

Implementation Guidance for the Improper Payments Information Act of 2002, P.L. 107-300

Introduction

A component of the President's Management Agenda is the initiative to reduce erroneous payments. Agencies with programs listed in Section 57 of the OMB Circular A-11 are required to report annually on the extent of the erroneous payments in those programs and the actions they are taking to reduce erroneous payments. The Improper Payments Information Act of 2002 (Act) (Public Law 107-300) has extended the erroneous payment reporting requirements to programs and activities beyond those listed in Circular A-11. This guidance implements the requirements of the Act and supercedes Section 57 of Circular A-11. (See below.)

What is an erroneous or improper payment? (The term "erroneous payment" and "improper payment" have the same meaning in this document.)

An erroneous payment is any payment that should not have been made or that was made in an incorrect amount under statutory, contractual, administrative, or other legally applicable requirement. Incorrect amounts are overpayments and under payments (including inappropriate denials of payment or service). An erroneous payment includes any payment that was made to an ineligible recipient or for an ineligible service. Erroneous payments are also duplicate payments, payments for services not received, and payments that do not account for credit for applicable discounts.

The term "payment" means any payment derived from Federal funds or other Federal sources or that will be reimbursed from Federal funds or other Federal resources (including a commitment for future payment, such as a loan guarantee) that is made by a Federal agency, a Federal contractor, or a governmental or other organization administering a Federal program or activity. This includes Federal awards subject to the Single Audit Act Amendments of 1996 (Single Audit Act) which are expended by both recipients and subrecipients as well as Federal grants and subgrants to for-profit and non-U.S. based entities not subject to the Single Audit Act.

What agencies are required to comply with the requirements of the Improper Payments Information Act of 2002 (Public Law No: 107-300)?

The Act defines agency broadly as "a department, agency, or instrumentality in the executive branch of the United States."

How is the term "program and activity" defined? (The term "program and activity" is referred to in this document as "program.")

The Act anticipates that agencies will examine the risk of erroneous payments in all programs and activities they administer, well beyond just those listed in Section 57 of OMB Circular A-11. The term program includes activities or sets of activities recognized as programs by the public,

OMB, or Congress as well as those that entail program management or policy direction. This definition includes, but is not limited to, all grants including competitive grant programs and block/formula grant programs, regulatory activities, research and development activities, direct Federal programs, all procurements including capital assets and service acquisition, and credit programs. It also includes the activities engaged in by the agency in support of its programs.

For Federal awards subject to the Single Audit Act or otherwise listed in the Catalog of Federal Domestic Assistance (CFDA), Federal agencies should consider using the groupings in the OMB Circular A-133 Compliance Supplement and the CFDA. However, unless specifically specified in OMB Circular A-11, each Federal agency, after consultation with OMB, is authorized to determine the grouping of programs which most clearly identifies and reports erroneous payments for their agency.

What are agencies required to do?

Agencies are required to review annually all programs and activities they administer and identify those which may be susceptible to significant erroneous payments. This includes payments from Federal awards made by recipients and subrecipients subject to the Single Audit Act Amendments of 1996 as well as Federal grants and subgrants expended by for-profit and non-U.S. based entities not subject to that Act. For all programs and activities where the risk of erroneous payments is significant, agencies shall estimate the annual amount of erroneous payments, and report the estimates to the President and Congress with a progress report on actions to reduce erroneous payments.

Step 1: Review all programs and activities and identify those which are susceptible to significant erroneous payments.

Many agencies already know which programs and activities are at the highest risk of erroneous payments. Agencies shall institute a systematic method of reviewing all programs and identifying those it believes are susceptible to significant erroneous payments. For the purposes of this guidance, significant erroneous payments are defined as annual erroneous payments in the program exceeding both 2.5 % of program payments and \$10 million. The agency shall maintain documentation to support this review and the results.

To clarify this step, we provide three examples:

Example 1. Under the analysis in step 1, a program has a potential error rate of 2.25% or \$14 million. Under this guidance, an agency need not perform step 2, making a statistically valid estimate of erroneous payments in the program, because the potential error rate does not exceed 2.5%. In addition, the agency need not report an error rate for the program in its annual Performance and Accountability Report.

Example 2. Under the analysis in step 1, a program has a potential error rate of 2.75% or \$9 million. Under this guidance, an agency need not perform step 2, making a statistically valid estimate of erroneous payments in the program, because the potential amount of erroneous payments in the program does not exceed \$10 million. In addition, the agency need not report an error rate for the program in its annual Performance and Accountability Report.

Example 3. Under the analysis in step 1, a program has a potential error rate of 2.75% or \$11 million. Under this guidance, an agency must perform step 2, making a statistically valid estimate of erroneous payments in the program, because the potential error rate exceeds 2.5% and the potential amount of erroneous payments exceeds \$10 million. The agency must report a statistically valid error rate for the program in its annual Performance and Accountability Report.

Step 2: Statistically Valid Estimate of the annual amount of erroneous payments in programs and activities

For all programs and activities susceptible to significant erroneous payments, agencies shall determine an annual estimated amount of erroneous payments made in those programs and activities. This estimate is a gross total of both over and under payments (i.e., not the net of over and under payments). Agencies should consult with a statistician in drawing their samples and in calculating the necessary sample size. The estimates shall be based on the equivalent of a statistical random sample with a precision requiring a sample of sufficient size to yield an estimate with a 90% confidence interval of plus or minus 2.5% around the estimate of the percentage of erroneous payments. And because the margin of error of a percentage estimate is related to the size of that estimate, the agency may use their initial determination of the *potential* error in step 1 to determine their sample size.¹

To clarify this step, we provide two examples:

Example 1: Under the analysis in step 1, the program has a potential error rate of

¹ The minimum sample size needed to meet the precision requirements can be approximated by the following formula, which is used in the examples:

$$n \geq \frac{2.706(1-P)}{\left(\frac{.025}{P}\right)^2}$$

where

n is the required minimum sample size

P is the estimated percentage of erroneous payments

(Note: This sample size formula is derived from *Sampling of Populations: Methods and Applications* (3rd edition); Levy, P. S. & Lemeshow, S. (1999); New York: John Wiley & Sons; at page 74.)

3 % (and at least \$10 million). Under this guidance the agency needs to draw a random sample of cases from the program that will yield a statistical estimate of the erroneous payment rate. The 90 % confidence interval around this estimate should be no more than plus or minus 2.5%. Using the initial determination of 3% yields a minimum sample size of approximately 126 cases.

Example 2: Under the analysis in step 1, the program has a potential error rate of 4.5 % (and at least \$10 million). The required minimum sample size to achieve a 90 % confidence interval around this estimate of 4.5% of plus or minus 2.5% is approximately 186 cases.

Because of the imprecision of the risk assessment performed in step 1, agencies should ensure that they do not select too small of a sample. Because the size of the error rate is related to its margin of error, agencies should be conservative and use a higher estimated error rate in their sample size calculations to ensure they will meet the precision targets. Furthermore, these guidelines for precision should be taken as the minimum, and agencies are encouraged to increase samples above the minimum to achieve greater precision in their estimates. The agency shall maintain documentation to support the calculation of these estimates. Agencies should consider working with entities subject to A-133 audits to use ongoing audits to assist in the process to estimate an erroneous payment rate.

Step 3: Implement a Plan to reduce erroneous payments

For all programs and activities as determined under Step 2 with erroneous payments exceeding \$10 million, agencies shall identify the precise reasons its programs and activities are at risk of erroneous payments and put in place a plan to reduce them. To determine the precise reasons for erroneous payments, agencies may be required to conduct an analysis of erroneous payments that produces an error rate at higher levels of confidence and precision than that prescribed by this guidance.

When compiling its plan to reduce erroneous payments, agencies shall set targets for future erroneous payment levels and a timeline by which the targets will be reached. In addition, agencies must ensure that agency managers (including the agency head) are held accountable for reducing erroneous payments. Agencies shall assess whether they have the information systems and other infrastructure needed to reduce erroneous payments to minimal cost-effective levels and identify any statutory or regulatory barriers which may limit the agencies' corrective actions in reducing erroneous payments.

Step 4: Report estimates of the annual amount of erroneous payments in programs and activities and progress in reducing them

Agencies shall report to the President and Congress an estimate of the annual amount of erroneous payments for all programs and activities as determined under Step 2 with erroneous payments exceeding \$10 million. As described in Step 2, the estimates shall be based on the equivalent of a statistical sample with 90% confidence and 5% precision and the reporting shall be the gross amount of both over and under payments. Agencies shall include the following in their reports to the President and Congress:

- The estimate of the annual amount of erroneous payments (gross over and under payments) made in the program and the methodology used to arrive at that estimate.
- A discussion of the causes of the erroneous payments identified, actions taken to correct those causes, and results of the actions taken to address those causes.
- A discussion of the amount of actual erroneous payments the agency expects to recover and how it will go about recovering them.
- A statement of whether the agency has the information systems and other infrastructure it needs in order to reduce erroneous payments to the levels the agency has targeted.
- 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 Congress to obtain the necessary information systems and infrastructure.
- A description of the steps (including time line) the agency has taken and plans to take to ensure that agency managers (including the agency head) are held accountable for reducing and recovering erroneous payments.
- A description of any statutory or regulatory barriers which may limit the agencies' corrective actions in reducing erroneous payments.
- Provided the agency has estimated a baseline erroneous payment rate for the program, a target for the program's future erroneous payment rate that is lower than the agency's most recent estimated error rate.

Where and when should agencies report the information required by the Act?

Agencies shall include the reporting requirements of this guidance in the Management Discussion and Analysis section of their Performance and Accountability Report for fiscal years ending on or after September 30, 2004. The annual estimate of erroneous payments reported in the Performance and Accountability Report can be based on data from a year other than the fiscal year the Performance and Accountability Report covers. Progress under the requirements of Section 57 of OMB Circular A-11 shall be reported in the FY 2003 Performance and Accountability Reports.

What constitutes an erroneous loan or loan guarantee payment?

Direct loans:

Under a direct loan program, erroneous payments may include loan disbursements based on incomplete, inaccurate, or fraudulent information. These may also include duplicate disbursements or other permitted third-party payments, disbursements in the incorrect amount, or loan funds used for purposes other than those allowed by law or program regulations.

Loan guarantee:

Under a loan guarantee, an erroneous payment may include disbursements to intermediaries for defaults, delinquencies, interest subsidies, other subsidies or other permitted third-party payments that are based on incomplete, inaccurate, or fraudulent information. Improper payments may also include duplicate disbursements, disbursements in the incorrect amount, or any disbursements that support loans not in compliance with law or program regulations.

When will this policy replace the current Section 57 of OMB Circular A-11.

Agencies and programs currently covered by Section 57 of OMB Circular A-11 (list attached) shall continue to estimate and reduce erroneous payments as they have been pursuant to Section 57 of A-11. Progress under the requirements of Section 57 of OMB Circular A-11 should be reported in the FY 2003 Performance and Accountability Reports. Subsequent reporting of erroneous payment remediation activities should follow this guidance, as it will supercede Section 57 of OMB Circular A-11.

How does this guidance affect recovery auditing activities?

This guidance does not affect recovery auditing activities in agencies. However, agencies may use data gathered as part of their recovery auditing activities in determining an erroneous payment rate for its procurement activities as required by this guidance.

Where can agencies go to find more information about estimating and reducing erroneous payments?

The Erroneous and Improper Payments Working Group, composed of members of the Chief Financial Officers Council and the President's Council on Integrity and Efficiency, reviewed the methods various agencies were using to assess the extent of erroneous payments they make. More information on the Erroneous and Improper Payments Work Group's analysis of agency

erroneous payment assessment practices can be found at
<http://www.cfoc.gov/documents/EIP%20Posn.Paper%2011-02.doc>.

The General Accounting Office surveyed public and private sector organizations and issued a report on the practices they employ to measure and prevent erroneous payments. That report, General Accounting Office Report: Strategies to Manage Improper Payments: Learning from Public and Private Sector Organizations (GAO-02-69G), can be found at www.gao.gov/cgi-bin/getrpt?gao-02-69G.

PROGRAMS FOR WHICH ERRONEOUS PAYMENT INFORMATION IS REQUESTED

Erroneous payment information is requested for the following:

Department of Agriculture	Federal Transit—Capital Investment Grants
Food Stamps	Federal Transit—Formula Grants
Commodity Loan Program	
National School Lunch and Breakfast	Department of Veterans Affairs
Women, Infants, and Children	Compensation
	Dependency and Indemnity Compensation
Department of Defense	Pension
Military Retirement	Insurance Programs
Military Health Benefits	
Department of Education	Environmental Protection Agency
Student Financial Assistance	Clean Water State Revolving Funds
Title I	Drinking Water State Revolving Funds
Special Education—Grants to States	
Vocational Rehabilitation Grants to States	National Science Foundation
	Research and Education Grants and
Department of Health and Human Services	Cooperative Agreements
Head Start	Office of Personnel Management
Medicare	Retirement Program (CSRS and FERS)
Medicaid	Federal Employees Health Benefits Program
TANF	(FEHBP)
Foster Care—Title IV-E	Federal Employees' Group Life Insurance
State Children's Insurance Program	(FEGLI)
Child Care and Development Fund	
Department of Housing and Urban Development	Railroad Retirement Board
Low Income Public Housing	Retirement and Survivors Benefits
Section 8 Tenant-Based	Railroad Unemployment Insurance Benefits
Section 8 Project Based	
Community Development Block Grants	Small Business Administration
(Entitlement Grants, States/Small Cities)	(7a) Business Loan Program
	(504) Certified Development Companies
Department of Labor	Disaster Assistance
Unemployment Insurance	Small Business Investment Companies
Federal Employee Compensation Act	
Workforce Investment Act	Social Security Administration
	Old Age and Survivors' Insurance
Department of Treasury	Disability Insurance
Earned Income Tax Credit	Supplemental Security Income Program
Department of Transportation	
Airport Improvement Program	
Highway Planning and Construction	