USDA

U.S. Department of Agriculture

Office of Inspector General
Midwest Region

Audit Report

USDA Compliance with the Improper Payments Information Act of 2002

Report No. 50601-0008-Ch
January 2005

UNITED STATES DEPARTMENT OF AGRICULTURE

OFFICE OF INSPECTOR GENERAL

WASHINGTON, D.C. 20250

DATE: January 11, 2005

REPLY TO
ATTN. OF: 50601-0008-Ch

SUBJECT: USDA Compliance with the Improper Payments Information Act of 2002

TO: Patricia E. Healy
Acting Chief Financial Officer

THROUGH: Kathy Donaldson
Audit Liaison
Office of the Chief Financial Officer

This report presents the results of our audit of the United States Department of Agriculture's (USDA) compliance with the Improper Payments Information Act (IPIA) of 2002.[1] The audit was conducted to determine the status of USDA's implementation of the IPIA and evaluate whether the agencies properly identified programs that were susceptible to improper payments and reported those to the Office of Management and Budget (OMB). Our primary objective was to evaluate the actions taken by Office of the Chief Financial Officer (OCFO) as the agency designated to lead and coordinate the Department's response to the IPIA and the implementing guidance provided by OMB.

In our estimation, OCFO's guidance to the agencies appeared to adequately guide them through the risk assessment process. We found, however, that the implementation of the guidance at the six agencies we reviewed ranged from nonexistent to inadequate and thus the requirements of the IPIA had not been met. As a result, we concluded that OCFO needs to revise its guidance to better prescribe the process to be followed Departmentwide to ensure implementation of the IPIA.

BACKGROUND

The IPIA requires the head of each agency to annually review all programs and activities the agency administers to identify those that may be susceptible to significant improper

[1] Public Law (P.L.) 107-300, November 26, 2002

payments. For each program or activity identified, the agency is required to estimate the annual amount of improper payments and, if the estimate is over $10 million, report the estimate to Congress along with the actions the agency is taking to reduce those improper payments. The OMB issued implementing guidance on May 21, 2003. This guidance required each agency to report the results of its estimates for improper payments, and corrective actions, in the Management Discussion and Analysis (MD&A) section of the USDA's Performance and Accountability Report for fiscal years ending on or after September 30, 2004. OMB also defined significant improper payments[2] and specified that if programs or activities exceeded this threshold, the estimate developed and reported to Congress was to be statistically valid.

The OCFO, designated as the lead agency for coordinating and reporting the Department's efforts to implement the IPIA, provided instructions to agencies in August and October 2003. The August memorandum transmitted Departmental policy and instructions for implementing program reviews to identify erroneous payments. The instructions included the detailed guidance from OMB regarding implementation and requirements for the IPIA.[3] The guidance from OMB provided that agencies examine the risk of erroneous payments in all programs and activities they administer. In a memorandum dated October 9, 2003, OCFO provided additional guidance on implementing the requirements of the IPIA and requested that all agencies provide an IPIA implementation status report.[4] The memorandum required that all programs with outlays of $10 million or more annually must undergo a risk assessment to determine if there is significant risk of erroneous payments. The memorandum also requested: (1) A chart detailing dates for risk assessments that have been completed; (2) planned dates for completion of remediation plans for programs with significant erroneous payments; and (3) planned dates when the agency will have determined its baseline plus improvement targets for the next 3 FYs.

The status report was updated February 17, 2004 and reported that USDA agencies had 179 programs, with outlays totaling $102.8 billion, that had been assessed by the individual agencies to determine their susceptibility to improper payments. A total of six programs, with outlays totaling $40.3 billion, were reported as having been determined to be susceptible to significant improper payments and required further actions as specified in the IPIA. For this audit, we reviewed six agencies that had reported 90 programs, with outlays totaling $47.3 billion, that had been assessed by the agencies; of which only one program, with outlays totaling $740 million, was determined to be susceptible to significant improper payments and required further action in accordance with the IPIA.

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[2] OMB defined significant improper payments as annual erroneous payments exceeding both 2.5% of program payments and $10 million. See OMB Memorandum M-03-13, dated May 21, 2003

[3] OCFO Guidance, Requirements for Implementing IPIA, August 11, 2003

[4] OCFO Guidance, Update on Requirements for Implementing the IPIA, Public Law 107-300, dated October 9, 2003

OBJECTIVE

The objective of the audit was to evaluate the actions taken by OCFO to implement the IPIA, specifically the assessment of the Department's programs to the risk of improper payments.

SCOPE AND METHODOLOGY

We performed our audit at USDA Headquarters in Washington, D.C. We interviewed OCFO officials to determine what they had done to implement the IPIA. We reviewed actions taken by OCFO to lead agencies in implementing the IPIA and the guidance issued to Departmental agencies explaining what was needed to be done. We also reviewed the IPIA and guidance issued by OMB. Further, we evaluated the actions taken by six agencies: Cooperative State Research, Education and Extension Service (CSREES), Farm Service Agency (FSA), Natural Resources Conservation Service (NRCS), Rural Utilities Service (RUS), Rural Business Service (RBS), and Rural Housing Service (RHS) in response to the OCFO guidance. The results of those reviews are summarized here and were reported to the appropriate agency through individual audit reports. The review was conducted during the period March through September 2004.

We judgmentally selected agencies for review in order to gain a broad perspective of the Department.

The audit was performed in accordance with Government Auditing Standards.

FINDING AND RECOMMENDATIONS

USDA Agencies Were Not in Compliance with the Improper Payments Information Act

Risk assessments performed by the six agencies we reviewed were not adequate to estimate their programs susceptibility to improper payments. This occurred because OCFO's guidance was not sufficiently prescriptive and detailed to translate into meaningful results. Foremost, the guidance did not include a methodology for quantitatively establishing agencies' estimated error rates. Instead, the guidance directed the agencies to assess risk factors as high, medium, or low. No criteria was provided, however, as to how the conclusion should be derived. In addition, direction was not provided translating how the overall ranking was to be compiled. In other words, it was not established, for example, what was needed to reach a determination of a high rating in the aggregate (e.g., a preponderance of risk factors ranked as high). Further, no provision was made to weight the individual risk factors. The ranking of a single critical risk factor (such as "Loan payments made only to eligible recipients") as high could well be sufficient to conclude that the overall rating should be high. Only one agency we reviewed, RHS, rated one of its programs (Rental Assistance) as high risk (though oddly we found that the risk assessment supported a low risk rating) and was developing plans to conduct the statistical sample. Another agency, NRCS, rated one of its programs (Environmental Quality Incentives Program) as medium risk but had no plans to perform any further analysis. All other programs of the agencies we reviewed rated the risk as low and determined the process to be completed.

Several agencies (RUS, RBS, and FSA) relied on the generic risk factors delineated in the OCFO guidance but did not modify them to address their specific programs. In addition, two agencies (RHS and FSA) had not given consideration to audit results in formulating its risk factors. Only one (RHS) agency explained (though only to some degree) its rating of the risk factors by describing control measures to mitigate those risks; two other agencies which made an effort to complete the analysis (FSA and NRCS) explained their ratings by referencing operational procedures rather than control techniques. (It should be noted that NRCS had initially reported it had no programs meeting the prescribed criteria based upon an informal and undocumented discussion by program officials; OMB subsequently directed NRCS to assess three programs).

In two cases (CSREES and RUS), the extent of the agencies assessment was merely limited to multiplying outlays by program by the 2.5 percent criterion and if the product was less than $10 million, they concluded that individual risk assessments were not required. The 2.5 percent criterion represented, however, the “floor” of the tolerable error rate established by OMB; the agencies were required to determine what the individual program error rates were.

In addition to misinterpreting the guidance, officials of three other agencies (NRCS, RBS and RHS) expressed confusion and uncertainty regarding what was expected of them by the guidance.

Although OCFO provided training to the agencies and met with selected agencies to discuss the process, risk assessment documents were not examined. Had more extensive oversight been given, such as reviewing documentation supporting the agencies’ implementation of the guidance, many of the problems noted above would have been readily apparent. As a result, because of the deficiencies our audits disclosed in agency actions to implement OCFO guidance and thereby the IPIA, we believe that OCFO needs to devote the necessary resources to oversee agency efforts. This would not require technical expertise in the specific programs but only knowledge of how risks are to be identified and their impact assessed.

As a result of our evaluation of the agencies’ implementation of the OCFO guidance, we concluded that the requirements for the conduct of the risk assessments need to be made more prescriptive, detailed, and clarified. The guidance should require methods and measures such as:

1. Risk factors should be identified which are discrete to the program being assessed and consider information from all sources, such as audits reports. Factors should be significant (pose a potential quantitative risk) and have a reasonable likelihood of occurrence.

2. Documented internal controls, designed to mitigate the risk factors, should be identified and preliminarily evaluated to provide reasonable assurance that they are adequate as prescribed (designed to preclude or detect errors and irregularities in a timely manner).

3. Tests of transactions should be performed to quantitatively determine error rates. The extent of testing should be scoped, in part, on the basis of the preliminary evaluation performed above and any other known vulnerabilities (from audits, internal reviews, or other sources).

4. The resultant error rate should be multiplied by the program outlays and the process continued, as appropriate.

These provisions should be achievable given the very analogous requirements of the Federal Managers' Financial Integrity Act of 1982. Agency heads have been certifying annually since then that internal controls have been assessed, and all material weaknesses identified and corrected.

Recommendation No. 1

Strengthen the guidance over the IPIA risk assessment to provide reasonable assurance that the requirements of the Act are met.

Agency Position: OCFO agreed with the recommendation and stated that on November 10, 2004, OCFO issued strengthened guidance for fiscal year 2005. It focuses USDA's resources on the largest programs most likely to meet the Improper Payments Information Act of 2002 reporting threshold and requires tests of transactions be performed on programs representing over 90 percent of the Department's outlays. In addition, OCFO stated that final guidance related to "tests of transactions" was issued to the IPIA Working Group on December 8, 2004.

OIG Position: We concur with the management decision. For final action, a copy of the issued guidance needs to be forwarded to the appropriate OCFO unit.

Recommendation No. 2

Monitor the agencies implementation of the OCFO guidance to ensure adherence**.**

Agency Position: OCFO concurred with the recommendation stating OCFO issued strengthened guidance on November 10, 2004 and outlining the Department's goals for each quarter of fiscal year 2005.

OIG Position: We concur with the management decision. For final action, evidence of monitoring the implementation of the guidance should be provided to the appropriate OCFO unit.

/s/
ROBERT W. YOUNG
Assistant Inspector General
for Audit

EXHIBIT A – AGENCY RESPONSE

USDA

United States Department of Agriculture

Office of the Chief Financial Officer

1400 Independence Avenue, SW

Washington, DC 20250

DEC 20 2004

TO: Robert W. Young
Assistant Inspector General for Audit
Office of Inspector General

FROM: Patricia E. Healy
Acting Chief Financial Officer

SUBJECT: Management Responses to "USDA Compliance with the Improper Payments Information Act of 2002," Audit Report No. 50601-0008Ch

Our response to the recommendations contained in "USDA Compliance with the Improper Payments Information Act of 2002," Audit Report No. 50601-0008Ch, is attached.

Should you have any questions, please contact me at (202) 720-5539 or have a member of your staff contact Kathy Donaldson, Audit Liaison Officer at (202) 720-1893.

Attachments

EXHIBIT A – AGENCY RESPONSE

Management Response
Audit Report No. 50601-0008Ch
USDA Compliance With the Improper Payments Information Act of 2002

Audit Recommendation No 1: Strengthen the guidance over the IPIA risk assessment to provide reasonable assurance that the requirements of the Act are met.

Management Response: We concur with the recommendation. On November 10, 2004, the Office of the Chief Financial Officer (OCFO) issued strengthened guidance for fiscal year 2005 (Copy attached). It focuses USDA's resources on the largest programs most likely to meet the Improper Payments Information Act of 2002 (IPIA) reporting threshold and requires tests of transactions be performed on programs representing over 90 percent of the Department's outlays. Final guidance related to "tests of transactions" will be issued to the IPIA Working Group on December 8, 2004.

Date Corrective Action will be Completed: 12/8/04

Responsible Organization: Credit, Travel, and Grants Policy Division (CTGPD)

Point of Contact: Matthew Faulkner, Director, CTGPD, (202) 720-1307

EXHIBIT A – AGENCY RESPONSE

Management Response
Audit Report No. 50601-0008Ch
USDA Compliance With the Improper Payments Information Act of 2002

Audit Recommendation No 2: Monitor the agencies implementation of the OCFO guidance to ensure adherence.

Management Response: We concur with the recommendation. OCFO issued strengthened guidance on November 10, 2004. The Inventory of USDA Programs has been labeled by color to identify the dollar range of the programs as follows: blue less than $10 million; green $10 - $50 million; orange $51 - $200 million; purple $200 - $400 million; and black more than $400 million. The programs identified as high risk in the Performance and Accountability Report are labeled red. Additional guidance on "tests of transactions" will be provided on December 8, 2004. Programs with over $200 million in outlays will complete their risk assessments in sections to be reviewed and discussed in the monthly IPIA Working Group meetings. Programs with less than $200 million in outlays will be completed by January 28, 2005, and reviewed by OCFO. All risk assessments will be completed by April 30, 2005, and will then be reviewed before being formally sent to the Office of Management and Budget (OMB) on May 16, 2005. Below is the timeline for completing and monitoring the FY 2005 risk assessments.

1st Quarter:

- OCFO completes risk assessment of all USDA blue and red programs.
- Agencies submit purple and black risk assessments with sections I-III completed.
- Agencies submit high risk plans to OCFO.
- Agencies provide OCFO with program manager contact information for all green programs.
- OCFO submits high risk plans to OMB for review and approval.
- IPIA Work Group discusses sections I-III for purple and black risk assessments.
- OCFO provides guidance (and the orange and purple programs selected) for "tests of transactions."

2nd Quarter:

- Agencies submit purple and black risk assessments with sections I-IV completed.
- IPIA Work Group discusses section IV for purple and black risk assessments.
- Agencies complete Orange risk assessments and provide to OCFO.
- Agencies submit Purple and Black risk assessments with sections I-V completed.
- IPIA Work Group discusses section V for purple and black risk assessments.

3rd Quarter:

- Agencies submit fully completed purple and black risk assessments.
- OCFO completes all green risk assessments.

Date Corrective Action will be Completed: 5/16/05

Responsible Organization: Credit, Travel, and Grants Policy Division (CTGPD)

Point of Contact: Matthew Faulkner, Director, CTGPD, (202) 720-1307

Information copies of this report have been distributed to:

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Office of the Chief Financial Officer Director, Planning and Accountability Division	1
Office of Management and Budget, Natural Resources Division, Agriculture Branch	1