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SHOW ME THE TAX DOLLARS—HOW MUCH IS LOST TO IMPROPER PAYMENTS EACH YEAR?

HEARING

BEFORE THE

SUBCOMMITTEE ON GOVERNMENT EFFICIENCY AND FINANCIAL MANAGEMENT

OF THE

COMMITTEE ON GOVERNMENT REFORM

HOUSE OF REPRESENTATIVES

ONE HUNDRED EIGHTH CONGRESS

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CONTENTS

	Page
Hearing held on May 13, 2003	1
Statement of:	
Springer, Linda M., Controller, Office of Federal Financial Management, Office of Management and Budget	5
Weems, Kerry N., Acting Assistant Secretary for Budget, Technology and Finance, Department of Health and Human Services	29
Williams, McCoy, Director, Financial Management and Assurance Team, U.S. General Accounting Office	14
Letters, statements, etc., submitted for the record by:	
Platts, Hon. Todd Russell, a Representative in Congress from the State of Pennsylvania, prepared statement of	3
Springer, Linda M., Controller, Office of Federal Financial Management, Office of Management and Budget, prepared statement of	8
Weems, Kerry N., Acting Assistant Secretary for Budget, Technology and Finance, Department of Health and Human Services, prepared statement of	31
Williams, McCoy, Director, Financial Management and Assurance Team, U.S. General Accounting Office, prepared statement of	16

SHOW ME THE TAX DOLLARS—HOW MUCH IS LOST TO IMPROPER PAYMENTS EACH YEAR?

TUESDAY, MAY 13, 2003

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON GOVERNMENT EFFICIENCY AND FINANCIAL MANAGEMENT,
COMMITTEE ON GOVERNMENT REFORM,
Washington, DC.

The subcommittee met, pursuant to notice, at 2 p.m., in room 2247, Rayburn House Office Building, Hon. Todd R. Platts (chairman of the subcommittee) presiding.

Present: Representatives Platts and Blackburn.

Staff present: Mike Hettinger, staff director; Dan Daly, counsel; Larry Brady, Kara Galles, and Tabetha Mueller, professional staff members; Amy Laudeman, clerk; Mark Stephenson, minority professional staff member; and Cecelia Morton, minority office manager.

Mr. PLATTS. We are going to get under way. Our vice chair, Marsha Blackburn, apparently is en route in the building and we will go ahead and get started, rather than waiting any further.

This hearing of the Subcommittee on Government Efficiency and Financial Management will come to order. I believe all of us here today can readily agree that taxpayers have a fundamental right to know how their tax dollars are being spent. Improper payments by Federal agencies are a serious and growing problem which costs taxpayers billions of dollars each year. We have seen some estimates that put the improper payment figure as high as $35 billion. As I said prior to the start of the hearing to a couple of you, coming from a community in which we still have 99 cents breakfast specials, when we start to talk billions of dollars, we pay close attention.

I cannot help but comment that as I sat down here with my Diet Pepsi, and on the front is a campaign promotional piece about $1 billion live on TV that you could win, so we are talking about 35 live winnings every year of $1 billion when we are talking about improper payments.

Commendably, President Bush has made the reduction of improper payments a significant part of his management agenda. A lack of consistency in calculating, defining and accounting for erroneous payments further complicates agencies' efforts to combat this problem. The Improper Payments Information Act signed into law just last November is designed to address these concerns and requires OMB to issue guidance by the end of this month which will

establish governmentwide procedures for dealing with erroneous payments.

An improper payment is any payment that should not have been made. It can be an incorrect payment, an over-or under-payment, and include among other things a payment to an ineligible recipient; a payment for an ineligible service; or a duplicate payment, as well as a payment for service not received at all.

While we do not yet have our arms around the total extent of this problem, what we do know is that these mistakes, which occur throughout government, are made because agencies do not have adequate internal financial controls and business process systems in place to protect against these types of errors. As we have pointed out time and time again during our last three hearings, agencies can get clean audit opinions, unfortunately without having sound internal financial controls that would prevent improper payments—what we described as heroic end of the year efforts to get that clean opinion, even though throughout the year their financial controls were not well planned or well implemented.

Over the years, various agencies have estimated the amount of improper payments, but many believe that these estimates represent only the tip of the iceberg. Last year, my esteemed former colleague, Congressman Steve Horn, who served as chairman of this subcommittee, was successful in securing the enactment of the Improper Payments Information Act of 2002. This law has helped bring to the forefront the need to address this issue more aggressively. Now, agencies will be required to make estimates of erroneous payments, and if those estimates are more than $10 million, to develop plans to reduce or eliminate these errors.

Today, we look forward to exploring the draft guidance from OMB and learning from GAO about strategies to identify and reduce improper payments. We are also eager to hear from HHS on the challenges they faced and the successes they have had in dealing with this problem.

[The prepared statement of Hon. Todd Russell Platts follows:]

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Opening Statement
Congressman Todd R. Platts
May 13, 2003

The President has made the reduction of improper payments a significant part of his management agenda. In support of that agenda, this subcommittee believes that taxpayers have a fundamental right to know how their tax dollars are being spent. Improper payments by federal agencies are a serious and growing problem which costs taxpayers billions of dollars each year. We have seen some estimates that put the improper payment figure as high as $35 billion.

The lack of consistency in calculating, defining and accounting for erroneous payments further complicates agencies' efforts to combat this problem. The "Improper Payments Information Act" is designed to address these very concerns and requires OMB to issue guidance by May 26, 2003, which will establish government-wide procedures for dealing with erroneous payments.

An improper payment is any payment that should not have been made. It can be incorrect payment, an over- or under- payment, and can include, among other things, a payment to an ineligible recipient, a payment for an ineligible service, a duplicate payment or a payment for a service not received.

While we do not yet have our arms around the total extent of the problem, what we do know is that these mistakes, which occur throughout government, are made because agencies do not have adequate internal financial controls and business process systems to protect against these types of errors. As we have pointed out time and time again during our last three hearings; agencies can get clean audit opinions without having sound internal financial controls that would prevent improper payments.

Over the years, various agencies have estimated the amount of improper payments, but many believe that these estimates represent only the tip of the iceberg. Last year, my esteemed former colleague, Congressman Steve Horn, who served as Chairman of this Subcommittee, was successful in securing the enactment of the

"Improper Payments Information Act of 2002" (P.L. 107-300). This law has helped bring to the forefront the need to address this issue more aggressively. Now, agencies will be required to make estimates of erroneous payments and, if those estimates are more than $10 million annually, to develop plans to reduce or eliminate these errors.

Today, we look forward to exploring the draft guidance from OMB and learning from GAO about strategies to identify and reduce improper payments. We're also eager to hear from HHS on the challenges they've faced and the successes they've had in dealing with this problem.

Mr. PLATTS. Today, we are pleased to have with us the Honorable Linda Springer, Controller of the Office of Federal Financial Management in the Office of Management and Budget; Mr. McCoy Williams, Director of the Financial Management and Assurance Team in the General Accounting Office; and Mr. Kerry Weems, Acting Assistant Secretary for Budget, Technology and Finance in the Department of Health and Human Services. Thank you for coming and we look forward to your testimonies here today.

We will give our vice chair a second to catch her breath. I understand you do not wish to make an opening statement?

Ms. BLACKBURN. No, Mr. Chairman.

Mr. PLATTS. OK. We will then proceed to our witnesses. I would ask each witness if you would stand, and anyone who will be advising you during your testimony to also stand, and take the oath together.

[Witnesses sworn.]

Mr. PLATTS. Thank you. The clerk will note that all witnesses, as well as others who will be advising them, have affirmed the oath. We now would like to proceed directly to the testimonies. Ms. Springer, we will begin with you, followed by Mr. Williams and Mr. Weems. The subcommittee appreciates the substantive written testimonies that each of you have provided for the record. We would ask that you keep your verbal testimonies here today to less than 5 minutes.

Ms. Springer, please proceed with your testimony.

STATEMENT OF LINDA M. SPRINGER, CONTROLLER, OFFICE OF FEDERAL FINANCIAL MANAGEMENT, OFFICE OF MANAGEMENT AND BUDGET

Ms. SPRINGER. Thank you, Mr. Chairman. I appreciate the opportunity to be before this subcommittee again. One of the reasons I am glad to be here is to continue the partnership that exists between the administration and the subcommittee in advancing many of the President's initiatives to improve management in the executive branch. This partnership is critical to the success of our efforts, particularly in the area of erroneous payments. We will need changes in law, some of which have already been proposed, to improve our payment processes. I ask for your help to get those tools which I will address in more detail in a moment.

Today, we are discussing the President's initiative to reduce erroneous payments made with Federal dollars. This committee is more familiar than most with the status of efforts in the government to address this critical problem. Not long ago, based on GAO compilations of erroneous payment estimates reported in agency financial statements, the estimate of governmentwide erroneous payments was said to be around $20 billion. GAO also said as significant as this amount is, the actual extent of improper payments governmentwide is unknown, and is likely to be billions of dollars more and will likely grow in the future without concerted and concentrated efforts by agencies, the administration and the Congress.

That statement is as true now as it was when GAO made it last summer. What we can say is that we know a lot more and we are doing a lot more than ever before about the extent and cause of erroneous payments made by the Federal Government.

As you know, Mr. Chairman, the President announced as part of his management agenda a renewed effort to reduce erroneous payments. Initially, the initiative focused on the government's major benefit programs. The administration identified programs that make in excess of $2 billion in payments annually and require those agencies to assess the risk, the extent, and to put in place a strategy to reduce erroneous payments. Based on the estimates of erroneous payments made in programs making almost $1 trillion in payments annually, erroneous payments exceed $35 billion a year. Error rates for those programs range from almost zero to more than 30 percent. That is obviously an unacceptable situation. We have an urgent duty to the American taxpayer to improve our stewardship over their resources.

There are agencies that we should commend, like the Office of Personnel Management, which manages the Federal Employees Health Benefits Program, with an error rate of just over 1 percent; Federal Retirement Benefit programs, less than 1 percent; and the Department of Defense which manages military retirement, 0.05 percent error rate, for keeping those error rates low. We should also commend Medicare and food stamps, which have shown remarkable progress in bringing their erroneous payment rates down.

Other programs for which we have estimated the rate of erroneous payments have not yet shown progress. I want to emphasize that the administration's initiative to reduce EITC, that is Earned Income Tax Credit payments, is one that we are also focused on. It has an error rate of almost 30 percent. Our initiative is not happening at the expense of the IRS's efforts to pursue other enforcement priorities, so there is a global effort with respect to tax issues. I am assured that the IRS is increasing its efforts to pursue with vigor those in upper-income brackets who would evade their taxpaying obligations.

Another area where the error rate is unacceptably high is in housing subsidies. The Department of Housing and Urban Development overpays more than $2 billion annually in low-income rent subsidies. The causes include incomplete reporting of tenant income and improper calculation of tenant rent contributions. HUD has committed to a goal of 50 percent reduction in these erroneous payments by 2005, but it needs a tool to achieve this goal. HUD needs access to the national directory of new hires so it can verify tenant income. Congressman Sessions has recently introduced legislation, H.R. 1030, to grant HUD this authority. If enacted, this legislation is expected to potentially garner up to $5 billion in savings over 10 years.

It is remarkable that we now have error rates for programs that make up almost $1 trillion in payments annually, but those programs targeted as part of the President's Management Agenda make an additional $300 billion in annual payments. With the passage of the Improper Payments Information Act, we are targeting even more programs that make hundreds of billions of dollars in payments annually for which we have no adequate measure of erroneous payments. As a result of legislation proposed by this committee, portions of recovered erroneous contract payments can now be used for recovery audit activities. Agencies are using this tool

to identify erroneous payments made, reveal why they were made, and most importantly, prevent erroneous contract payments in the future.

Of course, this subcommittee also authored the recently enacted Improper Payments Information Act in 2002. That law will require agencies to identify programs and activities in which there is a risk of erroneous payments, estimate the extent of the erroneous payments, and report to Congress all such programs and activities that make erroneous payments in excess of $10 million a year.

I am pleased to report that the administration's guidance, required by law to be issued by the end of May, will be distributed to agencies around the end of this week. We would like to hold that up and get the benefit of any information that comes out of this hearing as well, and reflect it. The result of the law and the guidance will be greater uniformity in the estimation and reporting of erroneous payments. For example, agencies will be required to estimate the extent of erroneous payments based on a statistical sample, with a 90 percent confidence level and 5 percent precision. That is 2.5 percent around either side, plus or minus, of the estimated rate. They will be required to report the extent of their payments in their annual performance and accountability reports.

Through all these activities, we are improving the payment accuracy of government programs and activities. The urgent duty I spoke of earlier is to ensure that America's taxpayer dollars are administered with the greatest integrity possible. Where we identify problems in payment processes, we are working diligently to address them. Where we do not know the extent of the problem, we will find it out. The end result will be better-administered programs and fewer wasted dollars. We are at the beginning of this process to reduce erroneous payments, but we could win this race with your continued support.

I would be glad to answer any questions. Thank you.

[The prepared statement of Ms. Springer follows:]

Statement of the Honorable Linda M. Springer,
Controller, Office of Federal Financial Management,
Office of Management and Budget
Before the
Subcommittee on Government Efficiency and Financial Management,
Committee on Government Reform,
United States House of Representatives
May 13, 2003

Reducing Erroneous Payments

Mr. Chairman, I appreciate the opportunity to be before this Subcommittee again. One of the reasons I'm glad to be here is to continue the partnership that existed between the Administration and this Subcommittee in advancing many of the President's initiatives to improve the management of the Executive Branch. This partnership is critical to the success of our efforts, particularly in the area of erroneous payments. We will need changes in law – some of which have already been proposed – to improve our payment processes. I ask for your help to get those tools, which I will address in more detail in a moment.

Today we are discussing the President's initiative to reduce erroneous payments made with Federal dollars. This Committee is more familiar than most with the status of efforts in the government to address this critical problem.

Not long ago, based on General Accounting Office (GAO) compilations of erroneous payment estimates reported in agency financial statements, the estimate of government-wide erroneous payments was said to be around $20 billion. GAO also said, "As significant as [this amount is], the actual extent of improper payments government-wide is unknown, is likely to be billions of dollars more, and will likely grow in the future

without concerted and coordinated efforts by agencies, the administration, and the Congress."[1]

That statement is as true now as it was when GAO made it last summer. What we can say is that we know a lot more and we're doing a lot more than ever before about the extent and causes of erroneous payments made by the Federal government.

Reducing Erroneous Payments as Part of
the President's Management Agenda

As you know, Mr. Chairman, the President announced, as part of his Management Agenda, a renewed effort by the government to reduce erroneous payments. Initially, the initiative focused on the government's major benefit programs. The Administration identified those programs that make payments in excess of $2 billion annually, required those agencies to assess the risk of, estimate the extent of, and put in place a strategy to reduce erroneous payments. Based on the estimates of erroneous payments made in programs making almost $1 trillion in payments annually, erroneous payments exceed $35 billion a year. Error rates for those programs range from almost zero to more than 30%. This is an unacceptable situation. We have an urgent duty to the American taxpayer to improve our stewardship over their resources.

We should commend agencies like the Office of Personnel Management, which manages the Federal Employee Health Benefit Program (1.14% error rate) and the federal retirement benefit programs (.35% error rate), and the Department of Defense, which manages military retirement (.05% error rate), for keeping their error rates low. We should also commend programs like Medicare (6.30% error rate) and Food Stamps (8.66% error rate), which have shown remarkable progress in reducing erroneous payments.

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[1] Report to the Ranking Minority Member, Committee on Governmental Affairs, U.S. Senate; *Financial Management, Coordinated Approach Needed to Address Government's Improper Payments Problems*; General Accounting Office, Report GAO-02-749; August 2002.

Other programs for which we have estimated the rate of erroneous payments have not yet shown progress. For instance, the error rate in the Earned Income Tax Credit [EITC] program is almost 30%. Almost one in every three dollars for this program is paid incorrectly. Having identified the three basic causes of erroneous EITC payments -- income reporting errors; taxpayers claiming a qualifying child who was also the qualifying child of someone else with higher modified adjusted gross income (AGI); and married taxpayers who should have filed as "married-filing separately" rather than "single" or "head of household"-- we are taking common sense steps to reduce errors in this program. For most EITC recipients, the process to apply for and receive the credit will be as simple as before. For others where the IRS identifies a risk of erroneous information on a tax return, the IRS will require information from taxpayers sufficient to verify their eligibility for the credit. The President has requested additional resources to fund this effort. The investment will ensure that EITC payments are getting to those Congress intended to receive them and we will reduce erroneous payments by billions.

I want to emphasize that the Administration's initiative to reduce erroneous EITC payments is not happening at the expense of the IRS' efforts to pursue its other enforcement priorities. I am assured that the IRS is increasing its efforts to pursue with vigor those in the upper income brackets who would evade their taxpaying obligations.

Data Sharing as a Tool to Prevent Erroneous Payments

Another area where the error rate is unacceptably high is in housing subsidies. The Department of Housing and Urban Development (HUD) overpays more than two billion dollars annually in low-income rent subsidies. The causes: incomplete reporting of tenant income; improper calculation of tenant rent contributions; and failure to fully collect all outstanding rent. HUD has committed to a goal of a 50 percent reduction in these erroneous payments by 2005, but it needs more tools to achieve this goal. HUD needs access to the National Directory of New Hires so it can verify tenant income. Congressman Sessions recently introduced legislation – H.R. 1030 -- to grant HUD this

authority. If enacted, the legislation is expected to potentially garner up to $5 billion in savings over ten years.

The Administration has requested similar authorities from Congress for other programs. One proposal would grant the State Workforce Agencies access to the National Directory of New Hires for quick detection of individuals who have gone back to work, but continue to collect unemployment compensation. Another proposal would grant the Department of Education the ability to verify the income reported on Federal student aid applications with income information reported to the Internal Revenue Service. Together, these proposals would prevent the waste of billions of dollars in erroneous payments over just the next several years.

I can not emphasize enough how critical Congressional support is to our efforts to reduce erroneous payments. As we learn more about why programs make erroneous payments, we will continue to need new tools to reduce them. I respectfully request, Mr. Chairman, this Subcommittee's active support for the proposals I mentioned above. These data sharing tools are important to prevent erroneous payments from going out the door in the first place.

More Rates to Come

It is remarkable that we now have error rates for programs that make almost $1 trillion in payments annually. But those programs targeted as part of the President's Management Agenda make an additional $300 billion in payments annually. With the passage of the Improper Payments Information Act, we are targeting more programs that make hundreds of billions of dollars in payments annually for which we have no adequate measure of erroneous payments. One of those programs targeted as part of the President's Management Agenda is Medicaid. Federal outlays for the Medicaid program will exceed $160 billion in FY 2003. We are working hard with states to establish a methodology that could be used across the country to establish a uniform error rate. What we have found is not surprising. Insufficient documentation to support claims was a leading basis

for classifying a payment as erroneous. Other errors include payments for medically unnecessary services or errors in coding, billing, or processing. Our effort to examine the integrity of Medicaid payments should reduce errors in these areas.

Recovery Auditing

For those who are not aware, it is worth noting that this Subcommittee has shown superb leadership in the past in the area of erroneous payments. It was one of the first in Congress to propose the use of recovery auditing, the examination of an agency's contract payments to determine the extent of things like duplicate payments; errors on invoices; payments for items not received; mathematical or other errors in determining payment amounts and executing payments; and the failure to obtain credit for returned merchandise. As a result of legislation proposed by this Subcommittee, portions of recovered erroneous contract payments can now be used to pay for recovery auditing activities. Agencies are now using this tool to identify erroneous payments made, reveal why they were made, and, most importantly, prevent erroneous contract payments in the future.

Improper Payments Information Act

Of course, this Subcommittee also authored the recently enacted Improper Payments Information Act of 2002 (Public Law 107-300). This law requires agencies to identify those programs and activities in which there is a risk of erroneous payments; estimate the extent of erroneous payments in those programs and activities; and report to Congress all such programs and activities that make erroneous in excess of $10 million. I am pleased to report that the Administration's guidance, required by law to be issued by the end of May, will be distributed to agencies this week. The result of this law and guidance will be greater uniformity in the estimation and reporting of erroneous payments. For instance, agencies will be required to estimate the extent of erroneous payments based on a statistical sample with 90% confidence and 5% precision. And they will be required to

report the extent of their erroneous payments in their annual Performance and Accountability Reports.

Through all of these activities, we are improving the payment accuracy of government programs and activities. The urgent duty I spoke of earlier is to ensure that American's tax dollars are administered with the greatest integrity. Where we identify problems in payment processes, we are working diligently to address them. Where we don't know the extent of the problem, we will find it out. The end result will be better administered programs and fewer wasted dollars. We are at the beginning of the race to reduce erroneous payments, but it is one that we can win with your continued support.

Mr. PLATTS. Thank you, Ms. Springer.
Mr. Williams.

STATEMENT OF MCCOY WILLIAMS, DIRECTOR, FINANCIAL MANAGEMENT AND ASSURANCE TEAM, U.S. GENERAL ACCOUNTING OFFICE

Mr. WILLIAMS. Thank you, Mr. Chairman and vice chairwoman. Thanks for the opportunity to discuss the governmentwide improper payment problems.

In general, improper payments are payments the government made in error or in the wrong amount and often result from weaknesses in systems of internal control. As we testified before this subcommittee last month, improper payment estimates disclosed in agency financial statements totaled approximately $20 billion each year for both fiscal years 2002 and 2001. OMB recently estimated the amount of improper payments at about $35 billion annually.

However, the scope of the problem is likely greater because most agencies have not yet estimated or publicly reported the magnitude of improper payments in their programs and activities. In October 2001, we issued an executive guide that provided information on strategies used successfully by public and private sector organizations to address their improper payment problems. We found that entities using these best practices shared a common focus of improving their systems of internal control.

Most recently, in a report issued last August, we pointed out that existing guidance did not require all Federal agencies to estimate the improper payments in their programs and activities, or offer agencies a comprehensive approach to measuring improper payments, developing and implementing corrective actions, or reporting on the results of actions taken. Today, we are seeing important leadership action, both from the Congress and from the administration, to address the improper payments problem.

I would like to highlight two areas and provide my perspective as to their potential impact. First, on the legislative side, two recent pieces of legislation, the Improper Payments Information Act of 2002 and Section 831 of the National Defense Authorization Act for Fiscal Year 2002, provided an impetus for all agencies to systematically address improper payments activities annually, and to identify and recover contract over-payments. To illustrate this, the Improper Payments Information Act of 2002, that this subcommittee sponsored, requires agency heads to annually review all programs and activities that they administer, and identify those susceptible to improper payments. For those with estimates of significant improper payments, the legislation requires further analysis and reporting. The law also requires OMB to prescribe agency guidance to implement the requirements of the act.

The National Defense Authorization Act for Fiscal Year 2002 contains a provision that requires agencies entering into sizable contracts to carry out a cost recovery program for improper payments made to contractors. With the passage of this law, the Congress removed multiple barriers and granted agencies a much-needed incentive for identifying and reducing their improper payments.

Second, on the administrative side, the President's Management Agenda has identified improper payments as a key element in the administration's initiative to improve financial performance throughout the Federal Government. As described in the agenda, OMB will work with agencies to establish goals to reduce improper payments for each program over $2 billion. In addition, OMB recently issued draft guidance on the implementation of the Improper Payments Information Act of 2002 for agency comment. The guidance should help ensure transparency in reporting for those agencies with programs and activities with significant risk for improper payments. As I stated earlier, recent legislation and other actions have brought the government's improper payment problems to the forefront. Implementing the legislative provisions and other actions I have discussed today is a shared responsibility. It will require continued strong support and active and cooperative involvement from the Congress, the administration and agency management.

In closing, I want to emphasize our commitment to continuing our work with the Congress, the administration and Federal agencies to ensure that improper payments are fully addressed governmentwide, and that actions are taken to reduce or eliminate the government's vulnerabilities to the significant problem of improper payments.

Mr. Chairman, this concludes my prepared statement. I would be happy to respond to any questions.

[The prepared statement of Mr. Williams follows:]

United States General Accounting Office

GAO

Testimony

Before the Subcommittee on Government Efficiency and Financial Management, Committee on Government Reform, House of Representatives

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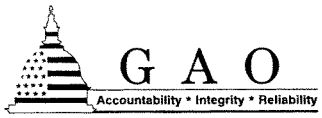
FINANCIAL MANAGEMENT

Challenges Remain in Addressing the Government's Improper Payments

Statement of McCoy Williams, Director
Financial Management and Assurance



GAO-03-750T

May 13, 2003

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Highlights

Highlights of GAO-03-750T, a report to Subcommittee on Government Efficiency and Financial Management, Committee on Government Reform, House of Representatives

FINANCIAL MANAGEMENT

Challenges Remain in Addressing the Government's Improper Payments

Why GAO Did This Study

The Subcommittee asked GAO to testify on the Improper Payments Information Act (PL-107-300) and related draft guidance issued by the Office of Management and Budget (OMB), and on GAO recommendations to agencies on actions they can take to prevent or reduce improper payments.

www.gao.gov/cgi-bin/getrpt?GAO-03-750T.

To view the full report, including the scope and methodology, click on the link above. For more information, contact McCoy Williams at 202-512-6906 or williamsm1@gao.gov.

What GAO Found

Improper payments are a longstanding, widespread, and significant problem in the federal government. Agency financial statements for both fiscal years 2002 and 2001 identified improper payment estimates of approximately $20 billion. OMB recently testified that the amount of improper payments was closer to $35 billion annually for major benefit programs. As significant as these amounts are, they do not represent a true picture of the magnitude of the problem governmentwide because they do not consider other significant but smaller programs and other types of agency activities that could result in improper payments.

Until recently OMB guidance did not require or offer agencies a comprehensive approach to measuring improper payments, developing and implementing corrective actions, or reporting on the results of the actions taken. Improper payment information varied across agencies and programs and included a mixture of estimated improper payment rates and actual improper payments, and was reported inconsistently in a variety of places, including annual financial statements, performance reports, and the federal budget. None of these reporting mediums provided a comprehensive view of either the scope of the improper payment problem or of individual agency or government efforts to reduce it.

We are seeing increased leadership and actions—both from the Congress and the administration—to address the improper payment problem.

Two recent pieces of legislation provide an impetus for all agencies to systematically address improper payment activity on an annual basis and to identify and recover contract overpayments. To illustrate this, the Improper Payments Information Act of 2002 requires agency heads to annually review all programs and activities that they administer and identify those susceptible to improper payments. For those with estimates of significant improper payments, the legislation requires further analysis and reporting. The National Defense Authorization Act for fiscal year 2002 contains a provision that requires agencies entering into sizeable contracts to carry out a cost recovery program for improper payments made to contractors.

OMB has taken some actions to address our prior improper payment-related recommendations. For example, it has issued draft guidance for agency use in identifying and reporting on improper payments within their programs and activities. Further, preliminary follow up work on our prior recommendations shows a wide range of agency activities regarding improper payment identification and reporting. Some agencies have implemented detailed action plans while others are in the early stages of such work. OMB and the agencies need to continue to work to identify and measure improper payments, set performance goals, implement corrective actions, and report results against those goals.

Mr. Chairman and Members of the Subcommittee:

Thank you for the opportunity to discuss the governmentwide improper payment problem. Specifically, I will discuss leadership actions taken by the Congress and the Office of Management and Budget (OMB) to address this problem, and I will highlight the results of our work in this area over the past few years that address actions agencies can undertake to prevent or reduce improper payments.

In general, improper payments are payments the government made in error and often result from a lack of or inadequate systems of internal controls. We use the term improper payments to include inadvertent errors such as duplicate payments and miscalculations; payments for unsupported or inadequately supported claims, payments for services not rendered, payments to ineligible beneficiaries, and payments resulting from fraud and abuse by program participants and/or federal employees.

Because improper payments are a longstanding, widespread, and significant problem in the federal government, few would argue that the goal of reducing them is not a worthy one. As we testified before this subcommittee on April 8, 2003,[1] improper payment estimates disclosed in agency financial statements totaled approximately $20 billion each year for both fiscal years 2002 and 2001. As significant as these amounts are, they do not present a true picture of the magnitude of the problem governmentwide. OMB recently estimated the amount of improper payments at about $35 billion annually. While either of these figures represent a considerable amount of wasted taxpayer dollars, the scope of the problem is likely greater because most agencies have not yet estimated or publicly reported the magnitude of improper payments in their programs and activities.

The risk of improper payments and the government's ability to prevent them has important long-term implications. As the baby boom generation leaves the workforce, spending pressures will grow rapidly due to increased costs of programs such as Medicare, Medicaid, and Social Security. Other federal expenditures are also likely to increase. These spending pressures and the increased size of federal programs all but

[1] U.S. General Accounting Office, *Fiscal Year 2002 U.S. Government Financial Statements: Sustained Leadership and Oversight Needed for Effective Implementation of Financial Management Reform*, GAO-03-572T (Washington, D.C.: Apr. 8, 2003).

guarantee that, absent improvement in internal controls and other proactive actions, the risk of even more improper payments will exist.

Our work has demonstrated that attacking improper payment problems requires a strategy appropriate to the organization involved and its particular risks, including a consideration of the legal requirements surrounding security and privacy issues. Our findings in this area have resulted in the identification of strategies to address improper payments and in governmentwide recommendations for proactive leadership at the highest levels of government, in addition to specific procedures designed to help agencies better identify, measure, reduce, and report their improper payments.

In October 2001, we issued an executive guide that provided information on strategies used successfully by public and private sector organizations to address their improper payment problems.[2] We found that the entities using these best practices shared a common focus of improving the internal control system. The components of this control system and a brief definition of each follows.

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

[2]U.S. General Accounting Office, *Strategies to Manage Improper Payments: Learning From Public and Private Sector Organizations*, GAO-02-69G (Washington, D.C.: Oct. 2001).

Most recently, in a report issued last August,[3] we pointed out that existing guidance did not require or offer agencies a comprehensive approach to measuring improper payments, developing and implementing corrective actions, or reporting on the results of the actions taken. Improper payment information varied across agencies and programs and included a mixture of estimated improper payment rates and actual improper payments. Moreover, the information was inconsistently reported in a variety of places, including annual financial statements, performance plans, and the federal budget. None of these reporting mediums provided a comprehensive view of either the scope of the improper payment problem or of individual agency or governmentwide efforts to reduce it. As such, there is inadequate substantive information for use in establishing (1) a baseline measure of the extent of improper payments, (2) appropriate response levels to correct improper payment problems, and (3) responsibility—holding organizations and/or individuals accountable for performance and results.

As a result of these findings, we recommended that federal executive branch agencies assign responsibilities for taking actions to minimize improper payments and that OMB assist agencies in developing methods to identify and implement those actions. We also presented matters for congressional consideration to assist agencies in addressing barriers to actions to better manage efforts to reduce improper payments and to help them with improvement efforts.

We are seeing important leadership and action—both from the Congress and from the administration—to address the improper payment problem. Today I will highlight these actions and provide my perspective as to their potential impact. I will also discuss our intent to follow up with the 24 Chief Financial Officer (CFO) Act agencies on our previous recommendations that address actions agencies can take to prevent and reduce improper payments.

[3]U.S. General Accounting Office, *Financial Management: Coordinated Approach Needed to Address the Government's Improper Payments Problems*, GAO-02-749 (Washington, D.C.: Aug. 9, 2002).

Legislation Mandates Agency Actions to Identify and Act on Improper Payment Problems

Two recent pieces of legislation—the Improper Payments Information Act of 2002[4], and Section 831 of the National Defense Authorization Act for Fiscal Year 2002[5]—provide an impetus for all agencies to systematically address improper payment activity annually, and to identify and recover contract overpayments.

Improper Payments Act

The Improper Payments Information Act of 2002, that this subcommittee sponsored, contains stringent requirements in the areas of improper payment review and reporting. Agency heads are to annually review all programs and activities that they administer and identify those that may be susceptible to improper payments. Across-the-board implementation of this provision will significantly increase the number of agencies analyzing their programs and activities for improper payments and coincides with our recommendation that the 24 CFO Act agencies assign responsibility for establishing procedures for assessing agency and program risks of improper payments.

Once agencies identify their programs that are susceptible to significant improper payments, the legislation requires agencies to estimate the annual amount of improper payments in those programs and activities. For programs for which estimated improper payments exceed $10 million, agencies are to report to the Congress on actions they are taking to reduce those errors. The report will also include a discussion of the causes of the improper payments identified, actions taken to correct those causes, and the results of the actions taken to address those causes. The provisions of this legislation coincide with our recommendation that CFO Act agencies take actions to reduce improper payments and report to the Congress, OMB, and the agency head on the progress made in achieving improper payment reduction targets and future action plans for controlling improper payments.

The law further requires OMB to prescribe agency guidance to implement the requirements of the act. For years, we have recommended that OMB develop and issue guidance to federal executive agencies to assist them in developing and implementing a methodology for annually estimating and

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

[5]Pub. L. No. 107-107, 115 Stat. 1012, 1186, (2001).

reporting improper payments, and for developing goals and strategies to address improper payments. I will discuss OMB's actions in this area later in my statement.

Recovery Auditing Legislation

Our October 2001 executive guide on improper payments recognized that some improper payments are inevitable and identified and described improper payment detection activities including recovery auditing. Recovery auditing entails examining payment file information to identify possible duplicate or erroneous payments and taking recovery action. Our guide suggested that the techniques used in recovery auditing could be used more in the federal government not only to identify improper payments already made, but also to analyze records prior to payment to prevent improper payments before they occur. In our opinion, it is both faster and cheaper to proactively identify and prevent potential improper payments than to try to detect such errors and collect them after the fact.

Section 831 of the National Defense Authorization Act for Fiscal Year 2002 contains a provision that requires agencies entering into contracts with costs exceeding $500 million annually to have cost-effective programs for identifying errors in paying contractors and for recovering amounts erroneously paid. The legislation further states that a required element of such a program is the use of recovery audits and recovery activities. The law authorizes agencies to retain recovered funds to cover in-house administrative costs as well as to pay contractors, such as collection agencies. Any residual recoveries, net of these program costs, may be credited back to the original appropriation, subject to restrictions as described in the legislation. With the passage of this law, the Congress has removed multiple barriers and granted agencies a much needed incentive for identifying and reducing their improper payments, in addition to recovering those improper payments that slip through agency prepayment controls. The techniques used in recovery auditing (such as examining payment file information to identify duplicate payments or calculation errors) offer the opportunity for identifying weaknesses in agency internal controls, which can then be modified or upgraded to be more effective in preventing improper payments before they occur. Further, accurate assignment of costs and a functioning cost accounting system to track those costs can assist agency management by providing the information needed to identify agency and contractor expenses reimbursable under this legislation.

OMB's Actions to Address Improper Payments

OMB's role in managing, implementing, and overseeing governmentwide administrative policy, its interagency perspective, and its leadership role on the various interagency councils make it a key player in the government's effort to reduce improper payments. I would like to briefly discuss two actions—one legislatively and the other administratively driven.

In the legislative area, OMB recently issued draft guidance on implementation of the Improper Payments Information Act of 2002 for agency comment. In this guidance, OMB addressed the specific reporting requirements provided by the act and laid out the steps necessary for agencies to meet those requirements. For example, the draft guidance calculates annual improper payments as the gross total of both over- and under- payments, and sets statistical sampling confidence and precision levels for estimating those payments. It also requires agencies with estimated improper payments in any program or activity exceeding $10 million to include, along with the estimated amount, a discussion of the amount of actual improper payments the agency expects to recover and how it will go about recovering them in the Management Discussion and Analysis section of their annual Performance and Accountability Report. These actions will help ensure transparency in reporting for those agencies with programs and activities with significant risks for improper payments.

On the administrative side, the President's Management Agenda has identified improper payments as a key element in the administration's initiative to improve financial performance throughout the federal government—one of five governmentwide initiatives that the Agenda addressed. As described in the Agenda, OMB will work with agencies to establish goals to reduce improper payments for each program over $2 billion. In the past, agencies' financial statements contained a mix of estimated improper payment rates and actually identified improper payments—this was for those agencies that had, in fact, reported improper payments. OMB now requires agencies to provide an improper payment rate based on a statistical sample projected to the universe of payments made. It revised the guidance in its Circular A-11 to require agencies to distinguish between overpayments, underpayments, and total improper payments, and to define the methodology used to develop their error rate. The revision was intended to ensure consistency in the error rates reported by the agencies. The Circular requires agencies to report this information with their initial budget submissions and prohibits agencies from publicly disclosing these submissions. We have stated in the past and continue to maintain that this information should be in the public

domain since it is necessary to enable oversight and monitoring by interested parties, including the Congress and the public.

Our August 2002 report on improper payments included recommendations to OMB designed to assist agencies with challenges in identifying and measuring their improper payments, setting performance goals, implementing corrective actions, and reporting the results against the goals. OMB has taken some actions to address these recommendations. For example, in October 2002 testimony before this committee, it addressed statutory roadblocks faced by the departments of Labor (Labor), Education (Education), and Housing and Urban Development (HUD) in gaining access to existing information that those agencies could use in verifying the employment status and income of applicants.[6] OMB testified that it had proposed legislation to eliminate the data-sharing barriers at Labor and Education, and that it was in the process of proposing legislation that would assist HUD in accessing much needed data that already exists at the Department of Health and Human Services. While this is a start, identifying and mitigating or eliminating barriers must be an ongoing process as additional agencies begin to address their improper payments and identify additional barriers that restrict their actions to reduce or eliminate improper payments. OMB's efforts in working with the Congress and federal agencies to ensure successful implementation of the provisions of the Improper Payments Information Act of 2002 and other legislation and administrative actions that can impact improper payments are critical to the governmentwide effort to reduce improper payments and facilitate the implementation of our recommendations.

OMB is providing additional leadership through a joint CFO Council and President's Council on Integrity and Efficiency (PCIE) workgroup—the Improper and Erroneous Payments Work Group—to assist agencies in identifying and reducing erroneous payments and to produce documentation that would be meaningful, applied to agencies. The workgroup surveyed agencies concerning the existing use of improper payment indicators and benchmarks, analyzed survey responses, and publicly released lists of indicators and techniques agencies currently use to identify improper payments.

[6]Office of Management and Budget, Testimony of the Honorable Mark W. Everson, Deputy Director for Management, before the Subcommittee on Government Efficiency, Financial Management, and Intergovernmental Relations, Committee on Government Reform, (Washington, D.C.: Oct. 3, 2002).

Limited Information Is Available on Improper Payments at Federal Agencies

As noted in our prior reports and testimonies on this topic, there is no clear picture on the extent of the improper payment problem, only that it is worse than what is now acknowledged. Relatively few federal agencies and their components publicly report improper payment information such as improper payment rates, causes, and strategies for better managing their programs to reduce or eliminate these payments. In reviewing fiscal year 2001 agency and component financial statements of the 24 CFO Act agencies, we found references to improper payments in just 10 agencies in 17 agency programs. This information increased to 17 agencies and 27 programs in fiscal year 2002 agency financial statements. Several of the 17 agencies that acknowledged the existence of improper payments did not present information on the amounts of those payments. While the fiscal year 2002 information is an improvement over fiscal year 2001 in terms of agencies acknowledging improper payments, merely acknowledging that improper payments exist is simply not enough. It is essential for agencies to develop appropriate methodologies for identifying and measuring those payments, identify cost-effective actions to correct them, implement actions to reduce or eliminate improper payments in their programs and activities, and periodically report to agency managers, the Congress, and the public, through publicly available documents.

In our August 2002 report, we made a recommendation to all 24 CFO Act agencies to assign responsibility to a senior agency official for assessing risks, taking actions to reduce, and reporting the results on those actions on agency improper payments. The report described specific actions that we feel are an integral part of that responsibility. As a result of preliminary information received from those agencies, we have found that agencies have begun to assign responsibility to lead and coordinate actions to reduce improper payments. Some agencies have developed detailed action plans to determine the nature and extent of improper payments. Some have set target goals for improper payment rates and have reported progress in their annual accountability reports. For other agencies, methodologies for identifying risks, determining the nature and extent of improper payments, and developing corrective actions are in the early stages of implementation. In ongoing work, we are meeting with officials from the 24 CFO Act agencies to discuss their progress in implementing our recommendations and OMB's draft guidance on implementing the Improper Payments Information Act of 2002.

In closing, I want to emphasize our commitment to continuing our work with the Congress, the administration, and federal agencies to ensure that improper payments are fully addressed governmentwide, and that actions are taken to reduce or eliminate the government's vulnerabilities to the

significant problem of improper payments. As I stated earlier, recent legislation and other actions have brought the government's improper payment problems to the forefront. Implementing the legislative provisions and other actions is a shared responsibility that will require continued strong support and active and cooperative involvement from the Congress, the administration, and agency management. Effective implementation of the Improper Payments Information Act of 2002 and recovery auditing should help resolve these problems. Along these lines, OMB needs to continue to work with agencies and groups like the CFO-PCIE Erroneous and Improper Payments Workgroup to address challenges in identifying and measuring their improper payments, setting performance goals, implementing corrective actions, and reporting the results against the goals. Further, agency management must work diligently to establish an environment in which improper payments are not acceptable business practices, evaluate program and activity risks for improper payments, identify and implement appropriate corrective actions, and openly report the progress made in reducing improper payments.

Mr. Chairman, this completes my prepared statement. I would be happy to respond to any questions you or other Members of the Subcommittee may have at this time.

Contact and Acknowledgements

For information about this statement, please contact McCoy Williams, Director, Financial Management and Assurance, at (202) 512-6906 or at williamsm1@gao.gov. Individuals who made key contributions to this testimony include Tom Broderick, Bonnie McEwan, and Donell Ries. Numerous other individuals made contributions to the GAO reports cited in this testimony.

Related GAO Products

Financial Management: Coordinated Approach Needed to Address the Government's Improper Payments Problems. GAO-02-749. Washington, D.C.: August 9, 2002.

Financial Management: Improper Payments Reported in Fiscal Year 2000 Financial Statements. GAO-02-131R. Washington, D.C.: November 2, 2001.

Executive Guide: Strategies to Manage Improper Payments, Learning From Public and Private Sector Organizations. GAO-02-69G. Washington, D.C.: October 2001.

Financial Management: Billions in Improper Payments Continue to Require Attention. GAO-01-44. Washington, D.C.: October 27, 2000.

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Mr. PLATTS. Thank you, Mr. Williams.
Mr. Weems.

STATEMENT OF KERRY N. WEEMS, ACTING ASSISTANT SECRETARY FOR BUDGET, TECHNOLOGY AND FINANCE, DEPARTMENT OF HEALTH AND HUMAN SERVICES

Mr. WEEMS. Good afternoon, Mr. Chairman, Madam Vice Chairwoman. Thank you for inviting me before you today. It is a pleasure and an honor for me to have the opportunity to speak about the Department of Health and Human Services' efforts to reduce improper payments in the programs it administers.

One of the Department's foremost strategic goals is achieving excellence in its management practices. In meeting this objective, the Department is committed to ensuring the highest measure of accountability to the American people. The Department was accountable for more than $493 billion in gross outlays in fiscal year 2002. Reducing improper payments and improving the related methods and systems is critical to achieving the excellence we seek.

The Department consists of 12 operating divisions that manage more than 300 programs with diverse missions. However, seven of those programs—Medicare, Medicaid, SCHIP, TANF, Child Care, Foster Care and Head Start—account for close to 90 percent of the total outlays of HHS. The Department expects to be reporting erroneous payment rates for these seven programs in the future, and is presently evaluating whether other programs would be covered under the Improper Payment Information Act of 2002.

The success of HHS's improper payment efforts can be traced to five fundamental efforts. First and foremost, our leadership is committed to this initiative. Publicly identifying and correcting errors is not without political risk, but the public benefits are enormous. Second, creating partnerships with all the parties with an interest in the program is critical for developing successful corrective actions. For instance, HHS works with the States across a number of programs, including Medicaid, SCHIP, and Child Care, just to name a few. Third, the Department has benefited from having one of the strongest Inspectors General in the Federal Government, and maintains a close relationship between the Office of the Inspector General and my Office of the Chief Financial Officer. Our two offices work closely together to monitor programs and reduce errors.

Fourth, we actively work with all parties to educate them on proper payment and program procedures, especially our clients and our intermediaries such as States, as well as our contractors, who in turn work with the ultimate client or beneficiary. Fifth, where there is a history of noncompliance with statutory and regulatory authority, we have sought civil and other legal remedies. Between the effort to educate and legal remedies, there is a wide spectrum of corrective actions the Department uses to identify and reduce improper payments. Finally, in the case of fraud, as opposed to innocent error, parties are prosecuted.

The Department's largest program, Medicare, accounts for close to 50 percent of the Department's outlays. For the Medicare program, HHS has been a leader in monitoring and mitigating improper payments. We began measuring errors in the Medicare pro-

gram in 1996 and have made progressive strides in reducing errors. The fiscal year 2002 rate of 6.3 percent is less than half of the 13.8 percent reported in fiscal year 1996. However, we have determined that substantially more detailed data are necessary to bring the error rate down further. HHS will be deploying a Comprehensive Error Rate Testing program to calculate improper Medicare payments. The CERT program, as it is called, will allow the Department to estimate specific error rates for individual contractors and provider types, in addition to a national error rate. It is our intention to publish contractor-specific error rates, as well as rates by provider type. We will keep this committee informed of our progress in this area.

Building on Medicare's success in measuring error, HHS is well into the process of creating a payment accuracy measure in the Medicaid program. Medicaid is a substantial program, accounting for over 30 percent of departmental outlays, but unlike Medicare, it is administered primarily by State governments. Each of the 56 State and territorial governments run their own unique program. To account for program variation, we are taking an incremental approach in the development of a national Medicaid error rate. Nine States entered the program in the first year; 12 states will participate this year; 25 States are targeted in 2004, and the program will be implemented nationwide in 2005. This collaborative approach will create a measure that is accurate and useful to the Federal Government, as well as State governments.

The Department administers a number of State-based programs that promote the economic and social well-being of children, families and communities. Those programs account for about $48 billion of outlays in the President's fiscal year 2004 budget. The Department closely monitors improper payments in these programs through the Single Audit Act, reviews of financial data, and program-specific mechanisms. Through the Single Audit Act, the vast majority of programs are audited at least once every 3 years, if not more frequently. In addition to the audit and the other mechanisms, HHS is taking steps to establish erroneous payments for the several State-based programs and we expect to be reporting on those soon.

Mr. Chairman, in conclusion, HHS has a robust program for identifying improper payments, taking appropriate management actions to reduce the incidence of improper payments, and exploring and developing innovative ways to increase compliance. We attribute our success to a strong commitment of our leadership, the focus on building and maintaining close relationships with the Inspectors General of the States and our contractors.

I hope that the information that I have provided today will be of value, and I am happy to answer any questions you might have.

[The prepared statement of Mr. Weems follows:]

TESTIMONY OF

KERRY WEEMS

ACTING ASSISTANT SECRETARY FOR

BUDGET, TECHNOLOGY AND FINANCE

AND ACTING CHIEF FINANCIAL OFFICER

U.S. DEPARTMENT OF HEALTH AND HUMAN SERVICES

BEFORE THE

HOUSE COMMITTEE ON GOVERNMENT REFORM

SUBCOMMITTEE ON GOVERNMENT EFFICIENCY

AND FINANCIAL MANAGEMENT

MAY 13, 2003

Good afternoon, Mr. Chairman and Members of the Committee.

Thank you for inviting me before you today. It is a pleasure and honor for me to have the opportunity to speak on the Department of Health and Human Services' (HHS) efforts to reduce the improper payments in the programs it administers. I hope the information I will provide today is helpful to this committee in evaluating the Office of Management and Budget's (OMB)'s guidance for implementation of the "Improper Payment Information Act of 2002," as well as to other agencies in their initiatives in estimating improper payments.

One of the Department's top strategic goals is achieving excellence in its management practices. In meeting this objective, the Department is committed to ensuring the highest measure of accountability to the American people. The Department was accountable for more than $493.4 billion in gross outlays in fiscal year 2002, and reducing improper payments and improving the related methods and systems is critical to this overall objective.

The Department consists of 12 Operating Divisions (OPDIVs) that manage more than 300 programs with diverse missions. You will note that seven of the Department's programs -- Medicare, Medicaid, SCHIP, TANF, Child Care, Foster Care and Head Start -- account for close to 90% of outlays. The Department expects to be reporting erroneous

payment rates for these seven programs and is presently evaluating whether several other programs would be covered under the "Improper Payment Information Act of 2002."

The success of the Health and Human Services improper payment reduction efforts can be traced to five fundamental elements. First and foremost, our leadership is committed to this initiative. Publicly identifying and correcting errors is not without political risk, but the public benefits are enormous. Second, creating partnerships with all parties with an interest in the program is critical for developing successful corrective actions. For instance, HHS works with states across a number of programs including Medicaid, SCHIP, and Child Care to name a few. Third, the Department has benefited from having one of the strongest Inspectors General in the Federal government and maintains a collaborative relationship between the Inspector General and the Chief Financial Officer. Our two offices work closely to monitor programs and reduce errors. Fourth, we actively work with all parties to educate them on proper payment and program procedures, especially our clients and intermediaries (grantees such as states and contractors) who in turn work with the ultimate client or beneficiary. Fifth, where there is a history of noncompliance with statutory and regulatory authority, we have sought civil and other legal remedies. Between the effort to educate and legal remedies, there exists a spectrum of corrective actions the Department uses to identify and reduce improper payments. Finally, in the case of fraud, as opposed to errors, parties are prosecuted.

MEDICARE

The Department's largest program, Medicare, accounts for close to 50% of the Department's outlays. For the Medicare program, HHS has been a leader in the area of monitoring and mitigating improper payments. Medicare contractors annually process over 1 billion fee-for-service claims, answer 40 million inquiries, handle nearly 8 million appeals, enroll and educate providers, and assist beneficiaries. HHS began measuring errors in the Medicare program in 1996 and has made progressive strides in reducing errors. The FY 2002 error rate of 6.3 percent is less than half the 13.8 percent error rate estimated in fiscal year 1996.

The sample size used to estimate the improper payments rate from 1996 to 2002 has been based on a small but statistically valid number of Medicare beneficiaries and claims. In 2002, OIG examined 4,985 claims filed on behalf of 610 beneficiaries nationwide. Beginning this fiscal year, however, the error rate will be calculated based on a sample of approximately 120,000 claims nationwide. The Department is deploying the Comprehensive Error Rate Testing (CERT) and the Hospital Payment Monitoring Program (HPMP) programs to calculate improper Medicare payments. HPMP, funded under the Quality Improvement Organization (QIO) program, will perform the error rate work for inpatient settings. Unlike previous error rate calculations, the CERT program will allow the Department to estimate specific error rates for individual contractors, provider types and beneficiary services. The new information will continue to be aggregated to produce national level estimates like those calculated by the OIG, but with greater precision.

It is not sufficient to identify improper payments; we must correct the errors and prevent their reoccurrence. When we first began measuring the Medicare fee-for-service error rate, we determined that in nearly all cases, the claim as submitted was processed correctly. Only through the more comprehensive review of a sample of claims were we able to detect claims that were erroneous as submitted. Because the claim was in error, payment based on the claim was also made in error. Errors include insufficient or lack of proper documentation of a claim, medically unnecessary claims, and incorrect diagnosis coding on a claim. As part of its initial corrective action plan, HHS embarked on an education and training campaign to improve provider and supplier knowledge of Medicare rules for submitting claims. Our intention is to avoid improper payments by making sure that providers and suppliers are fully aware of Medicare's rules before they submit their claim. We believe educating our partners contributed significantly to reducing the Medicare fee-for-service error rate from 13.8 percent in FY 1996 to 6.3 percent in FY 2002.

Despite this progress, more work needs to be done to reduce the Medicare fee-for-service error rate to achieve the Department's performance goal for erroneous payments.
We have determined that substantially more detailed error data are necessary to bring down the error rate further. Although the OIG's national error rate provided an excellent basis for the work we have undertaken over the past five years, statistically significant information at the contractor, provider type, and Medicare service levels -- detailed management information -- is needed for the next phase of action to reduce the error rate further.

The Department contracts with over 50 insurance companies to process fee-for-service claims; however, the Department is responsible for overseeing these contractors and for ensuring claims are paid accurately and efficiently. Because of the critical role Medicare contractors play in helping facilitate efficient and effective health care delivery, it is important they be held accountable for their role in the health care financing and delivery system. Improving contractor oversight is key to how the Medicare funds are managed. We have been working to consolidate contractor functions for some time. In 1989, we had well over 100 fiscal intermediary and carrier contracts—over the past decade, we have seen a substantial consolidation in the number of these contractors, so that, at present, Medicare claims are processed by 27 fiscal intermediaries and 19 carriers.

During FY 2001, the Department began developing its Unified Financial Management System (UFMS) initiative – a critical component of the Department's efforts to modernize its financial management systems and information technology infrastructure and improve financial operations and performance. UFMS will replace the five core accounting systems currently in use across the Department using two primary sub-components. Part of this initiative includes testing and implementing the Healthcare Integrated General Ledger Accounting System (HIGLAS) for the Medicare contractors and the Department's CMS regional central offices. The HIGLAS will have capabilities to incorporate Medicare contractor's financial data, including claim activity, into the CMS internal accounting system. This system is expected to significantly enhance

oversight of contractor accounting systems and be an important tool in improving financial management in the Medicare Program.

HIPAA established the Medicare Integrity Program (MIP), which was funded at its final capped amount of $720 million in FY 2003. In FY 2002, MIP returned $15 in recoveries, claims denials, and accounts receivable, a total of over $10 billion. Under MIP, the Department funds a number of traditional payment safeguard programs to ensure that claims that are paid are medically necessary, that Medicare is the primary payer of a claim, that Medicare providers' cost reports are reviewed and audited, and that instances of fraud are developed and referred to the Office of Inspector General and the Department of Justice. MIP also funds the Comprehensive Error Rate Testing (CERT) program and activities to educate and train providers and suppliers on appropriate billing practices to avoid billing improperly.

Findings and recommendations in reports issued by the General Accounting Office (GAO) continue to be of help whether specific to the Department or to a particular issue. In fact, Department staff will be meeting with representatives from GAO May 22nd to discuss its initiatives in addressing improper payments.

MEDICAID

Building upon Medicare's success in measuring errors, the Department is well into the process of creating a payment accuracy measure [PAM] in the Medicaid program. Medicaid is a substantial program, accounting for over 30 percent of Department outlays.

Federal outlays for the Medicaid program in Fiscal Year 2003 will be about $162 billion dollars with a State share of $122 billion. Therefore Medicaid's total outlays of $284 billion and its 41.4 million beneficiaries served are both greater than the Medicare program. Unlike Medicare, Medicaid is administered primarily by State governments. Each of the State and Territorial jurisdictions run their own unique program. To account for program variation, we are taking an incremental approach to development of the Medicaid error rate. Nine States entered the program in its first year, twelve States are participating this year, 25 States are targeted for FY 2004, and the program will be implemented nationwide in 2005. This collaborative approach will create a measure that is accurate and useful to both State and Federal agencies.

The payment accuracy measurement [PAM] Model has been modified for FY 2004 to measure errors other than overpayments. The modifications include estimating payment errors attributable to both underpayments and ineligible recipients. The model will be used to estimate payment accuracy for both Medicaid and SCHIP. The resultant measure will give State governments the ability to identify and target existing and emerging vulnerabilities. For example, PAM will enable the Department and States to identify the extent of problems in the claims payment system, study the causes of these problems, and better focus and strengthen internal controls. At the national level, PAM will enable the Department to estimate the size of potential problems and produce an overall payment accuracy estimate for Medicaid and SCHIP.

The Department has received a preliminary draft report from CMS outlining State methodologies and the results of the first year of these pilot programs. Initial results show that States created varied and innovative methodologies for the development of their preliminary State payment accuracy rates. Mississippi drew a statistically valid sample of eligible beneficiaries and tracked the accuracy of claims payment for each of these individuals throughout the year. New York, on the other, hand drew a stratified, random sample of claim lines from the total universe of claims. The innovative and unique methodologies submitted by each State will allow the Federal Government to accurately assess best practices in the development of a national PAM model. The core methodology is still being established, however, and findings to date are far from definitive.

During the third year of testing (FY 2004), States will be encouraged to pilot test the PAM Model in both their Medicaid and SCHIP programs. Based on best practices found, the final specifications for the PAM Model will be produced at the conclusion of the third year of pilot testing. This standard will be used for a nationwide implementation in FY 2005. Requiring States to implement PAM will necessitate publishing a regulation. Therefore, the earliest the Department will be able to estimate the rate of improper payments in Medicaid and SCHIP is FY 2005; however, this is pending a final rule.

In addition to the development of the PAM model, Medicaid program integrity efforts also include the use of Medicaid fraud control units (MFCUs). Currently 47 States and the District of Columbia have established MFCUs. These units conduct investigations

and prosecute providers charged with defrauding the Medicaid program or persons charged with patient abuse and neglect. Since the inception of the Medicaid fraud control program, the MFCUs have successfully convicted thousands of Medicaid providers and have recovered hundreds of millions of program dollars.

OTHER STATE-BASED PROGRAMS

In addition to Medicaid and SCHIP, the Department administers numerous state-based programs that promote the economic and social well-being of children, families, and communities. The States and HHS operate these programs in partnership and give special attention to vulnerable populations. These programs account for $48 billion in outlays within the President's FY 2004 Budget. Notably, this budget request includes $5 million to augment our efforts to identify and reduce erroneous payments. These funds will be focused on three programs - Temporary Assistance for Needy Families (TANF), Foster Care, and Head Start. Working with the States, we are committed to maintaining the integrity of these programs.

The Department closely monitors improper payments in these programs through Single Audit Act activities, reviews of financial data, and program-specific mechanisms. Through the Single Audit Act, the vast majority of these programs are audited at least once every three years if not more frequently. The Single Audit Act, as amended, establishes requirements for audits of States, local governments, Indian tribal

governments and non-profit organizations administering Federal financial assistance programs. Non-Federal entities expending $300,000 or more in a year in Federal awards shall have a single or program-specific audit conducted for that year in accordance with OMB Circular A-133, Audits of States, Local Governments, and Non-Profit Organizations. A-133 implements the Single Audit Act Amendments of 1996. The Department will use the information from audits required by the Single Audit Act amendments of 1996, to the extent possible, in determining the error rates and identifying the causes. Total HHS dollars covered by these audits totaled approximately $194.3 billion in FY 2002.

For the past several years, only a small percentage of our program costs have been classified as misspent funds. For the institutions subject to the audit as described above, in 2002, $20.6 million out of $194.3 billion were classified as misspent funds by the Office of the Inspector General's review of Single Audit reports. A sample of State auditors verified that States have systems in place to identify, report and reimburse the Federal Government for improper payments. HHS has provided technical assistance and financial oversight for many of their grant programs, which has helped prevent improper payments.

In addition to these program integrity activities, the Department is taking steps to strengthen and establish erroneous payment rates for several programs. Currently, the Foster Care program conducts eligibility reviews on a sample of cases to determine the amount of maintenance payments made in error and takes disallowances on those cases

that are reviewed and found to be ineligible. We will seek legislation to enable the program to develop new regulations to strengthen the statistical validity of the error rate methodology.

We will also seek legislation to authorize the collection of data necessary for determining an error rate in the Temporary Aid for Needy Families (TANF) program. The error rate will be an important tool in maintaining financial accountability from States. It will help ensure that the $16.9 billion in TANF funds are being spent appropriately in accordance State TANF laws and regulations. Our objective is to develop a statistically valid error rate on cash assistance payments while working to minimize burden on States.

The Child Care and Development Block grant totals $4.8 billion in both mandatory and discretionary funds. The Department currently holds States accountable for these funds mainly through the Single State Audit system. Last year, we began to take a more systematic approach to reviewing audit activity in order to see if there are any systemic problems or patterns that are causes for concern. Because of the highly flexible and extremely varied State-to-State nature of this program, developing a meaningful error rate poses some significant challenges. Therefore, we are carefully considering how we might undertake this effort in the most cost-effective way that would be useful to both the States and the Federal Government.

HEAD START

Head Start provides grants to local public and non-profit agencies to provide comprehensive child development services to children and families, primarily preschoolers from low-income families. The FY 2004 budget for Head Start is $6.8 billion and supports 923,000 children. The Head Start network consists of 1,570 grantees; with 200,000 staff; assisted by nearly 1.5 million volunteers; and housed in over 50,000 classrooms. Head Start grants are reviewed and approved for funding, as well as project oversight, through one of the ten regional offices of the Department or a specialized branch which focuses on grantees serving American Indian/Alaskan Natives and migrant/seasonal farm workers' children.

Head Start regulations allow Head Start programs to serve up to 10% of their enrolled children (49% in certain situations for tribal Head Start programs) from families who do not meet Head Start's income requirements. The real challenge will be in estimating an error rate as changes in employment, income and family status occur during the school year. In developing the Head Start error rate, the Department will be using findings contained in audits required under the Single Audit Act, and from information collected in site visits. It is expected that HHS will have an estimated error rate for the Head Start program as of September 30, 2003.

The Department has also begun to look at other programs in light of the "Improper Payment Information Act of 2002" requirement that programs susceptible to more than $10 million in erroneous payments report on amounts of and efforts to reduce improper payments.

FRAUD

My testimony today has focused on improper payments. I would briefly like to touch on one particular type of improper payment, fraud. An example of an actual fraud involved a New York physician who was sentenced to 37 months imprisonment and ordered to pay $1.3 million in restitution for health care fraud. The licensed cardiologist, internist and certified acupuncturist billed for nerve block injections when he actually performed acupuncture, a service not covered by Medicare. An example of an improper payment involved a physician who was paid $182 for an office visit and scanning diagnosis services. The physician acknowledged that the supporting medical records could not be located. Unless a pattern of similar abuse and the element of intent could be established, this case would not be identified as a fraud. A key element of a fraud is the intent to commit the crime.

In addition to the Department's initiatives described above to reduce improper payments, the Department's OIG continues to devote significant resources to investigating and monitoring the Department's programs, especially for the Medicare and Medicaid programs. These efforts have led to criminal, civil and/or administrative actions against

perpetrators of fraud and abuse. In FY 2001, OIG reported for all HHS programs $1.50 billion in investigative receivables and another $1.49 billion in FY 2002.

In 1996, Congress provided the Department with a stable and predictable funding source to detect and prevent errors and to combat Medicare and Medicaid fraud, waste, and abuse under the Health Insurance Portability and Accountability Act of 1996 (HIPAA). Through HIPAA's Health Care Fraud and Abuse Control (HCFAC) Program, anti-fraud and abuse funds flow to the Office of Inspector General, the Department of Justice, other HHS agencies, and the Federal Bureau of Investigation. HCFAC funded efforts returned $1.2 billion to the Medicare Trust fund in FY2002 alone.

The Department has and will continue to maximize the use of various resources in its initiatives to reduce improper payments, including considering the work of HHS OIG, GAO and non-Federal entity auditors. We value our relationship with our OIG and the OIG's superior work in addressing instances of fraud, waste and abuse in all of our programs. Because the great majority of providers are honest and wish to avoid fraud and abuse issues, the OIG has been actively working with the private sector to develop methods to prevent the submission of improper claims and inappropriate conduct. The resulting audits range in scope from work at individual health care providers or grantees to nationwide audits of some aspect of a departmental program.

CONCLUSION

Mr. Chairman, in conclusion, HHS has a robust program for identifying improper payments across its many programs, taking appropriate management actions to reduce the incidence of improper payments, and exploring and developing innovative ways to increase compliance as evidenced with the Medicaid pilot program and Head Start. We attribute our success to the strong commitment of our leadership; the focus on building and maintaining close partnerships with the Inspector General, the States, and our contractors; and the wide range of initiatives that support program integrity.

I hope that the information I have provided here today will be of value to the committee in their work in evaluating OMB's guidance on the "Improper Payment Information Act of 2002." At this time, I will be happy to answer any questions.

Mr. PLATTS. Thank you, Mr. Weems, and all of our panelists for your testimonies, and again, the efforts of you and your staffs in preparing your even more substantive written testimonies.

We will proceed to questions, with just two members. While we will alternate, we will not worry about being that strict with the 5-minute rule as far as alternating back and forth as we proceed through the questions.

Ms. Springer, one, I would like to commend OMB as you prepare to issue the guidance as required under the Improper Payments Information Act in a timely fashion, and your sharing some of where you stand with that. Could you give us a little more detail on what the agencies and all of us can expect to see from the guidance you are going to issue—for example, some of the things, how you are going to define improper or erroneous payments, will fraud be included in the definition, what are some of the more detailed specifics of the guidance, what will it be?

Ms. SPRINGER. I would be glad to do that, Mr. Chairman.

First of all, the guidance is almost final. It has been vetted over the past several months throughout the administration, partly through the partnership with the CFO Council and its subcommittee on erroneous payments, which is jointly made up of the Inspectors General community, as well as the financial community in the agencies. We have gotten very good feedback there, and have a process that really includes four steps. The first step is the requirement for agencies to inventory their programs and their activities.

The second step, then, based on that inventory, is to assess the risk of erroneous payments in those programs and activities. That risk assessment is really the key first activity point. Based on that, where the risk is high, we will ask the agencies to estimate based on the formula—and I will go over that formula with you in a moment—to actually do a statistically valid estimate of the amount of erroneous payments. That, as well as plans for remediation will be reported each year in the performance and accountability reports that are due back from the agencies. The first reporting period where that will be included will be in the November 2004 performance and accountability report. That is the first one where it will be required under the act.

We will continue to ask for information on erroneous payments, consistent with the directive that went out under the President's budget, under the A–11 guidance. So in the interim until we get to November 2004, we will continue to get that information and obviously I would be glad to share that with you and with the committee.

As far as the definition of erroneous and improper payments, to answer the question about fraud, yes, fraud is included in that definition. You mentioned earlier in your opening statement, Mr. Chairman, some of the types of erroneous payments. Certainly, it includes the very obvious ones of incorrect amounts, both over-and under-payments. We will be getting information very specifically about over-and under-payments that will not be a net amount. It will be the absolute value, if you will, or gross amounts, and we will be able to have those separately identified.

Of the $35 billion figure that we currently have for the $900 billion amount of programs, the $35 billion is made up roughly of $30

billion of over-payments and $5 billion of under-payments. So we will be able to continue to identify those separately.

Other categories in that definition would include inappropriate denials of payments for services. It would include payments made to ineligible recipients or for ineligible services; duplicate payments; payments that do not include the proper accounting for discounts that may be applicable. "Payment" means any payment that is derived from Federal funds or Federal sources, or down the line, from a Federal entity. So for example, Federal funds that go to a State and then from the State to an ultimate recipient, if that was made improperly, that would count and should be in the universe of what is reviewed under the guidance.

It also includes Federal awards that are subject to the Single Audit Act, and the Single Audit Act, obviously, and recovery auditing all provide additional tools, in addition to the very explicit guidance that we will be issuing later this week.

I could go on for a while, but maybe you have some very specific questions.

Mr. PLATTS. Actually, I have a couple of followups of things that you did highlight. One is, you mentioned that the first reporting under the act will actually be November 2004. It sounded like from what you said that while that is the first time we will actually see the reports pursuant to the new act, that there will be a constant oversight between now and then. So in some of our previous hearings where we have talked about where we would get to the end of the year, and where we have the financial accounting requirements, and we have these heroic efforts to get the books in order at the last minute. It sounds like OMB is going to be day-in and day-out, or month-in and month-out, between now and November 2004, working with the agencies, that they are moving forward pursuant to the guidance being offered to ensure that they are putting in place those internal controls, that when we get to the November 2004, deadline, that we have accurate information readily available.

Ms. SPRINGER. Yes, that is a good characterization. We certainly are not in the business of just issuing guidance and then being inactive. We expect to meet as soon as the guidance itself is issued, and hear about the plans; make sure there is a good understanding of the guidance, first of all, at the agency level and hear some feedback from the standpoint of its first assessment. Do we need to provide outside authorities, make them available, because these do involve some statistical formulas that need to be met and statistical standards. We believe that agencies will need to get some assistance from some outside parties that have been involved in this activity. So we will be involved in that respect.

We will want to get the plans. Similar to what we are doing on the financial reporting side, we will actually get from each agency the plan. The reporting in 2004 is just the culmination of the execution of that plan.

Additionally, we will continue to get information for a broad number of agencies that cover roughly half of Federal payments that were targeted under the President's Management Agenda. So that will not stop. That will be replaced by the act and the new guidance requirements, but up until that 2004 first reporting, we

will continue to get the reporting that was required under the President's Management Agenda. So there will not be a lapse in information coming or a lapse in our involvement.

Mr. PLATTS. OK. You touched also on guidance related to our Federal programs, but administered by the States. Mr. Weems also referenced them, such as Medicaid. How detailed, how involved will your guidance be in trying to get agencies to work with States who are really on the front lines of improper payments relating to those State-run, but federally funded programs?

Ms. SPRINGER. Right. The dollars associated there are not small, either. We have done several things. The guidance will certainly address that. We make reference to audits performed under the Single Audit Act, and that is probably the key focal point of activity, that Single Audit Act, in dealing with integrity issues in programs that involve the States. My staff and I have attended and worked with the State and local auditors, controllers and treasurers. We have been to their meetings. We have shared the guidance with them. I was on the phone as recently as yesterday with one of the State auditors general.

As a matter of fact, OMB just clarified where there was a point of confusion in recovery auditing, where the States had actually instructed contractors to not audit programs that were funded with Federal dollars because they felt—there was some misinterpretation out there—that the dollars that would be found could not be available to help pay for the cost of the audit, which was totally wrong. The Federal Government was not getting the attention it deserved from these audits. We have issued late last week, I believe, clarification, so we are making calls. So we are actively engaged is the message I am trying to give to you, and we have shared the guidance with them and gotten their input.

Mr. PLATTS. Let me yield to our vice chair, Ms. Blackburn. But just to put it in perspective, when we talk about these numbers—$35 billion—and we talk about Medicare and adding prescription drug benefits, over 10 years of spending $400 billion for that new plan. If even these conservative estimates of the erroneous payments are accurate, it would in essence be the cost of that new benefit being added, if we totaled it over 10 years. So we truly are dealing with some significant sums of money that can be put to much better use for our taxpayers.

Ms. SPRINGER. Right.

Mr. PLATTS. Ms. Blackburn.

Ms. BLACKBURN. Thank you, Mr. Chairman.

Mr. Williams, I want to just tag onto what he was saying, and come back to you. The $35 billion estimate, from your testimony, I was unclear as to whether you included what you thought may be erroneous payments in Medicaid in that amount or not, from your written testimony?

Mr. WILLIAMS. The $35 billion is the amount that OMB has estimated. What we are saying at GAO is that you have to put the procedures in place to have all agencies in the Federal Government go through the process of identifying where they have weaknesses and where they have improper payments, and, at that particular point in time, have all of those agencies report that information. We have recommended that reporting be transparent so that the Congress

and the American people will have some idea as to what the improper payment number is governmentwide. Until you establish that base, we are saying that you do not know what the total picture of this problem is.

Ms. BLACKBURN. OK. Thank you for that clarification. I appreciate that.

So basically what you are saying is that until we get to November 2004, with some procedures in place, you think we do not have a solid estimate? Would that be correct?

Mr. WILLIAMS. Until we get to that point where we have the entire government, that will be the first step, because this process is going to take some time for some agencies. Some agencies are already estimating their improper payments, and they have procedures in place where they can do a good job. For other agencies, this will be the first time, so it will probably take them some time to get up to speed with this particular process. So we will be getting closer to it at that particular point in time.

Ms. BLACKBURN. Thank you, sir.

Ms. Springer, we thank you for being back with us. Looking at the private sector, I know that GAO had an executive guide in October 2001 that provided some information on strategies used by private sector organizations. Now, how much of those private sector solutions have you incorporated into the draft guidelines that you had mentioned, for the Improper Payments Act?

Ms. SPRINGER. We have drawn from the GAO study. We have reviewed it, and we have looked at the techniques and the plans. There are really four or five main principles that are in that document. We have incorporated those. We believe that what we have in the guidance is very consistent with what GAO has put out in that August 2002 report.

If I may, may I just add one other piece to round out the scope of the problem that might be helpful to you as well. If you—and I did not bring a pie chart; if I had a little more time, I should have—but if you view the total government's budget as the universe of expenditures—a little bit in excess of $2 trillion—there is $900 billion of that that has been measured. Out of that, we had the $20 billion that was originally estimated from GAO and another $15 billion or so that surfaced as a result of the President's Management Agenda. So that is $900 billion. Another close to $200 billion, rounding off numbers, would be related to Medicaid, which has not yet been reviewed. Then there is another $100 billion or so that would take us up to the total encompassed by the existing original OMB guidance. That really leaves another roughly $1 trillion that would be picked up as a result of the act from last year. Included in that other $1 trillion is about $250 billion that is already covered by recovery auditing, to some degree. So there is another $750 billion or so that really has not been looked at. That makes up the full pie chart. So we have roughly covered half of that, between recovery auditing in the $900 billion that we have looked at so far.

Ms. BLACKBURN. OK. Thank you. That makes it come together a little bit better. Sometimes as we read testimonies and review, you guys know the total picture and we are trying to pull that together. It does get confusing with different testimonies and dif-

ferent numbers used as those benchmarks in those references, so I appreciate that.

Ms. Springer, going back, you mentioned the guidance on improper payments, with the inventories and the risk assessments in those four items. Now, other than that, or prior to issuing those guidances, what have you all done with the agencies in helping them address improper payments?

Ms. SPRINGER. I would say to a large degree we have worked with the agencies and identified for them which programs we think they should be looking at. We have talked with them about contractors that they can use that we understand from the private sector have done a good job. We have not put out any one single formula prior to this guidance. I think in anticipating that the act was moving along at a good pace that we did not actually sit down and put out a formula and then have to go back and modify to be consistent with the act. So we have worked with the agencies to just understand their own formulas, but now with this guidance we will actually be putting out something that is more directive, as opposed to just reacting to what they were doing.

Ms. BLACKBURN. Mr. Weems, looking at Medicaid specifically, is there anything that you all are doing to reduce erroneous payments with that program?

Mr. WEEMS. Yes. We began a pilot project last year with nine States where we asked them to develop their own method for calculating error. We expect to expand that to 12 States this year; 25 States in 2004; and then by 2005 be able to produce a national error rate.

Ms. BLACKBURN. To followup, OK, so you are letting the States take the lead in designing their program for the tracking?

Mr. WEEMS. Not entirely.

Ms. BLACKBURN. Not entirely, OK.

Mr. WEEMS. With the nine that we have begun with, we gave them, within a framework, the ability to do that. We are going to take that now and analyze it; look at the methods they used and make sure that what we do in the next round will have a higher degree of consistency and a higher degree of rigor; then in the next round, an even higher degree of consistency and a higher degree of rigor so that we can come to a point where all of the States will be using a method that will accurately give us a measure that is valid for the State, and also a national Medicaid error rate. We are proceeding in this fashion because States are an important partner in the Medicaid program. Right now, the funds are not quite evenly divided. I believe we spend about $160 billion and the States spend about $122 billion of their own money in the program. So, it is important for us to proceed with them as a partner. Their interest in this, given the state of State budgets right now, is obvious, but we want to proceed in a way that it is not just the Federal Government telling the States how to do it, when in fact we have significant variation across the States in the way that they run their own programs.

Ms. BLACKBURN. Mr. Chairman, may I continue on?

Mr. PLATTS. Yes.

Ms. BLACKBURN. OK. Thank you very much.

Do you have a budget? What is it costing you to run the pilot programs—just the implementation and the oversight of those?

Mr. WEEMS. I believe we expect to spend $10 million this next year to do that, and then we will have to look at it again when we phase it up to the 25 States.

Ms. BLACKBURN. OK. So basically, you are going through it—the nine States, you will develop a list of learned lessons and best practices, and use those with the 12, and then on with the 25.

Mr. WEEMS. Yes, that is correct. Yes, ma'am.

Ms. BLACKBURN. OK. Alright. Thank you very much.

Mr. Chairman.

Mr. PLATTS. I am going to continue, Mr. Weems, on the Medicaid issue. The nine States came on board in 2002?

Mr. WEEMS. Yes.

Mr. PLATTS. Are there any initial results from those nine States, or is it too early because of it being a new pilot program?

Mr. WEEMS. There are results, but I would be reluctant to characterize them right now because of the diversity of the way that the States approached it, and also the amount of rigor with which the States might have approached it. So it is possible that one State could have ended up reporting a very low error rate, when the degree of rigor they applied might not have been the same. So I would be reluctant to characterize. I would say that there is some variation. We are going to look at that, use the lessons learned from those 9 States, then as we proceed with the 12, apply more rigor.

Mr. PLATTS. But am I understanding correctly that as you go from the 9 to the 12, and the 25 and then ultimately to all States, that at some point you envision having a uniform system for every State to take the same approach so that you are comparing apples and apples, one State to the other?

Mr. WEEMS. Yes, for precisely the reason that you state, Mr. Chairman—for the sake of consistency so that if we say there is a national error rate and then one State has a certain error rate, it should be comparable to another State.

Mr. PLATTS. Is that something that is going to take legislative change to require States to implement this uniform plan? Or is it something that you believe you have the authority to require already?

Mr. WEEMS. We believe that we have the authority to do it now. If we discover that we need additional authority, we will be right back with you. Also, as we have proceeded so far, it has been a 100 percent federally funded effort. Whether or not we will sustain that through the future also remains a question.

Mr. PLATTS. Do you envision with recovery audits, where there is an ability to use some of the funds recovered for costs under the program, that you will have something similar for States, so there is an incentive to be more diligent and more of their costs are offset?

Mr. WEEMS. Absolutely, Mr. Chairman. That is the incentive for States to be our partner, as we have discussed.

Mr. PLATTS. OK. A question maybe for all three of you—the disparity between error rates is pretty significant from the 30 percent in the EITC to some of the ones, Ms. Springer, in your written tes-

timony you highlight the Federal Employees Health Benefits Program—1.4 percent; DOD when it comes to the military retirement, 0.05 percent error rate. Is it simple—I don't know if "simple" is the right word—but simply the internal controls in place that results in a 30 percent, which is a huge error rate compared to 1 percent or 0.05 percent rate. What would be your best estimates from the three of you why the great disparity that one program is doing such a great job and another program is doing such a horrific job?

Ms. SPRINGER. I will open with a couple of thoughts on that. I think some of it is the nature of the program. I think there is a certain amount that may be related to controls, and I will talk about controls in a minute. But I think some of it is the nature of the program. Ones like Federal employee benefits programs I think are going to be less prone to the types of verification—it would be easier to verify eligibility, to demonstrate that you are the right recipient; and the amount might be clearer to assess the right amount to pay. I think there are certain programs that just by their construct are more easily dealt with and it is easier to be accurate about the process of payment and to test it and to ascertain in fact that things are being executed properly.

Mr. PLATTS. Excuse me for interrupting—so would that be an example like with HUD, where Congressman Sessions is proposing legislation to give access to more information that would allow that control to be more significant of the decision of whether this is a valid payment or not?

Ms. SPRINGER. That is right. That would be a tool there. The information is available, in the case of the better players, the better actors, to make the assessment, as well as the construct of the program. HUD, and in some other situations—the Department of Education is another one for verifying direct student loans, where the administration would like to be able to provide the Education Department with access to information from the IRS, to be able to validate income levels and eligibility there. They do not have that tool yet. So where the tools exist, you will see lower rates; where the tools are not there and the construct of the program is a little bit more challenging, you will tend to see higher rates.

Mr. WILLIAMS. I would like to add to that. It is probably a combination of issues. As stated earlier, certain programs have inherent risks of improper payments. You might have one particular program in which the improper payment rate is 10 percent, and you would have another program in which the improper payment rate might be 4 percent. It might turn out that, when you do a total assessment that the 10 percent rate, people at that agency are doing a better job than the one that has 4 percent. So you have to look at the overall picture as far as what are the inherent risks in the particular program. You have to look at the commitment from management to address the program. Some programs might have a higher number because the agency is doing a better job of identifying its improper payments. Other agencies might have low numbers because their methodology of identifying the improper payments could be improved. So it is a combination of factors that you have to look at. That is why you want to get procedures in place that you can look at across the government, and you can make some comparisons and say that this particular program is doing a

great job and getting a handle on its improper payments and doing a great job in trying to reduce that number, but you should not expect to see where every department or agency within the Federal Government would have the same number or the same percentage, just because of the variations in the programs.

Mr. PLATTS. That is a point well taken, that goes into the many variables. It is something that I, until reading some of the testimony, assumed that access to information, like the student aid applications, access to the income data, was available. As one who is about to pay my last student loan payment after many years, for law school and undergrad, I want people who either have it to pay it back, or not get it if they are not eligible. I assume that that information was part of the review, to verify. Obviously, I have learned that it was not, and we need to correct some of those challenges that should not be challenges, but should be just readily shared between agencies.

Mr. WILLIAMS. That is correct.

Mr. PLATTS. Would you like to add anything, Mr. Weems?

Mr. WEEMS. Mr. Chairman, our experience in the Medicare program—Medicare has both a risk and it is a complex program. In a lot of ways, Medicare is an honor program in that we are billed for services. We do not have Federal employees go and check with beneficiaries and see if in fact those services are rendered. It is only through the audits or looking back through claims that we are able to actually discover some of those kinds of errors. We do have pre-payment gates in effect where we can look at a claim and determine, is this person a Medicare beneficiary, and does the service look valid. The classic one is, is this a male and is the procedure a hysterectomy—we would not pay that claim, for instance.

In our first experience, we found that many of the claims that we looked behind did not have proper documentation. That is, when we asked for the medical record, the medical record was improperly documented or there was not any documentation at all. So we called that a payment error. Now, it could quite possibly have been a correct payment, we were just not in a position to determine that. So given the complexity of the Medicare program, we have spent an awful lot of time and money educating our providers through the contractors on how to properly submit a Medicare claim; how to code them correctly; and how to properly document a procedure. As a result, our error rate has fallen and also the proportion of the error rate that is explained by improper documentation has fallen even more dramatically.

We understand those risks and I think from our experience we would say working with our clients and providing good education is a good way of mitigating both the inherent risk in the program and the complexity.

Mr. PLATTS. Maybe I would describe it as a kinder and gentler approach to not having wrongful payments in the first place, with that cooperation. It kind of goes to the internal controls of the provider. We are talking here about the internal controls of the agencies, because that is something when one of my work days I spent in an emergency room for about 12 hours with emergency department doctors and nurses, administrative staff. One of the things that was a little overwhelming was the paper documentation that

went with treating any patient, including or maybe even especially, a Medicare patient. What came through to me is that they understand that they need to be very thorough so that if after the fact there is a review of what has been paid to determine whether it was a proper or improper payment, that the documentation—the ducks are all in a line as need be.

Mr. WEEMS. That is very important to us, because looking across all of the programs in HHS, we administer very few directly. Most we administer either through the States or through contractors. So it is very important that the States and the contractors have in place proper controls.

Mr. PLATTS. And that highlights a point that while the estimates may be as high as—using Secretary Rumsfeld, I think he has been on record that as much as 5 percent of the payments by the DOD are improper in some fashion—correlating that to the whole budget and appropriations, would be as much as $80 billion a year; that some of that is intentional deception or fraud, but a lot of it is just not properly documented. It might be a legitimate payment, but we are not dotting the I's and crossing the T's, and we need to do a better job internally with the government and with the providers or contractors out there.

Mr. WEEMS. That is exactly right.

Mr. PLATTS. Ms. Blackburn, did you have further questions?

Ms. BLACKBURN. Yes. I think I want to go back to the point the chairman had made about incentivizing some of the agencies and the levels of government through the recovery audit. In doing that for a job well done, what kind of penalties are we looking at for the agencies who still have high rates of error payments, or is there any thought to that?

Ms. SPRINGER. My recollection is in the act as they are set out now, both the recovery audit guidance, and also the new guidance, I do not know that there is specifically a penalty that is laid out. It is an interesting thought. Certainly, one thing that does come into play here is that we have the performance assessment rating tool, the PART process that we have, that is meant to tie performance to the budget. In a certain sense, I would expect to see the erroneous payment rate become a part of those assessments of programs.

To the extent that there is not progress in bringing that rate down to a targeted rate, I would expect that to be a factor in the appropriations and the budget submission process. That could work in two ways. It could manifest itself in saying we could do more—even somebody who is making progress, but slowly could say, well, we would like to do more, but we would like to get some funding. If you can demonstrate progress, then maybe that could work as an additional amount. It could also work in the opposite direction as more of a penalty. So I think there is an opportunity through the PART process for that to have some consequence for agencies that are not making progress.

Ms. BLACKBURN. Thank you.

Mr. Williams, you spoke just a moment ago about the different rates, and where 10 percent can be a good rate at one, and 4 percent at another one.

Mr. WILLIAMS. Yes.

Ms. BLACKBURN. Now, when you know that there are these improper payments that are out there, and we know it is never going to hit zero all across the board, what do you think is more or less a benchmark of an acceptable rate, or do you have a set rate that you are looking to get these down? And what is your timeline for getting these down? Is it November 2004 or where are we on that?

Mr. WILLIAMS. There is no specific number right now that I could give you for the various agencies in the Federal Government. The first thing that you have to do is to get a handle on the process. I think the legislation has gone a long way by requiring agencies to go through the process of assessing their operations. What you have to do at that particular point in time is make your assessment and form a baseline. Then you are in a position to set targets and goals, and look at your operations and say, this is where I would like to get to. So at this particular point in time, it is very difficult to say what a good number would be for the various agencies.

There are some that, as I said earlier, have been doing this process. They have a good feel for what is going on. But across the government, to get this issue addressed governmentwide, you need to have all of the agencies go through this process. What might be a good number for one agency would not be for another. So you have to take it on an agency-by-agency basis and take it from there.

As far as the timeline, one of the things that you have to consider in this area is that some agencies are further along than others in this particular process. Just getting in the information in fiscal year 2004 might be good for some, but it could take some additional time before agencies get to the point where they really do have a good handle on what those numbers should be.

Ms. BLACKBURN. I know. I think it is just troublesome to some of us who watch this process to think of how many years this has gone on, and how many billions of dollars have been improperly tracked and unaccounted for. There has seemingly been no recourse or no change of activity. I think that does make it difficult.

Mr. WILLIAMS. Yes.

Ms. BLACKBURN. In that vein, what specific recommendations for action do you all have on making the information on improper payments per agency more readily available and more transparent?

Mr. WILLIAMS. I think the Congress has taken the action that we suggested in our August 2002 report, and, with the passage of the legislation, to require the agencies to report this information, to go through the process. That is the first step. I think if you look at this from a root cause of these problems, most times it can be traced back to the lack of good internal controls in place. As we talk about our framework for establishing a good internal control system, the first thing that we talk about is the control environment. We talk about setting the tone at the top. I think the President's Management Agenda and the Congress passing legislation requiring agencies to take these various steps to identify and to report improper payments all point to us heading in the right direction. So I think the Congress has taken the step that we need to get this process under way to do more than just talk about it, but to have some accountability here in which agency management is responsible for identifying and addressing the improper payment issue.

Ms. BLACKBURN. Yes, I think you are right. The public has a tendency to get tired of talk, and they want to see some action.

One more question.

Mr. WILLIAMS. OK.

Ms. BLACKBURN. Mr. Weems, I am new to Congress this year. I came from a State Senate. We were always tackling and working through TANF and Child Care, and some of the problems that surrounded that. Now, you have spoken of Medicaid, the work there with the audits and the improper payments. What are you doing specifically looking at Child Care dollars and improper payments there?

Mr. WEEMS. Child Care—we are at the point of evaluating that program and doing our initial risk assessment on it. That is one that I would say is farther back in the queue for us. It is on our list of seven. We are just not as far along on it as we are for the others. With respect to TANF, as you know, in the TANF legislation, the Federal Government does not have a substantial ability to review data and information from that program. One of the tools that we will need in the TANF program is legislation to open that up a bit so that we can get that information. We are currently in discussions to craft that legislation correctly and get it up to the Congress.

Ms. BLACKBURN. Will you review that basically more than in a macro sense, I would assume?

Mr. WEEMS. Because of the variation in the States, we will have to look a little farther in. At initial blush, the thing that we are going to concentrate on is the actual cash payments, rather than some of the other things that are possible under the TANF program.

Ms. BLACKBURN. Thank you very much.

Thank you, Mr. Chairman.

Mr. PLATTS. Thank you.

The followup on that with specific suggestions—you had identified the administration of the foster care program I believe as well. Is there specific legislation that you have in mind, or is that still in the draft stage?

Mr. WEEMS. It is still in the draft stage. We are still discussing our needs with our colleagues, but we expect to be able to provide the Congress something soon.

Mr. PLATTS. Because as I stated earlier, one of the benefits of these hearings is not just for the general public and for Members to understand how agencies hands are tied in some ways, with Congressman Sessions addressing the issue at HUD and access to information there. We talked about student loans, foster care, TANF—that we can all be on the same page and working diligently if there are legislative changes needed, that we identify them and try to move forward as quickly as possible to give the agencies that information. Because we are putting the onus on developing the internal controls, but if there is information outside of their ability to acquire that is still going to hinder their efforts, then it is something that we should not really be holding them responsible for—our inability to get them that additional information.

The question—and Mr. Williams, you talked about a baseline and the Improper Payments Information Act will help establish

that now by requiring all the agencies to identify their improper payments—and that coming forth in the 2004 performance and accountability standards report. As a general taxpayer, sometimes watching the various TV broadcasts or reading the paper about this improper payment that comes to light, I will be watching a show at night at home and my wife will say, "Is that really happening? Why don't you stop it from happening?"

Why so long? Even though the guidance is just coming out now, the agencies have known since November when it was signed into law that this was going to be a requirement, why the 2004? Although not required to be in the 2003 reports, what would hinder us from getting it in the 2003 report, a year sooner, so we get on track and get that baseline established a year earlier?

Mr. WILLIAMS. Yes. I would support any early reporting of this information because the sooner that we start reporting this information and put as much transparency in the reporting process as we can, the better, in my opinion. I would say also that there are some things that you have to look at when you are talking about an issue like this, and using this internal control framework. I will repeat what I said earlier, and that is, in order to address these issues, you have to have a control environment. I am not just talking about at the agencies, but I am talking about you need a control environment that collectively involves the Congress, the administration, agency management—the entire government. So it is going to take a coordinated effort of everyone working toward addressing this issue. You are going to have to continue to hold hearings like this to hold people accountable for what they are doing. I think it all gets back to accountability as to what needs to be the focus in this particular process.

I have worked on other issues. I have seen longstanding problems. But one of the things that I have observed in a lot of the issues that I have addressed over the years is that you have to have things like this. You have to have these hearings to hold people accountable, to make sure that they are aware that the Congress is looking at this process. It should result in getting some action. You need to get progress reports. This is where we are at this particular point in time. This is where we are trying to get to.

So that is what needs to be done—that tone at the top, which as I stated in my opening statement—I am beginning to see that. I think that is going to result in some positive events as we move down the road in addressing this problem.

Mr. PLATTS. Maybe that leads into a followup question, Mr. Weems. You mentioned about the tone at the top of HHS that has really helped to put a focus within that agency. Can you share some examples of the actions at the leadership of HHS that have helped to set that tone on the right track, that this is a serious issue and we are really going to dive into it in all ways possible?

Mr. WEEMS. Absolutely. In this case, certainly Secretary Thompson is an extremely energetic boss that demands an awful lot of accountability from his employees, as he should. He also is from Elroy, WI, where I am sure one can still get a 99 cent breakfast. [Laughter.]

These are large numbers to him. So he sets that tone, and we do a number of things. First of all, the management agreement

that we have with our colleagues with OMB and with the President is reflective of that commitment. We have been and our colleagues have been very aggressive in coming to that commitment and to that arrangement. Also, once a month we have management meetings with the senior management leadership in the Department where we are expected to report on our results, where we are on the management plan. This is part of it. And then quarterly, the entire leadership of the Department meets to go over where we are on our management objectives. It is something that is with us night and day.

Mr. PLATTS. And with the Secretary being a big fan of Harley-Davidson, and his District is home to a large manufacturer of Harley-Davidson, a plant, we think well of the Secretary as well.

Ms. Springer, how about—and realizing that the agencies are heading in the right direction and HHS is an example of that, trying to bring more scrutiny and more focus and energy to this issue, is OMB considering—you mentioned how you are going to have this information being shared in a more voluntary sense, or part of the management plan between now and 2004. Would OMB consider strongly encouraging it being in the 2003 reports as opposed to waiting until 2004?

Ms. SPRINGER. Certainly for the programs that reflect that $900 billion—that roughly half—there is no question that we have requested that, and we could make that available, and we can ask them to put that in their plans. That covers 15 agencies. So even though it is only roughly half of the total Federal outlays, most agencies will have some piece that they are already required to do, and we can certainly make that a requirement for 2003 for those plans.

Mr. PLATTS. OK. I am checking my notes here. As we share questions and in your opening statements, you covered a lot of the issues I wanted to explore a little further, but I want to see if I missed anything.

I want to come back to a final question. We kind of touched on this earlier when we talked about the EITC program and trying to get our arms around that 30 percent error rate. If I remember my numbers correctly, the administration has asked for about $100 million of additional funds to get our arms around it, to try to reduce that; that if we spend that $100 million, we will save a lot more than that if we can get a better plan. Can you give more detail what you envision that $100 million being used for, and what the cost-benefit analysis is if we spend that $100 million, we estimate we will maybe save X dollars or reduce our error percentage of X amount?

Ms. SPRINGER. Yes. Well, just to put the full perspective on it, the EITC program has been under review by various consultants that the IRS has brought in. They estimate the total erroneous payments to be in excess of $9 billion. That is one of the largest single program amounts in the $35 billion total—close to one-third of it; I guess one-quarter. So in any event, out of $9 billion, I do not know the exact percentage. I could find that out for you. They actually came to OMB and asked last fall for even more money than the $100 million. We thought $100 million was a good amount—they could get a lot accomplished with $100 million and

then based on the accomplishments associated with that, how much they could bring back in the way of improvements, then they could in effect re-up for additional funding.

There are three basic causes of erroneous payments in the EITC area. There are income reporting errors; there are taxpayers that claim that they have a qualifying child, and they do not always; and then there are also taxpayers that will claim the wrong status. They will claim that they are married when they are really single, and that affects it as well. Sometimes you also get a child being claimed more than once. So there are a variety of things there and it can be done at the front end.

In most cases, it will not involve any additional paperwork or effort on the part of the applicant. It is just that we will be able to verify that the information is correct, and then if there is a follow-up, we would need to get some additional information to support what they have requested. Again, I do not know the exact percentage of the $9 billion, but it is not an insignificant number and I could get back to you with that.

Mr. PLATTS. If you could followup on this in maybe a little more detail on what that $100 million is proposed to actually do—how you are going to go about trying to reform the program and what that projected benefit is.

Ms. SPRINGER. Right. I would be glad to do that. I do know that again, there was a study done in advance. It was not, give us $100 million and we will try and figure something out. They actually have had a consultant on board and are doing an assessment, so we will be able to get that for you.

Mr. PLATTS. Mr. Williams, in one of GAO's previous reports, there was acknowledgement of departments or agencies changing their goals and objectives, which perhaps has had an impact on ability to really assess the level of improper payments.

Mr. WILLIAMS. Yes.

Mr. PLATTS. I assume that with the new law in place that we will overcome that because of establishing more of a uniform approach to evaluating improper payments. Is it your sense, or was it in that statement in the report, that there was an intentional effort to try to hide that level of error rate, or to reorganize and start over because we will see if we can do better? What is your read on that effort?

Mr. WILLIAMS. My sense is that this was agencies' attempt to better report their performance in the GPRA. I do not think it was an attempt to hide what the amount of their improper payments were, but we have been critical of agencies in their GPRA reporting over the years. I think you see these changes as agencies attempt to better report how well they performed over the years. So I think that is what the focus would be more on.

Mr. PLATTS. Not just presenting their information in a more positive light under GPRA?

Mr. WILLIAMS. That is correct.

Mr. PLATTS. A question for all three of you, and I think maybe my final question is on having more accountability and internal controls. As part of the Sarbanes-Oxley financial reforms regarding publicly traded companies, we required audit opinions on their internal controls. I would be interested in each of your opinions on

whether we should require audit opinions on the internal controls of each of our departments and agencies within the Federal Government, as we are now requiring these publicly held companies to do.

Mr. WILLIAMS. We at GAO have always supported having an opinion on the internal controls. We think that this would be, at least we consider this to be a best practice. We think it would provide more information on the various control weaknesses in an organization. The current reporting basically is one in which the auditor talks about those areas in which they look at and which they consider material, but we think it would be much better to have the auditor look at the entire control process. Without getting too technical, there is a process that we as auditors go through in identifying the controls. We use that information for various reasons. I am of the belief that in order to get to the point where you would be in a position to issue an opinion, there would be additional testing that would be required to put you, as an auditor, in the position to do that. We think that would be much better information under a control environment at an agency than the current report model.

Mr. PLATTS. Ms. Springer.

Ms. SPRINGER. Yes, it is a good question. It is a timely question. Let me just provide you with an understanding of what is done today, versus what is not done today, that would be contemplated under expressing an opinion. It is very consistent with what Mr. Williams just mentioned.

Today, as far as the internal control environment goes, the independent auditor gets an understanding of the control environment. They assess the risk of any kind of material weakness. They will test the internal controls and report any findings. They stop short of expressing an opinion. So there is a lot of work that is done, but it is a testing type of review, as opposed to an opinion level review. There is a difference. But the fact that they do not express an opinion does not mean that there is no testing or risk assessment or review for material weaknesses.

It is my understanding that the IG community estimates that it would cost an additional 20 to 30 percent of existing audit fees to go from that testing review up to signing an opinion. What we would need to do—and I am not prepared to say that it is worth that or not; I have not seen a cost-benefit assessment—but that is the assessment that would need to be made to determine whether or not that additional rigor, and there would be some additional, is warranted and what the benefit is. We believe that within the context of this discussion of erroneous payments that there is a lot of ground that we can get by just instituting these practices that we talked about today, over and above just what we would get from this extra 20 or 30 percent cost.

So it is not as if there is nothing, and that is the point that I want to make.

Mr. PLATTS. Yes.

Ms. SPRINGER. The fair amount of review today just stops short of rendering an actual opinion. It is not inappropriate to look at the merits of that, but I am not sure where we come out.

Mr. Weems.

Mr. WEEMS. I agree with Ms. Springer. Our audits do significant testing on internal controls and doing risk assessments of those controls. We are concerned about the cost. Without a cost-benefit analysis, and this is certainly something that we need to pursue, some of our instincts tell us that marginal dollar might be spent on correcting identified weaknesses, rather than seeking an audit opinion on the internal controls themselves.

Mr. PLATTS. Ms. Springer, I was not sure, is there a cost-benefit being done to look at that? Or are you just saying that you would want that to be done before moving to that level?

Ms. SPRINGER. The latter.

Mr. PLATTS. OK. Because I am not certain of that total cost of that testing level of audit that is done today, and what 20 or 30 percent equates to, and then to make a comparison when we are talking $35 billion or as much as $70 billion or $80 billion in erroneous payments, and whether there is an added benefit to the level to make that worthwhile. But for those in scrutinizing from somebody from the outside, that audit opinion of the internal controls would certainly help OMB in looking at all the departments and agencies, or Congress in looking at just not it has been tested, but here is our opinion of how it is working or not—that would give some added information to assess who is being thorough and doing a good job, and who is doing something, but not necessarily as good a job as they could otherwise do.

Ms. SPRINGER. There is no question that being able to have an opinion to point to is like having that Good Housekeeping seal of approval, and that answers any questions.

Mr. PLATTS. You know that is going to be public, so there is maybe more pressure to fine-tune your controls.

Ms. SPRINGER. Right. And it is indisputable. I agree with you 100 percent. The only question that I would still need to have answered for me is the cost-benefit—proving that there really is an added-value to it; a cost-justified value. I will tell you that it is an issue that has come up. You are familiar, I think, with the fact that the principals—the Director of OMB, Comptroller General Walker and Secretary Snow, and OPM Director James and I and some others meet at least quarterly and review financial management issues within the government. We met last week and this was an issue that we discussed. We will not lose track of this.

Mr. PLATTS. I was wondering what you are doing with Medicaid in 9 States and 12, to pick a small department, maybe a large agency, to pilot it to see in actual implementation whether there is a benefit worth the investment? Is that part of the discussion?

Ms. SPRINGER. It is possible. We have not specifically had that teed up, but that is a possible way.

Mr. PLATTS. OK.

Mr. WILLIAMS. Could I add a point to that? One of the things that you have to take into consideration in that process of looking at it from a cost-benefit standpoint. If you never look at those areas that you have not tested, it might be difficult in coming up with the benefits you would gain because you do not know what the control weaknesses may be. You also do not know how much those weaknesses could be costing you from the standpoint of not identifying what those weaknesses are and having agencies put proce-

dures in place to plug those weaknesses. So it might be a difficult challenge to look at what is the cost-benefit of having auditors issue an opinion on internal controls.

One thing that you would know for sure by having that opinion is that the auditors have looked at the whole operation and assessed the controls of the entire agency or component that you are looking at. But how much do you save by not looking at an area? If you have not looked at that area, you do not know what those weaknesses are. It might be difficult to determine.

Ms. SPRINGER. And I guess it is the issue of beyond just looking at it, to actually rendering the opinion.

Mr. PLATTS. Right.

I do have one final question, Ms. Springer. With your final guidance about to be issued, I assume that there will be for each of the departments and agencies, I will call him an ombudsman or a point person at OMB that will be responsible for working with each department or agency as you move forward and the guidance being actually acted on and implemented?

Ms. SPRINGER. Yes, that is absolutely right, in several ways. OMB, as you know, on the budget side is already constructed with focal points for each agency, but within my office, the Federal Financial Management Office, there is a person that is dedicated for each agency, so they will also be charged with the erroneous payments review. I expect personally, as well as with one of my associates who has been leading this effort, to meet with all of them as well. So, yes.

Mr. WILLIAMS. Mr. Platts.

Mr. PLATTS. Sure.

Mr. WILLIAMS. We at GAO would strongly support that. We think it would be a great idea for OMB to take a very active role in that particular process. We have had an opportunity to look at the guidance. One of the things that is mentioned in the guidance is it recommends that agencies take a look at our best practices report that we issued a couple of years ago and use that as a tool. One of the things that we would encourage OMB to do is to work very closely with the agencies to develop additional tools—tools that would be specific to the individual agency. Individuals that will be working with the various agencies on this issue should consider what additional tools can we come up with to help address this improper payment problem.

Mr. PLATTS. So the guidance being kind of a broad floor on which you build, depending on the individual needs of that agency?

Mr. WILLIAMS. That is correct. In addition to that, we have begun some work in which we are following up on the recommendations that we made in our August 2002 report. We will continue to look at this process to see what agencies are doing, and, as part of that process, what is OMB doing in working with the individual agencies, as well as the various councils in the Federal Government in the overall coordinated effort that we have stated is needed to address this improper payment issue.

Mr. PLATTS. OK.

I want to thank each of you for your testimony, and the partnership that is clear between the executive branch with OMB, congressional efforts with GAO, and then the agencies out on the front

lines. I think that is an important message we want to come out of this hearing is that there is a coordinated and very dedicated effort that we get to the bottom of these erroneous payments. I would again highlight my predecessor, Chairman Horn, in his great work in getting the legislation enacted into law that we are now talking about and moving forward with. Cooperatively, we can do right by the taxpayers.

Thanks for your efforts here today and in your respective agencies day in and day out.

In closing, I also want to thank our staff, both majority and minority staff, who do an exceptional job and once again have been great in putting together this hearing. As this hearing has demonstrated, improper payments are unfortunately a widespread problem across our Federal agencies. Although it may be unrealistic to expect a perfect system with no erroneous payments, the American taxpayer deserves far better than the current situation. We must have internal controls and financial management systems that work to prevent this kind of unacceptable handling of the taxpayer's hard-earned dollars. Since improper payments occur across all agencies, establishing sound internal controls, providing guidance to agencies, and working together to learn from each other's successes and failures will ensure that taxpayer dollars are being used in the most efficient way possible.

We will certainly welcome the additional information that will be provided as we discussed in the hearing, and we will hold the record open for 2 weeks from this date for those who may want to forward submissions for possible inclusion.

This meeting is adjourned.

[Whereupon, at 3:35 p.m., the subcommittee was adjourned, to reconvene at the call of the Chair.]

[Additional information submitted for the hearing record follows:]

EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

THE CONTROLLER

July 1, 2003

The Honorable Todd Russell Platts
Chairman
Subcommittee on Government Efficiency
and Financial Management
Committee on Government Reform
U.S. House of Representatives
Washington, DC 20515

Dear Chairman Platts:

At a May 13, 2003, hearing before the Subcommittee on Government Efficiency and Financial Management, we discussed the extent of the erroneous payments problem in the administration of the Earned Income Tax Credit (EITC) program. I promised you then that I would provide you with more details on the Internal Revenue Service's (IRS) plan to address the problem.

According to the most recent data available, almost 1/3 of EITC payments are made in error. The IRS recently released details about its revised strategy to improve its administration of this program. In his new five-point initiative, IRS Commissioner Mark W. Everson is attempting to improve service, fairness and compliance with the EITC law. According to the IRS, the five-point initiative will:

- reduce the backlog of pending EITC examinations to ensure that eligible taxpayers whose returns are being examined receive their refunds quickly,
- minimize burden and enhance the quality of communications with taxpayers by improving the existing audit process;
- encourage eligible taxpayers to claim the EITC by increasing outreach efforts and making the requirements for claiming the credit easier to understand,
- ensure fairness by refocusing compliance efforts on taxpayers who claimed the credit but were ineligible because their income was too high, and
- pilot a certification effort to substantiate qualifying child residency eligibility for claimants whose returns are associated with a high risk for error.

According to the IRS, taxpayers with income or filing status errors are responsible for about $4 billion in annual erroneous payments. Pursuant to its revised initiative, the IRS plans to identify returns with the highest risk of income misreporting by using its document matching systems. It

will request information from 175,000 taxpayers who appear ineligible for the credit because they have failed in the past to report all of their income and will also identify returns with the highest probability of filing status error by enhancing its error detection technology, using third party data and requiring EITC claimants to submit limited additional information about their marital status and, where applicable, about their spouse or former spouse. In January, the IRS will also ask 5,000 taxpayers to document their filing status where it appears that married taxpayers may have avoided the EITC income or claim limitations by improperly filing as single or head of household.

Another major source of erroneous EITC payments is individuals improperly claiming a qualifying child. Individuals can claim a child for EITC purposes only if the child has one of the legally-specified relationships with the claimant and the child has lived with the claimant for more than half the year. Qualifying child errors cause about $3.0 billion in annual erroneous payments. The IRS will select 45,000 of the higher risk claimants and ask those claimants to provide documentation to verify that the claimed EITC child or children resided with them for more than half the year. To establish residency, the IRS will ask claimants to provide documentation from third parties, such as clergy, doctors, daycare providers, community-based organizations and social services agencies, who have information about the residency of the claimant and child — either through their records or personal experience.

This revised plan responds to concerns raised by some that placing onerous proof-of-eligibility requirements on EITC applicants might discourage eligible recipients from applying for the credit. I am confident that IRS' new strategy will focus its error reduction efforts on the applicants at the highest risk of error and therefore will have the greatest impact on reducing the EITC error rate.

For your information, I have provided some IRS materials related to the revised initiative. The IRS should also be able to provide you with more details. Should you have further questions, please feel free to contact me directly.

Sincerely,

Linda M. Springer
Controller

Attachment

Internal Revenue Service The Digital Daily
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The Newsroom

EITC Reform Initiative

FS-2003-14, June 2003

Related Documents: IR-2003-78 , Announcement 2003-40 , Draft Form 8836

Overview
The Internal Revenue Service (IRS) is responsible for administering the Earned Income Tax Credit (EITC), which is a refundable Federal income tax credit for low-income working individuals and families. Congress originally approved the tax credit legislation in 1975, in part to offset the burden of social security taxes and give these individuals an incentive to work. Since its adoption in 1975, the amount of the EITC has increased in dollar amount, as well as in the number of individuals and families benefiting from it. Approximately 19 million taxpayers — roughly one out of every seven families who filed — claimed over $32 billion of such credits on tax year (TY) 2002 returns.

Although the EITC has been successful in lifting millions of low-income taxpayers and their children above the poverty line, it has been plagued by persistent compliance problems. In 1997 the IRS released a compliance study that showed a high rate of noncompliance with the EITC. In response Congress provided a special $716 million appropriation for 5 years (FY 1998 to 2002) to reduce EITC errors through expanded customer service and public outreach programs, strengthened enforcement activities, and enhanced research efforts.

Despite these efforts, the IRS has been unable to significantly reduce noncompliance. The most recent compliance study (of TY 1999 returns), reported that between $8.4 and $9.9 billion in EITC claims (27% to 32%) had been improperly paid. Based on "significant compliance problems" associated with the EITC, the General Accounting Office has listed the administration of the credit as a "high risk area for the federal government."

The EITC is a social benefits program embedded in the tax code. While traditional government benefits programs generally require proof of eligibility prior to payment, the tax system primarily relies on self-reporting. Thus, unlike most benefits programs, the IRS has not required proof of eligibility prior to payment and has relied on a claimant's self-assessment that he or she meets the EITC eligibility criteria. In addition, it is difficult for the IRS to confirm or refute crucial facts about an EITC claimant's eligibility (e.g., marital status, residency of a claimed child) without resorting to an examination. For claimants selected for examination, the entire refund is frozen pending resolution of the disputed issues.

EITC Reform Initiative
Recognizing the importance of the EITC to millions of hard working taxpayers, today the IRS is announcing a five-point EITC initiative to: (1) reduce the backlog of pending EITC examinations to ensure that eligible claimants receive the refunds quickly, (2) review the existing audit process to minimize the burden on taxpayers and improve the quality of communications with taxpayers, including notices, (3) increase outreach efforts to improve participation and to ensure that the requirements for claiming the credit are clearly understood, (4) enhance compliance efforts with regard to taxpayers who have claimed the credit but are ineligible because their income is too high, and (5) pilot a certification effort to establish prior to payment that certain higher risk taxpayers lived with the children they claim for the EITC for the required length of time (more than half of the year).

Reducing the Backlog of EITC Examinations
Currently, approximately 7 percent of pending EITC examinations have been in process for

more than one year and are old under the agency's own guidelines. In many of these cases, refunds are frozen pending resolution of the examination. The agency will begin a review of current EITC examination inventories to determine how to reduce this backlog.

Reviewing the Existing Audit Process and Improving the Quality of Communications
Currently, an average EITC pre-refund examination takes 225 days to resolve. During an EITC examination, a taxpayer will receive a minimum of 2 different notices and can receive up to 6 different notices. Many claimants selected for EITC pre-refund examinations fail to respond. The agency will review the notices and letters sent to taxpayers to ensure that they clearly explain why the IRS is questioning a claim and tell taxpayers exactly what they must do to prove their eligibility. In addition, the IRS will look for other ways to improve the examination process and make it less burdensome for taxpayers.

Increasing Outreach Efforts
Currently, the IRS undertakes extensive EITC outreach and education efforts to encourage eligible taxpayers to claim the EITC and to ensure that taxpayers and their advisors understand the eligibility requirements. During FY 2002 and FY 2003, the IRS allocated $31 million on these activities. Through its Stakeholder Partnerships, Education and Communication (SPEC) organization the IRS has reached over 50 million EITC taxpayers. SPEC works with the media, national partnerships and local community-based coalitions to provide EITC information with utility bills, school report cards, Forms W-2, Forms 1099, and company newsletters; through direct mailings by housing authorities and social service agencies; and through advertising, workshops, seminars, and neighborhood outreach. To reduce errors, the IRS also made 600 visits and issued over 700 letters to paid preparers who were responsible for the highest number of returns with qualifying child errors. The National Taxpayer Advocate and SPEC also are working to develop additional partners and methods for increasing awareness of the EITC and to ensure that eligibility rules are clearly understood. The IRS also intends to expand its media campaign and increase its efforts to educate return preparers.

Increasing Focus on Taxpayers Who Circumvent EITC Income or Claim Limitations
Taxpayers who circumvent the EITC income or claim limitations include (1) taxpayers who fail to report all of their income, (2) married taxpayers who each file as single or head of household because their combined income is above the EITC limit, and (3) married taxpayers with 2 or more children who each file as single or head of household and split the children claimed, thereby receiving up to about $8,000 — twice the maximum EITC claim limit. Taxpayers with income or filing status errors are responsible for about $4 billion in annual erroneous payments. The IRS will identify returns with the highest risk of income misreporting by using its document matching systems (Form W-2 and Form 1099 information). In 2004, it will request information from 175,000 taxpayers who appear ineligible for the credit because they have failed in the past to report all of their income. The IRS will also identify returns with the highest probability of filing status error by enhancing its error detection technology, using third party data and requiring EITC claimants to submit limited additional information about their marital status and, where applicable, about their spouse or former spouse. In January, the IRS will ask 5,000 taxpayers to document their filing status where it appears that married taxpayers may have avoided the EITC income or claim limitations by improperly filing as single or head of household.

Piloting a Qualifying Child Residency Certification Program
Individuals can claim a child for EITC only if the child has one of the legally-specified relationships with the claimant and the child has lived with the claimant for more than half the year. Qualifying child errors cause about $3.0 billion in annual erroneous payments. The vast majority of qualifying child overclaims are caused by residency errors -- either alone or in combination with relationship errors. For this reason, the IRS will pilot a certification program to establish residency before the EITC is paid. Certification will only be required for certain taxpayers who have a high risk of claiming children who do not satisfy the residency requirement. Certification will not be required for taxpayers who pose significantly lower risk of error (such as mothers and married, joint-filing parents).

The IRS will select 45,000 of the higher risk claimants and ask those claimants to provide documentation to verify that the claimed EITC child or children resided with them for more than half the year. The claimants will be contacted initially in August of 2003. They will have from August until December to provide the required documentation prior to filing their returns and avoid any delay of their EITC claims. Claimants who choose not to pre-certify can submit documentation with their return, but the EITC-portion of their refund will be delayed until that

documentation is processed.

To establish residency, the IRS will ask claimants to provide documentation from third parties, such as clergy, doctors, daycare providers, community based organizations and social services agencies, who have information about the residency of the claimant and child — either through their records or personal experience. Claimants who cannot obtain the suggested documentation can seek help at an IRS Taxpayer Assistance Center or through a special toll-free number to speak with IRS personnel specializing in the EITC qualifying child certification process. Additionally, claimants will be assigned one of the qualifying child specialists who will be responsible for handling the claimant's qualifying child issues from start to finish.

The goal of the certification pilot is to evaluate high-risk EITC claims before they are paid, using a process that is less burdensome to taxpayers and less costly to the government than an audit. In addition, the certification program will enable eligible, but high risk, taxpayers to receive their refunds faster than if they were subsequently challenged by the IRS. By helping to ensure that certain high-risk taxpayers receive the right amount of the credit before refunds are paid, the program will also reduce the burden that is imposed when taxpayers must repay erroneous refunds.

Throughout the pre-filing and filing season, the IRS will continually evaluate all aspects of the certification process, including claimant response to the certification proposal, to refine the process and to determine how to maximize participation and minimize burden for legitimate claimants. To help refine the certification proposal, the IRS is requesting public comments on how the agency can establish EITC claimants' qualifying child eligibility to the credit in advance of filing their returns.

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