





EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
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MEMORANDUM FOR THE HEADS OF EXECUTIVE DEPARTMENTS AND AGENCIES

FROM: Danny Werfel 
Controller
Office of Federal Financial Management

Daniel I. Gordon 
Administrator
Office of Federal Procurement Policy

SUBJECT: Increasing Efforts to Recapture Improper Payments by Intensifying and Expanding Payment Recapture Audits

As part of its Accountable Government Initiative, the Administration has moved to cut programs that do not work, streamline how government operates to save money and improve performance, and make government more open and responsive to the needs of the American people. One of the biggest sources of waste and inefficiency is the nearly \$110 billion in improper payments¹ made in Fiscal Year (FY) 2009 to individuals, organizations, and contractors. Whether the errors resulted from inadequate recordkeeping, inaccurate eligibility determinations, inadvertent processing errors, the lack of timely and reliable information to confirm payment accuracy, or fraud, the amount of payment errors is unacceptable and must be addressed aggressively and comprehensively.

As a result, the President has challenged his Administration with an aggressive goal to reduce government-wide improper payments by \$50 billion, and to recapture under existing criteria and authorities at least \$2 billion in actual improper payments, by FY 2012. To meet these goals, the Administration has taken several important steps to intensify and enhance the government's efforts to prevent and recapture improper payments. In November 2009, the President issued Executive Order 13520 on Reducing Improper Payments; on March 10, 2010, the President issued a memorandum on intensifying and expanding payment recapture audits (75 FR 12119); and on June 18, 2010, the President issued a memorandum to enhance payment accuracy by creating a "Do Not Pay" List (75 FR 35953). Most recently, on July 22, 2010, the President signed into law the Improper Payments Elimination and Recovery Act (IPERA, Pub.L. 111-204), which amends the Improper Payments Information Act of 2002, generally repeals the Recovery Auditing Act (RAA, Section 831 of the FY 2002 Defense Authorization Act, Pub.L. 107-107), and significantly increases agency payment recapture efforts — by expanding the types

¹ For this memorandum, the term "improper payments" has the same meaning as the definition in Appendix C to Office of Management and Budget (OMB) Circular A-123.

of payments that can be reviewed and lowering the threshold of annual outlays that requires agencies to conduct payment recapture audit programs.

In accordance with the March 10, 2010 Presidential memorandum, we are issuing instructions for agencies on intensifying and expanding payment recapture audit reviews (See Attachment 1, “Requirements for Finding and Recapturing Improper Payments”) that will serve as interim guidance for the broader program of payment recapture audits established under IPERA. Final guidance on agency payment recapture audit programs, as required by IPERA, will be issued by January 2011. The final guidance will likely address, among other things, instructions on which programs should be reviewed under payment recapture audit programs, what it means to have a cost-effective program, and how recaptured funds should be used. In the meantime, agencies should follow this guidance and existing guidance in OMB Circular A-123, Appendix C.

All agencies are required to submit one payment recapture audit plan that describes their current payment recapture efforts under authorities that pre-date IPERA (if applicable, since IPERA subsumes the prior RAA payment recapture audit requirements) and their planned recapture efforts based on new authorities contained within IPERA. If an agency currently does not have a payment recapture audit program, the agency must submit a timetable and plan for implementing such a program. The action plan should be submitted to OMB and the agency’s Inspector General by January 14, 2011. OMB and the agency’s Inspector General will review the action plan and provide feedback, if any, to the agency.

For agency efforts to recapture payment errors under authorities that pre-date IPERA (e.g., contract payment reviews at agencies with more than \$500 million in annual contract outlays in accordance with the RAA and the Medicare Fee-For-Service Recovery Audit Contractors program), this guidance: (1) requires each agency to demonstrate how the agency is prioritizing payment recapture activities to maximize recoveries, and describe how it is leveraging or exploring new processes and/or technologies in its efforts; and (2) identifies agencies that are responsible for establishing agency-specific quarterly and annual payment recapture goals. Attachment 1, “Requirements for Finding and Recapturing Improper Payments,” provides more details on these requirements.

For agency efforts to recapture payment errors under the new authorities provided under IPERA, the following background and set of initial requirements are intended to support immediate action by Federal agencies:

- IPERA lowers the threshold for conducting payment recapture audits² from \$500 million in annual outlays to \$1 million in annual outlays if conducting such audits would be cost effective.³ IPERA also expands the scope of the audits from reviewing just contract payments to all programs and activities (e.g., if a grant, loan, benefit, contract program or another program or activity has more than \$1 million in annual outlays, it should be reviewed to identify improper payments that could be recaptured).

² The term “payment recapture audits” is defined in Attachment 1.

³ For this memorandum, “cost effective” means the benefits or recovered funds are greater than the costs associated with recovering the funds.

- IPERA requires the Director of OMB to develop specific criteria as to when an agency should be required to obtain a separate, annual audit opinion on internal control over improper payments, and criteria for establishing a multiyear cycle for obtaining an audit for internal control over improper payments.
- The Director of OMB has one year to develop the criteria for obtaining opinions on internal control over improper payments. Payment recapture audits are an effective tool to identify improper payments and their root causes. An agency that does not have a robust payment recapture audit program would likely trigger a separate opinion on internal control over improper payments under the forthcoming guidance on internal control over improper payments.
- In accordance with IPERA's expansion of payment recapture audits, all Federal agencies shall review all programs and activities to identify new areas where payment recapture audits can be initiated to strengthen program integrity and accountability over the next one to two years, and which are likely to result in a positive return on investment over the next two to four years.
- For the review required above, all agencies must consult Attachment 1, "Requirements for Finding and Recapturing Improper Payments," as they plan their payment recapture audit expansion, in particular, the discussion on strategies for strengthening current payment recapture audit activities.

Thank you for your ongoing efforts to improve payment accuracy. If you or your staff have any questions about these instructions, please do not hesitate to contact Joseph Pika in the Office of Federal Financial Management (202-395-1040) or Raymond Wong in the Office of Federal Procurement Policy (202-395-6805).

Attachment

Requirements for Finding and Recapturing Improper Payments

While it is imperative that agencies recapture improper payments (especially duplicative payments, overpayments, and payments sent to the incorrect recipient), agencies must also strive to prevent improper payments from occurring in the first place. Agencies should identify the root causes of their improper payments and implement corrective actions that prevent future improper payments.

On March 10, 2010, the President issued a memorandum⁴ directing agencies to use every tool available to identify and reclaim the funds associated with improper payments. In addition, the President ordered agencies to expand the use of “payment recapture audits,” which are a mechanism for detecting and recapturing payment errors.

On July 22, 2010, the Improper Payments Elimination and Recovery Act (IPERA) was enacted, requiring agencies to expand efforts to recapture improper payments by lowering the threshold for conducting recovery audits and expanding their scope to program and activity payments beyond contracts.

Both the Presidential memorandum and IPERA instructed the Office of Management and Budget (OMB) to issue guidance on implementing the new requirements including actions and strategies that executive departments and agencies must take. This document contains instructions for agencies on intensifying and expanding their payment recapture audit programs, and for submitting plans to OMB that describe their payment recapture audit programs. OMB will issue subsequent, final guidance on implementing IPERA to agencies by January 2011.

Plans and Targets for Improving Payment Recapture Efforts:

1) What should be included in the agency payment recapture audit plan that is due on January 14, 2011?

For agencies already conducting a payment recapture program under authorities that pre-date IPERA, the agency payment recapture audit plan must contain:

- A general description of the agency’s existing payment recapture audit program, such as types of program or activity payments reviewed, the quantity and dollar amount of payment reviews, who performed the review and any tools that were used to review the payments, when the payments were made, and a description of the root causes of error giving rise to the agency’s contract improper payments and corrective actions the agency is implementing to address these root causes. This plan should only include information on an actual or planned payment recapture audit program, and should not include information on improper payments identified and recaptured through other activities (such as single audit reviews or other management reviews).

⁴ The March 10, 2010 Presidential memorandum is available at: <http://www.whitehouse.gov/the-press-office/presidential-memorandum-regarding-finding-and-recapturing-improper-payments>.

- A description of whether the payment recapture audit program focuses on types of programs, or moments in the life-cycle of a payment, that are at higher-risk of fraud, waste, and abuse. If the agency payment recapture audit program does not already focus on types of payments or moments in the life-cycle of a payment that are at higher-risk of improper payments, then the agency plan shall include a process and timeline to realign the payment recapture audit program to focus examination on higher-risk areas.
- A description of any guidance that the agency provides for agency staff and payment recapture auditors (agency payment recapture auditors may be public or private sector employees) related to responsibilities and procedures to implement its payment recapture audit program.
- Information on whether the agency payment recapture audit program leverages any existing improper payments sampling measurements or other sources of information on potential waste, fraud, and abuse (such as Government Accountability Office reports or Inspector General reports), to identify and recapture contract payment errors.
- An assessment of the agency's payment recapture audit program's performance and any changes the agency will make to their program to improve the identification and recapture of improper payments. Agencies should evaluate their payment recapture audit program performance based on measures like: amount of payments reviewed and identified as improper; percent of improper payments identified that are actually improper and recovered; timeliness of information provided; quality of information provided on root causes of improper payments; and ability to meet payment recapture audit targets.
- A description of any technology or software that the agency is already using, or is considering using, that will assist in preventing and recapturing improper payments.
- For certain agencies identified by OMB, quarterly and annual targets for payment recapture amounts for FY 2011 and FY 2012, and any analysis the agency completed to support these targets (See Questions 2 and 3 of this attachment for additional information on setting these targets).
- An assessment of legislative authorities that may be needed to restructure programs or provide the necessary authority to recapture overpayments.

If an agency does not currently have a payment recapture audit program (e.g., it is either re-establishing a payment recapture audit program, or establishing one for the first time), it should:

- Submit a timetable and plan for establishing (or re-establishing) such a program, taking into account strategies contained in this memorandum (See Question 6 of this attachment for more information on re-establishing a payment recapture audit program).

All agencies, both those that did and did not have payment recapture programs that predated IPERA, should also include in their payment recapture audit plan:

- A list of all potential program and activity areas that could be reviewed by payment recapture auditors under IPERA's expanded authorities, including newly created and existing programs and activity areas. This list could include program and activity areas like payroll, loan programs, grant programs, or contract outlays that were not previously examined under the RAA. This review must take into account the short-term goal of improving program integrity and accountability in programs and goals (e.g., identify programs and activities where the agency could improve its internal controls and financial management through payment recapture audit programs), and a long-term goal of a payment recapture audit program that generates a positive return-on-investment while minimizing the occurrences of improper payments. Agencies should also identify a timeline for when they will be able to review these new areas to identify improper payments.

2) What types of payments are included in the government-wide target for recapturing improper payments?

The Administration set a goal of recapturing at least \$2 billion in improper payments⁵ (e.g., improper contract overpayments or overpayments to health care providers) by FY 2012. This goal applies to funds subject to existing payment recapture audit programs that were in place prior to IPERA's enactment, such as reviews of contract payments under the RAA and the Medicare Fee-For-Service Recovery Audit Contractor program, and does not include any additional reviews that will be conducted under the expanded IPERA authorities.

3) Which agencies are responsible for establishing payment recapture targets? How should these agencies set agency-specific payment recapture targets?

OMB will review agency efforts to recapture improper payments that were reported in agencies' previous annual Performance and Accountability Reports (PARs) and Agency Financial Reports (AFRs). Based on this annual reporting, OMB will identify the agencies that account for the majority of government-wide improper payments that were recaptured under the RAA and the Medicare Fee-For-Service Recovery Audit Contractor program, and will notify these agencies within two weeks of the issuance of this document that they are responsible for establishing payment recapture targets.

For those agencies notified by OMB that they will need to establish payment recapture targets, the agency must submit proposed quarterly and annual payment recapture targets (i.e., dollar amounts of improper payments to be recaptured) for FY 2011 and FY 2012 that are based on current and previous performance, and that anticipate future performance, as part of their plan that is due on January 14, 2011. Agencies shall set agency-specific targets for recapturing improper payments subject to existing payment recapture audit programs that were in place prior to IPERA's enactment. Agencies shall not include expected recoveries under IPERA's expanded authorities (e.g., the expansion of payment recapture audits to new programs and activities) in these targets. OMB will review and approve the proposed quarterly and annual targets; if it does not believe that the agency-proposed targets are appropriate or aggressive enough, then OMB reserves the right to set agency-specific targets.

⁵ For this goal, improper payments related to overpayments should be measured. Improper payments due to underpayments should not be included.

We believe that agencies can make significant improvements to their payment recapture audit programs to meet aggressive, agency-specific recapture goals. If met, the targets will allow the Federal government to meet our government-wide goal of recapturing at least \$2 billion in improper payments by FY 2012. Following FY 2012, OMB will evaluate the need to re-establish agency payment recapture audit targets.

4) Is an agency that is not notified by OMB as needing to establish payment recapture targets under Question 3 required to establish targets?

No. Agencies that are not notified by OMB that they need to establish payment recapture targets are not required to establish and submit payment recapture targets to OMB as part of the report that is due on January 14, 2011. However, agencies that are not notified by OMB are also encouraged to establish payment recapture targets to help drive performance and may include these voluntary targets in their report.

Payment Recapture Audit Program Requirements:

5) What steps might agencies take for cost-reimbursement contracts, which have traditionally not been covered by payment recapture audit activities for the reasons described in Part II of Appendix C to OMB Circular A-123?

Agencies must already review the adequacy of the contractor's accounting system for determining costs related to cost-reimbursement contracts. This review is required because agencies rely on the contractor's accounting system to determine the validity, assignment, and allocation of costs. Without an adequate contractor system, the government is at an increased risk of making overpayments due to missteps such as misallocation of overhead, mischarging of direct costs, or payment of unallowable costs. Reviews of contractor accounting systems reduce this risk, especially where there have been changes to organizational structure or operational practices, turnover in key personnel, or material weaknesses in internal controls.

The government is also part of the improper payment landscape, and along with the contractor, can also be responsible for improper payments. Agency internal controls over improper payments will be addressed in separate guidance.

6) What should agencies do if they previously determined that conducting annual payment recapture audits is not cost effective?

Prior to IPERA's enactment, Section 831 of the Defense Authorization Act of FY 2002 (Pub.L. 107-107) and Appendix C to OMB Circular A-123 required agencies with more than \$500 million in annual contract outlays to conduct reviews of contract payments to identify improper payments if cost effective.

In order to meet the President's goal to intensify and expand agency efforts to recapture improper payments, agencies that stopped implementing an annual payment recapture audit program because it did not prove to be cost effective under the pre-IPERA authorities, must re-establish a payment recapture audit program considering the expanding IPERA criteria and

authorities, and must submit a timetable and plan for implementing such a program. Agencies shall report the results of the renewed payment recapture audit program in their annual PAR or AFR. If an agency re-established its payment recapture audit program and again determines that it is not cost effective, then it must submit its analysis and justification for OMB's review and approval. Agencies that previously determined that conducting a payment recapture audit program review of contracts payments was not cost effective may also submit a description of the agency's previous payment recapture audit program, and the analysis used by the agency to determine that a payment recapture audit program that reviewed contract payments was not cost effective. OMB may review these materials and determine that the agency may use these materials in lieu of re-establishing its payment recapture audit program to review contract payments, or that the agency needs to re-establish a payment recapture audit program to review contract payments.

Public Reporting:

7) What information on recaptured improper payments should be reported to the public?

Agencies must continue to report information on improper contract payments reviewed, identified, and recaptured, pursuant to instructions contained in OMB Circulars A-123 and A-136. In addition, agencies shall report information on other types of recaptured improper contract payments. For instance, where applicable, agencies shall also identify and report information on improper contract payments recovered – if not already included in the annual reporting - such as:

- Improper contract payments voluntarily returned to agencies by contractors prior to agency or payment recapture auditor identification;
- Improper contract payments identified by the vendors, contractors, or agency staff, and used to provide offsets in future payments rather than returned to agencies;
- Improper contract payments identified and returned through agency Office of Inspector General efforts such as audits, reviews, or tips from the public ;
- Improper contract payments identified and recovered through management post-payment reviews besides payment recapture audits;
- Improper contract payments identified and returned or paid through contract closeout; and
- Payment recapture targets and performance in meeting those targets on an annual and quarterly basis.

Reporting this information is optional for reporting in agencies' FY 2010 PARs or AFRs. However, agencies are required to annually report this information in their PARs or AFRs in FY 2011 and in subsequent years, and to the improper payments website established by the Department of the Treasury under Executive Order 13520.

8) How should agencies report on their performance and targets for recapturing improper payments?

Agencies must report on their progress in meeting their quarterly targets for recapturing improper payments. Agencies shall include their performance in recapturing improper payments in their quarterly high-dollar overpayment reports that are required under Executive Order 13520, and this information may be displayed on PaymentAccuracy.Gov (the improper payments website established under Executive Order 13520).

General Questions:

9) What is a “payment recapture audit”?

A “payment recapture audit” has the same meaning as the term “recovery audit” as defined in Appendix C to OMB Circular A-123. In that guidance, a recovery audit is defined as: *“...a review and analysis of the agency's books, supporting documents, and other available information supporting its payments that is specifically designed to identify overpayments ... that are due to payment errors. It is not an audit in the traditional sense. Rather, it is a control activity designed to assure the integrity of ... payments, and, as such, is a management function and responsibility.”*

In addition, effective payment recapture audits are investigations in which specialized auditors (oftentimes private sector auditors) use cutting-edge technology and tools to scrutinize government payments and then find and reclaim taxpayer funds made in error or gained through fraud. Private sector auditors that conduct payment recapture audits are compensated based on the amount of improper payments they identify that are then reclaimed (i.e., they are paid on a contingency basis on the amounts actually recovered), and are incentivized to find and recapture overpayment errors. However, as stated in Appendix C to OMB Circular A-123, agencies may also utilize Federal personnel to conduct their payment recapture audits.

10) What laws require agencies to conduct payment recapture audits? When should agencies conduct payment recapture audits?

Prior to IPERA’s enactment, the Recovery Auditing Act (Section 831 of the Defense Authorization Act of FY 2002, Pub.L. 107-107) and Appendix C to Office of Management and Budget Circular A-123, required agencies with more than \$500 million in annual contract outlays to carry out a cost effective program for identifying improper contract payments. Agencies with less than \$500 million in annual contract outlays were also encouraged to conduct payment recapture audits, but were not required to do so. With IPERA’s enactment, the scope and authorities for conducting payment recapture audits has been greatly expanded. Under IPERA, the threshold for conducting payment recapture reviews is lowered to \$1 million in annual outlays, and the authorities expanded to all types of payments (including contracts, grants, loans, benefits, etc.) when the agency makes more than \$1 million in such annual outlays.

In addition, other laws also require some agencies to conduct payment recapture audits of certain payments or programs. For instance, under Section 302 of Division B of the Tax Relief

and Health Care Act (Section 1893 of the Social Security Act; 42 U.S.C. 1395ddd) and Section 6411 of the Patient Protection and Affordable Care Act (Pub.L. 111-148), the Department of Health and Human Services is required to conduct reviews of certain Medicare program payments to identify and recover improper payments, and States are required to conduct similar reviews under Medicaid. Similarly, under the authority of 31 U.S.C. 3726, the General Services Administration audits agency transportation payments for improper payments.

11) Which agencies are subject to the requirements of the Presidential memorandum of March 10, 2010, on finding and recapturing improper payments?

The Presidential memorandum applies to “executive departments and agencies.”

12) What is the relationship between this guidance to agencies and existing guidance in Appendix C to Office of Management and Budget Circular A-123?

IPERA amends the Improper Payments Information Act of 2002, generally repeals the Recovery Auditing Act and significantly increases agency payment recapture efforts—by expanding the types of payments that can be reviewed and lowering the threshold of annual outlays that requires agencies to conduct payment recapture audit programs. Agencies should follow this guidance, and the existing guidance in Appendix C to OMB Circular A-123, when implementing their payment recapture audit programs. In addition, OMB will release implementing guidance for IPERA in January 2011 that will update Appendix C to OMB Circular A-123.