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Audit of Department of State FY 2014 Compliance With Improper Payments Requirements

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Audit of Department of State FY 2014 Compliance With Improper Payments Requirements

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

Kearney & Company, P.C. (Kearney), has performed an audit of the Department of State's (Department) FY 2014 compliance with improper payments requirements. This performance audit, performed under Contract No. SAQMMA14A0050, was designed to meet the objective identified in the report section titled "Objectives" and further defined in Appendix A, "Scope and Methodology," of the report.

Kearney conducted this performance audit from September 2014 through April 2015 in accordance with *Government Auditing Standards*, 2011 Revision, issued by the Comptroller General of the United States. The purpose of this report is to communicate the results of Kearney's performance audit and its related findings and recommendations.

Kearney appreciates the cooperation provided by personnel in Department offices during the audit.

Kearney & Company

Kearney & Company, P.C.
Alexandria, Virginia
April 17, 2015

Abbreviations

AFR	Agency Financial Report
CGFS	Bureau of the Comptroller and Global Financial Services
CGFS/MC	Bureau of the Comptroller and Global Financial Services, Office of Management Controls
CGFS/F/OC	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
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
OIG	Office of Inspector General
OMB	Office of Management and Budget
PMS	Payment Management System
WCF	Working Capital Fund

Section Page

Executive Summary

Improper Federal payments totaled an estimated $125 billion in FY 2014.[1] The Federal Government has implemented safeguards to reduce improper payments. In 2010, the Improper Payments Elimination and Recovery Act[2] (IPERA), which amended the Improper Payments Information Act of 2002[3] (IPIA), was signed into law. IPERA strengthened IPIA by increasing requirements for identifying and reporting on improper payments. In 2013, the Improper Payments Elimination and Recovery Improvement Act of 2012[4] (IPERIA) was enacted. IPERIA further amended IPIA by redefining "payment" to include payments made to employees and requiring that the Office of Management and Budget (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 pre-award review. In October 2014, OMB issued guidance to implement IPERIA.[5]

IPIA, as amended by IPERA,[6] requires agencies' Offices of Inspector General (OIG) to annually assess compliance with improper payments requirements.[7] In accordance with this requirement, Kearney & Company, P.C. (Kearney), an external audit firm acting on OIG's behalf, conducted an audit of Department of State (Department) FY 2014 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) conducted a risk assessment for employee payment programs, newly established programs, and programs that experienced a significant change in funding. However, the method used for identifying programs with a significant change in funding may not have identified all programs with increased risks of significant improper payments because of increased funding.

In addition, the Department published its Agency Financial Report (AFR)[8] for FY 2014 and posted the AFR on its website. The AFR included the disclosures required by OMB. However, one disclosure relating to improper payments identified and recovered outside the recapture audit[9] process was not complete. Kearney also found that CGFS had improved its recapture audit process by initiating recapture audit activities for annuity and grant payments. However, the activities for annuity payments will not be fully implemented until FY 2016, and

[1] Government Accountability Office (GAO) report *Government Efficiency and Effectiveness: Opportunities to Reduce Fragmentation, Overlap, Duplication, and Improper Payments and Achieve Other Financial Benefits* (GAO-15-440T, Mar. 2015).
[2] Pub. L. No. 111-204.
[3] Pub. L. No. 107-300.
[4] Pub. L. No. 112-248.
[5] OMB Memorandum M-15-02, "Appendix C to Circular No. A-123, *Requirements for Effective Estimation and Remediation of Improper Payments*," Oct. 20, 2014.
[6] Unless otherwise indicated, the term "IPIA" implies "IPIA as amended by IPERA and IPERIA" in this report.
[7] Pub. L. No. 111-204 § 3(b).
[8] 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.
[9] 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 activities for grant payments are still being developed. In addition, salary and benefit payments to employees amounting to approximately $5 billion and other payments amounting to $18 million were excluded from recapture audit activities. CGFS plans to expand its recapture activities to include these payments in FY 2015.

OIG is recommending that CGFS expand its process to identify programs with significant funding changes, develop and implement a method to obtain information on improper payments identified and recovered by other Department offices and bureaus, and fully implement recapture audit procedures for all payment types.

In its April 17, 2015, response to the draft report (see Appendix C), CGFS stated that it will "carefully evaluate the new recommendations . . . and implement them to the extent they are a beneficial and cost-effective use of government funds." CGFS further stated that it will conduct recapture audit procedures on employee salary payments. Based on the response, OIG considers Recommendations 1 and 2 unresolved because CGFS did not indicate agreement with the recommendations or provide an alternative solution that meets the intent of the recommendations. OIG considers Recommendation 3 resolved because CGFS agreed to conduct recapture audits on employee salary payments.

Background

According to the Government Accountability Office, Federal agencies reported improper payments estimated at $125 billion, funded by taxpayer dollars, that were issued to individuals, organizations, and contractors during FY 2014. Improper payments are payments that should not have been made or that were made in an incorrect amount. Improper payments include overpayments 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.

The Federal Government has implemented safeguards to reduce improper payments. IPIA, as initially enacted in 2002, required Federal agencies to annually identify programs and activities[10] at high risk of improper payments, estimate the amount of improper payments in those programs, perform recovery auditing if program payments exceed $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 with improper payments requirements and established additional requirements for agencies that were deemed noncompliant.

[10] The term "program and activity" is referred to in this report as "program."

In January 2013, IPERIA was enacted. IPERIA amended the definition of "payment" to include payments made to employees. IPERIA also required 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 pre-award review. In October 2014, OMB issued guidance for agencies implementing IPERIA requirements as Appendix C, Revised Parts I and II, of OMB Circular A-123, *Management's Responsibility for Internal Control.*[11] The guidance, among other things, defines the programs and payments that agencies must assess for the risk of improper payments, and it 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.

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 2014, the Department made payments of approximately $30.7 billion, of which payments of $23.8 billion were subject to IPIA requirements.[12] The payments subject to IPIA requirements included payments to vendors and contractors; payments to employees; and Federal Financial Assistance payments, including grants, assessed contributions,[13] and voluntary contributions.[14] 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, analyzing and reporting financial information, managing financial information systems, and establishing management controls. Management controls, also known as "internal controls," are the processes designed and implemented by an organization to help it accomplish

[11] OMB Circular A-123, Appendix C, Revised Parts I and II, is referred to in this report as OMB Circular A-123, Appendix C.

[12] OMB Circular A-123, Appendix C, states that agencies are not obligated to review intra-governmental transactions for improper payments unless directed to do so by OMB. Of the $30.7 billion in Department payments, payments of approximately $6.9 billion were intergovernmental and intradepartmental transactions.

[13] 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.

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

its goals or objectives. Important internal control activities include those aimed at ensuring that only proper payments are made.

Within CGFS, the Office of Management Controls (CGFS/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/OC) 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 for performing internal control and quality control reviews.

Prior OIG Report

In 2014, OIG reported[15] that the Department was in substantial compliance with IPIA requirements. Specifically, 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 AFR. 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 recommended 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. OIG also recommended that CGFS improve its controls over improper payments reporting to ensure the completeness of the information disclosed in the AFR.

Objective

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

- Evaluated whether the Department conducted a program-specific risk assessment for all programs covered by OMB requirements.

- Reviewed the Department's FY 2014 AFR to determine whether the Department complied with improper payments reporting requirements.

- Evaluated the Department's performance in preventing, reducing, and recapturing improper payments.

[15] *Audit of Department of State FY 2013 Compliance With Improper Payments Requirements* (AUD-FM-14-23, April 2014).

Audit Results

Department Was in Substantial Compliance With IPIA

Kearney found that the Department substantially complied with improper payment requirements.[16] Specifically, the Department conducted a risk assessment for employee payment programs, newly established programs, and programs that experienced a significant change in funding. However, the method used for identifying programs with a significant change in funding may not have identified all programs with increased risks for significant improper payments. In addition, the Department published its AFR for FY 2014 and posted the AFR on the Department's website. The AFR included the disclosures required by OMB. However, one disclosure relating to improper payments recovered outside the Department's recapture audit process was not complete.

Kearney also found that CGFS had improved its recapture audit process by initiating a recapture audit process for annuity payments as well as a review of grant payments made through the U.S. Department of Health and Human Services Payment Management System (PMS). However, recapture audit activities for annuity payments will not be implemented fully until FY 2016, and the activities for PMS grant payments are still being developed. In addition, approximately $5 billion in payments to American and Locally Employed staff for salaries and benefits were excluded from recapture audit activities. Other payments amounting to $18 million were also excluded from recapture audit activities. As a result, CGFS/OMA may not have identified all improper payments. CGFS/OMA officials stated that CGFS/OMA plans to expand its recapture activities to include these payments in FY 2015.

Finding A. Required Program Risk Assessments Were Performed, but Methodology Needs Refinement

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, requires that agencies perform risk assessments for programs deemed low risk of having significant improper payments at least every three years. However, agencies are required annually to consider whether significant changes to either legislation or funding would affect each program's risk susceptibility. Additionally, beginning in FY 2014, IPIA required that agencies include payments made to employees in their risk assessments.

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[16] OMB Circular A-123, Appendix C, identifies six requirements that agencies must meet to be compliant with improper payment requirements: (1) conduct a program specific risk assessment for each program; (2) publish an AFR and post the AFR on the agency website with information required by OMB; (3) publish improper payment estimates for all programs identified as susceptible to improper payments, if required; (4) publish programmatic corrective actions plans in the AFR, if required; (5) publish and meet annual reduction targets for each program at risk for improper payments, if required; and (6) report a gross improper payment rate of less than 10 percent for each program for which an improper payment estimate was obtained and published in the AFR. Requirements 3 through 6 apply to agencies that have identified programs susceptible to significant improper payments. The Department has not identified any programs susceptible to significant improper payments. Therefore, only requirements 1 and 2 apply to the Department.

The Department performed the required program risk assessments in FY 2014. Specifically, CGFS/MC identified programs requiring improper payments risk assessments and performed a risk assessment for each program.[17]

Programs Requiring a Risk Assessment Were Identified

Of the 43 programs subject to IPIA requirements, CGFS/MC identified 14 programs requiring improper payments risk assessments in FY 2014, including employee payment programs, new programs, and existing programs with significant increases in funding. Appendix B provides a list of the 14 programs.

- **Employee Payment Programs –** CGFS/MC identified three employee payment programs: American Compensation, Locally Employed Staff Compensation, and Annuity Compensation. CGFS/MC developed these three separate program groups for IPIA risk assessment purposes rather than include the payroll expenditures in the program to which they related because the payments within each program shared the same control structure.

- **New Programs –** CGFS/MC identified five new programs with more than $100 million in payments that were subject to an improper payments risk assessment. To identify new programs, CGFS/MC reviewed budget requests, appropriations, and financial accounting symbols and obtained input from Department bureau management.

- **Existing Programs With Significant Funding Changes**[18] **–** CGFS/MC identified six programs that had a significant funding change. CGFS/MC defined a significant funding change as any increase in expenditures greater than $100 million. To identify programs that had significant funding changes, CGFS/MC evaluated program expenditure data from the Department's financial management system for FYs 2012 and 2013.

The method CGFS/MC used to identify existing programs with significant funding changes may not have identified all programs that had increased risks of improper payments because of increased funding. Specifically, the use of a $100 million expenditure increase threshold did not take into account the relative size of a program and the extent to which an increase in funding of less than $100 million may affect the program's operations. For example, a program that had expenditures of $101 million in year one and experienced an increase in expenditures of $99 million (98 percent) in year two would not meet the $100 million threshold. Therefore, that program would not be identified as a program with significant funding changes. A program that experiences such a significant percentage increase in spending may not have the

[17] The Department performed a risk assessment of all programs in FY 2013. Based on the results of those assessments, the Department identified its programs to be at low or moderate risk of significant improper payments.
[18] CGFS also reviewed the Congressional Budget Justification to identify existing programs that had significant legislative changes, as well as the Secretary of State's statements in the Congressional Budget Justifications, to identify changes in the Department's emphasis or focus that would significantly impact existing programs. Based on its review, CGFS/MC concluded that no programs experienced a change in legislation significant enough to require that an improper payments risk assessment be performed in FY 2014.

resources or control structure in place to adequately handle the increased activity. Thus the program may be at higher risk for making improper payments.

Recommendation 1: OIG recommends that the Bureau of the Comptroller and Global Financial Services expand its process to identify programs with significant funding changes to consider additional factors that may increase the risk of significant improper payments, including, at a minimum, the percentage increase of the change.

Management Response: CGFS stated that it will "carefully evaluate the new recommendations . . . and implement them to the extent they are a beneficial and cost-effective use of government funds."

OIG Reply: OIG considers the recommendation unresolved because CGFS did not indicate agreement with the recommendation or provide an alternative solution that meets the intent of the recommendation. This recommendation can be resolved when CGFS completes its evaluation and notifies OIG that it will take action to implement the recommendation. The recommendation can be closed when OIG reviews and accepts documentation showing that CGFS has expanded its process to identify programs with significant changes to consider additional factors.

Improper Payments 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 1.5 percent[19] 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.

During FY 2014, CGFS/MC performed and documented a qualitative risk assessment of each of the 14 programs it identified as requiring an assessment. To perform the assessment, CGFS/MC developed a scorecard for each program that included an evaluation of the risk factors specified by OMB. CGFS/MC obtained information for its evaluation by reviewing the Congressional Budget Justification, information on internal and external websites, and information contained in internal and external reports. Based on the information obtained, CGFS/MC assigned a numerical rating of 1, 3, or 5 to each program for each of the risk factors, with a rating of 1 representing low risk, 3 representing moderate risk, and 5 representing high risk. CGFS/MC then averaged the risk factor ratings for each program to determine the program's overall risk level. The overall ratings showed that 10 of the 14 programs were at low

[19] IPERIA reduced the percentage error rate from 2.5 percent to 1.5 percent upon its enactment in FY 2013 but delayed implementation of the reduced percentage error rate until FY 2014.

risk for incurring significant improper payments and that the remaining 4 programs were at moderate risk.

CGFS/MC performed an additional assessment of the four programs that were at 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 identified previously. The results of this assessment indicated that the four programs' overall risk remained moderate and that additional evaluations were therefore not deemed necessary. CGFS/MC concluded that none of the Department's programs were susceptible to significant improper payments as defined by OMB Circular A-123, Appendix C.

Finding B. Agency Financial Report Was Published and Included Required Disclosures, but One Disclosure Was Not Complete

The Department published its FY 2014 AFR on its website, and the AFR included the required improper payments disclosures. For example, CGFS disclosed its improper payments risk assessment process and recapture audit activities and results. CGFS had also taken action to address a reporting deficiency identified in the report on the Department's FY 2013 compliance with IPIA. Although CGFS had improved its improper payments reporting, a disclosure relating to the amount of improper payments recaptured outside the payment recapture audits was not complete. By not including complete information in its AFR, the Department was not providing users with complete information about its efforts related to improper payments.

Improper Payments Disclosures Were Made

IPIA 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 website. 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 2014 AFR on its website. 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 and the results of recapture activities.

CGFS had also taken action to address one reporting deficiency identified in the report on the Department's FY 2013 compliance with IPIA. Specifically, we reported that CGFS did not disclose in the FY 2013 AFR that CGFS/OMA had excluded annuity payments from the scope of its recapture audits. The FY 2014 AFR includes information on CGFS/OMA's efforts to expand its recapture audit activities to include annuity payments.

One Required Disclosure Was Not Complete

Although the Department included additional information in its FY 2014 AFR, one disclosure was not complete. OMB Circular A-136 requires agencies to report on improper payments identified and recovered through sources other than payment recapture audits. However, CGFS did not include complete information on the payments identified and recovered by all sources in the table "Overpayments Recaptured Outside of Payment Recapture Audits" in the FY 2014 AFR. CGFS included the amounts identified and recovered by CGFS/F/OC during post-payment reviews of vendor and employee payments, the amounts identified and recovered during the CGFS Retirement Accounts Division's annuity payment reviews, and OIG recoveries. However, CGFS did not include information on payments identified as improper and recovered by other Department offices and bureaus, such as contract closeout recoveries, management post-payment reviews, and recoveries resulting from grant compliance reviews.

A CGFS official stated that CGFS did not track and assess improper payments identified and recovered by other Department offices and bureaus because it was difficult to obtain this information from the bureaus and offices. The official stated that each bureau and office has its own process for tracking and documenting improper payments and recoveries.

By not including complete information in its AFR, the Department did not provide users with all relevant information about its efforts to prevent and then identify and recover improper payments.

The report on the Department's FY 2013 compliance with IPIA included the following recommendation relating to the Department's improper payments reporting:

<u>Recommendation 2 (AUD-FM-14-23).</u> *OIG recommends that the Bureau of the 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.*

Based on the actions CGFS has taken to disclose its payment recapture efforts relating to annuity payments, OIG is closing this recommendation upon issuance of this report and issuing a new recommendation to further improve CGFS controls over improper payments reporting.

Recommendation 2: OIG recommends that the Bureau of the Comptroller and Global Financial Services develop and implement a method to obtain information on improper payments identified and recovered by other Department of State offices and bureaus to ensure that the Agency Financial Report includes all amounts required by the Office of Management and Budget.

Management Response: CGFS stated that it will "carefully evaluate the new recommendations . . . and implement them to the extent they are a beneficial and cost-effective use of government funds."

OIG Reply: OIG considers the recommendation unresolved because CGFS did not indicate agreement with the recommendation or provide an alternative solution that meets the intent of the recommendation. This recommendation can be resolved when CGFS completes its evaluation and notifies OIG that it will take action to implement the recommendation. The recommendation can be closed when OIG reviews and accepts documentation showing that CGFS has developed and implemented a method to obtain information on improper payments identified and recovered by other Department offices and bureaus.

Finding C. Recapture Audit Process Was Improved, but Improvements Were Not Fully Implemented

The Department implemented a program of internal control to prevent, detect, and recapture improper payments. The Department has 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 2014, CGFS/OMA improved its improper payments recapture audit process. Specifically, CGFS/OMA initiated a recapture audit of certain annuities, as well as a review of grant payments made through PMS. However, recapture audit activities for annuities will not be fully implemented until FY 2016, and recapture audit activities for PMS grants are still being developed. In addition, approximately $5 billion in payments to American and Locally Employed Staff for salaries and benefits were excluded from recapture audit activities. Other payments amounting to $18 million were also excluded from recapture audit activities. As a result, CGFS/OMA may not have identified all improper payments. CGFS/OMA officials stated that CGFS/OMA plans to expand its recapture activities to include these payments in FY 2015.

Prepayment Reviews

OMB Circular A-123, Appendix C, states that when implementing a payment recapture audit program, agencies are required to have a program of internal control to prevent overpayments.

The Department has controls in place to help prevent improper payments from being made. For a vendor 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 has also implemented system controls that require the certifying officer to return the invoice to the voucher examiner for correction if errors are found, and 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 annuity payments). The Department has prepayment controls in place for these payments. For example, grantee eligibility and compliance with grant covenants on prior awards are reviewed prior to disbursement of grant payments. Annuity payments are also reviewed prior to disbursement against the Social Security Administration's listing of deceased individuals to ensure that payments are not made to those individuals.

Post-Payment Reviews

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

CGFS/F/OC performed post-payment reviews as part of the routine payment process. Specifically, CGFS/F/OC selected random samples on a monthly basis and reviewed the sampled items for adequate support, proper approval, and the validity and accuracy of the amounts disbursed. This process would identify payments made to the wrong individuals, payments made in incorrect amounts, and payments that should not have been made. CGFS/F/OC also used data-matching techniques to identify potential duplicate payments disbursed in the current fiscal year.

On a monthly basis, CGFS/F/OC prepared a Quality Management report that summarized the improper payments identified. This report tracked improper payments identified against key metrics, including the number of improper payments as a percentage of total payments issued. CGFS/F/OC identified the root causes and trends of the improper payments and reported the improper payments at the bureau level by the offices responsible and the vendors paid. If CFGS/F/OC identifies bureaus with frequent improper payments, CGFS/F/OC performs targeted sampling of those bureaus' 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.

CGFS/OMA implemented an improper payments recapture audit process in FY 2007 to identify potential duplicate domestic payments. In FYs 2012 and 2013, CGFS/OMA expanded its recapture audit activities to include payments for employee travel and overseas payments. CGFS/OMA also strengthened its recapture audit process to identify payments made to ineligible recipients or for ineligible goods and payments made with inadequate supporting documentation

In FY 2013, we reported that CGFS/OMA's improper payments recapture audit process did not cover approximately $3.6 billion in payments subject to IPIA requirements. Specifically, the following payments were excluded: grant payments amounting to $2.5 billion that were made through PMS; annuity payments amounting to approximately $894 million that were processed by the Retirement Accounts Division; and other payments of approximately $188 million that included supplemental payments, shipping payments, passport fee reimbursements, training payments, and certain transportation payments.

In FY 2014, CGFS/OMA developed and implemented processes to expand its recapture audit coverage over the excluded payments. Specifically, CGFS/OMA piloted a recapture audit process for annuity payments. CGFS/OMA categorized annuity payments by payment types, such as child survivor, disability, and surviving spouse. CGFS/OMA then evaluated the risks and controls of each payment type to identify areas of higher risk. Based on its analysis, CGFS/OMA identified child survivor student annuity payments as a higher risk and initiated a pilot recapture audit of this payment type. As part of this pilot audit, CGFS/OMA evaluated all payments made for eight selected child survivor accounts, which amounted to $249,683. This pilot audit found issues with each of the eight accounts reviewed and identified $62,366 in overpayments. Based on these findings, CGFS/OMA recommended that the Retirement Accounts Division strengthen its internal controls. Annuity payments in FY 2014 totaled $713 million. Child survivor annuity payments represented a small percentage of that amount. For example, for the month of September 2014, when the pilot audit was initiated, child survivor student annuity payments represented less than one percent of total annuity payments for the month. CGFS/OMA officials stated that CGFS/OMA plans to implement recapture audit activities on all annuity payment types by the end of FY 2016.

Also during FY 2014, CGFS/OMA began analyzing grant payments made through PMS as part of its payment recapture activities. Specifically, CGFS/OMA performed a duplicate payments review similar to the reviews for vendor payments. The analysis performed did not identify duplicate or other improper payments. CGFS/MC officials attempted but were unable to obtain useful information from the Department of Health and Human Services about the data in PMS and how it could be analyzed for improper payments. The lack of such information limited CGFS/OMA's ability to assess the payments for risk and identify efficient and effective recapture audit activities for the payments. A CGFS/OMA official stated that a detailed review of grants records (for example, sampling all grant payments) would be too labor intensive. CGFS/OMA officials stated that CGFS/OMA plans to continue to assess the functionality of PMS and further develop its recapture audit activities for PMS grant payments made in FY 2015.

CGFS/OMA excluded certain categories of payments, amounting to approximately $5.018 billion, from its recapture audit activities. The improper payments recapture audit process for FY 2014 did not include the majority of payments to American and Locally Employed Staff for salaries and benefits. These payments totaled approximately $5 billion in FY 2014. CGFS/OMA performed recapture audit activities on some employee payments, such as payments for employee travel, since FY 2012. CGFS/OMA interpreted OMB Circular A-123, Appendix C, to not require the inclusion of employee payments in recapture activities until FY 2015. However, the OMB guidance states that, unless otherwise noted, the requirements found in

Appendix C are effective in FY 2014. In addition, an OMB official stated that agencies were required to include employee payments in recapture audit activities for FY 2014 unless doing so would not be cost effective. CGFS/OMA also continued to exclude other categories of payments from recapture audit activities, including passport fee reimbursements and training payments. These payment exclusions amounted to approximately $18 million in FY 2014. CGFS/OMA officials stated that CGFS/OMA plans to expand its recapture activities to include these payments in FY 2015.

The report on the Department's FY 2013 compliance with IPIA included the following recommendation relating to the Department's recapture audit activities:

Recommendation 1 (AUD-FM-14-23). 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.*

Based on CGFS/OMA's actions to expand its recapture audit procedures to include annuity payments and PMS grant payments, OIG is closing Recommendation 1 from the FY 2013 report and issuing a new recommendation to increase recapture audit coverage over all payments.

Recommendation 3: OIG recommends that the Bureau of the Comptroller and Global Financial Services fully implement recapture audit procedures for all payment types, including annuity payments, grant payments made through the Payment Management System, employee salary and benefit payments, and other excluded payments.

Management Response: CGFS stated that it will "carefully evaluate the new recommendations . . . and implement them to the extent they are a beneficial and cost-effective use of government funds." CGFS further stated that it will conduct recapture reviews on employee salary payments in FY 2015.

OIG Reply: OIG considers the recommendation resolved because CGFS agreed to conduct recapture audits on employee salary payments and is developing and implementing recapture audit activities for annuity and grant payments. This recommendation can be closed when OIG reviews and accepts documentation showing that CGFS has fully implemented recapture audit procedures for all payment types.

Post-Payment Review and Payment Recapture Audit Results

As reported in the Department's FY 2014 AFR, CGFS/F/OC identified $5.0 million in overpayments through its FY 2014 post-payment reviews. The Department recovered $4.6 million of the $5.0 million. The Department also recovered $1.3 million in improper payments that were identified during post-payment reviews in previous years. CGFS/OMA identified $55,940 in improper payments through its FY 2014 payment recapture audit process and recovered $45,503 of that amount.

Together, the CGFS/F/OC post-payment reviews and CGFS/OMA payment recapture audits have identified improper payments totaling approximately $84 million from FYs 2005 through 2014. Of that amount, the Department recovered approximately $83 million, as shown in Table 1.

Table 1. Improper Payments Identified and Recovered, FYs 2005 through 2014 (in millions)

Review Process	Amounts Identified	Amounts Recovered
Post-Payment Review	$42.8	$41.8
Payment Recapture Audit	41.2	41.2
Total	**$84.0**	**$83.0**

Source: Department's FY 2014 AFR.

List of Recommendations

Recommendation 1: OIG recommends that the Bureau of the Comptroller and Global Financial Services expand its process to identify programs with significant funding changes to consider additional factors that may increase the risk of significant improper payments, including, at a minimum, the percentage increase of the change.

Recommendation 2: OIG recommends that the Bureau of the Comptroller and Global Financial Services develop and implement a method to obtain information on improper payments identified and recovered by other Department of State offices and bureaus to ensure that the Agency Financial Report includes all amounts required by the Office of Management and Budget.

Recommendation 3: OIG recommends that the Bureau of the Comptroller and Global Financial Services fully implement recapture audit procedures for all payment types, including annuity payments, grant payments made through the Payment Management System, employee salary and benefit payments, and other excluded payments.

Appendix A

Scope and Methodology

The Improper Payments Elimination and Recovery Act of 2010[1] (IPERA), which amended the Improper Payments Information Act of 2002[2] (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.[3]

Kearney conducted the audit work from December 2014 through February 2015 in Washington, DC, and at the Office of the Comptroller and 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 whether the Department conducted a program-specific risk assessment for all programs covered by Office of Management and Budget requirements; (2) to evaluate the Department's performance in preventing, reducing, and recapturing improper payments; (3) to determine whether the Department's FY 2014 Agency Financial Report (AFR) complied with improper payments reporting requirements; and (4) to reach a conclusion as to whether the Department was compliant with IPIA according to Office of Management and Budget guidance.

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 2014 financial statement audit and audits of the Department's compliance with IPIA during FYs 2011, 2012, and 2013 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

[1] Pub. L. No. 111-204.
[2] Pub. L. No. 107-300.
[3] Unless otherwise indicated, the term "IPIA" implies "IPIA, as amended by IPERA and the Improper Payments Elimination and Recovery Improvement Act of 2012 (Pub. L. No. 112-248)" in this report.

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 2014 pre- and post-payment internal control reviews, risk assessments, 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 to the Department the conclusions reached and the findings and recommendations for the actions it 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 (that is, spreadsheets) and reporting packages to aid in determining whether the Department complied with IPIA. More specifically, this 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 2014 financial statements.

Appendix B

Department of State Programs Subject to FY 2014 Improper Payments Risk Assessment

	Fund Group	Program	FY 2013 Net Payments* (in millions)	Reason for FY 2014 Assessment
1	Multiple**	American Compensation	$3,986.2	Employee Payment
2		FSN/Locally Employed Staff Compensation	$1,624.6	Employee Payment
3		Annuity Compensation	$712.9	Employee Payment
4		Voluntary Contributions	$2,131.9	Significant Funding Change
5		Assessed Contributions	$3,043.8	Significant Funding Change
6	0113	Diplomatic & Consular Programs – Machine Readable Visas	$516.3	Significant Funding Change
7	0113	Diplomatic & Consular Programs – Security – Afghanistan, Pakistan	$155.9	New Program
8	0113	Diplomatic & Consular Programs – Overseas Contingency Operations	$545.7	Significant Funding Change
9	0535	Overseas Building Operations – Leaseholds and Functional Programs	$192.1	New Program
10	0535	Overseas Building Operations – Real Property Acquisitions Program	$127.4	New Program
11	0535	Overseas Building Operations – Capital Security Cost Sharing Initiative	$170.9	New Program
12	4519	Working Capital Fund – ICASS	$1,169.2	Significant Funding Change
13	4519	Working Capital Fund – Aviation WCF Cost Centers	$338.4	Significant Funding Change
14	0535	Overseas Building Operations – Project Construction – Major Rehabilitation	$123.8	New Program

*These amounts represent the expenditures subject to Improper Payments Information Act requirements and therefore do not include payments made to other Federal agencies.

**Although these activities support several significant programs across multiple funds, the Bureau of the Comptroller and Global Financial Services determined that each activity has the same control environment and concluded that it was appropriate to assess the activities as separate programs.

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

Appendix C

Bureau of the Comptroller and Global Financial Services Response

United States Department of State
Comptroller
Washington, DC 20520

APR 17 2015

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MEMORANDUM

TO: OIG – Steve A. Linick

Christy H Flaggs

FROM: CGFS – Christopher H. Flaggs

SUBJECT: Report on Audit of Department of State FY 2013 Compliance with Improper Payments Requirements (AUD/FM-14-23, April 2014)

Thank you for the opportunity to comment on the Office of Inspector General's (OIG) Draft Report titled Audit of Department of State FY 2014 Compliance with the Improper Payments Requirements.

The Department has made significant efforts to comply with all guidance for the Improper Payments Information Act of 2002 (IPIA), Improper Payments Elimination and Recovery Act in 2010 (IPERA), and Improper Payments Elimination and Recovery Improvement Act in 2012 (IPERIA). We strive to do so in a manner that also leverages the good stewardship of government funds and ensures our initiatives are cost-effective. We are pleased that our program is compliant with IPIA, but we recognize that more improvements can be made and will continue doing so. The Department takes the OIG recommendations very seriously, as demonstrated by the accomplishments and closure noted in the report relative to recommendations made in the FY 2013 audit. We will carefully evaluate the new recommendations made this year and implement them to the extent they are a beneficial and cost-effective use of government funds.

As acknowledged in the Draft Report, the Department employs numerous preventative and identification methods to support the broad array of improper payments requirements. We have dedicated considerable resources to prevent improper payments from occurring, and take satisfaction in our track record of success based on the low volume of actual improper payments identified and recovered each year. 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

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addition, we have strengthened our payment internal controls through our efforts under OMB's Do Not Pay initiative. Prior IPIA regulatory guidance was geared toward high-risk programs and activities that were deemed susceptible to significant improper payments. And, as part of our risk assessment process, we have identified no high risk program.

Notwithstanding, 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. For example, the Department performs broad systemic reviews for duplicate payments. In addition, since we have no identified high risk programs, we have prioritized our recapture audit resources on conducting detailed reviews of programs that have been evaluated as medium risk through our risk assessment process. Employee salary payments were not required by OMB guidance to be evaluated or reviewed until FY 2014. The salary payments noted in the report as "excluded" from recapture auditing were evaluated by the risk assessment process in FY 2014 and determined to be medium risk. However, given the time required to make the determination, there was insufficient time remaining in FY 2014 to plan and conduct the recapture reviews. Therefore, this review will be conducted in FY 2015.

We recognize that the IPIA, as amended, 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, Director of Management Controls (CGFS/DCFO/MC), at (202) 663-[redacted]

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