriate. The recommendations contained in the report were developed on the basis of the best knowledge available and were discussed in draft form with those individuals responsible for implementation. OIG's analysis of management's response to the recommendations has been incorporated into the report. OIG trusts that this report will result in more effective, efficient, and/or economical operations.

I express my appreciation to all of the individuals who contributed to the preparation of this report.

A handwritten signature in blue ink, appearing to read "Norman P. Brown".

Norman P. Brown
Assistant Inspector General for Audits

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Audit of Department of State FY 2013 Compliance With Improper Payments Requirements

Office of Inspector General
U.S. Department of State
Washington, D.C.

Kearney & Company, P.C. (referred to as “we” in this letter), has performed an audit of the Department of State’s FY 2013 compliance with improper payments requirements. This performance audit, performed under Contract No. SAQMMA09D0002, was designed to meet the objective identified in the report section titled “Objective” and further defined in Appendix A, “Scope and Methodology,” of the report.

We conducted this performance audit in accordance with *Government Auditing Standards*, issued by the Comptroller General of the United States. We communicated the results of our performance audit and the related findings and recommendations to the U.S. Department of State Office of Inspector General.

We appreciate the cooperation provided by personnel in Department offices during the audit.

A handwritten signature in blue ink that reads "Kearney & Company". The signature is written in a cursive, flowing style.

Kearney & Company, P.C.
Alexandria, Virginia
April 15, 2014

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Acronyms

AFR	Agency Financial Report
CGFS	Bureau of the Comptroller and Global Financial Services
CGFS/DCFO/MC	Bureau of the Comptroller and Global Financial Services, Deputy Chief Financial Officer, Management Controls
CGFS/F/C	Bureau of the Comptroller and Global Financial Services, Office of Claims
CGFS/OMA	Bureau of the Comptroller and Global Financial Services, Office of Oversight and Management Analysis
D&CP	Diplomatic and Consular Programs
ECA	Educational and Cultural Exchange Programs
ESCM	Embassy Security, Construction & Maintenance
INL	International Narcotics Control and Law Enforcement
IPERA	Improper Payments Elimination and Recovery Act of 2010
IPERIA	Improper Payments Elimination and Recovery Improvement Act of 2012
IPIA	Improper Payments Information Act of 2002
NADR	Non-Proliferation, Anti-Terrorism, Demining, and Related Programs
OIG	Office of Inspector General
OMB	Office of Management and Budget
WCF	Working Capital Fund

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Executive Summary

Improper Federal payments totaled an estimated \$106 billion in FY 2013. Over the past decade, the Federal Government has implemented safeguards to reduce improper payments. In 2010, the Improper Payments Elimination and Recovery Act¹ (IPERA), which amended the Improper Payments Information Act of 2002² (IPIA), was signed into law. IPERA strengthened IPIA by increasing requirements for identifying and reporting on improper payments. In April 2011, the Office of Management and Budget (OMB) issued guidance to implement IPERA.

IPIA, as amended by IPERA,³ requires agencies' Offices of Inspector General (OIG) to annually assess compliance with improper payments requirements.⁴ In accordance with this requirement, Kearney & Company, P.C. (Kearney), an external audit firm acting on OIG's behalf, conducted an audit of the Department of State's (Department) FY 2013 compliance with IPIA.

Kearney found that the Department was in substantial compliance with IPIA requirements. Specifically, the Bureau of the Comptroller and Global Financial Services (CGFS) defined the Department's programs and conducted systematic improper payments risk assessments of significant programs. CGFS also strengthened its improper payments recapture audit policies and procedures and made the required improper payments disclosures in the Department's FY 2013 Agency Financial Report (AFR).⁵ However, CGFS excluded a significant amount of payments from its recapture audits, and two disclosures relating to the recapture audit process were not complete.

OIG is recommending that CGFS enhance its recapture audit procedures to include all payment types, or formally document its justifications for the exclusions and communicate the exclusions to OMB and OIG, and improve its controls over improper payments reporting to ensure the completeness of the information disclosed in the AFR.

In its April 3, 2014, response (see Appendix C) to the draft report, CGFS concurred with the two recommendations. Based on the response, OIG considers the two recommendations resolved, pending further action. Management's response and OIG's replies to those responses are included after each recommendation.

Background

Improper Federal payments to individuals, organizations, and contractors totaled an estimated \$106 billion during FY 2013.⁶ Improper payments are payments that should not have been made or that were made in an incorrect amount. Improper payments include overpayments

¹ Pub. L. No. 111-204.

² Pub. L. No. 107-300.

³ Unless otherwise indicated, the term "IPIA" will imply "IPIA, as amended by IPERA" in this report.

⁴ Pub. L. No. 111-204 § 3(b).

⁵ Federal agencies may publish their financial statements in either an AFR or a Performance Accountability Report. The Department has elected to use the AFR format.

⁶ Sean Reilly, "Improper payment rate falls again," *Federal Times*, Dec. 31, 2013.

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and underpayments, duplicate payments, payments made to an ineligible recipient, payments for an ineligible good or service, payments for goods or services not received (except for such payments authorized by law), payments that do not account for credit for applicable discounts, and payments for which an agency cannot determine whether the payments were proper because of insufficient or lack of supporting documentation.

Over the past decade, the Federal Government has implemented safeguards to reduce improper payments. IPIA, as initially enacted in 2002, required Federal agencies to annually identify programs and activities⁷ at high risk of improper payments, estimate the amount of improper payments in those programs, perform recovery auditing if program payments exceeded \$500 million, and report to Congress on steps taken to reduce improper payments.

In July 2010, IPERA, which amended IPIA, was enacted in an effort to further reduce improper payments. IPERA clarified the programs to be reviewed and expanded improper payments recapture activities. IPERA also required inspectors general to determine whether an agency is in compliance and established additional requirements for agencies that were deemed noncompliant. In April 2011, OMB issued guidance for agencies implementing IPERA requirements, as Appendix C, Revised Parts I and II, of OMB Circular A-123, *Management's Responsibility for Internal Control*.⁸ The guidance, among other things, defines the programs and payments that agencies must assess for the risk of improper payments and provides requirements for determining whether the risk of improper payments is significant, for developing an estimate of improper payments, for performing recapture audit activities, and for reporting improper payments activities.

In January 2013, the Improper Payments Elimination and Recovery Improvement Act of 2012⁹ (IPERIA) was enacted. IPERIA further amended IPIA by requiring, among other things, that OMB identify high-priority Federal programs for greater levels of oversight and review, provide guidance to agencies for improving estimates of improper payments, and establish a working system for prepayment and preaward review.

Department of State Payments

The Department is the primary agency through which the U.S. Government conducts its diplomacy. The Department operates more than 270 embassies, consulates, and other posts worldwide. The Department provides policy guidance, program management, administrative support, and in-depth expertise in areas such as law enforcement, economics, the environment, intelligence, arms control, human rights, counternarcotics, counterterrorism, public diplomacy, humanitarian assistance, security, nonproliferation, and consular services.

Because of the nature and the extent of its programs, the Department makes significant payments to third-party vendors, contractors, and grantees. During FY 2013, the Department made approximately \$31.5 billion in payments, of which \$15.1 billion were payments subject to

⁷ The term "program and activity" is referred to in this report as "program."

⁸ OMB Circular A-123, Appendix C, Revised Parts I and II will be referred to in this report as OMB Circular A-123, Appendix C.

⁹ Pub. L. No. 112-248.

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IPIA requirements.¹⁰ The payments subject to IPIA requirements included payments to vendors and contractors and Federal Financial Assistance payments, including grants, assessed contributions,¹¹ and voluntary contributions.¹² The amount and volume of payments made by the Department, the Department's emphasis on expediting certain payments (for example, payments for necessary foreign financial assistance), and the decentralized nature of the Department's operations increase the Department's risk for improper payments.

CGFS has oversight responsibilities for the Department's financial management program. Financial management program responsibilities include establishing financial policy and procedure, financial reporting and analysis, management of financial information systems, and management controls. Management controls, also known as "internal controls," are the processes designed and implemented by an organization to help it accomplish its goals or objectives. Important internal control activities include those that are aimed at ensuring that only valid, proper payments are made.

Within CGFS, the Deputy Chief Financial Officer, Office of Management Controls (CGFS/DCFO/MC), is responsible for overseeing the Department's management control program and other financial management functions, such as administering compliance with IPIA. The Office of Claims (CGFS/F/C) is the central domestic funding paying agent of the Department. The Office of Oversight and Management Analysis (CGFS/OMA) is responsible for, among other things, ensuring compliance with financial laws, policies, and procedures and performing internal control and quality control reviews.

Prior OIG Reports

In 2013, OIG reported¹³ that, although the Department had taken steps to comply with IPIA, significant areas of improvement remained. The Department had expanded and standardized improper payments risk assessment procedures, implemented a recapture audit process, and included information on the risk assessment process and recapture audit activities in its FY 2012 AFR. However, the Department's improper payments risk assessment methodology required additional refinement, and baseline risk assessments had not been performed for all programs as required. In addition, recapture audit activities were not performed for all types of improper payments or all payments, and some improper payments disclosures required to be included in the AFR were omitted. OIG recommended that the Department conduct full baseline improper payments risk assessments for all programs and enhance its methodologies and policies

¹⁰ OMB Circular A-123, Appendix C, states that agencies are not obligated to review payments to employees and intragovernmental transactions for improper payments unless directed to do so by OMB. Of the \$31.5 billion in Department payments, approximately \$7.2 billion were payments to employees and \$9.2 billion were intergovernmental and intradepartmental transactions. Beginning in FY 2014, IPERIA requires that agencies include payments to employees as subject to risk assessment.

¹¹ Assessed contributions represent assistance provided to foreign countries, international societies, commissions, proceedings or projects that are lump sum, quota of expenses, or fixed by treaty.

¹² Voluntary contributions represent discretionary financial assistance provided to foreign countries, international societies, commissions, proceedings, or projects.

¹³ *Audit of Department of State FY 2012 Compliance With Improper Payments Requirements* (AUD-FM-13-23, March 2013).

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and procedures for performing risk assessments and recapture audit activities and for reporting information relating to improper payments in its AFR.

Objective

The overall objective of this audit was to determine whether the Department was in compliance with IPIA. To accomplish this objective, Kearney

- Evaluated whether the Department conducted a program-specific risk assessment for all programs.
- Evaluated the Department's performance in preventing, detecting, and recapturing improper payments.
- Determined whether the Department reported the required improper payments information in its 2013 AFR.

Audit Results

Department Was in Substantial Compliance with IPIA

Kearney found that the Department had taken sufficient steps during FY 2013 to substantially comply with IPIA requirements. Specifically, CGFS defined the Department's programs and conducted systematic improper payments risk assessments of significant programs in compliance with IPIA. CGFS also strengthened its improper payments recapture audit policies and procedures by implementing procedures to ensure coverage of all improper payments types, programs with higher risks, and overseas payments. However, CGFS continued to exclude a significant amount of payments from its recapture audits without performing cost-benefit analyses to support the exclusions. In addition, CGFS reported the required improper payments information in the Department's FY 2013 AFR; however, two disclosures relating to the improper payments recapture audit process were not complete.

Finding A. Programs Were Defined and Systematic Program Risk Assessments Were Performed

During FY 2013, CGFS/DCFO/MC defined the Department's programs and performed full systematic risk assessments of all significant programs in accordance with OMB Circular A-123, Appendix C.

Programs Were Defined

IPIA requires agencies to periodically review all programs and identify those that may be susceptible to significant improper payments. OMB Circular A-123, Appendix C, states that a program includes "activities or sets of activities recognized as programs by the public, OMB, or Congress, as well as those that entail program management or policy direction."

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During FY 2013, CGFS/DCFO/MC defined its programs for IPIA risk assessment purposes to align with the Department's budget requests and appropriations and the manner in which Department officials manage their operations. Specifically, CGFS/DCFO/MC identified each major program receiving appropriations in its FY 2013 Congressional Budget Justification. Using Department of the Treasury fund symbols, CGFS/DCFO/MC identified the FY 2013 expenses for each of the major programs. For major programs in which the Department performed different activities or operations around the world, CGFS/DCFO/MC obtained information from Department bureaus and program managers to determine how best to group these activities into separate programs. Based on the information received, CGFS/DCFO/MC developed an inventory of the Department's programs along with each program's payments subject to IPIA.

Systematic Program Risk Assessments Were Performed

OMB Circular A-123, Appendix C, requires that agencies perform a risk assessment of all programs for susceptibility for significant improper payments. The Circular defines "significant improper payments" as gross annual improper payments in the program exceeding (1) both 2.5 percent¹⁴ of program outlays and \$10 million of all program payments made during the fiscal year or (2) \$100 million. Agencies must institute a systematic method of performing the risk assessments. An agency can perform a quantitative evaluation based on a statistical sample or it can perform a qualitative evaluation by considering risk factors likely to contribute to significant improper payments. For qualitative evaluations, the Circular lists eight risk factors that should be considered, including the age of the program; the complexity of the program; the volume of payments made annually; whether payment eligibility decisions are made outside of the agency; recent major changes in the program; the level, experience, and quality of training of certain personnel; significant deficiencies identified in audit reports; and results from prior improper payment work.

During FY 2013, CGFS/DCFO/MC performed a systematic risk assessment of all significant Department programs. Concluding that programs with less than \$100 million in expenditures would be highly unlikely to have improper payments that exceeded both 2.5 percent of program outlays and \$10 million of all program payments, CGFS/DCFO/MC established a threshold of over \$100 million to select programs for review. Using its inventory of Department programs, CGFS/DCFO/MC identified 35 programs with more than \$100 million in payments subject to IPIA. Appendix B provides a list of the 35 programs.

CGFS/DCFO/MC performed and documented a qualitative risk assessment of each of its 35 significant programs. To perform the assessment, CGFS/DCFO/MC developed a scorecard for each program that included an evaluation of the eight risk factors specified by OMB. CGFS/DCFO/MC obtained information for its evaluation by reviewing the Congressional Budget Justification, internal and external Web sites, and internal and external reports. Based on the information obtained, CGFS/DCFO/MC assigned a numerical rating of 1, 2, or 3 to each program for each risk factor. For example, for one risk factor—results from prior improper

¹⁴ Although IPERA reduced the percentage error rate from 2.5 percent to 1.5 percent beginning in FY 2013, IPERIA delayed implementation of the reduced percentage until FY 2014.

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payment work—CGFS/DCFO/MC assigned a rating of 1 (low risk) to programs with 0 to 3 improper payments or improper payments totaling less than \$5,000; a rating of 2 (moderate risk) to programs with 4 to 8 improper payments or improper payments totaling between \$5,000 to \$100,000; and a rating of 3 (high risk) to programs with over 8 improper payments or improper payments totaling over \$100,000. After completing similar analyses of each of the eight OMB risk factors for all programs, CGFS/DCFO/MC averaged the risk factor ratings for each program to determine the program's overall risk level. The overall ratings for each program indicated that 26 of the 35 programs had low risk for incurring significant improper payments, and the remaining nine programs had moderate risk.

CGFS/DCFO/MC performed an additional assessment of the nine programs with moderate risk. This second assessment considered factors such as the location in which the program's costs were incurred and whether significant deficiencies in the program's internal control had been previously identified. The results of this assessment indicated that the nine programs' overall risk remained unchanged as moderate, and therefore, additional evaluations were not deemed necessary. As a result, CGFS/DCFO/MC concluded that none of the Department's programs were susceptible to significant improper payments as defined by OMB Circular A-123, Appendix C.

The report on the Department's FY 2012 compliance with IPIA included the following recommendation relating to the Department's improper payments risk assessment:

Recommendation 1 (AUD-FM-13-23). OIG recommends that the Bureau of Comptroller and Global Financial Services:

- *Conduct full baseline risk assessments for all programs.*
- *Ensure all costs assigned to programs reflect the actual payments of the program.*
- *Refine the risk assessment process to provide additional guidance for rating each risk factor.*
- *Implement a method to obtain input from the bureaus and offices responsible for the programs.*

Based on the actions that CGFS/DCFO/MC has taken since the 2013 report, OIG is closing this recommendation upon the issuance of this report.

Finding B. Controls To Prevent, Detect, and Recapture Improper Payments Were Strengthened But Recapture Audit Excluded Some Payments

The Department had implemented a program of internal control to prevent, detect, and recapture improper payments. The Department had policies and procedures for prepayment reviews to prevent improper payments, post-payment reviews to detect improper payments, and recapture audits to recover improper payments. During FY 2013, the Department strengthened its improper payments recapture audit policies and procedures. Specifically, CGFS/OMA implemented procedures to ensure coverage of improper payments types other than duplicate payments as well as programs with higher risk for improper payments. In addition, CGFS/OMA implemented procedures to review overseas payments. The Department's post-payment reviews

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and recapture audits have identified and recovered improper payments totaling over \$77 million since FY 2005.

Although improvements were made, CGFS continued to exclude a significant amount of payments from its improper payments recapture audits without performing and documenting cost-benefit analyses to support the exclusions. The recapture audit exclusions have limited the Department's ability to identify and recover all improper payments.

Prepayment Reviews

OMB Circular A-123, Appendix C, states that when implementing a payment recapture, audit program agencies shall have a program of internal control to prevent, detect, and recover overpayments. Prevention activities are designed to prevent improper payments from occurring.

The Department has controls in place to help prevent improper payments from occurring. For payments to vendors, vendors must submit invoices to either the Department's financial service centers or to the foreign post that procured the good or service. For an invoice to be paid, an approved official must certify that the good or service was received and ensure that the invoice is valid and accurate. Once the invoice is approved, two Department personnel, a voucher examiner and a certifying officer, are required to process the payment. The voucher examiner enters the transaction into the Department's accounting system and ensures that all supporting documentation has been submitted. The certifying officer reviews the transaction and verifies that the supporting documentation is complete and the accounting data is correct. The Department's financial accounting systems have automated controls that also verify certain payment-related information. For example, the domestic financial management system does not process payments with duplicate invoice numbers from one vendor.

The Department uses other systems and processes to disburse payments for other activities (for example, grant payments or payments to pensioners). The Department has prepayment controls in place for these payments as well. For example, grantee eligibility and compliance with grant covenants on prior awards are reviewed prior to disbursement of grant payments. Prior to disbursement, pension payments are reviewed against the Social Security Administration's listing of deceased individuals to ensure payments are not made to these individuals.

Post-Payment Reviews

OMB Circular A-123, Appendix C, states that detection activities occur subsequent to payment and are intended to detect improper payments that may have occurred. These actions test the accuracy of payment processes and identify improper payments made during those processes. For example, routine payment verification or quality control would review a universe of payments, using different criteria than are used during prepayment reviews, to detect potential improper payments.

The Department performed post-payment reviews as part of the routine payment process. Specifically, CGFS/F/C selected random samples of payments on a monthly basis and reviewed

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the sampled items for adequate support, proper approval, and the validity and accuracy of the amounts disbursed. This process would identify payments made to incorrect individuals, payments made in incorrect amounts, as well as payments that should not have been made. CGFS/F/C also used data-matching techniques to identify potential duplicate payments disbursed in the current fiscal year.

On a monthly basis, CGFS/F/C prepared a monthly Quality Management report that summarized the improper payments identified. This report tracked improper payments identified against key metrics, including improper payments as a percentage of total payments issued. Based on its analysis of the improper payments, CGFS/F/C identified the root causes and trends of improper payments and reported the improper payments by office responsible, vendors paid, and at the bureau level. Additionally, if CGFS/F/C identifies a bureau to be problematic, the Department performs targeted sampling of that bureau's payments.

Recapture Audits

IPIA requires agencies to conduct recovery audits (also known as "recapture audits") for each program that expends \$1 million or more annually if conducting such audits would be cost effective. According to OMB Circular A-123, Appendix C, a recapture audit is a review and analysis of accounting and financial records, supporting documentation, and other information supporting payments that is specifically designed to identify overpayments.

The Department implemented an improper payments recapture audit process for domestic payments in FY 2007.¹⁵ On a monthly basis, CGFS/OMA extracted a data file of payments made during the previous month from the domestic financial management system and imported the file into a data analysis tool. CGFS/OMA then performed a search for potential duplicate payments by comparing the invoice number and dollar amount of each payment in the monthly data file against the payments made during the previous 3 years. Payments with the same invoice number and dollar amount were extracted into a separate file of potential duplicate payments. CGFS/OMA provided the potential duplicate payments to CGFS/F/C for review.

During FY 2013, CGFS/OMA strengthened its recapture audit activities. Specifically, CGFS/OMA sampled domestic payments and obtained supporting documentation for the selected payments to identify other types of improper payments, such as payments made for incorrect amounts, payments made to ineligible recipients or for ineligible goods, or payments made with inadequate supporting documentation. In addition, CGFS/OMA leveraged the results of the FY 2012 improper payments risk assessments completed by CGFS/MC to ensure that sufficient samples were taken from higher risk programs.

Also new in FY 2013, CGFS/OMA implemented an improper payments recapture audit process for overseas payments. CGFS/OMA obtained a data file of overseas payments from the overseas financial management system and imported the file into a data analysis tool. From this file, CGFS/OMA performed a manual review for potential duplicate payments by comparing monthly payments against invoices processed in the overseas financial management system. In

¹⁵ CGFS/OMA began performing improper payments recapture audits in FY 2007; however, an external contractor performed recapture audits for the Department in FYs 2005 and 2006.

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addition to the duplicate payment review, CGFS/OMA selected a random sample of overseas payments on vouchers that had individual amounts exceeding \$10,000. CGFS/OMA obtained supporting documentation from posts for each selected payment and reviewed the documentation to identify payments made for incorrect amounts, payments made to vendors on the Department of the Treasury’s “Do Not Pay” listing, payments made for improper or unapproved purchases, and payments made with inadequate supporting documentation.

Post-Payment Review and Payment Recapture Audit Results

As reported in the Department’s FY 2013 AFR, the Department identified \$11.2 million in overpayments through its post-payment reviews during FY 2013. Of the \$11.2 million, the Department recovered \$9.7 million. The Department also recovered \$205,000 in improper payments that were identified during post-payment reviews in previous years. In addition, the Department identified \$2,253 in improper payments through its FY 2013 payment recapture audit process and recovered the entire amount. Together, the Department’s post-payment reviews and payment recapture audits have identified improper payments totaling approximately \$79 million from FYs 2005–2013. Of that amount, the Department recovered approximately \$77 million as shown in Table 1.

Table 1. Improper Payments Identified and Recovered FYs 2005 – 2013 (in millions)

Review Process	Amount Identified	Amount Recovered
Post-Payment Review	\$37.9	\$35.9
Payment Recapture Audit	41.1	41.1
Total	\$79.0	\$77.0

Source: Department’s FY 2013 AFR.

Recapture Audit Exclusions

OMB Circular A-123, Appendix C, states that agencies may exclude payments from payment recapture audit activities if the agency determines that payment recapture audits are not a cost-effective method for identifying and recapturing improper payments. If an agency excludes a program that expends more than \$1 million, the agency must notify OMB and OIG and include any analysis used by the agency to reach this decision.

The Department’s FY 2013 improper payments recapture audit process did not include a significant amount of payments. Specifically, grant payments amounting to approximately \$2.5 billion that were made through the Payment Management System,¹⁶ which processes the majority of the Department’s financial assistance-related payments, and pension annuity payments amounting to approximately \$894 million,¹⁷ which were processed by CGFS’s Retirement Accounts Division, were excluded. CGFS/OMA also excluded supplemental payments, shipping payments, passport fee reimbursements, training payments, and certain transportation payments. These additional payment exclusions exceeded \$188 million in FY 2013.

¹⁶ The Payment Management System is a grant payment system maintained by the U.S. Department of Health and Human Services.

¹⁷ Amount disbursed to beneficiaries as disclosed in the Department’s FY 2013 AFR, Note 10.

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CGFS/OMA stated that recapture audits were not performed over grant payments processed through the Payment Management System because of issues obtaining payment information from the U.S. Department of Health and Human Services. In addition, CGFS/OMA excluded pension annuity payments because the Retirement Accounts Division has effective controls in place and performs an analysis to identify and recover improper payments.

As a result of the exclusions, the Department's FY 2013 recapture audit activities did not cover approximately \$3.6 billion in payments subject to IPIA requirements. Although it excluded a significant amount of payments, the Department did not perform and document a cost-benefit analysis supporting the basis for these exclusions, as was required.

By excluding significant payment types from recapture audits, the Department may have made but may not have identified and recovered all improper payments. Although traditionally used as a technique to identify improper payments already made, recapture auditing results can also be used to identify trends in improper payments and improve controls to prevent improper payments.

The report on the Department's FY 2012 compliance with IPIA included the following recommendation relating to the Department's recapture audit activities:

Recommendation 2 (AUD-FM-13-23).** **OIG recommends that the Bureau of Comptroller and Global Financial Services update existing policies and standard procedures for its recapture audit activities to ensure compliance with all OMB requirements. These revised policies and procedures should include, but not be limited to, the following:

- *Program, as well as payment, audit activities to help target recapture audits on programs or payment types that are deemed higher risk.*
- *Alternative procedures to audit payments occurring outside the Global Financial Management System.*
- *Analytics and other proven recapture audit techniques (for example, predictive modeling, additional forensic accounting tools, additional data matches, and financial incentives) that address improper payments types other than duplicate payments.*
- *Requirements for performing a cost-benefit analysis for programs and payment types excluded from recapture audit activities and communicating the exclusions to the Office of Management and Budget and OIG.*

Based on the actions CGFS/OMA has taken to strengthen its recapture audit activities by implementing activities to address improper payments types other than duplicate payments, ensure coverage of programs with higher risks, and review overseas payments, OIG is closing this recommendation upon issuance of this report. However, CGFS/OMA should continue its efforts to identify ways to expand its recapture audit coverage over currently excluded payments.

Recommendation 1. OIG recommends that the Bureau of the Comptroller and Global Financial Services:

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- Expand its recapture audit procedures to include pension annuity and Payment Management System grant payments or formally document the justification for excluding these payment types.
- Communicate the recapture audit exclusions to the Office of Management and Budget and OIG, along with the justification or cost-benefit analysis.

Management Response: CGFS concurred with the recommendation, stating that it “will carefully evaluate” the recommendation and “implement corrective actions as appropriate.”

OIG Reply: OIG considers the recommendation resolved. This recommendation can be closed when OIG reviews and accepts documentation showing that CGFS has expanded its recapture audit procedures to include all payment types or communicated the exclusions, along with the justification, to OMB and OIG.

C. Required Improper Payments Disclosures Were Made but Some Were Not Complete

The Department included the required improper payments disclosures in its FY 2013 AFR. Specifically, CGFS disclosed its improper payments risk assessment process and recapture audit activities and results. CGFS had also taken action to address reporting deficiencies identified in the report on the Department’s 2012 compliance with IPFA. Although CGFS had improved its improper payments reporting, two disclosures relating to the Department’s improper payments recapture audit process were not complete. By not including complete information in its AFR, the Department is not providing users with complete information about its efforts related to improper payments.

Improper Payments Disclosures Were Made

IPFA states that for an agency to be in compliance with the act, the agency must publish an annual financial statement for the most recent fiscal year and post that report, with the information on improper payments required by OMB, on the agency’s Web site. OMB Circular A-123, Appendix C, requires an agency to disclose specific information relating to improper payments in its annual AFR in the format provided in OMB Circular A-136, Revised, *Financial Reporting Requirements*.

The Department published its FY 2013 AFR on its Web site. The AFR included the required improper payments disclosures. For example, the AFR included summary information on improper payments, a description of the Department’s improper payments risk assessment process, and a description of the Department’s payment recapture audit program.

CGFS had also enhanced its policies and procedures to address reporting deficiencies identified in the report on the Department’s 2012 compliance with IPFA. As a result, the FY 2013 AFR included additional required information. For example, the Management’s Discussion and Analysis section of the AFR included a brief description of the Department’s

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progress on eliminating and recovering improper payments; the payment recapture tables followed the format provided in OMB Circular A-136; and the Department disclosed that grant payments made through the Payment Management System were not included in its improper payments recapture audits.

The report on the Department's FY 2012 compliance with IPIA included the following recommendation relating to the Department's improper payments reporting:

***Recommendation 3 (AUD-FM-13-23).** OIG recommends that the Bureau of Comptroller and Global Financial Services enhance existing policies and standard procedures that ensure that the improper payments information included in the Department of State Agency Financial Report is complete and accurate.*

Based on the actions the Department had taken to enhance its policies and procedures, OIG is closing this recommendation upon issuance of this report.

Some Required Disclosures Were Not Complete

Although the Department included the required disclosures in its AFR, two required disclosures were not complete. OMB Circular A-136 requires that an agency provide a description and justification of the classes of payments excluded from payment recapture audits. CGFS properly disclosed in the Department's AFR that grant payments processed through the Payment Management System were excluded from its payment recapture audits because of data related issues. However, CGFS did not disclose that it had also excluded pension annuity payments from the scope of its recapture audits. This issue was first reported in the report on the Department's 2011 compliance with IPIA.¹⁸

Further, the recapture tables did not include complete information on the payments identified and recovered through sources other than payment recapture audits. CGFS included the amounts identified and recovered by CGFS/OMA during improper payments recapture audit activities and by CGFS/F/C during post-payment reviews, as well as OIG recoveries. However, CGFS did not track and assess information on payments identified as improper and recovered in other Department offices and bureaus, such as contract close-out recoveries, recoveries resulting from grant compliance reviews, and pension annuity overpayment recoveries. This issue was first reported in the report on the Department's 2012 compliance with IPIA.

By not including complete information in its AFR, the Department did not provide users with all relevant and reliable information about its efforts to prevent and identify and recover improper payments. AFRs play a key role in fulfilling the Government's duty to be accountable for the use of public funds, and AFRs can be used to assess an agency's efficiency and effectiveness in performing activities such as identifying and recapturing improper payments.

Recommendation 2. OIG recommends that the Bureau of Comptroller and Global Financial Services improve its controls for improper payments reporting to ensure that all

¹⁸ *Audit of Department of State Compliance With the Improper Payments Information Act (AUD/FM-12-31, March 2012).*

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payment types excluded from recapture audits are disclosed and all improper payments identified and recovered are reported in the Agency Financial Report.

Management Response: CGFS concurred with the recommendation, stating that it “will carefully evaluate” the recommendation and “implement corrective actions as appropriate.”

OIG Reply: OIG considers the recommendation resolved. This recommendation can be closed when OIG reviews and accepts documentation showing that CGFS has improved its controls for improper payments reporting.

List of Recommendations

Recommendation 1. OIG recommends that the Bureau of the Comptroller and Global Financial Services:

- Expand its recapture audit procedures to include pension annuity and Payment Management System grant payments or formally document the justification for excluding these payment types.
- Communicate the recapture audit exclusions to the Office of Management and Budget and OIG, along with the justification or cost-benefit analysis.

Recommendation 2. OIG recommends that the Bureau of Comptroller and Global Financial Services improve its controls for improper payments reporting to ensure that all payment types excluded from recapture audits are disclosed and all improper payments identified and recovered are reported in the Agency Financial Report.

Scope and Methodology

The Improper Payments Elimination and Recovery Act of 2010¹ (IPERA), which amended the Improper Payments Information Act of 2002² (IPIA), requires the Office of Inspector General (OIG) to conduct an annual audit of the Department of State's (Department) compliance with improper payments requirements. In accordance with the IPERA requirement, an external audit firm, Kearney & Company, P.C. (Kearney), acting on OIG's behalf, performed this audit to determine whether the Department was in compliance with IPIA, as amended by IPERA.³

Kearney conducted the audit work from December 2013 through February 2014 in Washington, DC, and at the Office of Global Financial Services in Charleston, SC. Kearney conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that the auditor plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for the findings and conclusions based on the audit objectives. Kearney and OIG believe that the evidence obtained provides a reasonable basis for Kearney's findings and conclusions based on its audit objectives.

Kearney focused the scope of the audit on the following objectives: (1) to evaluate the accuracy and completeness of the Department's improper payments risk assessment process; (2) to evaluate the Department's performance in preventing, reducing, and recapturing improper payments; and (3) to determine whether the Department reported the required improper payments information in its FY 2013 Agency Financial Report (AFR).

Kearney designed the audit to obtain insight into the Department's current processes, procedures, and organizational structure with regard to compliance with IPIA requirements. To expedite the audit process, Kearney leveraged the results of its FY 2013 financial statement audit and audits of the Department's FY 2012 and 2011 compliance with IPIA to confirm its understanding of the nature and profile of Department operations, IPIA standards, regulatory requirements, and supporting information systems and controls.

Kearney conducted process walkthroughs and interviews with Department officials to obtain a sufficient understanding of the steps taken by the Department to assess the risk of improper payments; its process of identifying significant improper payments; the steps taken to prevent, reduce, and recapture improper payments; and the process of reporting improper payments information. Consistent with the fieldwork standards for performance audits, Kearney established performance criteria and identified sources of audit evidence to complete the testing phase.

During the testing phase, Kearney obtained and reviewed documentation supporting the Department's FY 2013 pre- and post-payment internal control reviews, risk assessments,

¹ Pub. L. No. 111-204 §3(b).

² Pub. L. No. 107-300.

³ Unless otherwise indicated, the term "IPIA" will imply "IPIA, as amended by IPERA" in this report.

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recapture audits, and improper payment disclosures. The testing phase provided Kearney with evidence to determine the findings of the report issued for the performance audit. The criteria determined in the planning phase served as the bases for assessing the Department's compliance with IPIA requirements. The testing phase included procedures to assess the Department's IPIA reporting process, the recapture audit process, and the AFR disclosures.

During the reporting phase, Kearney formally communicated the conclusions reached and the findings and recommendations for the actions the Department should take to comply with IPIA requirements.

Work Related to Internal Controls

Kearney performed steps to assess the adequacy of internal controls related to the areas audited. Specifically, Kearney assessed the controls contained in the Department's policies and procedures for making payments, performing risk assessments, reviewing payments, and reporting improper payments information. However, Kearney did not perform testing of these controls because it was beyond the scope of this audit.

Use of Computer-Processed Data

Kearney obtained computer processed data (i.e., spreadsheets) and reporting packages to aid in determining whether the Department complied with IPIA. More specifically, these data provided evidence that the Department had taken steps to comply with IPIA. Kearney did not perform tests to validate the spreadsheet amounts because such testing was not necessary to accomplish audit objectives. However, Kearney assessed the data provided as reasonable based on our understanding of the financial information gained during the audit of the Department's FY 2013 financial statements.

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Appendix B

Department Programs Subject to Improper Payments Risk Assessment

	Fund Group	Program	FY 2012 Net Payments* (in millions)	
1	Multiple**	Voluntary Contributions	\$1,887.7	
2		Assessed Contributions	\$3,740.5	
3		Post-Assignment Travel	\$138.2	
4		Temporary-Duty Travel	\$368.5	
5	0210	National Endowment for Democracy	\$123.4	
6	1037	Economic Support Fund	\$315.0	
7	0113	Diplomatic and Consular Programs (D&CP) – Miscellaneous Foreign Service Institute and Human Resources Operational Expenses	\$119.1	
8		D&CP – Western Hemisphere Travel Surcharge	\$131.1	
9		D&CP – Overseas Contingency Operations	\$201.9	
10		D&CP – Iraq Embassy Building Support	\$267.0	
11		D&CP – Public Outreach Programs	\$155.1	
12		D&CP – Expedited Fee	\$170.8	
13		D&CP – Machine Readable Visa Processing Fee	\$386.6	
14		D&CP – Overseas Programs	\$381.5	
15		D&CP – Diplomacy Policy and Support	\$504.4	
16		D&CP – U.S. Mission Iraq Associated Costs	\$573.9	
17		D&CP – Worldwide Security Protection	\$912.8	
18		0535	Embassy Security, Construction & Maintenance (ESCM) – Overseas Building Renovations and Maintenance	\$142.1
19			ESCM – Overseas Physical Security Upgrades	\$90.4
20		4519	Working Capital Fund (WCF) – WCF	\$330.9
21	WCF – International Cooperative Administrative Support Services		\$954.0	
22	WCF – Aviation WCF Cost Centers		\$144.5	
23	1143 & 0040	Migration and Refugee Assistance – Refugee Admissions	\$170.9	
24	0209	Educational and Cultural Exchange Programs (ECA) – Citizen Exchange Program	\$99.9	
25		ECA – Fulbright Program	\$249.2	
26	1022 & 1154	International Narcotics Control and Law Enforcement (INL) – Interregional Aviation Support	\$235.2	
27		INL – Aviation Support	\$161.8	
28		INL – Promote the Rule of Law	\$214.2	
29		INL – Other Anticrime Programs	\$229.3	
30		INL – Counternarcotics and Interdiction	\$192.4	
31	1032	Peacekeeping Operations – Supply, Transportation and Procurement	\$225.9	
32	1075	Non-Proliferation, Anti-Terrorism, Demining, and Related Programs (NADR) – Demining and Operational Expenses	\$131.2	
33		NADR – Non-Proliferation	\$214.8	
34		0535	ESCM – Overseas Short Term Lease Residential Program	\$329.4
35		ESCM – Overseas Construction	\$1,181.7	

Source: Prepared by Kearney based on information contained in the Department's "Definitions of Programs and Activities Memo."

*These amounts represent the expenditures subject to IPIA requirements and, therefore, do not include payments to employees and other Federal agencies.

**Although these activities support several significant programs across multiple funds, CGFS/DCFO/MC determined that each of the activities has the same control environment and concluded that it was appropriate to assess the activities as separate programs.



United States Department of State
Comptroller
P.O. Box 150008
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APR 03 2014

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MEMORANDUM

TO: OIG – Steve A. Linick

FROM: CGFS – James L. Millette 

SUBJECT: Draft Report on Audit of Department of State FY 2013 Compliance
 with the Improper Payments Requirements

Thank you for the opportunity to comment on the Office of Inspector General's (OIG) Draft Report titled Audit of Department of State FY 2013 Compliance with the Improper Payments Requirements.

Significant amendments have been made in the past few years regarding the Improper Payments Information Act of 2002, with the passage of IPERA (Improper Payments Elimination and Recovery Act) in 2010 and most recently IPERIA (Improper Payments Elimination and Recovery Improvement Act) in 2012. The Department has made significant efforts to comply with all guidance in a manner that also leverages the good stewardship of government funds and ensures our initiatives are cost-effective. We take pride that our program is compliant with IPIA, but we recognize that more improvements can be made and will continue doing so. As such, we concur with the OIG recommendations regarding the Department's recapture and reporting activities for improper payments. The Department takes the OIG recommendations very seriously, as demonstrated by the accomplishments noted in the report. We will carefully evaluate the new recommendations made and implement them to the extent they are a beneficial and cost-effective use of government funds. After we have fully evaluated the recommendations, we will implement corrective actions as appropriate.

As acknowledged in the Draft Report, the Department employs numerous preventative and identification methods to support IPIA requirements. We have

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dedicated considerable resources to prevent improper payments from occurring, and take pride in our track record of success based on the low volume of actual improper payments identified and recovered each year. Prior IPIA regulatory guidance was geared toward high-risk programs and activities that were deemed susceptible to significant improper payments. Despite having no programs or activities susceptible to significant improper payments, as previously defined, the Department uses risk assessment and recapture initiatives to assist in identifying improper payments and related payment issues. With the implementation of our Global Financial Management System in 2007, we fully integrated acquisitions into the financial system at the line level, significantly enhancing the integrity of our payments. In addition, we have strengthened our payment internal controls through our efforts under OMB's Do Not Pay initiative.

We recognize that the IPERA, IPERIA and related guidance has raised the bar on transparently accounting for and preventing improper payments for all Agencies, including the Department. We are committed to meeting these compliance requirements in a reasoned manner. We look forward to working with both the OIG and the Independent Auditor on further enhancements to our existing programs in the coming year.

If you have any questions concerning this status summary, please contact Carole Clay (CGFS/DCFO/MC) at (202) 663-[REDACTED]

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