

GAO

Report to the Chairman, Subcommittee
on Government Management, Finance,
and Accountability, Committee on
Government Reform, House of
Representatives

April 2006

IMPROPER PAYMENTS

Federal and State Coordination Needed to Report National Improper Payment Estimates on Federal Programs



G A O

Accountability * Integrity * Reliability



GAO
Accountability Integrity Reliability

Highlights

Highlights of [GAO-06-347](#), a report to the Chairman, Subcommittee on Government Management, Finance, and Accountability, Committee on Government Reform, House of Representatives

Why GAO Did This Study

Over the past several years, GAO has reported that federal agencies are not well positioned to meet requirements of the Improper Payments Information Act of 2002 (IPIA). For fiscal year 2005, estimated improper payments exceeded \$38 billion but did not include some of the highest risk programs, such as Medicaid with outlays exceeding \$181 billion for fiscal year 2005. Overall, state-administered programs and other nonfederal entities receive over \$400 billion annually in federal funds. Thus, federal agencies and states share responsibility for the prudent use of these funds. GAO was asked to determine actions taken at the state level to help federal agencies estimate improper payments for state-administered federal programs and assistance needed from the federal level to support the respective federal agencies' implementation of IPIA.

What GAO Recommends

GAO is making four recommendations to the Office of Management and Budget (OMB) to better assist federal agencies' implementation of IPIA requirements for state-administered federal programs, including determining states' role in assisting federal agencies to report national improper payment estimates on federal programs. OMB agreed with GAO's recommendations.

www.gao.gov/cgi-bin/getrpt?GAO-06-347.

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

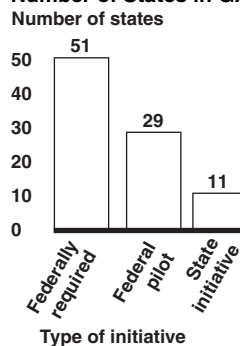
IMPROPER PAYMENTS

Federal and State Coordination Needed to Report National Improper Payment Estimates on Federal Programs

What GAO Found

To date, states have been subject to limited requirements to assist federal agencies in estimating improper payments. For the 25 major state-administered federal programs surveyed, only 2 programs—the Food Stamp and Unemployment Insurance programs—have federal requirements for all states to estimate improper payments. A limited number of federal agencies are conducting pilots to estimate improper payments in other programs, but state participation is voluntary. Where no federal requirement or pilot is in place, 5 programs involving 11 states had estimated improper payments during fiscal years 2003 or 2004.

Number of States in GAO Survey Estimating Improper Payments



Source: GAO analysis.

Note: The 51 states are the 50 states and the District of Columbia.

States have a fundamental responsibility to ensure the proper administration of federal awards by using sound management practices and maintaining internal controls. To do this, states reported using a variety of techniques to prevent and detect improper payments. All states, except for one, responded that they use computer-related techniques, such as fraud and abuse detection programs or data matching, to prevent or detect improper payments. Other techniques selected states used included performing statewide assessments and recovery auditing methods. States also reported receiving federal incentives and penalties to assist with reducing improper payments, although most of these actions related to the Food Stamp Program, which gives incentives and penalties to states having error rates below and above the program's national error rate.

Of the 240 state program officials surveyed, 100 identified tools that would be needed to estimate improper payments and help federal agencies meet various IPIA requirements, including guidance on estimating improper payments and performing risk assessments. OMB has begun planning for increased state involvement in measuring and reporting improper payments via the Erroneous and Improper Payments Workgroup and IPIA guidance. However, much work remains at the federal level to identify and estimate improper payments for state-administered federal programs, including determining the nature and extent of states' involvement to assist federal agencies with IPIA reporting requirements.

Contents

Letter		1
	Results in Brief	3
	Background	6
	Estimating Improper Payments at the State Level Is Limited	8
	States Reported Using Various Techniques to Detect, Prevent, or Reduce Improper Payments	15
	Federal Action Needed to Help States Report Improper Payment Information	23
	Conclusions	27
	Recommendations for Executive Action	28
	Agency Comments	29

Appendixes

Appendix I: Objectives, Scope, and Methodology	30
Appendix II: States and Programs Included in Our Review	36
Appendix III: Food Stamp Quality Control System	43
Appendix IV: UI Benefit Accuracy Measurement and National Directory of New Hires Database	51
Appendix V: Highway Planning and Construction Pilot to Estimate Improper Payments	57
Appendix VI: Medicaid Payment Accuracy and Payment Error Rate Measurement Project	60
Appendix VII: Comments from the Office of Management and Budget	66
Appendix VIII: GAO Contact and Staff Acknowledgments	69

Related GAO Products	70
-----------------------------	----

Tables		
	Table 1: Program Use of Computer-Related Techniques	17
	Table 2: Amount of Improper Payments Collected through State Recovery Auditing Efforts	20
	Table 3: Number of States for Which Each of the 25 Programs Was Defined as Major	32
	Table 4: Number of Major Programs in Each State	33
	Table 5: Food Stamp Improper Payment Amounts by State for Fiscal Years 2003 and 2004	45

Table 6: Summary of Factors Contributing to Declining Food Stamp Improper Payment Error Rates and Amounts	49
Table 7: UI Overpayments and Underpayments by State for Calendar Years 2003 and 2004	53
Table 8: Number of States Participating in CMS's Medicaid Pilots to Estimate Improper Payments	60
Table 9: Timeline of CMS Regulations and Initiatives to Estimate Medicaid Improper Payments	63

Figures

Figure 1: Number of States in Our Survey Estimating Improper Payments	9
Figure 2: Food Stamp National Payment Error Rate, Fiscal Years 1999-2004	47
Figure 3: UI Overpayment National Error Rates, Calendar Years 1988-2004	52
Figure 4: Example of Test Procedures for Asphalt	58

This is a work of the U.S. government and is not subject to copyright protection in the United States. It may be reproduced and distributed in its entirety without further permission from GAO. However, because this work may contain copyrighted images or other material, permission from the copyright holder may be necessary if you wish to reproduce this material separately.



United States Government Accountability Office
Washington, D.C. 20548

April 14, 2006

The Honorable Todd R. Platts
Chairman
Subcommittee on Government Management, Finance,
and Accountability
Committee on Government Reform
House of Representatives

Dear Mr. Chairman:

Each year federal agencies expend more than \$2 trillion through thousands of programs and activities to address the needs of the American people. Of this amount, over \$400 billion in federal funds are distributed to states and other nonfederal entities. These funds, typically issued through grants, are used to implement over 1,000 individual programs from 26 federal grant-making agencies.¹ As the steward of taxpayer dollars, the federal government is accountable for how its agencies and grantees spend this money, including the safeguarding of federal funds from improper payments. Grantees are also responsible for ensuring that funds are used for the purposes for which the funds were provided.

Our work over the past several years has demonstrated that improper payments are a significant and widespread problem in the federal government, with agencies reporting improper payments over \$38 billion in their fiscal year 2005 performance and accountability reports (PAR). This estimate, however, does not include all programs. In our review of agencies' fiscal year 2005 PARs,² we noted that some agencies still have not instituted systematic methods of reviewing all programs and activities, have not identified all programs susceptible to significant improper payments, or have not annually estimated improper payments for their high-risk programs. For example, seven state-administered³ federal

¹Federal funds are distributed through a variety of awards, including grants and cooperative agreements.

²For GAO's audit report on the U.S. government's consolidated financial statements for fiscal year 2005, see Department of the Treasury, *Fiscal Year 2005 Financial Report of the United States Government* (Washington, D.C.: December 2005), 152-153, which can be found on GAO's Internet site at www.gao.gov.

³For report purposes, the term state-administered indicates federal programs that are managed on a day-to-day basis at the state level to carry out program objectives.

programs with outlays totaling about \$228 billion still have not been annually estimated for improper payments, even though the Office of Management and Budget (OMB) required them to report such information about 4 years ago in their fiscal year 2003 budget submissions.

The Improper Payments Information Act of 2002 (IPIA)⁴ prompted all executive branch agencies to systematically address improper payment activity annually. While states do not have a direct role in meeting IPIA requirements, they do play an important role in federal fund stewardship. In particular, states are responsible for the proper administration of federal awards through using sound management practices and maintaining internal control.⁵ Payments, as defined under IPIA, include payments made by a governmental or other organization administering a federal program or activity. An improper payment is defined by IPIA as any payment that should not have been made or that was made in an incorrect amount, a duplicate payment, and payment for services not rendered or rendered to ineligible beneficiaries. OMB's implementing guidance for IPIA⁶ requires that estimates of improper payments, and if applicable, a corrective action report, be included in all federal executive branch agencies' PARs beginning with fiscal year 2004.

Because of the Subcommittee's continued interest in addressing the governmentwide improper payments issue, you asked us to determine (1) what actions are being taken by states to assist federal agencies in estimating improper payments; (2) what techniques related to detecting, preventing, or reducing improper payments have states employed to ensure the proper administration of federal awards; and (3) what assistance can be provided by OMB that state program administrators would find helpful in supporting the respective federal agencies with the implementation of IPIA.

To identify states' actions and assistance needed, we conducted a survey of all 50 states and the District of Columbia regarding actions to estimate

⁴Pub. L. No. 107-300, 116 Stat. 2350 (Nov. 26, 2002).

⁵OMB Circular No. A-87, *Cost Principles for State, Local, and Indian Tribal Governments*. See also OMB Circular No. A-102, *Grants and Cooperative Agreements with State and Local Governments*, and OMB Circular No. A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, and the related A-133 Compliance Supplement.

⁶OMB Memorandum M-03-13, "Improper Payments Information Act of 2002 (Public Law 107-300)," May 21, 2003.

improper payments for state-administered federal programs for fiscal years 2003 and 2004. Statewide surveys were completed by state officials with knowledge of statewide administration of operations. We received 50 of the 51⁷ statewide surveys for a response rate of 98 percent. In addition, program-specific surveys were completed by state program administrators or directors for the major programs in each state. We received 227 of 240 program-specific surveys for a response rate of 95 percent. The high response rates for the variety of state-administered programs provided a wide range of survey responses regarding actions to address improper payments.

For the purposes of this review, we defined major programs as those state-administered programs that expended the largest amounts of federal funds in decreasing order, which in aggregate covered at least 60 percent of the total federal portion of state-administered expenditures in each state. Together, the states identified 25 programs as major (see table 3 in app. I). The 5 most common major programs were Medicaid (all 51 states), Highway Planning and Construction (44 states), Food Stamp (36 states), Temporary Assistance for Needy Families (28 states), and Unemployment Insurance (26 states). As shown in table 4 in appendix I, the number of major programs varied from 1 to 12 programs per state, and in total, added up to the 240 program-specific surveys we sent. We also visited selected states that had ongoing initiatives already in place to estimate improper payments for certain programs, conducted interviews with OMB and other federal officials as well as state officials regarding state efforts to estimate improper payments, and reviewed federal agencies' fiscal year 2005 PARs and prior GAO and office of inspector general (OIG) reports. We conducted our work from April 2005 through December 2005 in accordance with generally accepted government auditing standards. See appendix I for more details on our scope and methodology.

Results in Brief

To date, states have been subject to limited requirements to assist federal agencies in estimating improper payments. For the 25 major programs surveyed, only 2 programs—the Department of Agriculture's (USDA) Food Stamp Program and the Department of Labor's (Labor) Unemployment Insurance (UI) Program—have federal requirements for all states to estimate improper payments. A limited number of federal agencies are

⁷For reporting purposes, we used 51 when quantifying the universe of states, which comprises the 50 states and the District of Columbia.

conducting pilots to estimate improper payments for certain state-administered programs, but state participation is voluntary. Where no federal requirement or pilot is in place, 11 states estimated improper payments involving 5 programs during fiscal years 2003 or 2004.

States have a fundamental responsibility to ensure the proper administration of federal awards by using sound management practices and maintaining internal controls. To ensure proper administration of federal funds, states reported using a variety of techniques to prevent, detect, and reduce improper payments. All states, except for 1, responded that they use computer-related techniques, such as fraud and abuse detection programs or data matching for this purpose. Twenty-one of the 51 states in our survey responded that they have performed a statewide assessment of their programs to identify those that may be at risk for improper payments.

In addition, 15 states reported that they conducted recovery audits in fiscal year 2003, fiscal year 2004, or both, collectively recovering over \$335 million for the 2 fiscal years. Thirty-two states reported receiving federal incentives, such as enhanced funding or reduced reporting requirements, for reducing improper payments, and 17 states reported receiving federal penalties, such as decreased funding and increased reporting requirements, for failing to reduce improper payments. Most of these actions related to the Food Stamp Program, which applies incentives and penalties to states having error rates below and above the national error rate, respectively.

Of the 227 program surveys received, 100 of the state program administrators or their designees responded that guidance or resources from OMB, cognizant federal agencies, or both were needed if the states were to assist the federal agencies in meeting the requirements of IPIA. Specifically, state program officials requested guidance on estimating improper payments and performing risk assessments. Selected states also asked for additional funding to subsidize efforts, if they were required to estimate improper payments; requested that OMB and federal agencies share best practices and available guidance; and requested that their input be considered prior to any state IPIA program reporting requirement taking effect.

OMB has recognized the important role that states have in assisting federal agencies to meet the requirements of IPIA. In August 2005, OMB issued Circular No. A-136, *Financial Reporting Requirements*, to consolidate,

clarify, and update existing guidance relating to agency and governmentwide financial reporting. Among other things, OMB specifically requires federal agencies with grant-making programs to report in their fiscal year 2005 PARs accomplishments in the area of funds stewardship beyond the primary recipient⁸ and the status of projects under way and results of any reviews. Our review of the fiscal year 2005 PARs showed that in general federal agencies either did not report on their grant-making activities, did not clearly identify grant programs, or did not address fund stewardship beyond the primary recipient.

OMB has continued to conduct its improper payments work through the Chief Financial Officers Council (CFOC) and President's Council on Integrity and Efficiency's (PCIE) Erroneous and Improper Payments Workgroup. The workgroup, consisting of federal agency chief financial officers, OMB officials, and inspectors general, periodically convenes to discuss and develop best practices and other methods to reduce or eliminate improper payments. It has issued reports and other products to CFOC/PCIE, reflecting workgroup deliberations and determinations. One of these products was a report on initial considerations regarding state and grantee involvement in the process of developing methodologies for federal agencies to estimate improper payments.

In November 2005, OMB issued draft revisions to its IPIA implementing guidance. This implementing guidance, together with recovery auditing guidance, is to be consolidated into future Parts I and II of Appendix C to OMB Circular No. A-123, *Management's Responsibility for Internal Controls* (Dec. 21, 2004).⁹ While this guidance begins the process to further address the complexities related to reporting improper payment information for federally funded, state-administered programs, additional enhancements could be made that address how federal agencies define state-administered programs and the methodology to be employed for generating a national estimate. Specifically, we found that the proposed changes do not clearly define the term state-administered programs.

⁸The primary recipient is the state or other entity that receives funding directly from the federal government. Past the primary recipient would be funding that flows from the state or other entity to a beneficiary or subrecipient.

⁹OMB's improper payment guidance is cited in footnote 6 of this report. OMB's recovery auditing guidance refers to two OMB memorandums—OMB Memorandum M-03-07, "Programs to Identify and Recover Erroneous Payments to Contractors," January 16, 2003, and OMB Memorandum M-03-12, "Allowability of Contingency Fee Contracts for Recovery Audits," May 8, 2003.

Without a clear definition, OMB is at risk of receiving inconsistent improper payment reports because agencies could define programs differently. In addition, we noted that the draft guidance did not provide basic criteria, such as the nature and extent of data and documentation that agencies should consider when developing a plan or methodology to calculate a national improper payment error rate for these state-administered programs.

We are making four recommendations to OMB to help ensure successful implementation of IPIA requirements for federally funded, state-administered programs. Specifically, we recommend that OMB (1) clearly define in its IPIA guidance the term state-administered programs so that federal agencies can consistently identify all such programs; (2) provide criteria in its IPIA guidance that address the nature and extent of data and documentation needs to calculate a national improper payment estimate; (3) communicate and make available to states guidance on conducting risk assessments and estimating improper payments for federally funded, state-administered programs; and (4) share ideas, concerns, and best practices with federal agencies and states regarding improper payment reporting requirements for these programs.

In commenting on a draft of this report, OMB agreed with our recommendations and highlighted several initiatives under way to ensure that accurate improper payment rates can be generated without creating an undue cost and burden on federal agencies or state partners that manage federally funded programs. OMB also provided technical comments that we incorporated, as appropriate. OMB's written comments are reprinted in appendix VII.

Background

In November 2002, the Congress passed IPIA. The major objective of IPIA is to enhance the accuracy and integrity of federal payments. The law requires executive branch agency heads to annually review all programs and activities that they administer, identify those that may be susceptible to significant improper payments, and estimate and report annually on the amount of improper payments in those programs and activities. IPIA also requires the agencies to report annually to the Congress on the actions they are taking to reduce erroneous payments for programs for which estimated improper payments exceed \$10 million.

IPIA further requires OMB to prescribe guidance for federal agencies to use in implementing the act. OMB issued this guidance in Memorandum M-03-

13 in May 2003. It requires use of a systematic method to annually review and identify those programs and activities that are susceptible to significant improper payments. OMB guidance defines significant improper payments as annual improper payments in any particular program exceeding both 2.5 percent of program payments and \$10 million. The OMB guidance then requires agencies to estimate the annual amount of improper payments using statistically valid techniques for each susceptible program or activity. For those agency programs, including state-administered programs, determined to be susceptible to significant improper payments and with estimated annual improper payments greater than \$10 million, IPIA and related OMB guidance require each agency to report the results of its improper payment efforts. OMB guidance requires the reporting to be in the Management Discussion and Analysis section of the agency's PAR for each fiscal year ending on or after September 30, 2004. IPIA requires the following information to be reported to the Congress:

- a discussion of the causes of the improper payments identified, actions taken to correct those causes, and results of the actions taken to address those causes;
- a statement of whether the agency has the information systems and other infrastructure it needs to reduce improper payments to minimal cost-effective levels;
- if the agency does not have such systems and infrastructure, a description of the resources the agency has requested in its most recent budget submission to the Congress to obtain the necessary information and infrastructure; and
- a description of the steps the agency has taken and plans to take to ensure that agency managers are held accountable for reducing improper payments.

OMB's guidance in M-03-13 requires that three additional things be included in the PAR:

- a discussion of the amount of actual erroneous payments that the agency expects to recover and how it will go about recovering them;
- a description of any statutory or regulatory barriers that may limit the agency's corrective actions in reducing improper payments; and

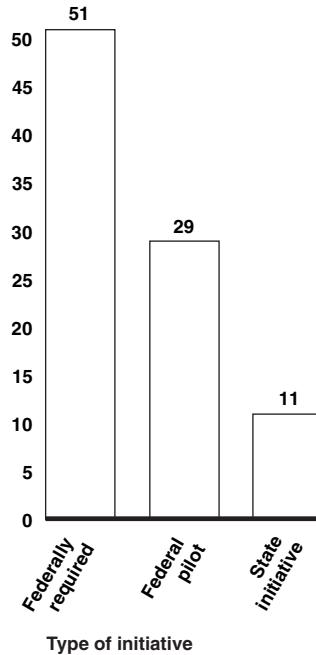
-
- provided the agency has estimated a baseline improper payment rate for the program, a target for the program's future improper payment rate that is lower than the agency's most recent estimated error rate.

In August 2004, OMB established Eliminating Improper Payments as a new program-specific initiative in the President's Management Agenda (PMA). The separate improper payments PMA program initiative began in the first quarter of fiscal year 2005. Previously, agency efforts related to improper payments were tracked along with other financial management activities as part of the Improving Financial Performance initiative. The objective of establishing a separate initiative for improper payments was to ensure that agency managers are held accountable for meeting the goals of IPIA and are therefore dedicating the necessary attention and resources to meeting IPIA requirements. This program initiative establishes an accountability framework for ensuring that federal agencies initiate all necessary financial management improvements for addressing this significant and widespread problem. Specifically, agencies are to measure their improper payments annually, develop improvement targets and corrective actions, and track the results annually to ensure the corrective actions are effective.

Estimating Improper Payments at the State Level Is Limited

State responses to our survey show that the number of state-administered federal programs (state programs) estimating improper payments significantly decreases if there is no federal requirement to estimate or if the states are not participating in a federally administered pilot to estimate. For the 25 major programs reviewed for fiscal years 2003 and 2004, all 51 states estimated improper payments where there was a federal requirement to do so. For the federally administered improper payment pilots, the number decreased to 29 states. Where there was no federal requirement or pilot in place, only 11 states reported estimating improper payments on their own initiative, as shown in figure 1.

Figure 1: Number of States in Our Survey Estimating Improper Payments
Number of states



Source: GAO analysis.

Note: The 51 states are the 50 states and the District of Columbia.

Programs with Federal Requirements

Only 2 of the 25 major programs in our review had federal requirements for all the states to annually estimate improper payments—the Food Stamp and UI programs. In total, 47 states reported estimating improper payments for one or more major programs, which represented 97 program surveys for fiscal year 2003, fiscal year 2004, or both. More than half of the reported estimates were for the Food Stamp and UI programs.¹⁰ Food Stamp and UI program outlays expended by the states totaled about \$61 billion for fiscal year 2004. This constitutes about 15 percent of the total federal funds that are estimated to be annually distributed to states and other nonfederal entities for redistribution to eligible parties. Both of these programs are

¹⁰All 51 states reported an estimate for their Food Stamp and UI programs in fiscal year 2003 and fiscal year 2004. However, these programs were not identified as major programs for 4 of the 51 states, thereby limiting to 47 the number of states asked to respond to our survey for those programs.

benefit programs, have a history of measuring improper payments through established systems, and can calculate a national error rate.

- The purpose of the Food Stamp Program is to help low-income individuals and families obtain a more nutritious diet by supplementing their incomes with benefits to purchase food. As reported in USDA's fiscal year 2005 PAR, the causes of improper payments in the Food Stamp Program include client errors, such as incomplete or inaccurate reporting of income, assets, or both by participants at the time of certification or by not reporting subsequent changes. Causes can also be provider based, such as errors in determining eligibility or benefit amounts or delays in action or inaction on client reported changes. The Food Stamp quality control system¹¹ measures payment accuracy and monitors how accurately states determine food stamp eligibility and calculate benefits. USDA reports a rate and dollar amount of estimated improper payments for the Food Stamp Program in its annual PAR based on the quality control system. In its fiscal year 2005 PAR, USDA reported a national improper payment error rate of 5.88 percent, or \$1.4 billion, for the Food Stamp Program. A national error rate is calculated and incentives and penalties are applied to the states that have rates lower or higher than the national rate. Recent initiatives reported in USDA's fiscal year 2005 PAR include the agency's fiscal year 2004 nationwide implementation of an electronic benefit transfer (EBT) system for the delivery of food stamp benefits. The EBT card, which replaced paper coupons, creates an electronic record for each transaction that makes fraud easier to detect. Other USDA efforts include Partner Web, which is an intranet for state food stamp agencies, and the National Payment Accuracy Workgroup, which consists of representatives from USDA headquarters and regional offices who meet to discuss best practice methods and strategies. (See app. III for more details on the Food Stamp Program.)
- The UI Program provides temporary cash benefits to workers who lose their jobs through no fault of their own. Labor reported in its fiscal year 2005 PAR that the principal cause of improper payments was claimants who continue to claim benefits despite having returned to work. Pursuant to Part 602 of Title 20, *Code of Federal Regulations*, Labor implemented the Benefit Accuracy Measurement system to measure

¹¹Department of Agriculture, Food and Nutrition Service, *FNS Handbook 310: Food Stamp Program Quality Control Review Handbook* (Alexandria, Va.: October 2003).

state payment accuracy in the UI Program.¹² Labor also reports a rate and dollar amount of estimated improper payments for the UI Program in its annual PAR. In its fiscal year 2005 PAR, Labor reported an annual error rate of 10.13 percent, or \$3.2 billion, for the UI Program. Labor's initiatives to reduce improper payments in the UI Program include implementing new cross-matching technologies like the National Directory of New Hires database and funding states' data-sharing efforts with federal agencies, such as the Social Security Administration, and other state agencies, such as the state departments of motor vehicles. Further, Labor is instilling additional performance measures for states to detect and recover overpayments of benefits and continuing analyses of the causes, costs, and benefits of improper payment prevention or establishing recovery operations. (See app. IV for more details on the UI Program.)

Federal Programs with Pilots

Twenty-nine states in our review responded in our surveys or during interviews that they voluntarily participated in federally administered pilot projects to estimate improper payments. We visited the state participating in the Department of Transportation's (DOT) Highway Planning and Construction Program and one of the states participating in the Department of Health and Human Services' (HHS) Medicaid program and discussed the states' efforts to measure improper payments. These pilots serve as models for the federal agencies on obtaining improper payment information and establishing a methodology for other states to estimate improper payments for those programs. Neither of the two pilots was sufficiently comprehensive to allow the responsible federal agency to project an error rate with statistical precision to all of the states.

- DOT provides funding to the state departments of transportation to administer the nation's federal Highway Planning and Construction Program. During our review, DOT had a pilot in place to estimate improper payments for two construction projects in Tennessee. The sampled transactions reviewed to identify improper payments for these two projects were selected from a population of almost \$35 million, which represented a small portion of DOT's fiscal year 2005 outlays totaling \$31 billion for the Highway Planning and Construction

¹²GAO, *Unemployment Insurance: Increased Focus on Program Integrity Could Reduce Billions in Overpayments*, [GAO-02-697](#) (Washington, D.C.: July 12, 2002).

Program.¹³ For one of these projects, DOT reported that the estimated improper payments amount was statistically insignificant. For the other project, DOT reported an improper payment estimate of \$111,671. The methodology and testing procedures that resulted from DOT's pilot project will be used to extend the methodology nationwide. In its fiscal year 2005 PAR, DOT reported a zero-dollar improper payment estimate for this program. However, the DOT OIG also reported that detecting improper payments for several grant programs, including the Highway Planning and Construction Program, was a top management challenge for the agency. In particular, the OIG reported that the DOT pilot project was too limited and that OIG investigators continue to identify instances of improper payments. The OIG cited two improper payment examples totaling over \$1.3 million, which was reimbursed to DOT as a result of OIG investigations. In response, DOT is reorganizing and redesigning its procedures to better improve oversight of research agreements. This includes creating a new division within DOT's Office of Acquisition Management devoted to the award and administration of cooperative agreements. (See app. V for more details on the improper payment pilot for the Highway Planning and Construction Program.)

- In coordination with the states, HHS finances health care services to low-income individuals and families through the Medicaid program. Medicaid improper payments are caused by medical review, eligibility review, or data-processing review errors.¹⁴ In fiscal year 2002, HHS began a pilot to estimate improper payments for its Medicaid program. The number of states voluntarily participating in the pilot has increased each year, and in the second year of the pilot, fiscal year 2003, 12 states participated. In the third year, fiscal year 2004, 24 states participated in the pilot. Because HHS had not fully implemented a statistically valid methodology, the agency did not report an improper payment estimate for the Medicaid program in its fiscal year 2005 PAR. According to

¹³The Highway Planning and Construction Program is also referred to as the Federal-Aid Highway Program.

¹⁴According to HHS, a medical review error is an error that is determined from a review of the medical documentation compared with the information presented on the claim. An eligibility review error occurs when a payment for the sampled service or when a capitation payment, which is a payment based on a predetermined agreement rather than actual cost, covering the date of service is in error in full or in part based on the eligibility status of the person as of the proper date of review. A data-processing review error is an error resulting in an overpayment or underpayment that could be avoided through the state's information system.

agency officials, HHS is in the process of implementing a methodology for estimating payment error rates for Medicaid in all states. HHS stated that it expects to be fully compliant with the IPIA requirements for the Medicaid program by fiscal year 2008. Other initiatives HHS is undertaking for the Medicaid program are the hiring of additional staff to do prospective reviews of state Medicaid operations and the Medicare/Medicaid data match program designed to identify improper payments and areas in need of improved payment accuracy. (See app. VI for more details on the Medicaid program.)

We identified other improper payment pilot initiatives during our review of agencies' fiscal year 2005 PARs. Specifically, HHS reported that improper payment pilots are being conducted for three other state-administered programs to assist HHS in its efforts to report a national improper payment estimate in the future. For HHS's State Children's Health Insurance Program (SCHIP), 15 states participated in a payment accuracy measurement pilot in fiscal year 2004. The states performed a combination of medical, eligibility, or data-processing reviews of claims and applicable payments for the period October 1, 2003, to December 31, 2003. Using a standard methodology, those states computed a payment accuracy error rate for their programs. Based on these results, HHS has adopted a national strategy using federal contractors to obtain a national error rate for SCHIP with expected implementation in fiscal year 2006. In fiscal year 2007, HHS expects to begin measuring SCHIP error rates nationwide for its fee-for-service component. HHS expects to report SCHIP error rates for its fee-for-service, managed care, and eligibility components in its fiscal year 2008 PAR.

For HHS's Child Care and Development Fund (CCDF) Program, 11 states participated in an improper payment pilot in fiscal year 2004 to assess states' efforts to prevent and reduce improper payments. The states worked with HHS to assess the adequacy of state systems, databases, policy, and administrative structures. In fiscal year 2005, HHS expanded pilot participation to 18 states. HHS also conducted an error rate study in 4 states to assess those states' ability to verify information received from clients during the initial eligibility process or to establish eligibility correctly. In addition, HHS conducted interviews in 5 other states to gather information about improper payment activities. HHS reported that it will continue to work with states during fiscal year 2006 to identify an appropriate strategy for determining estimates of payment errors in the CCDF Program.

For HHS's Temporary Assistance for Needy Families (TANF) Program, one state participated in a pilot to undergo a more in-depth review of TANF expenditures as part of its single audit requirement.¹⁵ The objective of the pilot was to explore the viability of estimating improper payments in the single audit process. Using statistical sampling, the auditors reviewed 208 cases to test controls. According to HHS, the auditors reported an overall case error rate of 20 percent and a payment error rate of 3.9 percent from their review of the 208 cases. In addition to this pilot, state-led initiatives involving the TANF Program were also under way, as described below.

State Initiatives to Estimate Improper Payments

During our review of survey responses, we also noted that 11 states, on their own initiative, were estimating improper payments related to 5 separate programs for fiscal year 2003, fiscal year 2004, or both. For example, 6 of the 11 states indicated in their survey responses that they were estimating improper payments for HHS's TANF Program.¹⁶ Among the varying methods the 11 states used to estimate amounts, error rates, or both were statistically representative samples of payments and findings from states' single audits.¹⁷ Other techniques respondents reported using included Food Stamp Program quality control reviews to ascertain the accuracy of TANF payments, which would be reasonable to do if the eligibility requirements of the two programs were similar.

¹⁵31 U.S.C. §§ 7501-7507. Under the Single Audit Act, as amended, and implementing guidance, independent auditors audit state and local governments and nonprofit organizations that expend federal awards to assess, among other things, compliance with laws, regulations, and the provisions of contracts or grant agreements material to the entities' major federal programs. Organizations are required to have single audits if they expend \$500,000 or more in federal funds.

¹⁶Prior to fiscal year 1997, there was a federal requirement that each state have a quality control system in place for what was then known as the Aid to Families with Dependent Children Program, and report on payment accuracy. Concurrent with the restructuring of this program, in fiscal year 1997, this requirement was removed, but six states in our survey continued the payment accuracy reviews.

¹⁷We should note that single audits, by themselves, may lack the level of detail necessary for achieving IPPIA requirements. Specifically, single audits generally focus on the largest dollars in an auditee's portfolio. Thus, all programs identified as susceptible to improper payments at the federal level may not receive extensive coverage under a single audit. Consequently, both the depth and level of detail of single audit results are, generally, insufficient to identify improper payments, estimate improper payments, or both.

States Reported Using Various Techniques to Detect, Prevent, or Reduce Improper Payments

As part of their funds stewardship responsibilities for federal awards, states are required to establish and maintain internal control designed to provide reasonable assurance that funds are administered in compliance with federal laws, regulations, and program requirements. This includes maintaining accountability over assets and safeguarding funds against loss from unauthorized use or disposition. To ensure proper administration of federal funds, states reported using a variety of prepayment and postpayment mechanisms. For example, states reported the use of computer-related techniques to identify and prevent improper payments as well as recovery audits to collect overpayments. In addition, selected programs reported that federal incentives and penalties are in place to help reduce improper payments. These types of actions contribute to a strong internal control structure that helps mitigate the risk and occurrence of improper payments.

Generally, improper payments result from a lack of or an inadequate system of internal control, but some result from program design issues. Our *Standards for Internal Control in the Federal Government*¹⁸ provides a road map for entities to establish control for all aspects of their operations and a basis against which entities' control structures can be evaluated. Also, our executive guide on strategies to manage improper payments focuses on internal control standards as they relate to reducing improper payments.¹⁹ The five components of internal control—control environment, risk assessment, control activities, information and communication, and monitoring—are defined in the executive guide in relation to improper payments as 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—analyzing program operations to determine if risks exist and the nature and extent of the risks identified.

¹⁸GAO, *Standards for Internal Control in the Federal Government*, [GAO/AIMD-00-21.3.1](#) (Washington, D.C.: November 1999).

¹⁹GAO, *Strategies to Manage Improper Payments: Learning From Public and Private Sector Organizations*, [GAO-02-69G](#) (Washington, D.C.: October 2001).

-
- 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 communication—using and sharing relevant, reliable, and timely financial and nonfinancial information in managing activities related to improper payments.
 - Monitoring—tracking improvement initiatives over time, and identifying additional actions needed to further improve program efficiency and effectiveness.

For this engagement, we focused on two of these internal control components—risk assessments and control activities, which are discussed in more detail in the following sections.

States Frequently Use Risk Assessments and Computer-Related Techniques to Prevent or Detect Improper Payments

All states except 1 acknowledged using computer-related techniques to prevent or detect improper payments, while 21 states reported having performed some type of statewide assessments to determine what programs are at risk of improper payments. Strong systems of internal control provide reasonable assurance that programs are operating as intended and are achieving expected outcomes. A key step in the process of gaining this assurance is conducting a risk assessment, an activity that entails a comprehensive review and analysis of program operations to determine where risks exist and what those risks are, and then measuring of the potential or actual impact of those risks on program operations. In performing a risk assessment, management should consider all significant interactions between the entity and other parties, as well as all internal factors at both the organizationwide and program levels.

IPIA requires agencies to review all of their programs to identify those that may be susceptible to significant improper payments. Since the programs in our review were state administered, we asked the states if they performed statewide reviews to assess if their programs may be at risk of improper payments. Twenty-one states responded that they had performed some type of statewide assessment of their programs. Some of the states’ risk assessment processes included internal control assessments, which were generally self-assessments performed by the states’ program agencies and entities. Two states noted that these self-assessments can be used as a tool by state auditors to evaluate weaknesses or to plan work to be performed. Regular evaluation of internal control systems is statutorily

required by at least 2 states. Other risk assessment methods states reported using included single audits and other audits or reviews performed by state auditors or by state agencies.

Survey respondents also cited using control activities, such as computer-related techniques, to aid in the detection and prevention of improper payments. Computer-related techniques play a significant role not only in identifying improper payments, but also in providing data on why these payments were made and, in turn, highlighting areas that need strengthened prevention controls. The adoption of technology allows states to have effective detection techniques to quickly identify and recover improper payments. Data sharing, data mining, smart technology, data warehousing, and other techniques are powerful internal control tools that provide more useful and timely access to information. The use of these techniques can achieve potentially significant savings by identifying client-related reporting errors and misinformation during the eligibility determination process—before payments are made—or by detecting improper payments that have been made. Fifty of the 51 states representing 21 different programs reported in their surveys that they used computer-related techniques to prevent or detect improper payments. Table 1 shows the number of programs that reported using each technique.

Table 1: Program Use of Computer-Related Techniques

Program	Fraud detection ^a	Data matching ^b	Data mining ^c	Smart technology ^d	Data warehouse ^e	Other techniques ^f
1 Abandoned Mine Land Reclamation Program	1	1	0	0	1	0
2 Airport Improvement Program	0	1	0	0	1	0
3 Appalachian Development Highway System	0	0	0	0	0	1
4 Child Care and Development Block Grant	0	0	1	0	0	1
5 Child Care and Development Fund	1	0	0	0	0	1
6 Capitalization Grants for Drinking Water State Revolving Funds	0	0	0	0	0	1
7 Emergency Preparedness Funding	1	1	1	0	1	0
8 Food Stamp Program	18	13	13	1	16	12
9 Foster Care Title IV-E	0	0	0	0	1	1
10 Highway Planning and Construction	10	6	9	1	19	12

(Continued From Previous Page)

Program	Fraud detection ^a	Data matching ^b	Data mining ^c	Smart technology ^d	Data warehouse ^e	Other techniques ^f
11 Home Investment Partnerships Program	0	0	1	0	1	0
12 Medicaid	35	43	42	16	43	23
13 National School Lunch Program	1	1	0	0	3	2
14 Special Education State Grants	1	1	1	0	5	2
15 Special Supplemental Nutrition Program for Women, Infants, and Children	1	1	1	0	1	0
16 Temporary Assistance for Needy Families	13	9	9	2	12	7
17 Technology Transfer	0	0	0	0	1	0
18 Title I Grants to Local Educational Agencies	3	3	3	0	7	3
19 Improving Teacher Quality State Grants	0	0	0	0	1	0
20 Unemployment Insurance	21	9	9	2	9	6
21 Federal Transit Formula Grants	0	0	0	0	0	1
Total	106	89	90	22	122	73

Source: GAO analysis.

^a*Fraud systems.* Help detect fraud and abuse in programs.

^b*Data matching.* The process in which information from one source is compared with information from another to identify any inconsistencies.

^c*Data mining.* Offers a tool to review and analyze diverse data for relationships that have not previously been discovered. Applying data mining to a data warehouse allows an organization to efficiently query the system to identify questionable activities.

^d*Smart technology.* Software that analyzes patterns in claim data and feeds the information back into the system to identify new patterns.

^e*Data warehouse.* Stores historical and current data and consist of tables of information that are logically grouped together. The warehouse allows program and financial data from different nonintegrated systems throughout an organization to be captured and placed in a single database where users can query the system for information.

^f*Other computer-related techniques.* Various.

As table 1 shows, for the state programs that reported using a computer-related technique, 106 state program administrators reported using some sort of fraud detection system. One example is the Transportation Software Management Solution, a fraud detection system used by several states for the Highway Planning and Construction Program. This software contains a Bid Analysis Management System that allows highway agencies to analyze bids for collusion. Also, a limited number of states in our survey reported using smart technology. For example, the Medicaid Fraud, Abuse and Detection System is designed to structure, store, retrieve, and analyze management information. It has the ability to detect fraud patterns, and it

works with the Medicaid Management Information System, which contains a data warehouse that can be queried for information to be used in a variety of analyses. Other techniques include one state's use of a Web-based system that allows National School Lunch Program participants to enter monthly claims by site. System checks are in place to ensure that sites do not overclaim meals based on days served and eligible students.

States Have Implemented Recovery Auditing Efforts

Recovery auditing is another method that states can use to recoup detected improper payments. Recovery auditing focuses on the identification of erroneous invoices, discounts offered but not received, improper late payment penalties, incorrect shipping costs, and multiple payments for single invoices. Recovery auditing can be conducted in-house or by recovery audit firms.

Section 831 of the National Defense Authorization Act for Fiscal Year 2002²⁰ contains a provision that requires all executive branch agencies entering into contracts with a total value exceeding \$500 million in a fiscal year to have cost-effective programs for identifying errors in paying contractors and for recovering amounts erroneously paid. The legislation further states that a required element of such a program is the use of recovery audits and recovery activities. The law authorizes federal agencies to retain recovered funds to cover in-house administrative costs as well as to pay contractors, such as collection agencies. OMB guidance²¹ suggests that federal agencies awarding grants may extend their recovery audit programs to cover significant contract activity by grant recipients (e.g., states). States may engage in their own recovery audit programs.

As shown in table 2, based on our review of survey responses, 15 states reported conducting recovery audits in fiscal year 2003, fiscal year 2004, or both. In fiscal year 2003, states reported recovering over \$180 million, compared to \$155 million for fiscal year 2004.

²⁰Pub. L. No. 107-107, div. A, title VIII § 831, 115 Stat. 1012, 1186 (Dec. 28, 2001) (codified at 31 U.S.C. §§ 3561-3567).

²¹OMB Memorandum M-03-07, "Programs to Identify and Recover Erroneous Payments to Contractors," January 16, 2003.

Table 2: Amount of Improper Payments Collected through State Recovery Auditing Efforts

State	Fiscal year 2003	Fiscal year 2004
Delaware	\$0 ^a	\$66,397
District of Columbia	13,057,400	15,561,561
Florida	44,354,018	45,142,905
Idaho	10,501,900	10,535,500
Michigan	15,865,807	11,804,269
New Jersey	73,939	37,356
New York	31,656,087	28,693,436
Ohio	21,517,996	14,386,026
Utah	71,285	189,107
Virginia	12,730,919	7,495,281
West Virginia	30,380,716	21,532,950
Total recovered^b	\$180,210,067	\$155,444,788

Source: GAO analysis.

^aDid not perform a recovery audit in fiscal year 2003.

^bWe noted four additional states—Colorado, Connecticut, Kentucky, and Tennessee—that performed recovery auditing in fiscal year 2003 or fiscal year 2004; however, the respondents did not report an amount for our survey because the information is reported at the state agency level and not reported in aggregate at the statewide level.

In survey responses, states reported using either outside contractors to perform recovery audits or establishing in-house fraud and detection units to recover improperly paid amounts. One state noted that it passed legislation requiring the use of recovery auditors in its state agencies. In June 2005, Texas enacted legislation that directs the state's Comptroller of Public Accounts to contract to conduct recovery audits of payments made by state agencies to vendors and to recommend improved state agency accounting operations.²² The law requires state entities with more than \$100 million in biennial expenditures to undertake annual recovery audits.²³ The state expects to recover up to \$4.5 million annually starting in state fiscal year 2007.²⁴

²²TEX. GOV'T CODE ANN. §2115.002 (2005).

²³TEX. GOV'T CODE ANN. §2115.003 (2005).

²⁴State of Texas, Legislative Budget Board, *Staff Performance Report to the 79th Legislature* (Austin, Tex.: January 2005).

Few State-Administered Programs Receive Incentives or Penalties regarding Improper Payments

Viewed broadly, agencies have applied limited incentives and penalties for encouraging improved state administration to reduce improper payments. Incentives and penalties can be helpful to create management reform and to ensure adherence to performance standards. The IPIA implementing guidance requires that each federal agency report on steps it has taken to ensure that agency managers are held accountable for reducing and recovering improper payments. When a culture of accountability over improper payments is instilled in an organization, everyone in the organization, including the managers and day-to-day program operators, have an incentive to reduce fraud and errors. Transparency, through public communication of performance results, also acts as an incentive for agencies to be vigilant in their efforts to address the wasteful spending that results from lapses in controls that lead to improper payments.

In the survey, we asked the state program administrators to identify any incentives they have received from the federal government to encourage them to reduce improper payments. We also asked them to identify any penalties they have received from the federal government for not doing so. Thirty-two states reported incentives such as enhanced funding and reduced reporting requirements for 5 of the 25 major programs. Most incentives were related to the Food Stamp Program, largely because of a statutory requirement that USDA assess penalties and provide financial incentives to the states. As we previously reported on the Food Stamp Program,²⁵ the administration of the quality control process and its system of performance bonuses and sanctions is a large motivator of program behavior and has assisted in increasing payment accuracy. Examples of other incentives identified by the state programs included reduced reporting requirements for benefit recipients and additional funding received for a fraud and abuse detection system.

Penalties such as decreased funding, increased reporting, and client sanctions were reported by 17 states for four different programs. As with incentives, most of the penalties identified related to the Food Stamp Program. States can get approval from USDA to reinvest portions of their penalties toward corrective actions to reduce the error rate as opposed to USDA recovering the penalty from the state; thus the distinction between incentives and penalties is somewhat blurred. Our survey results showed

²⁵GAO, *Food Stamp Program: States Have Made Progress Reducing Payment Errors, and Further Challenges Remain*, [GAO-05-245](#) (Washington, D.C.: May 5, 2005).

that some states believed that being able to reinvest a portion of their food stamp penalty toward corrective action plans to improve payment accuracy was actually an incentive, while other states considered it a penalty. For another program, one state noted in its survey response that it was penalized by the federal government for not applying applicable reductions to TANF beneficiaries for noncompliance with child support enforcement regulations. In lieu of paying a penalty of over \$1 million, the state submitted a corrective action plan to address the problems.

Certain states perceive limitations in their ability to adequately address improper payments. For example, 37 states reported in their survey responses that federal legislative and program design barriers hinder their ability to detect, prevent, and reduce improper payments for one or more programs. Legislative barriers relate to an agency's ability to take actions to reduce improper payments. Program design barriers relate to the complexity and variety of programs.

From our review of survey responses, several state program officials, representing multiple programs, reported that they encountered legislative barriers related to due process. Specifically, states are not permitted to stop or adjust payments until the due process hearing or appeals processes are complete, even though they know the payment is improper. For example, one state reported that it has a state superior court ruling that requires paying UI benefits conditionally under certain circumstances, and that the recovery of the paid benefits can only take place once the courts have determined the payments were incorrect. Another state program response said that lack of authority to mandate the submission of Social Security numbers for those applying for benefits was a barrier that limited the ability to identify and prevent improper payments. Additionally, 23 state programs identified statutory restrictions over the use of certain data as a barrier to improved accuracy. For example, three state programs noted that because of security policies, they were restricted from accessing and using information from the Internal Revenue Service.

Program design barriers have also contributed to states' inability to reduce improper payments. Generally, states receive broad statutory and regulatory program guidelines from the responsible federal agency. States then issue state-specific guidelines to manage day-to-day operations, which may vary among the states. A few survey respondents indicated that inconsistent requirements between programs hindered their ability to reduce improper payments. For example, four state programs noted that efforts to manage improper payments are hindered because of the different

eligibility requirements among the federal programs that they administer. The survey responses of the state programs also indicated that they encountered resource barriers, such as lack of funding for additional personnel or information technology. For example, one state program responded that the lack of funding needed to identify eligible beneficiaries through data matching was a barrier.

Federal Action Needed to Help States Report Improper Payment Information

Minimizing improper payments is often most efficiently and effectively achieved through the exchange of relevant, reliable, and timely information between individuals and units within an organization and with external entities that have oversight and monitoring responsibilities. For state-administered programs, assistance from the federal agencies and OMB may be needed in order for the states and state programs to successfully assist the federal agencies in implementing IPIA requirements. The types of communication and information that may be necessary at both the state and federal levels include (1) a determination of what information is needed by managers to meet and support initiatives aimed at reducing improper payments; (2) adequate means of communicating with, and obtaining information from, external stakeholders that may have a significant impact on improper payment initiatives, such as periodic meetings with oversight bodies; and (3) working relationships with other organizations to share information on improper payments.

Of the 227 state program surveys received, 100 identified one or more areas where guidance or resources from the federal government would be helpful. OMB can play an important role in encouraging and coordinating efforts between the state programs and federal agencies. OMB, as part of its responsibilities, develops and implements budget, program, management, and regulatory policies. As such, OMB can set the tone at the top by creating a general framework and setting expectations for federal agencies in meeting the requirements of IPIA.

Selected States Want Federal Assistance

Additional resources and guidance would be needed for increased state involvement. As noted above, 100 state program officials²⁶ requested various tools cited as needed in their efforts to estimate improper payments and to help the federal agencies in meeting various IPIA requirements, including guidance on estimating improper payments, additional funding for staffing and various projects, sharing of best practices and available guidance, and guidance on performing risk assessments. State programs also indicated that they would want an opportunity to comment on any proposed regulations prior to implementation that would require state actions to estimate and report improper payment information.

In our survey, we asked the state program officials what types of guidance and resources from the federal agencies or OMB would be beneficial to better estimate improper payments. State program officials identified one or more types of guidance or resources that would be helpful to assist the federal agencies in meeting the requirements of IPIA. We classified these responses into the following areas:

- **Guidance on estimating improper payments.** Forty-four of the state programs asked for general procedures, program-specific procedures, or both for identifying and detecting improper payments, calculating error rates, and establishing sampling methodologies. One state program suggested that guidance related to training for detecting improper payments and on how to design controls to facilitate improper payment detection be made available.
- **Additional funding.** Forty-three of the state programs indicated a need for additional funding to train and support the additional staff levels they believe would be necessary to estimate improper payments. Additional funding also was requested for automation projects. One state requested enhanced funding to update its eligibility system to include fraud detection. Another state requested additional funding for developing an automated Quality Management System to capture data from all levels of reviews and programs.

²⁶Because one or more responses were identified for each of the 100 program surveys, the universe of responses related to the types of guidance and resources needed totaled 170. We categorized these responses as follows: (1) guidance on estimating improper payments, (2) additional funding, (3) sharing of best practices and available guidance, (4) assessing risk/risk assessment instruments, (5) recognition of state input, and (6) other.

-
- **Sharing of best practices and available guidance.** Fifteen of the state programs also expressed interest in the creation of groups to discuss trends and best practices in improper payment-related areas, while other states wanted general information on IPIA and the states' roles.
 - **Assessing risk/risk assessment instruments.** Thirteen of the state programs requested procedures for assessing risk of improper payments, including items to take into consideration when assessing their programs for risk susceptibility.
 - **Recognition of state input.** Seven of the state programs want an opportunity to comment on any proposed regulations prior to implementation of any requirements to estimate or report improper payment information. For example, one state responded in its survey that the state, in coordination with its cognizant federal agency, should determine its own plans to detect improper payments. Additionally, another state program inquired as to the purpose of involving the states, particularly those that have had little occurrence of audit findings, and another wanted clarification on what sanctions would be assessed for those that identified improper payments.
 - **Other guidance and resources.** Forty-eight of the state programs requested other types of guidance and resources relating to enhancing the use of information technology, overcoming legislative barriers, and establishing incentives and penalties for subrecipients, among others. For example, one state program wanted the creation of a national database to track the activity of medical providers that operate in multiple states.

Actions Initiated at the Federal Level to Involve States in Measuring Improper Payments

OMB has continued to conduct its improper payments work through CFOC and PCIE's Erroneous and Improper Payments Workgroup. The workgroup periodically convenes to discuss and develop best practices and other methods to reduce or eliminate, where possible, improper payments made by federal government agencies. It has issued reports and other products to CFOC/PCIE, reflecting workgroup deliberations and determinations. OMB officials have told us that they have started to draft a plan on developing and maintaining partnerships with states to facilitate state's estimating and reporting information to the federal agencies. For federal agencies' fiscal year 2005 PAR reporting, OMB included a new requirement in Circular No. A-136, *Financial Reporting Requirements*, that federal agencies were to

report on their actions and results at the grantee level. However, based on our review of selected federal agencies' fiscal year 2005 PARs, reporting of fund stewardship at the grantee level was limited.

The CFOC and PCIE Erroneous and Improper Payments Workgroup created the Grants Subgroup in March 2004 to explore the feasibility of using various tools to measure and report improper payments, including evaluating currently available policies and guidance and modifying OMB single audit guidance to fulfill IPIA reporting requirements. Specifically, the Grants Subgroup's work focused on developing cost-effective approaches for tracking improper payments at each stage of the payment cycle, including (1) evaluating existing policies and guidance that could be used to measure and report improper payments and (2) examining the possibilities of measuring improper payments using the audits conducted under the Single Audit Act of 1996, as amended; OMB's Circular No. A-133 Single Audit Compliance Supplement; and the Federal Single Audit Clearinghouse.

In March 2005, the subgroup issued a report²⁷ reflecting the results of its work. Specifically, the subgroup identified issues with (1) the current structure and design of grant programs' distribution of funding, which hinders determining a national payment error rate; (2) little incentive for states to assist federal agencies with IPIA reporting; (3) lack of funding to perform IPIA compliance activities; and (4) awareness and commitment from all levels of management within an agency to address the causes of improper payments. Further, in an effort to foster working relationships among federal agencies and the states, OMB has begun work to clarify state and federal roles in estimating and reporting improper payments information and planning the development of state partnerships for certain state-administered programs.

Additionally, beginning with fiscal year 2005 PARs, OMB included three reporting requirements for those agencies with grant-making programs: (1) agency's accomplishments in the area of funds stewardship past the primary recipient, (2) status of projects, and (3) results of any reviews. Our preliminary review of these PARs showed that in general agencies either did not report on their grant-making activities, did not clearly identify grant programs, or did not address fund stewardship beyond the primary

²⁷CFOC/PCIE Federal Erroneous and Improper Payments Workgroup, *Grants Subgroup Report* (Washington, D.C.: March 2005).

recipient. However, we noted that some agencies provided partial information on the three reporting requirements. For example, eight agencies reported on the status of their projects, including one that discussed linking grants management and financial data to produce better information to ensure that projects funded by grants achieve program objectives and grant recipients are technically competent to carry out the work.

In November 2005, OMB issued draft revisions to its IPIA implementing guidance. This implementing guidance, together with recovery auditing guidance, is to be consolidated into future Parts I and II of Appendix C to OMB Circular No. A-123, *Management's Responsibility for Internal Controls* (Dec. 21, 2004). Among the proposed changes, OMB provides that for state-administered programs, federal agencies may provide state-level estimates either for all states or a sample of states to generate a national improper payment rate for that program. Also, OMB proposes to allow modifications to agency-specific compliance supplements²⁸ to enhance implementation of IPIA for federal grant-making agencies, such as the ones discussed in this report. While OMB has taken steps to begin addressing the complexities related to reporting improper payment information for federally funded, state-administered programs, additional enhancements could be made that address how federal agencies define state-administered programs and the methodology to be employed for generating a national estimate. Specifically, we found that the proposed changes do not clearly define the term state-administered programs. Without a clear definition, OMB is at risk of receiving inconsistent improper payment reports because agencies could define programs differently. In addition, we noted that the draft guidance did not provide basic criteria, such as the nature and extent of data and documentation that agencies should consider when developing a plan or methodology to calculate a national improper payment error rate for these state-administered programs.

Conclusions

Federal agencies continue to make progress toward meeting the requirements of IPIA, in response to the PMA and other key initiatives to

²⁸OMB issues a Compliance Supplement (March 2004, as revised) with Circular No. A-133, *Single Audits of States, Local Governments, and Non-Profit Organizations*, as revised (June 27, 2003), which identifies compliance requirements that should be considered in state and local government single audits. Portions of the compliance supplement have requirements for specific programs.

eliminate improper payments. However, measuring improper payments and designing and implementing actions to reduce or eliminate them are not simple tasks, particularly for grant programs that rely on quality administration efforts at the state level. With budgetary pressures rising across the federal government, agencies are under constant and increasing pressure to do more with less. Preventing improper payments and identifying and recouping those that occur become an even higher priority in this environment. States have a fundamental responsibility to ensure the proper administration of federal awards by using sound management practices and maintaining internal controls to ensure distribution of federal funding to subrecipients or beneficiaries in accordance with federal and state laws and regulations. Given their involvement in determining eligibility and distributing benefits, states are in a position to assist federal agencies in reporting on IPIA requirements. In fact, the success of several existing programs and pilots in estimating improper payment rates indicates that such efforts could logically be expanded. Communication, coordination, and cooperation among federal agencies and the states will be critical factors in estimating national improper payment rates and meeting IPIA reporting requirements for state-administered programs.

Recommendations for Executive Action

We are making four recommendations to help further the progress toward meeting the goals of IPIA and determining states' role in assisting federal agencies to report a national improper payment estimate on federal programs. Specifically, we recommend that the Director, Office of Management and Budget,

- revise IPIA policy guidance to clearly define state-administered programs so that federal agencies can consistently identify all such programs;
- expand IPIA guidance to provide criteria that federal agencies should consider when developing a plan or methodology for estimating a national improper payment estimate for state-administered programs, such as criteria that address the nature and extent of data and documentation needed from the states to calculate a national improper payment estimate;
- require federal agencies to communicate, and make available to the states, guidance on conducting risk assessments and estimating improper payments for federally funded, state-administered programs; and

-
- share ideas, concerns, and best practices with federal agencies and states regarding improper payment reporting requirements for federally funded, state-administered programs.

Agency Comments

We received written comments on a draft of this report from OMB and reprinted them in appendix VII. OMB agreed with our recommendations and highlighted several initiatives under way to ensure that accurate improper payment rates can be generated without creating undue cost and burden on federal agencies or state partners that manage federally funded programs. OMB also provided technical comments that we incorporated, as appropriate.

We are sending copies of this report to the Director, Office of Management and Budget; Secretaries of Agriculture, Health and Human Services, Labor, and Transportation; appropriate congressional committees; and other interested parties. We will also make copies available to others upon request. In addition, the report is available at no charge on GAO's Web site at <http://www.gao.gov>.

Please contact me at (202) 512-9095 or williamsm1@gao.gov if you have any questions about this report. Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this report. Major contributors to this report are listed in appendix VIII.

Sincerely yours,



McCoy Williams
Director, Financial Management and Assurance

Objectives, Scope, and Methodology

The objectives of this report were to determine (1) what actions are being taken by states to assist federal agencies in estimating improper payments; (2) what techniques, related to detecting, preventing, or reducing improper payments, have states employed to ensure proper administration of federal awards; and (3) what assistance can be provided by the Office of Management and Budget (OMB) that state program administrators would find helpful in supporting the respective federal agencies with the implementation of the Improper Payments Information Act of 2002 (IPIA).

To address each of these objectives, we

- conducted a statewide survey in all 50 states and the District of Columbia¹ regarding actions to estimate improper payments for state-administered federal programs for fiscal years 2003 and 2004,
- conducted a program-specific survey of the major programs in each of the states,
- performed site visits to selected states,
- conducted interviews with federal and state officials, and
- reviewed federal agencies' fiscal year 2005 performance and accountability reports (PAR) and prior GAO and office of inspector general (OIG) reports.

More detailed information on each of these aspects of our research is presented in the following sections. We conducted our work from April 2005 through December 2005 in accordance with generally accepted government auditing standards.

Survey Development and Implementation

The surveys were developed based on IPIA, the National Defense Reauthorization Act for Fiscal Year 2002, and our executive guide on managing improper payments,² and included questions about

¹Consistent with the report, we refer to all respondents to the survey as states.

²GAO, *Strategies to Manage Improper Payments: Learning From Public and Private Sector Organizations*, [GAO-02-69G](#) (Washington, D.C.: October 2001).

- state-issued policies or guidance on internal controls or on estimating improper payments;
- statewide risk assessments for improper payments;
- state recovery auditing efforts;
- state program efforts to prevent, detect, and reduce improper payments;
- state program participation in improper payment pilots; and
- additional assistance needed by state programs to support efforts in measuring and reporting improper payments.

The surveys were pretested with state officials in two states. Revisions to the survey were made based on comments received during the pretests.

To determine the state programs that would receive the program-specific survey, we designed a spreadsheet for each state containing its major programs, which we defined as those programs for which federal funds covered at least 60 percent of total state-administered expenditures. To do this, we used the Federal Audit Clearinghouse single audit database to identify a universe of federally funded, state-administered programs for each state. We sorted the programs from largest to smallest expenditure amount and identified the major programs in decreasing order until we obtained, in aggregate, at least 60 percent of the total federal portion of state-administered expenditures in each state. We provided this spreadsheet to states so they could confirm it with their state records. Table 3 lists the 25 major programs and the number of states in which each major program was included. The number of states identified for each major program ranged from 1 to 51.

Appendix I
Objectives, Scope, and Methodology

Table 3: Number of States for Which Each of the 25 Programs Was Defined as Major

	Major program name	Number
1	Medicaid	51
2	Highway Planning and Construction	44
3	Food Stamp Program	36
4	Temporary Assistance for Needy Families	28
5	Unemployment Insurance	26
6	Title I Grants to Local Educational Agencies	15
7	Special Education State Grants	10
8	National School Lunch Program	5
9	Child Care and Development Block Grant	4
10	Foster Care Title IV-E	3
11	Home Investment Partnerships Program	2
12	Capitalization Grants for Clean Water State Revolving Funds	2
13	Capitalization Grants for Drinking Water State Revolving Funds	2
14	Special Supplemental Nutrition Program for Women, Infants, and Children	1
15	Emergency Preparedness Funding	1
16	Lower Income Housing Assistance Program Section 8 Moderate Rehabilitation	1
17	Abandoned Mine Land Reclamation Program	1
18	Airport Improvement Program	1
19	Federal Transit Formula Grants	1
20	Appalachian Development Highway System	1
21	Technology Transfer	1
22	Surveys, Studies, Investigations, and Special Purpose Grants	1
23	Improving Teacher Quality State Grants	1
24	Child Support Enforcement	1
25	Child Care and Development Fund	1
	Total programs	240

Source: GAO.

As shown in table 4, the number of major programs identified for each state ranged from 1 to 12.

Appendix I
Objectives, Scope, and Methodology

Table 4: Number of Major Programs in Each State

	State	Number of programs
1	Alabama	3
2	Alaska	8
3	Arizona	4
4	Arkansas	3
5	California	3
6	Colorado	10
7	Connecticut	3
8	Delaware	12
9	District of Columbia	4
10	Florida	4
11	Georgia	5
12	Hawaii	5
13	Idaho	3
14	Illinois	3
15	Indiana	3
16	Iowa	8
17	Kansas	7
18	Kentucky	4
19	Louisiana	3
20	Maine	3
21	Maryland	7
22	Massachusetts	7
23	Michigan	1
24	Minnesota	3
25	Mississippi	3
26	Missouri	3
27	Montana	6
28	Nebraska	3
29	Nevada	4
30	New Hampshire	5
31	New Jersey	3
32	New Mexico	5
33	New York	3
34	North Carolina	4
35	North Dakota	5

Appendix I
Objectives, Scope, and Methodology

(Continued From Previous Page)

	State	Number of programs
36	Ohio	6
37	Oklahoma	4
38	Oregon	4
39	Pennsylvania	3
40	Rhode Island	4
41	South Carolina	1
42	South Dakota	6
43	Tennessee	2
44	Texas	4
45	Utah	5
46	Vermont	3
47	Virginia	10
48	Washington	7
49	West Virginia	6
50	Wisconsin	7
51	Wyoming	8
	Total programs	240

Source: GAO.

We e-mailed the surveys in June 2005 and followed up with subsequent mailings and telephone communications. The collection of survey data ended in October 2005 with a response rate of 98 percent for the statewide surveys (50 of the 51 states) and a 95 percent response rate for the program-specific surveys (227 of the 240 programs).

We conducted follow-up phone calls to clarify responses where there appeared to be discrepancies; however, we did not independently verify the responses or information obtained through the surveys.

Although no sampling errors were associated with our survey results, the practical difficulties of conducting any survey may introduce certain types of errors, commonly referred to as nonsampling errors. For example, differences in how a particular question is interpreted or differences in the sources of information that participants use to respond can introduce unwanted variability into the survey results. We included steps in both the data collection and data analysis stages to reduce such nonsampling errors. Specifically, social science survey specialists designed draft questionnaires, we pretested two versions of the questionnaire, and we performed reviews to identify inconsistencies and other indications of error prior to analysis of

data. The data were keyed and verified after data entry. We conducted our survey work from June 2005 through December 2005.

Site Visits

We visited two states and interviewed state agency officials and other relevant parties about initiatives in place to estimate improper payments for the Highway Planning and Construction, Medicaid, and Unemployment Insurance (UI) programs. The two states were selected based on our knowledge of actions under way for programs in Tennessee and Texas. We went to Tennessee to obtain information about the Department of Transportation's (DOT) implementation of a pilot project to estimate improper payments related to the Highway Planning and Construction Program. The pilot was the first that DOT's Federal Highway Administration had conducted to estimate improper payments in a state and covered two construction projects.

We went to Texas to obtain information about the Department of Health and Human Services's (HHS) Medicaid program and the Department of Labor's (Labor) UI Program. One reason for selecting Texas was that HHS's Center for Medicare and Medicaid Services had identified Texas as having a leadership role in estimating improper payments for its Medicaid program. In addition, Texas was one of three states participating in a new pilot project organized by Labor to begin data-matching work using the National Directory of New Hires. More information about these states' efforts in these three programs is provided in appendixes IV, V, and VI. Detailed information regarding the Department of Agriculture's Food Stamp Program and its efforts in estimating and reporting improper payments is presented in appendix III. Improper payment estimates and references from agencies' PARs are used for background purposes. We did not assess the reliability of these data.

States and Programs Included in Our Review

State	Program
1 Alabama	1 Medicaid
	2 Highway Planning and Construction
	3 Food Stamp Program
2 Alaska	4 Medicaid
	5 Highway Planning and Construction
	6 Airport Improvement Program
	7 Food Stamp Program
	8 Unemployment Insurance
	9 Temporary Assistance for Needy Families
	10 Surveys, Studies, Investigations, and Special Purpose Grants
3 Arizona	11 Child Care and Development Block Grant
	12 Medicaid
	13 Unemployment Insurance
	14 Food Stamp Program
4 Arkansas	15 Highway Planning and Construction
	16 Medicaid
	17 Highway Planning and Construction
5 California	18 Food Stamp Program
	19 Medicaid
	20 Unemployment Insurance
6 Colorado	21 Temporary Assistance for Needy Families
	22 Medicaid
	23 Highway Planning and Construction
	24 Food Stamp Program
	25 Temporary Assistance for Needy Families
	26 Title I Grants to Local Educational Agencies
	27 Special Education State Grants
	28 National School Lunch Program
	29 Foster Care Title IV-E
	30 Special Supplemental Nutrition Program for Women, Infants, and Children
	31 Technology Transfer
7 Connecticut	32 Medicaid
	33 Unemployment Insurance
	34 Highway Planning and Construction

Appendix II
States and Programs Included in Our Review

(Continued From Previous Page)

State	Program
8 Delaware	35 Medicaid
	36 Highway Planning and Construction
	37 Food Stamp Program
	38 Temporary Assistance for Needy Families
	39 Title I Grants to Local Educational Agencies
	40 Special Education State Grants
	41 Lower Income Housing Assistance Program Section 8 Moderate Rehabilitation
	42 Child Care and Development Fund
	43 Improving Teacher Quality State Grants
	44 National School Lunch Program
9 District of Columbia	45 Child Support Enforcement
	46 Federal Transit Formula Grants
	47 Medicaid
	48 Highway Planning and Construction
	49 Emergency Preparedness Funding
10 Florida	50 Temporary Assistance for Needy Families
	51 Medicaid
	52 Highway Planning and Construction
	53 Food Stamp Program
11 Georgia	54 Temporary Assistance for Needy Families
	55 Medicaid
	56 Highway Planning and Construction
	57 Food Stamp Program
	58 Temporary Assistance for Needy Families
12 Hawaii	59 National School Lunch Program
	60 Medicaid
	61 Food Stamp Program
	62 Highway Planning and Construction
	63 Temporary Assistance for Needy Families
13 Idaho	64 Capitalization Grants for Clean Water State Revolving Funds
	65 Medicaid
	66 Unemployment Insurance
14 Illinois	67 Highway Planning and Construction
	68 Medicaid
	69 Unemployment Insurance

Appendix II
States and Programs Included in Our Review

(Continued From Previous Page)

State	Program
	70 Food Stamp Program
15 Indiana	71 Medicaid
	72 Unemployment Insurance
	73 Highway Planning and Construction
16 Iowa	74 Medicaid
	75 Highway Planning and Construction
	76 Food Stamp Program
	77 Temporary Assistance for Needy Families
	78 Special Education State Grants
	79 Home Investment Partnerships Program
	80 Title I Grants to Local Educational Agencies
	81 National School Lunch Program
17 Kansas	82 Medicaid
	83 Highway Planning and Construction
	84 Food Stamp Program
	85 Unemployment Insurance
	86 Temporary Assistance for Needy Families
	87 Title I Grants to Local Educational Agencies
	88 Special Education State Grants
18 Kentucky	89 Medicaid ^a
	90 Unemployment Insurance
	91 Highway Planning and Construction
	92 Food Stamp Program
19 Louisiana	93 Medicaid
	94 Food Stamp Program
	95 Highway Planning and Construction
20 Maine	96 Medicaid
	97 Highway Planning and Construction
	98 Food Stamp Program
21 Maryland	99 Medicaid
	100 Highway Planning and Construction
	101 Food Stamp Program
	102 Temporary Assistance for Needy Families
	103 Unemployment Insurance
	104 Title I Grants to Local Educational Agencies
105 Foster Care Title IV-E	
22 Massachusetts	106 Medicaid

Appendix II
States and Programs Included in Our Review

(Continued From Previous Page)

State	Program
	107 Unemployment Insurance
	108 Highway Planning and Construction
	109 Temporary Assistance for Needy Families
	110 Food Stamp Program
	111 Title I Grants to Local Educational Agencies
	112 Special Education State Grants
23 Michigan	113 Medicaid
24 Minnesota	114 Medicaid
	115 Unemployment Insurance
	116 Highway Planning and Construction
25 Mississippi	117 Medicaid
	118 Highway Planning and Construction
	119 Food Stamp Program
26 Missouri	120 Medicaid ^a
	121 Unemployment Insurance ^a
	122 Highway Planning and Construction ^a
27 Montana	123 Medicaid
	124 Highway Planning and Construction
	125 Food Stamp Program
	126 Temporary Assistance for Needy Families
	127 Title I Grants to Local Educational Agencies
	128 Special Education State Grants
28 Nebraska	129 Medicaid
	130 Highway Planning and Construction
	131 Unemployment Insurance
29 Nevada	132 Medicaid
	133 Highway Planning and Construction
	134 Food Stamp Program
	135 Temporary Assistance for Needy Families
30 New Hampshire	136 Medicaid
	137 Highway Planning and Construction ^a
	138 Temporary Assistance for Needy Families
	139 Food Stamp Program
	140 Unemployment Insurance
31 New Jersey	141 Medicaid
	142 Highway Planning and Construction
	143 Temporary Assistance for Needy Families

Appendix II
States and Programs Included in Our Review

(Continued From Previous Page)

State	Program
32 New Mexico ^a	144 Medicaid ^a
	145 Highway Planning and Construction
	146 Food Stamp Program ^a
	147 Temporary Assistance for Needy Families ^a
	148 Title I Grants to Local Educational Agencies ^a
33 New York	149 Medicaid
	150 Temporary Assistance for Needy Families
	151 Unemployment Insurance
34 North Carolina	152 Medicaid
	153 Unemployment Insurance
	154 Highway Planning and Construction
	155 Food Stamp Program
35 North Dakota	156 Medicaid
	157 Highway Planning and Construction
	158 Food Stamp Program
	159 Temporary Assistance for Needy Families
	160 Title I Grants to Local Educational Agencies
36 Ohio	161 Medicaid
	162 Highway Planning and Construction
	163 Food Stamp Program
	164 Temporary Assistance for Needy Families
	165 Title I Grants to Local Educational Agencies
	166 Child Care and Development Block Grant
37 Oklahoma	167 Medicaid
	168 Highway Planning and Construction
	169 Food Stamp Program
	170 Temporary Assistance for Needy Families
38 Oregon	171 Medicaid
	172 Unemployment Insurance
	173 Food Stamp Program
	174 Highway Planning and Construction
39 Pennsylvania	175 Medicaid
	176 Highway Planning and Construction
	177 Unemployment Insurance
40 Rhode Island	178 Medicaid
	179 Unemployment Insurance
	180 Highway Planning and Construction

Appendix II
States and Programs Included in Our Review

(Continued From Previous Page)

State	Program
	181 Temporary Assistance for Needy Families
41 South Carolina	182 Medicaid
42 South Dakota	183 Medicaid
	184 Highway Planning and Construction
	185 Capitalization Grants for Clean Water State Revolving Funds
	186 Food Stamp Program
	187 Home Investment Partnerships Program
	188 Capitalization Grants for Drinking Water State Revolving Funds
43 Tennessee	189 Medicaid
	190 Food Stamp Program
44 Texas	191 Medicaid
	192 Highway Planning and Construction
	193 Food Stamp Program
	194 Title I Grants to Local Educational Agencies
45 Utah	195 Medicaid
	196 Highway Planning and Construction
	197 Temporary Assistance for Needy Families
	198 Unemployment Insurance
	199 Food Stamp Program
46 Vermont	200 Medicaid
	201 Highway Planning and Construction
	202 Unemployment Insurance
47 Virginia	203 Medicaid
	204 Highway Planning and Construction
	205 Food Stamp Program
	206 Unemployment Insurance
	207 Special Education State Grants
	208 National School Lunch Program
	209 Title I Grants to Local Educational Agencies
	210 Temporary Assistance for Needy Families
	211 Foster Care Title IV-E
	212 Child Care and Development Block Grant
48 Washington	213 Medicaid
	214 Unemployment Insurance
	215 Highway Planning and Construction
	216 Food Stamp Program

Appendix II
States and Programs Included in Our Review

(Continued From Previous Page)

State	Program
	217 Temporary Assistance for Needy Families ^a
	218 Child Care and Development Block Grant ^a
	219 Special Education State Grants
49 West Virginia	220 Medicaid
	221 Highway Planning and Construction
	222 Food Stamp Program
	223 Appalachian Development Highway System
	224 Temporary Assistance for Needy Families
	225 Title I Grants to Local Educational Agencies
50 Wisconsin	226 Medicaid
	227 Highway Planning and Construction
	228 Temporary Assistance for Needy Families
	229 Unemployment Insurance
	230 Food Stamp Program
	231 Title I Grants to Local Educational Agencies
	232 Special Education State Grants
51 Wyoming	233 Medicaid
	234 Food Stamp Program ^a
	235 Title I Grants to Local Educational Agencies
	236 Abandoned Mine Land Reclamation Program
	237 Temporary Assistance for Needy Families ^a
	238 Unemployment Insurance
	239 Capitalization Grants for Drinking Water State Revolving Funds
	240 Special Education State Grants

Source: GAO.

^aNo survey received.

Food Stamp Quality Control System

Overview of Program

The Food Stamp Program is intended to help low-income individuals and families obtain a more nutritious diet by supplementing their incomes with benefits to purchase food. The Department of Agriculture's (USDA) Food and Nutrition Service (FNS) administers the program in partnership with the states. FNS pays the full cost of Food Stamp benefits and shares the states' administrative costs and is responsible for promulgating program regulations and ensuring that state officials administer the program in compliance with program rules. States handle day-to-day operation and management, including certifying eligibility of participants, delivering the benefits, and monitoring recipients' compliance. The states usually administer the program out of local assistance offices that determine whether households meet the program's eligibility requirements, calculate monthly benefits for qualified households, and issue benefits to participants. The local assistance offices often administer other benefit programs as well, including Temporary Assistance for Needy Families (TANF), Medicaid, and child care assistance.

To measure the accuracy of Food Stamp payments, FNS and the states have an extensive quality control (QC) system from which the Food Stamp Program payment error rate is developed. The QC system, established in 1970, reviews and measures the accuracy of household certifications using a statistically valid methodology to calculate improper payment estimates for the Food Stamp Program for all 50 states, Guam, the Virgin Islands, and the District of Columbia. The system is mandated by the Food Stamp Act, as amended, and further defined in program regulations and agency guidance.¹

The QC process uses a systematic random sampling of Food Stamp Program participants. State agencies select cases monthly that are reviewed to determine the accuracy of the eligibility and benefit-level determination. The review includes a client interview, verification of all elements of eligibility, and the basis of issuance of food stamp benefits. The states report the findings of all QC reviews to FNS. FNS reviewers validate a sample of the states' reviews by conducting a second review. The results of the federal validation and state findings are used to calculate a final error rate for each state agency.

¹ U.S.C. § 2025(c); 7 C.F.R. §§ 275.10-14; and *FNS Handbook* 310.

As reported in USDA's fiscal year 2005 PAR, the causes of improper payments in the Food Stamp Program include client errors, such as incomplete or inaccurate reporting of income, assets, or both by participants at the time of certification or by not reporting subsequent changes. Causes can also be provider based, such as errors in determining eligibility or benefits by caseworkers or eligibility worker delays in action or inaction on client-reported changes. In its fiscal year 2005 PAR, USDA reported a national error rate of 5.88 percent, or \$1.4 billion, for the Food Stamp Program. The estimate is based on fiscal year 2004 data, the most current data available for this measure.

Statistically valid state error rates are weighted annually to determine a national average error rate for the Food Stamp Program. Once the error rates are finalized, FNS compares each state's performance with the national error rate and imposes penalties or provides incentives according to specifications in the law.

Improper Payment Estimates

OMB's implementing guidance requires that agencies report overpayments and underpayments in their programs if the figures are available. USDA reports these amounts in its PAR for the Food Stamp Program. Table 5 provides the overpayment and underpayment amount for each state. In fiscal year 2003, overpayments ranged from \$454,636 to \$103,236,074 while underpayments ranged from \$126,288 to \$40,679,714. In fiscal year 2004, overpayments ranged from \$756,935 to \$94,118,074 and underpayments ranged from \$151,016 to \$46,714,340.

**Appendix III
Food Stamp Quality Control System**

Table 5: Food Stamp Improper Payment Amounts by State for Fiscal Years 2003 and 2004

State	FY 2003 overpayment amount	FY 2003 underpayment amount	FY 2004 overpayment amount	FY 2004 underpayment amount
Alabama	\$32,022,705	\$5,313,811	\$36,036,075	\$5,023,521
Alaska	7,124,955	1,998,142	3,207,363	1,275,217
Arizona	23,438,760	5,623,312	29,586,835	8,205,724
Arkansas	10,712,762	1,521,699	14,118,057	4,370,701
California	103,236,074	40,679,714	94,118,074	31,836,981
Colorado	12,361,379	2,683,720	5,893,540	1,517,650
Connecticut	11,572,762	2,884,948	7,150,599	2,607,401
Delaware	1,945,107	626,066	2,425,654	1,102,570
District of Columbia	6,380,065	1,703,153	4,631,618	877,570
Florida	54,335,945	24,006,609	66,471,972	11,670,652
Georgia	31,296,436	9,075,967	48,592,664	8,776,242
Hawaii	5,388,605	2,077,346	5,237,425	1,366,285
Idaho	6,049,789	2,611,365	5,576,573	2,656,377
Illinois	43,162,302	8,106,091	56,449,466	11,507,938
Indiana	38,405,811	9,964,228	23,903,276	8,132,609
Iowa	6,163,775	1,641,683	8,781,450	2,116,012
Kansas	11,287,114	3,383,327	6,573,509	1,501,162
Kentucky	24,797,796	5,932,022	25,346,127	5,210,339
Louisiana	30,220,286	9,456,688	27,819,108	8,519,131
Maine	12,605,513	3,883,391	12,467,964	2,848,225
Maryland	13,154,521	5,421,102	12,614,597	4,099,744
Massachusetts	9,059,608	3,603,542	9,071,744	5,418,693
Michigan	64,603,806	22,317,679	43,193,936	21,238,512
Minnesota	13,604,820	4,497,086	12,399,691	4,880,200
Mississippi	10,286,766	3,350,738	15,557,052	5,703,049
Missouri	30,479,379	7,832,690	42,591,976	6,634,264
Montana	3,392,350	592,972	2,843,188	799,894
Nebraska	5,063,401	1,402,035	4,608,506	1,478,200
Nevada	7,278,706	2,016,855	7,362,460	1,625,478
New Hampshire	2,500,909	498,586	2,517,133	574,847
New Jersey	6,200,425	2,032,926	7,663,778	3,737,507
New Mexico	8,918,362	2,385,570	9,479,693	2,674,317
New York	61,527,878	37,050,848	60,972,532	46,714,340
North Carolina	25,429,487	6,454,185	16,269,128	7,607,324

**Appendix III
Food Stamp Quality Control System**

(Continued From Previous Page)

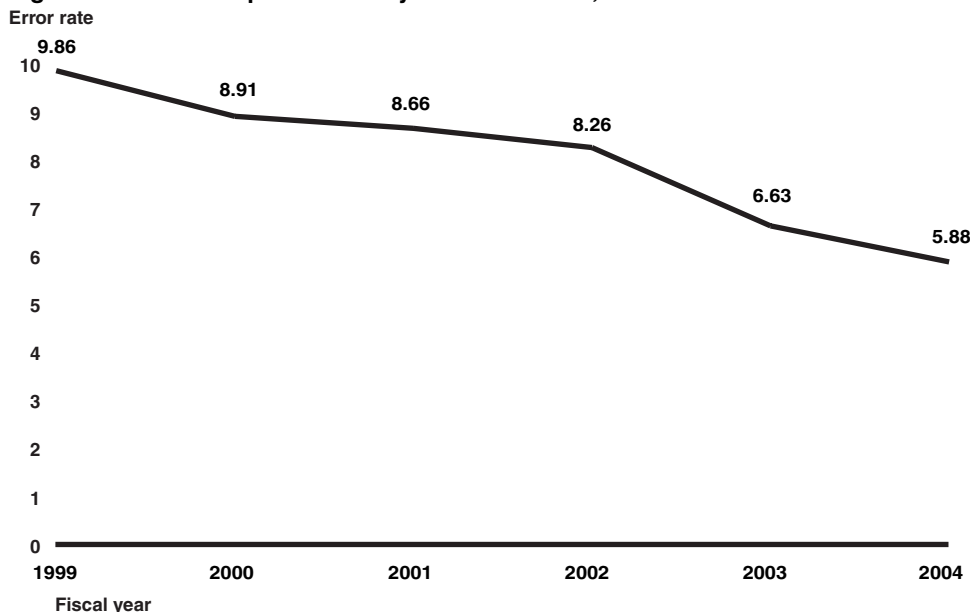
State	FY 2003 overpayment amount	FY 2003 underpayment amount	FY 2004 overpayment amount	FY 2004 underpayment amount
North Dakota	1,394,697	381,706	1,079,676	588,182
Ohio	44,728,801	13,357,127	70,446,518	14,735,232
Oklahoma	28,380,204	4,168,229	19,769,506	3,699,324
Oregon	40,765,571	8,762,693	25,082,127	7,599,386
Pennsylvania	49,012,613	15,473,533	26,691,625	10,639,319
Rhode Island	4,843,564	1,307,212	7,686,034	2,096,191
South Carolina	18,709,605	3,147,825	27,716,610	3,658,793
South Dakota	454,636	126,288	911,490	151,016
Tennessee	44,246,038	7,723,207	40,427,562	13,881,753
Texas	41,942,991	19,937,027	65,743,403	29,296,183
Utah	3,474,989	1,635,289	3,361,379	1,268,213
Vermont	2,630,295	575,730	1,631,109	424,810
Virginia	15,124,786	4,870,694	24,760,618	6,618,704
Washington	19,798,026	4,969,226	26,770,075	7,921,757
West Virginia	10,371,097	3,068,116	12,721,487	2,548,932
Wisconsin	15,828,776	5,929,954	13,040,841	4,876,844
Wyoming	728,845	288,651	756,935	414,691
Total	\$1,076,443,893	\$338,352,603	\$1,100,129,758	\$344,728,006

Source: USDA FNS.

State and Federal Improper Payment Initiatives Under Way

Since fiscal year 1999, the combined Food Stamp error rate has continued to decline. Figure 2 displays the error rates for the 6-year period from fiscal years 1999 to 2004.

Figure 2: Food Stamp National Payment Error Rate, Fiscal Years 1999-2004



Source: USDA FNS.

Actions taken by both the states and FNS contributed to the declining error rates. For example, the state of Arizona has completed a statewide implementation of a fingerprint imaging system. The state is using the system as a means of positive identification of welfare applicants and clients to ensure that participants do not use false identities to receive benefits to which they are not entitled; the system is also used in the eligibility determination process. The state reported that cost avoidance savings resulted from welfare fraud reduction achieved through the identification and prevention of duplicate enrollments in the Food Stamp and TANF programs.

Recent initiatives reported in USDA's fiscal year 2005 PAR include FNS's nationwide implementation of an electronic benefit transfer (EBT) system for the delivery of food stamp benefits. EBT recipients use a plastic card, much like debit cards, to pay for their food at authorized retail stores. Funds are transferred from a Food Stamp benefits account to a retailer's account. With EBT cards, food stamp customers pay for groceries without any paper coupons changing hands. By eliminating paper coupons, EBT creates an electronic record for each transaction that precludes certain

types of fraudulent claims and makes other attempted frauds easier to detect.

Other FNS efforts include Partner Web, a Web-based system to facilitate communication and information exchange between USDA and its nutrition assistance program partners. Another initiative, the National Payment Accuracy Workgroup, consists of representatives from USDA headquarters and regional offices who meet to discuss best practice methods and strategies. The practices the states are promoting include

- preparing reports detailing causes and sources of errors for the local offices and publishing and distributing monthly error rates for all local offices;
- transmitting the results of statewide error review panels on the source and causes of errors to local offices, along with suggested corrective actions;
- sponsoring statewide QC meetings and state best practices conferences for local offices to discuss error rate actions taken and common problems; and
- sponsoring local office participation in FNS regional conferences.

Table 6 summarizes these and other factors contributing to the declining error rate.

Table 6: Summary of Factors Contributing to Declining Food Stamp Improper Payment Error Rates and Amounts

Factor	Description
USDA FNS – general actions	
FNS monitors and validates states' QC reviews	FNS approves sampling plans and state samples to determine improper payment rates and amounts.
FNS is responsible for determining efficiency and effectiveness of state agency	FNS establishes an opinion on efficiency and effectiveness of the state based on (1) reports submitted to FNS by the state; (2) FNS reviews of state agency operations; (3) state performance reporting systems and corrective action efforts; and (4) other available information, such as federal audits and investigations, civil rights reviews, administrative cost data, complaints, and pending litigation.
FNS imposes penalties and incentives on state Food Stamp programs	FNS compares state error rates to the national error rate to determine incentives and penalties for state Food Stamp programs.
FNS promotes knowledge sharing of good practices	FNS provides funding to state and local food stamp officials to promote knowledge sharing. States are using information from the QC system to track the results of their policy and program changes over time and communicate timely operational information to local offices.
USDA FNS – specific actions	
USDA Partner Web	FNS has established an intranet Web site for state Food Stamp agencies.
National Payment Accuracy Workgroup	The workgroup is an information-sharing tool across regions and states that consists of representatives from USDA headquarters and regional offices.
Payment Accuracy Branch	This national level group works with the FNS regions to suggest policy and program changes and to monitor state performance.
USDA Early Detection System	This system targets states that may be experiencing a higher incidence of errors based on preliminary QC data.
Technological	
EBT	EBT electronically transfers funds from a food stamp benefits account to a retailer's account.
GovBenefits	GovBenefits is a citizen-centered guide to government assistance and benefits, including food stamps; school lunch and breakfast; Women, Infants, and Children; and nutrition assistance. It includes a new prescreening tool that enables anyone with access to the Internet to determine his or her eligibility for food stamps.

Appendix III
Food Stamp Quality Control System

(Continued From Previous Page)

Factor	Description
Data matches	<p>Income Eligibility and Verification System. This is a tool for state agencies to use in comparing income reported by program applicants and recipients with income reported on six databases containing information on earnings reported to the state by in-state employers; earned and unearned income reported to the Internal Revenue Service; and the receipt of Social Security, unemployment insurance, and supplementary security income benefits.</p> <p>Systematic Alien Verification Eligibility system matches. This program enables federal, state, and local government agencies to obtain immigration status information for determining applicant's/recipient's eligibility for public benefits.</p>
Fingerprint imaging system	This is an automated fingerprint imaging system used by certain states as a means of positive identification of welfare applicants and clients.
Legislation and oversight	
Farm Security and Rural Investment Act of 2002	The act has allowed states to adopt simplified reporting requirements, which require food stamp households to report interim changes in their income only when they rise to a level that would make them ineligible for benefits.
Congress	Congress passed IPIA and has held congressional hearings.
OMB	OMB issued guidance to federal agencies for IPIA reporting.
External auditors	GAO and USDA OIG audited and reviewed the Food Stamp Program. GAO has issued reports on governmentwide improper payment reporting.

Source: GAO.

UI Benefit Accuracy Measurement and National Directory of New Hires Database

Overview of Program

The UI Program was established by Title III of the Social Security Act in 1935 and is a key component in ensuring the financial security of America's workforce. The program, which is administered by the states with oversight from Labor's Employment and Training Administration, provides temporary cash benefits to workers who lose their jobs through no fault of their own. Although Labor provides oversight and guidance to ensure that each state operates its program consistent with federal guidelines, the federal-state structure of UI places primary responsibility for administering the program on the states. The states can administer their UI programs in ways that best suit their needs within the guidelines established by federal law. Eligibility for UI, benefit amounts, and the length of time benefits are available are determined by the state law under which UI claims are established. In the majority of states, benefit funding is based solely on a tax imposed on employers.

Labor has two initiatives in place to identify, estimate, and prevent improper payments—the Benefit Accuracy Measurement (BAM) program and the National Directory of New Hires (NDNH). Labor's BAM program is designed to determine the accuracy of paid and denied claims in the UI Program. It does this by reconstructing the UI claims process from samples of weekly payments and denied claims using data verified by trained investigators. For claims that were overpaid, underpaid, or improperly denied, the BAM program determines the cause of and the party responsible for the error, the point in the UI claims process at which the error was detected, and actions taken by the agency and employers prior to the error. For erroneously paid claims, the BAM program determines the amount of benefits the claimants should have received, which becomes the basis for subsequent recovery efforts.

The NDNH is a database, maintained by HHS's Office of Child Support Enforcement (OCSE), that contains information on all newly hired employees, quarterly wage reports for all employees, and UI claims nationwide. The NDNH enhances states' ability to detect unreported work violations by UI claimants working in other states or for certain employers that operate in multiple states.¹ In addition, the NDNH can help improve the accuracy of Labor's error estimates. Output files from the NDNH cross-match can be easily integrated into Labor's BAM program by cross-

¹Under current statute, employers need only be registered in one state's new hire database, despite having work locations or employees in other states.

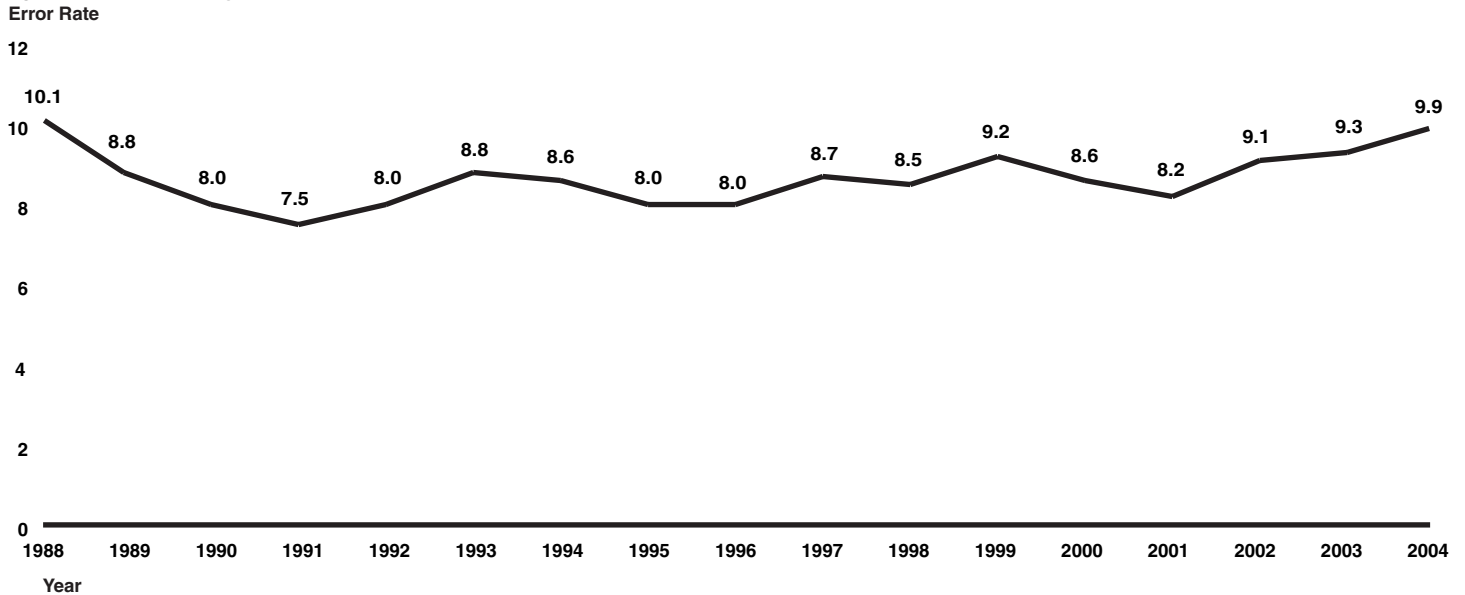
matching the Social Security numbers of the claimants against the NDNH results.

Improper Payment Estimates

Since 1988, Labor has reported a national improper payment estimate for its UI Program. As part of the BAM program's quality control, each state is responsible for selecting representative samples and investigating the accuracy of the benefit determinations, benefit payments, and recoveries. The results of these reviews are integrated with the BAM system to identify erroneously paid claims.

UI overpayments at a national level have fluctuated over the past 16 years. The lowest reported national error rate occurred in 1991 at 7.5 percent while the highest national error rate occurred in 1988 with 10.1 percent, as shown in figure 3.

Figure 3: UI Overpayment National Error Rates, Calendar Years 1988-2004



Source: Labor.

We also noted that since 2001, UI's national error rate has steadily increased. Labor attributes the rise in error rates to an increase in payments to claimants who improperly continue to claim benefits despite having returned to work. Although when combined, the dollar amounts of

overpayments and underpayments decreased between calendar years 2003 and 2004, the national error rate increased from 9.9 percent in calendar year 2003 to 10.6 percent in calendar year 2004.

At the state level, the improper payment overpayments in calendar year 2003 ranged from \$2,829,017 to \$450,073,624, while underpayments ranged from \$100,263 to \$37,825,338. In calendar year 2004, overpayments ranged from \$2,250,919 to \$317,991,985 and underpayments ranged from \$20,184 to \$40,330,046. Table 7 lists the UI improper payment overpayments and underpayments by state.

Table 7: UI Overpayments and Underpayments by State for Calendar Years 2003 and 2004

State	CY 2003 overpayment amount	CY 2003 underpayment amount	CY 2004 overpayment amount	CY 2004 underpayment amount
Alabama	\$35,105,972	\$584,587	\$32,171,531	\$554,682
Alaska	11,162,449	1,596,636	17,821,095	946,371
Arizona	72,804,546	431,189	86,486,204	395,947
Arkansas	29,215,897	949,596	36,479,866	1,261,552
California	414,858,548	37,825,338	317,991,985	16,002,843
Colorado	41,184,047	2,164,869	39,215,471	2,695,087
Connecticut	30,687,056	2,247,107	27,402,585	6,134,051
Delaware	15,302,193	1,561,448	14,709,043	1,312,533
District of Columbia	11,165,946	910,817	8,798,087	731,650
Florida	57,582,448	4,465,578	39,949,285	3,886,117
Georgia	39,528,066	3,311,252	25,628,425	4,440,834
Hawaii	7,389,037	484,995	4,588,132	377,273
Idaho	32,543,779	1,635,577	26,574,852	854,074
Illinois	198,225,860	21,203,264	258,873,508	7,863,974
Indiana	81,364,624	3,517,644	72,745,986	1,504,146
Iowa	49,946,856	4,540,623	35,151,973	4,695,390
Kansas	105,514,650	453,015	95,028,141	115,817
Kentucky	12,066,382	2,912,575	19,653,481	2,591,230
Louisiana	43,613,878	3,371,922	53,374,181	2,799,155
Maine	10,618,736	489,105	8,639,827	197,681
Maryland	69,819,363	1,637,991	40,050,308	418,379

Appendix IV
UI Benefit Accuracy Measurement and
National Directory of New Hires Database

(Continued From Previous Page)

State	CY 2003 overpayment amount	CY 2003 underpayment amount	CY 2004 overpayment amount	CY 2004 underpayment amount
Massachusetts	59,951,206	22,975,313	81,028,654	25,012,542
Michigan	171,063,097	11,938,973	169,804,248	13,363,398
Minnesota	74,342,318	5,950,738	61,201,839	6,762,257
Mississippi	14,667,566	737,159	11,691,476	777,317
Missouri	37,829,265	455,774	42,021,818	1,322,721
Montana	19,084,853	357,651	10,666,139	554,886
Nebraska	28,983,959	442,606	16,286,657	559,465
Nevada	27,517,223	647,102	24,515,908	596,053
New Hampshire	8,914,628	723,087	5,895,778	595,850
New Jersey	237,090,931	27,525,068	222,110,349	40,330,046
New Mexico	3,734,779	100,263	15,847,493	956,518
New York	234,778,623	18,566,677	228,731,314	10,745,766
North Carolina	120,614,563	2,535,441	61,128,148	3,182,783
North Dakota	3,787,405	120,433	2,830,433	84,326
Ohio	155,256,162	17,731,594	251,668,448	22,282,432
Oklahoma	5,296,937	1,000,533	6,485,106	495,540
Oregon	76,283,709	2,087,765	71,048,437	3,265,205
Pennsylvania	211,443,998	24,573,951	177,952,460	12,198,354
Rhode Island	11,154,488	870,796	13,413,248	1,161,938
South Carolina	34,591,337	910,298	35,610,338	803,766
South Dakota	2,963,279	147,069	2,413,427	20,184
Tennessee	46,661,937	1,903,459	20,595,851	1,455,381
Texas	450,073,624	3,038,105	271,753,213	9,491,381
Utah	18,988,138	1,804,303	11,817,023	1,366,489
Vermont	2,829,017	887,148	2,250,919	388,363
Virginia	127,967,956	2,610,323	107,088,844	2,392,156
Washington	167,103,334	3,326,944	118,052,534	2,052,148
West Virginia	3,630,150	1,264,231	6,652,142	1,222,713
Wisconsin	64,602,987	2,345,646	86,624,141	3,788,730
Wyoming	5,360,715	151,887	5,662,231	360,752
Total	\$3,796,268,517	\$254,025,465	\$3,404,182,582	\$227,368,246

Source: Labor.

State and Federal Improper Payment Initiatives Under Way

In addition to its leadership role in producing improper payment estimates on a national level, Labor has initiated the NDNH pilot for the UI Program to further assist in identifying, detecting, and preventing improper payments. In fiscal year 2005, three states (Texas, Utah, and Virginia) participated in the pilot. Labor initiated the NDNH pilot to determine how a cross-match between NDNH and state UI claimant data would help identify and reduce improper payments. For further review of Labor's pilot project, we visited the state of Texas.

Texas's participation in the NDNH pilot was through its Texas Workforce Commission (TWC). During this pilot, TWC conducted three matches of the state UI claimant data against the NDNH's new hire data, UI claimant data, and quarterly wage data to identify potential overpayments. Generally, to perform these matches, TWC electronically transmitted state UI claimant data to HHS's OCSE. OCSE then compared the state UI claimant data to data in the NDNH. Potential matches of claimants who may have improperly received unemployment benefits were then transmitted to TWC. TWC investigated all matches to determine the validity and amount of overpayment. According to TWC, using the national cross-match along with the statewide cross-match helped detect 50 percent more cases of potential fraud in one quarter than it would have detected otherwise.

Besides the NDNH pilot, Texas also communicated to us that it had several other actions in place to manage UI improper payments. In July 2004, the Texas governor issued an executive order² for each state agency to report on efforts to assess risk in the agency; identify best practices for eliminating fraud in contracting, contract management, and procurement; and describe common components for fraud prevention and elimination programs. Each agency was also to develop a fraud prevention program. Additionally, the executive order required TWC to prioritize prevention, detection, and elimination of fraud and abuse in the UI Program by

- identifying any state policies, weaknesses in computer cross-matching systems, and other appropriate factors that are ineffective in preventing fraud and abuse;

²Executive Order RP36, Relating to Preventing, Detecting, and Eliminating Fraud, Waste and Abuse, Governor of the State of Texas (July 12, 2004).

- developing strategies to address benefit fraud and claims overpayments; and
- identifying and implementing national best practices for detecting and prosecuting fraudulent schemes, identifying cost-effective strategies designed to eliminate fraud, and increasing recovery of overpayments.

Further, TWC has been educating employers on their responsibilities to provide TWC with information to make benefit determinations. For example, TWC sent letters to those employers that have a history of not providing complete or timely information during the initial claims investigation. These letters reiterated employers' responsibilities and TWC's expectations for receiving timely information during an investigation.

Based on its NDNH pilot results, Labor reported in its fiscal year 2005 PAR that a substantial amount of additional overpayments could be detected using the database. In addition, Labor reported that it is already moving ahead with full implementation of the NDNH cross-match with 5 states (Connecticut, Texas, Utah, Virginia, and Washington). Labor expects 29 states to use NDNH by the end of fiscal year 2006.

In addition to funding initiatives related to the new hire cross-matches, Labor has announced that states will be given an additional incentive to prevent and detect overpayments by implementing core measures in states' performance budget plans based on the level of overpayments the states have detected. Labor's fiscal year 2006 budget request contained a legislative proposal that is designed to give states the means to obtain funding for integrity activities, including additional staff, to enhance recovery and prevent overpayments. Also, to reduce overpayments and facilitate reemployment, Labor awarded Reemployment and Eligibility Assessments grants to 21 states during fiscal year 2005. The grants have been used to conduct in-person claimant interviews to assess UI beneficiaries' need for reemployment services and their continued eligibility for benefits and to ensure that beneficiaries understand that they must stop claiming benefits upon their return to work. Further, Labor continues to promote data sharing with other agencies, such as the Social Security Administration, to identify, detect, and prevent improper payments.

Highway Planning and Construction Pilot to Estimate Improper Payments

Overview of Program

The objective of the Highway Planning and Construction Program is to assist state transportation agencies in the planning and development of an integrated, interconnected transportation system. The program is also called the Federal-Aid Highway Program since federal funding for highways is provided to the states mostly through a series of formula grant programs collectively known by that name. The Federal Highway Administration under DOT administers the Highway Planning and Construction Program and distributes most highway funds, which can be used for a variety of projects, such as capital improvement and development of transportation management systems. Most projects are administered by or through state transportation departments, and the states have considerable discretion in selecting specific highway projects and in determining how to allocate available federal funds among the various projects they have selected.

In fiscal year 2004, DOT conducted a review of its programs and activities, as required by IPIA. As a result of this review, DOT found that data did not exist at the department level to adequately estimate the amount of improper payments for its grant programs. To address this issue, DOT contracted with an outside firm and initiated a research and development project to develop a methodology to estimate improper payments in its grant programs. The Highway Planning and Construction Program was selected as the test pilot program. The pilot project had two objectives: (1) develop a testing methodology for grantees and (2) test the developed methodology.

The pilot was conducted on two construction projects in Tennessee. Samples were selected from payment transaction files using statistical sampling. For items selected, documentation that supported payment was requested and reviewed. The contractor developed a comprehensive document that described the planning and construction phases of projects and a methodology to determine whether the goods and services received were in accordance with contractual terms and conditions. Figure 4 is an example of the testing procedures for asphalt, one component of the construction project.

Figure 4: Example of Test Procedures for Asphalt

Test Procedures

- 1. Are prices billed for asphalt in accordance with allowable tables of asphalt process for the area and period?
- 2. Are asphalt deliveries supported by delivery tickets?
- 3. Based on inspection reports, is asphalt quality in accordance with contract provisions or is the price adjusted based on quality and/or pavement smoothness?
- 4. Based on inspection reports is asphalt depth in accordance with contract provisions?
- 5. Improper payment calculation
 - A. Calculate price differences.
 - B. Calculate volume differences.
 - C. Compute the monetary effect of price differences by multiplying the difference by billed volume.
 - D. Compute the monetary effect of volume differences by multiplying the volume difference by the billed price for billed volume.
 - E. The amount of improper payment is the sum of the monetary effect of price differences and volume differences.

Source: DOT.

Improper Payment Estimates

In its fiscal years 2004 and 2005 PARs, DOT reported a zero-dollar amount for its improper payment estimate for the Highway Planning and Construction Program. To enhance its reporting of improper payments,

DOT conducted a pilot in the state of Tennessee. DOT completed this project in the summer of 2005. Testing disclosed three underpayments, one of which was determined by DOT to be statistically insignificant. An extrapolation of the other two errors to the population of payments for that construction project resulted in an improper payment estimate of \$111,671. The sample was not designed to produce an estimate for the Tennessee statewide Highway Planning and Construction Program.

State and Federal Improper Payment Initiatives Under Way

DOT noted in its fiscal year 2005 PAR that the Tennessee pilot resulted in a methodology and testing procedures that will be used nationwide, but that the testing procedures may need to be modified based on each state's grant management policies. DOT plans to pilot the project in more volunteer states in fiscal year 2006 and extend the process nationwide in fiscal year 2007. In addition to participating in the pilot, states work to reduce improper payments by implementing computer software to detect fraud and abuse. One such tool is the Transportation Software Management Solution, which was used by several state programs in their Highway Planning and Construction programs and contains a Bid Analysis Management System that allows highway agencies to analyze bids for collusion. At the federal level, DOT improper payment initiatives for the future include citing the inherent higher risk of improper payments because of concentrated and accelerated spending related to Hurricanes Katrina and Rita. Fiscal year 2006 Highway Planning and Construction Program testing will be focused on these hurricane regions. In its fiscal year 2006 PAR, DOT will provide interim information on the amounts and causes of improper payments and control procedures that can be used to prevent or detect improper payments in national emergency situations.

Medicaid Payment Accuracy and Payment Error Rate Measurement Project

Overview of Program

Title XIX of the Social Security Act authorizes states to provide health care services to low-income individuals and families through the Medicaid program. Although jointly financed by the states and the federal government, Medicaid is administered directly by the states. Within broad federal guidelines, each state establishes its own eligibility standards; determines the type, amount, duration, and scope of covered services; and sets payment rates.

The Centers for Medicare and Medicaid Services (CMS), an agency under HHS, has the role of facilitating states' program integrity efforts and seeing that states have the necessary processes in place to prevent and detect improper payments. In July 2001, CMS began soliciting states to participate in Year 1 of the Medicaid Payment Accuracy Measurement (PAM) pilot project. CMS continued to administer the PAM pilot until its Year 3 study in fiscal year 2004. For fiscal year 2005, CMS modified the pilot to measure improper payment error rates rather than payment accuracy, and changed the name of the pilot from PAM to Payment Error Rate Measurement (PERM). Table 8 shows the number of states that participated in the pilot each year.

Table 8: Number of States Participating in CMS's Medicaid Pilots to Estimate Improper Payments

Pilot name	Number of states participating
PAM Year 1 (FY 2002)	9
PAM Year 2 (FY 2003)	12
PAM Year 3 (FY 2004)	24
PERM Year 1 (FY 2005)	26

Source: CMS.

In Year 2 of the pilot, CMS adopted a standard methodology for the states to use. Specifically, sampling strata consisting of Medicaid services were identified and states could perform sampling for the fee-for-service (FFS)¹

¹FFS is a traditional method of payment for medical services under which providers are paid for each service rendered.

component, the managed care² component, or both. The methodology was refined for Year 3 to include a subsample for eligibility review. For the fiscal year 2005 PERM pilot, CMS set the sample size and provided states the following general methodology:

1. Plan the project, including assembling and training staff and collecting policies and procedures for reviews.
2. Select a sample of payments and validate the sample. For FFS, the sample is a claim or line item, which is a request for payment for services rendered relating to the care and treatment of a disease or injury. For managed care, the sample is a capitation payment, which is a payment based on a predetermined agreement rather than on actual cost of care, services delivered, or both.³
3. Conduct a processing review on each claim.
4. Conduct a medical record review on each FFS claim.
5. Conduct an eligibility review on a subsample of claims.
6. Calculate the overall error rate as well as error rates for the FFS and managed care components.
7. Develop a final report.

Improper Payment Estimates

Because of the variations in the states' Medicaid programs, CMS provided states the option of either testing for the FFS or managed care components, including testing eligibility for the two components. The rates⁴ for the 12 states that participated in the PAM pilot for Year 2 (fiscal year 2003) ranged from 0.3 percent to 18.6 percent for the FFS component and 0 percent to

²Managed care is any system of delivering health services through a specified network of doctors and hospitals that agree to comply with the care approaches established by a care-management process.

³All sampling units, including the FFS line item and managed care capitation payment, are referred to as a claim.

⁴To determine the states' error rates, we used the inverse of the accuracy rates published by HHS's CMS.

2.5 percent for the managed care component. The rates for the 24 states that participated in the Year 3 PAM pilot (fiscal year 2004) ranged from 0.80 percent to 54.3 percent for the FFS component and 0 percent to 7.45 percent for the managed care component. Rates for the Year 1 PERM pilot (fiscal year 2005) had not been published at the conclusion of our fieldwork.

Although all states used a standard methodology to produce the rates, CMS noted that these rates should not be compared among states. Specifically, states applied different administrative standards that resulted in a lack of a common approach to the reviews among states. For medical reviews, states have different policies against which the reviews are conducted. For eligibility reviews, states had two review options under the PAM Year 3 pilot for verifying program eligibility. Other differences include the level of provider cooperation in submitting information and whether states conducted reviews in-house or contracted with vendors to perform the reviews.

CMS identified Texas as having a leadership role in estimating improper payments for its Medicaid program. Texas was estimating improper payments prior to implementing the CMS pilots. Under state statute, effective 1997, Texas was required to biennially estimate improper payments for its Medicaid program. In September 2003, the state of Texas passed another statute, among other things, to fund 200 additional positions to investigate Medicaid fraud. Texas has also initiated a Medicaid Integrity Pilot (MIP) project to assist in preventing improper payments. The MIP project incorporates the use of biometric technology, such as fingerprint imaging and smart cards,⁵ as eligibility verification tools. For example, Texas issues smart cards to Medicaid clients participating in the pilot and smart card and biometric readers to medical providers. When a client obtains services, he or she inserts the card into the smart card reader and positions his or her finger on the biometric reader, which compares the print to the fingerprint image contained on the card. The use of this type of technology promotes positive identification, incorporates automated eligibility determination, and assists in an electronic billing process.

⁵Smart cards can contain various information, such as client account, biometric, and health information. Smart cards can be programmed to be ATM enabled and be used as a source of data transmission between providers, pharmacies, and labs.

Furthermore, Texas has performed a feasibility study to consolidate multiple program benefits onto a single card called an Integrated Benefits Card (IBC). This study has identified four primary benefit programs for consolidation—Medicaid; TANF; Food Stamps; and Women, Infants, and Children. Texas believes that the IBC may facilitate the needs of the Medicaid program by preventing fraud, making payments to medical providers more quickly, and offering a means for providers to quickly and accurately verify the eligibility of a client.

In addition to the above initiatives, CMS has taken additional steps programwide to estimate improper payments at the national level. See table 9 for a detailed description of actions taken.

Table 9: Timeline of CMS Regulations and Initiatives to Estimate Medicaid Improper Payments

Date	Medicaid improper payment regulation/initiative
Fiscal year 2000	Established payment accuracy Government Performance Results Act goals
July 2001	CMS formally solicited states to participate in the PAM Year 1 pilot
May 2002	CMS solicited states to participate in the PAM Year 2 pilot
November 2002	Enactment of IPIA
December 2002	Issued PAM Year 1 pilot final report (FY 2002)
June 2003	CMS solicited states to participate in the PAM Year 3 pilot
April 2004	Issued PAM Year 2 pilot final report (FY 2003)
July 2004	CMS solicited states to participate in the PERM Year 1 pilot
August 27, 2004	<i>Medicaid Program and SCHIP: Payment Error Rate Measurement</i> , 69 Fed. Reg. 52620-32 (Aug. 27, 2004) (to be codified at 42 C.F.R. pts. 431 and 457)
December 13, 2004	Results of the Year 2 PAM pilot (FY 2003) reported in the FY 2004 PAR
June 15, 2005	Issued PAM Year 3 pilot final report (FY 2004)
July 22, 2005	Agency Information Collection Activities: Proposed Collection; Comment Request, 70 Fed. Reg. 42324-CMS-10166
August 26, 2005	Agency Information Collection Activities: Submission for OMB Review; Comment Request, 70 Fed. Reg. 50357-CMS-10166
October 5, 2005	<i>Medicaid Program and SCHIP: Payment Error Rate Measurement</i> , 70 Fed. Reg. 58260-77 (Oct. 5, 2005) (to be codified at 42 C.F.R. pts. 431 and 457)
November 15, 2005	Results from Year 3 PAM pilot (FY 2004) were reported in the FY 2005 PAR

(Continued From Previous Page)

Date	Medicaid improper payment regulation/initiative
Fiscal year 2006	Results of the PERM pilot will be reported in the FY 2006 PAR
Fiscal year 2007	Results of the FY 2006 national Medicaid FFS error rate will be reported in the FY 2007 PAR, based on a statistically valid sample of states and claims within those states
Fiscal year 2008	Results of the FY 2007 federal contractor estimate of a national error rate for Medicaid's FFS, managed care, and eligibility components will be reported in the FY 2008 PAR

Sources: GAO and CMS.

Note: Shading represents future actions.

State and Federal Improper Payment Initiatives Under Way

In October 2005, CMS published an interim final rule, with plans to publish a final rule that would include responses to comments received. According to the interim final rule, states would be stratified based on the states' annual FFS Medicaid expenditures from the previous year, and a random sample of up to 18 states would be reviewed. States would only be selected once every 3 years. The interim final rule also outlines the strategy for conducting medical and data-processing reviews on claims made for FFS only. CMS will address estimating improper payments for Medicaid's managed care and eligibility components at a later time. In November 2005, CMS sent a memo to the states selected for review during fiscal year 2006.

Subsequent to the publication of the October 2005 interim final rule, CMS stated that it anticipates the number of states selected each year will be 17 to ensure that each state and the District of Columbia would only be selected once every 3 years. This approach would exclude any U.S. territories or possessions that receive Medicaid funds. In a discussion with CMS's consultant firm, it communicated to us that the sampling approach to be employed was statistically valid since every state was selected by strata, for each of the 3 years, in year 1 of this process, and thus, each state had an equal chance of being selected for years 1 through 3. Because CMS's sampling methodology, including sampling plans, had not been fully documented by the conclusion of our fieldwork, we were unable to independently assess the statistical validity of CMS's approach to obtain a national improper payment estimate for its Medicaid program.

In its fiscal year 2005 PAR, HHS also identified efforts to detect and reduce improper payments through activities other than the pilot project. For example, HHS's Health Care Fraud and Abuse Control Office has two projects under way that will assist in reporting improper payments. The office plans to hire 100 staff to conduct prospective reviews of state

Appendix VI
Medicaid Payment Accuracy and Payment
Error Rate Measurement Project

Medicaid operations and the Medicare/Medicaid data match program⁶ to identify areas where efficiencies could be made to enhance payment accuracy. Additionally, HHS expects to improve its data match capabilities to detect improper payments for Medicaid, as well as other programs, through the use of its Public Assistance Reporting Information System (PARIS). PARIS is a voluntary project that enables the 33 participating states' public assistance data to be matched against several databases to help maintain program integrity and to detect and deter improper payments. CMS expects to be fully compliant with the IPIA requirements for its Medicaid program by fiscal year 2008.

⁶In the Medicare/Medicaid data match program, claims data from both programs are analyzed together to detect patterns that may not be evident when billings for either program are viewed separately. This data match allows CMS to identify previously undetected patterns, such as providers who bill the government for more than 24 hours a day in both programs.

Comments from the Office of Management and Budget



THE CONTROLLER

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

MAR 03 2006

McCoy Williams, Director
Financial Management and Assurance
United States Government Accountability Office
440 G Street, NW
Washington, DC 20548

Dear Mr. Williams:

Thank you for giving us the opportunity to comment on the Government Accountability Office (GAO) draft report entitled, "Federal and State Coordination Needed to Report National Improper Payment Estimates on Federal Programs." In general, OMB agrees with the recommendations GAO made to enhance progress toward meeting the goals of the Improper Payment Information Act of 2002 (IPIA), and in determining the role States in assisting Federal agencies to report a national improper payment estimate for Federal programs.

During fiscal year 2005, the Federal Government made substantial progress in meeting the objectives of the IPIA. Most notably the government-wide improper payments total reported last year decreased by approximately \$7.8 billion, due to dramatic improvements implemented by the Department of Health and Human Services in the stewardship of Medicare funds. In addition, agencies demonstrated improved error detection and measurement, providing improper payment data on programs for which no improper payment statistics had been available in the past. Much of the success achieved in the past year can be attributed to the PMA initiative to eliminate improper payments, which established an effective accountability framework for ensuring that Federal agencies initiate all necessary financial management improvements for addressing this critical problem area.

Going forward, the Federal financial community will work to achieve additional reductions to the government-wide improper payment total, while also improving improper payment measurement and detection. As discussed in the instant report, OMB is working closely with the Chief Financial Officers Council (CFOC) to develop and implement strategies for improving the measurement of improper payments in grant programs. Our objective is to ensure that accurate improper payment rates can be generated without creating undue cost and burden on Federal agencies or our state partners.

As noted in the report, OMB and CFOC have several initiatives underway to help achieve this objective. First, we are exploring opportunities, such as the Single Audit, where we can leverage existing processes for relevant information on the incidence of improper payments. Second, OMB has begun a new effort to establish a Federal-State

partnership to foster improved understanding and cooperation between the two levels of government. It is hoped that this effort will lead to enhanced improper payment identification, measurement and reporting on Federally-funded programs which are State-administered. Third, OMB has revised Circular A-136 to require grant-making agencies to provide additional information in their annual Performance and Accountability Reports (PARs) in regard to the program integrity activities conducted with their grant recipients.

GAO made four recommendations to OMB to help further the progress toward meeting the goals of IPPIA and determining states' role in assisting federal agencies to report a national improper payment estimate on federal programs.

1. Revise IPPIA policy guidance to clearly define state-administered programs so that federal agencies can consistently identify such programs.

OMB agrees with this comment. Following discussion of GAO's comments to our draft guidance revision (Appendix C to OMB Circular A-123), and in response to written comments received from GAO, OMB agrees that our definition would benefit from further clarity. OMB will work closely with GAO and other relevant stakeholders to revise and enhance this definition.

2. Expand IPPIA guidance to provide criteria that Federal agencies should consider when developing a plan or methodology for estimating a national improper payment estimate for State-administered programs, such as criteria that address the nature and extent of data and documentation needed from the States to calculate a national improper payment estimate.

OMB agrees with this comment. OMB has provided a great deal of guidance to agencies on developing their measurement plans. Nonetheless, we plan to expand our discussion of these concepts in our revised guidance, particularly in relationship to State-administered programs that are partially or fully funded by Federal agencies. In addition, as additional programs are identified as risk susceptible in the grants community, this type of information would prove helpful. For the most part, the agencies involved either have statisticians on staff or under contract to ensure their measurement strategies are statistically valid. We look forward to continuing to work collaboratively with GAO to ensure Federal agencies fully understand the nature and extent of data and documentation necessary from States in order to calculate a national improper payment estimate.

3. Require Federal agencies to communicate and make available to the States, guidance on conducting risk assessments and estimating improper payments for Federally-funded, State-administered programs.

OMB agrees with this comment. Federal agencies go to great lengths to ensure that their State partners have all the information they need to undertake tasks that are mandated at the Federal level and not at the State level. Nevertheless, we agree that including this type of instruction in our guidance may prove helpful in clarifying what is necessary to be included in a proper risk assessment.

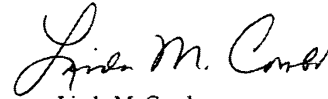
Appendix VII
Comments from the Office of Management
and Budget

4. Share ideas, concerns, and best practices, with Federal agencies and States, regarding improper payment reporting requirements for Federally-funded, State-administered programs.

OMB agrees with this comment. As stated previously, OMB is in the beginning stages of its efforts to launch a Federal-State partnership to accomplish the very items listed in GAO's fourth recommendation. We also take every opportunity to collaborate with States through conferences, State auditor/controller meetings, and grant management gatherings, and to attempt enlist States' participation and cooperation in our program integrity efforts.

We were pleased to have the opportunity to comment on GAO's draft report GAO-06-347. Feel free to address any questions to Sally Beecroft of my staff at (202) 395-1040 or sbeecroft@omb.eop.gov. In addition, we have included technical comments as the enclosure to this letter, as Appendix 1.

Sincerely,



Linda M. Combs
Controller

Enclosure

GAO Contact and Staff Acknowledgments

GAO Contact

McCoy Williams, (202) 512-9095 or williamsml@gao.gov

Acknowledgments

In addition to the contact named above, Carla Lewis, Assistant Director; Verginie Amirkhanian; Francine DeVecchio; Louis Fernheimer; Danielle Free; Wilfred Holloway; Stuart Kaufman; Donell Ries; and Bill Valsa made important contributions to this report.

Related GAO Products

Financial Management: Challenges Continue in Meeting Requirements of the Improper Payments Information Act. [GAO-06-581T](#). Washington, D.C.: April 5, 2006.

Financial Management: Challenges Remain in Meeting Requirements of the Improper Payments Information Act. [GAO-06-482T](#). Washington, D.C.: March 9, 2006.

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

Financial Management: Challenges in Meeting Requirements of the Improper Payments Information Act. [GAO-05-605T](#). Washington, D.C.: July 12, 2005.

Food Stamp Program: States Have Made Progress Reducing Payment Errors, and Further Challenges Remain. [GAO-05-245](#). Washington, D.C.: May 5, 2005.

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

Medicaid Program Integrity: State and Federal Efforts to Prevent and Detect Improper Payments. [GAO-04-707](#). Washington D.C.: July 16, 2004.

TANF and Child Care Programs: HHS Lacks Adequate Information to Assess Risk and Assist States in Managing Improper Payments. [GAO-04-723](#). Washington, D.C.: June 18, 2004.

Financial Management: Fiscal Year 2003 Performance and Accountability Reports Provide Limited Information on Governmentwide Improper Payments. [GAO-04-631T](#). Washington, D.C.: April 15, 2004.

Financial Management: Status of the Government Efforts to Address Improper Payment Problems. [GAO-04-99](#). Washington, D.C.: October 17, 2003.

Financial Management: Effective Implementation of the Improper Payments Information Act of 2002 Is Key to Reducing the Government's Improper Payments. [GAO-03-991T](#). Washington, D.C.: July 14, 2003.

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

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

Unemployment Insurance: Increased Focus on Program Integrity Could Reduce Billions in Overpayments. [GAO-02-697](#). Washington, D.C.: July 12, 2002.

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

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.

GAO's Mission

The Government Accountability Office, the audit, evaluation and investigative arm of Congress, exists to support Congress in meeting its constitutional responsibilities and to help improve the performance and accountability of the federal government for the American people. GAO examines the use of public funds; evaluates federal programs and policies; and provides analyses, recommendations, and other assistance to help Congress make informed oversight, policy, and funding decisions. GAO's commitment to good government is reflected in its core values of accountability, integrity, and reliability.

Obtaining Copies of GAO Reports and Testimony

The fastest and easiest way to obtain copies of GAO documents at no cost is through GAO's Web site (www.gao.gov). Each weekday, GAO posts newly released reports, testimony, and correspondence on its Web site. To have GAO e-mail you a list of newly posted products every afternoon, go to www.gao.gov and select "Subscribe to Updates."

Order by Mail or Phone

The first copy of each printed report is free. Additional copies are \$2 each. A check or money order should be made out to the Superintendent of Documents. GAO also accepts VISA and Mastercard. Orders for 100 or more copies mailed to a single address are discounted 25 percent. Orders should be sent to:

U.S. Government Accountability Office
441 G Street NW, Room LM
Washington, D.C. 20548

To order by Phone: Voice: (202) 512-6000
TDD: (202) 512-2537
Fax: (202) 512-6061

To Report Fraud, Waste, and Abuse in Federal Programs

Contact:

Web site: www.gao.gov/fraudnet/fraudnet.htm

E-mail: fraudnet@gao.gov

Automated answering system: (800) 424-5454 or (202) 512-7470

Congressional Relations

Gloria Jarmon, Managing Director, JarmonG@gao.gov (202) 512-4400
U.S. Government Accountability Office, 441 G Street NW, Room 7125
Washington, D.C. 20548

Public Affairs

Paul Anderson, Managing Director, AndersonP1@gao.gov (202) 512-4800
U.S. Government Accountability Office, 441 G Street NW, Room 7149
Washington, D.C. 20548