















Audit Report



OIG-13-034

The Department of the Treasury Was Not in Compliance With the Improper Payments Elimination and Recovery Act for Fiscal Year 2012

March 15, 2013

Office of Inspector General

Department of the Treasury

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Abbreviations

AFR	Agency Financial Report
DO	Departmental Offices
EITC	Earned Income Tax Credit
FY	Fiscal Year
IPERA	Improper Payments Elimination and Recovery Act of 2010
IPIA	Improper Payments Information Act of 2002
IRS	Internal Revenue Service
OIG	Office of Inspector General
OMB	Office of Management and Budget
PAR	Performance and Accountability Report
RCG	Risk and Control Group
TIGTA	Treasury Inspector General for Tax Administration

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OIG

Audit Report

The Department of the Treasury Office of Inspector General

March 15, 2013

Nani A. Coloretti Assistant Secretary for Management

This report presents the results of our audit of the Department of the Treasury's (Treasury) compliance with Public Law 111-204, Improper Payments Elimination and Recovery Act of 2010 (IPERA). IPERA was enacted to help Federal agencies strengthen the framework for reducing and reporting improper payments. IPERA amended the Improper Payments Information Act of 2002 (IPIA) and expanded requirements for improper payment reporting and recovering overpayments across a broad range of federal programs.

This mandated audit requires that we assess and report on Treasury's compliance with improper payment requirements. The objectives, scope, and methodology of our audit are described in appendix 1.

This report incorporates the results of the Treasury Inspector General for Tax Administration's (TIGTA) assessment of the Internal Revenue Service's (IRS) compliance with IPERA. TIGTA issued its report on February 25, 2013. That report is included as appendix 2 of this report. The results of our audit, insofar as they relate to IRS, are based solely on TIGTA's report.

Results in Brief

Treasury was not in compliance with IPERA for Fiscal Year (FY) 2012 due to IRS's Earned Income Tax Credit (EITC) improper payments reporting deficiencies reported by TIGTA. Specifically, IRS did not publish annual EITC improper payment reduction targets and has not reported an improper payment rate of less than 10 percent. This is the second consecutive year we have determined that Treasury is not in compliance with IPERA due to IRS's EITC improper payments reporting deficiencies.

In accordance with IPERA, since we have determined that Treasury was not in compliance for 2 consecutive fiscal years for the same program, the Director of the Office of Management and Budget (OMB) will review the EITC program and determine if additional funding will help Treasury come into compliance. If the Director of OMB determines that additional funding will help Treasury come into compliance, Treasury will need to obligate additional funding to intensified compliance efforts.

Our audit also identified the need for Treasury to improve its IPERA reporting. Specifically, Treasury's corrective action plan to become compliant with IPERA did not address IRS's EITC improper payments reporting deficiencies and we noted errors and omissions in Treasury's payment recapture audit reporting.

TIGTA also reported that (1) Information provided to Treasury was incomplete in that information related to certain compliance activities was omitted from reporting in Treasury's FY 2012 Agency Financial Report (AFR) and IRS's estimated EITC improper payment rate did not include an estimate of EITC underpayments, and (2) IRS faces significant challenges to becoming compliant with IPERA related to the process of assessing improper payment risk for IRS revenue program funds and the characteristics of the EITC program.

We are making three recommendations in this report to address our findings. In its written response to this report, which is included as appendix 3, Treasury agreed with our recommendations and provided a description of its planned corrective actions.

Background

The Improper Payments Elimination and Recovery Act of 2010

IPERA amended IPIA by strengthening agency reporting requirements. It also requires increased agency efforts by expanding the types of payments that should be reviewed and lowering the threshold of annual outlays that requires agencies to conduct payment recapture audit programs. On April 14, 2011, OMB issued Revised Parts I and II to Appendix C, "Requirements for Effective Measurement and Remediation of Improper Payments," of OMB Circular No. A-123, Management's Responsibility for Internal Control, on the implementation of IPERA (OMB Circular No. A-123, Appendix C). This guidance provided federal agencies with the required steps to follow in (1) identifying and reporting on improper payments and (2) performing and reporting on payment recapture audits.

To determine compliance with IPERA and OMB guidance, we are required to review the AFR and any accompanying information to assess whether Treasury has:

- Published an AFR for the most recent fiscal year and posted that report and any accompanying materials required by OMB on Treasury's website;
- Conducted a program specific risk assessment for each program or activity that conforms with 31 U.S.C. §3321, if required;
- Published improper payment estimates for all programs and activities identified as susceptible to significant improper payments under its risk assessment, if required;
- Published programmatic corrective action plans in the AFR, if required;
- Published, and has met, annual reduction targets for each program assessed to be at risk and measured for improper payments;
- Reported a gross improper payment rate of less than 10 percent for each program and activity for which an improper payment estimate was obtained and published in the AFR; and
- Reported information on its efforts to recapture improper payments.

If an agency does not meet one or more of these requirements, then it is not compliant with IPERA.

Improper Payment Risk Assessment

Treasury's Risk and Control Group (RCG), under the Deputy Chief Financial Officer, issued *Treasury-Wide Guidance for the FY 2012*

Implementation of Circular A-123, Appendix C, Requirement for the Effective Measurement and Remediation of Improper Payments (Treasury's IPERA Guidance) to all Treasury bureaus and Departmental Offices (DO) subcomponents (hereafter we refer to bureaus and DO subcomponents collectively as "components"). RCG identified the programs for which components were required to assess the risk of improper payment. Treasury components used the Improper Payments Elimination and Recovery Risk Assessment Questionnaire for FY 2012 developed by RCG to assess the level of risk for each program identified. Each component was to provide the results and documentation for all risk assessments to RCG. For any program identified as having a high risk for improper payment, the responsible component was also required to provide the following information for inclusion in the AFR:

- The rate and amount of improper payment;
- The root causes of improper payments;
- Actions taken to address the root causes;
- Annual improper payment reduction targets; and
- A discussion of any limitations to the component's ability to reduce improper payments.

For FY 2012, Treasury identified the EITC, administered by IRS, as its only high risk program. Treasury provided ongoing and planned corrective actions to reduce the EITC's improper payment rate in its FY 2012 AFR.

Payment Recapture Audits

IPERA requires agencies to conduct payment recapture audits (also known as recovery audits) for each program and activity that expends \$1 million or more annually, if conducting such audits would be cost-effective. A payment recapture audit is a review and analysis of an agency's or program's accounting and financial records, supporting documentation, and other pertinent information supporting its payments, that is specifically designed to identify overpayments. Agencies are required to have a cost-effective program of internal control to prevent, detect, and recover overpayments. Treasury's IPERA Guidance required each component to complete a worksheet providing a consistent reporting format that includes information on the component's payment recapture audits. The worksheets were to be submitted to RCG for review and the results were then consolidated and reported in the AFR.

Findings and Recommendations

Finding 1 Treasury's Corrective Action Plan to Become Compliant with IPERA Was Not Complete

In our FY 2011 audit of Treasury's compliance with IPERA, we concluded that Treasury was not in compliance with IPERA due to IRS's EITC improper payments reporting deficiencies reported by TIGTA. In accordance with OMB Circular No. A-123, Appendix C, Treasury was to submit, within 90 days of the determination of non-compliance, a plan to Congress describing the actions that it will take to come into compliance with IPERA.

The plan was to include:

- Measurable milestones to be accomplished in order to achieve compliance for each program or activity;
- The designation of a senior agency official who shall be accountable for the progress of the agency in coming into compliance for each program or activity; and
- The establishment of an accountability mechanism, such as a performance agreement, with appropriate incentives and consequences tied to the success of the senior agency official in leading agency efforts to achieve compliance for each program and activity.

On June 11, 2012, Treasury submitted its plan to Congress; however, the plan did not address the non-compliance with IPERA due to IRS's EITC improper payments reporting deficiencies. The plan only addressed the findings and recommendations regarding reporting on payment recapture audits.

According to Treasury officials, its plan to Congress did not address IRS's EITC improper payments reporting deficiencies because Treasury believed that by reporting on it in its AFR submission, the OMB Circular No. A-123, Appendix C requirement was satisfied. We discussed Treasury's position with OMB staff and were told that Treasury's reporting in its AFR did not satisfy the IPERA reporting requirement.

Recommendation

We recommend that the Assistant Secretary for Management ensure that Treasury submits a comprehensive plan to Congress that includes a description of the corrective actions Treasury will take to remediate non-compliance with IPERA due to IRS's EITC improper payments reporting deficiencies.

Management Response

Treasury stated that it is working with OMB to require EITC annual improper payment estimate updates instead of reduction targets. IRS also plans to work with OMB to develop supplemental measures for EITC that gauge the impact of compliance and outreach efforts in lieu of developing error reduction targets. According to Treasury, IRS currently has corrective actions in place to reduce the improper payment rate, but there are numerous barriers, including authentication errors, verification errors, the complexity of the tax law, and the structure of the EITC. These actions will help ensure that Treasury submits a comprehensive plan to Congress.

OIG Comment

Treasury's commitment to submit a comprehensive plan to Congress generally meets the intent of our recommendation. It must be kept in mind that the contemplated change to report EITC annual improper payment estimate updates instead of reduction targets is a deviation from IPERA. TIGTA's report, included as appendix 2, provides additional context as to the challenges faced by IRS to becoming compliant with IPERA.

Finding 2 Payment Recapture Audit Reporting Needs Improvement

During our review of Treasury's payment recapture audit reporting in the AFR, we identified the following:

- Payment Recapture Audit Reporting table The improper payments amount recovered in FY 2012 was understated. The calculation of the improper payments amount recovered in FY 2012 did not include the recapture of improper payments before a receivable was set up for 7 of the 14 sampled components tested, totaling \$111,000.
- Disposition of Recaptured Funds table The table did not include the disposition of all funds recaptured in FY 2012. Five (5) of the 14 sampled components tested did not report the disposition of \$220,000 in unexpired recaptured funds when reporting data to RCG.
- Treasury did not report Treasury Managed Accounts administered by FMS as an activity it had determined would not be cost-effective to conduct a payment recapture audit program nor did it provide the related justification and analysis supporting this decision.

OMB Circular No. A-123, Appendix C, requires that agencies report annually on their payment recapture audit program in their Performance and Accountability Report (PAR)/AFR. This reporting is to include improper payment amounts recovered in the current year as well as a summary of how recaptured funds were disposed of.

OMB Circular No. A-123, Appendix C, states "the agency shall report in its annual PAR or AFR: (1) a list of programs and activities where it has determined conducting a payment recapture audit program would not be cost-effective; and (2) a description of the justifications and analysis that it used to determine that conducting a payment recapture audit program for these programs and activities was not cost-effective."

The payment recapture audit reporting deficiencies identified above resulted from the misinterpretation or misunderstanding of reporting requirements by Treasury and its components. As a result, the FY 2012 improper payments amounts recovered, disposition of recaptured funds, and programs for which Treasury determined were not cost-effective to perform a payment recapture audit were not reported completely and accurately in accordance with OMB guidance.

Recommendations

We recommend that the Assistant Secretary for Management:

- Ensure that the current year total amounts of improper payments recovered and dispositions of recaptured funds are accurately reported in the PAR/AFR in accordance with OMB requirements.
- 2. Ensure that Treasury reports in its PAR/AFR, all programs and activities where it has determined conducting a payment recapture audit program would not be costeffective and a description of the justification and analysis supporting the decision.

Management Response

Treasury stated that it plans to enhance its annual IPERA guidance and oversight activities to ensure that required improper payments information is completely and accurately aggregated and reported in the PAR/AFR.

OIG Comment

Treasury's planned actions satisfy the intent of the recommendations.

* * * * * *

We appreciate the courtesies and cooperation extended to our staff during this audit. Should you have any questions, you may contact me at (202) 927-5400, or Mike Fitzgerald, Director, Financial Audit at (202) 927-5789. Major contributors to this report are listed in appendix 4.

/s/ Marla A. Freedman Assistant Inspector General for Audit The objective of our audit was to determine Treasury's compliance with IPERA; OMB Circular No. A-123, Appendix C; and OMB Circular No. A-136, Financial Reporting Requirements. Our scope did not include the review of programs and activities administered by IRS. TIGTA is responsible for the audit of IRS's compliance with IPERA. TIGTA's scope was limited to an assessment of EITC information that IRS provided for inclusion in Treasury's AFR. EITC was the only program identified by the IRS for improper payment reporting.

To accomplish our objective, we reviewed applicable laws, OMB guidance, and Treasury-wide guidance related to IPERA; interviewed key DO and component personnel; and performed testing of Treasury's risk assessment and payment recapture audits. We reviewed the AFR to determine if Treasury complied with the reporting requirements of IPERA. We conducted our fieldwork in Washington, DC, from August 2012 to February 2013.

To review Treasury's risk assessment process, we randomly selected a sample of 27 of the 66 non-IRS programs identified by Treasury for risk assessment. To determine the reasonableness and accuracy of the information reported and compliance with the applicable guidance for the sample, we reviewed the program risk assessments and conducted interviews of personnel involved in their preparation and review.

To review the payment recapture audit program, we randomly selected a sample of 14 of the 20 non-IRS components. To determine the reasonableness and accuracy of the information reported, and compliance with the applicable guidance for the sample, we reviewed the components' submissions and conducted interviews with component personnel, as well as reviewed supporting documentation.

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.





The Internal Revenue Service Was Not in Compliance With All Requirements of the Improper Payments Elimination and Recovery Act for Fiscal Year 2012

February 25, 2013

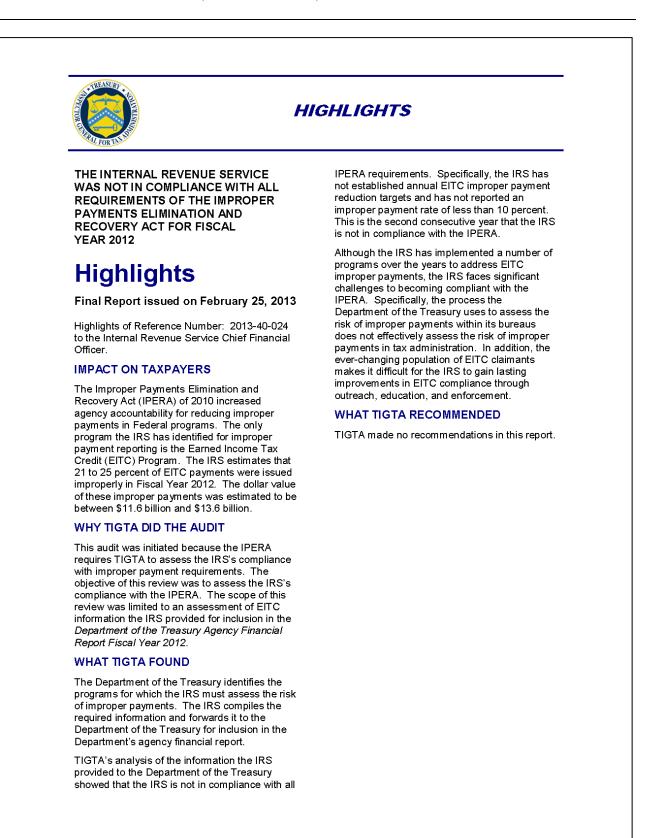
Reference Number: 2013-40-024

This report remains the property of the Treasury Inspector General for Tax Administration (TIGTA) and may not be disseminated beyond the Internal Revenue Service without the permission of the TIGTA. This report may contain confidential return information protected from disclosure pursuant to I.R.C. § 6103(a). Such information may be disclosed only to Department of the Treasury employees who have a need to know this information in connection with their official tax administration duties.

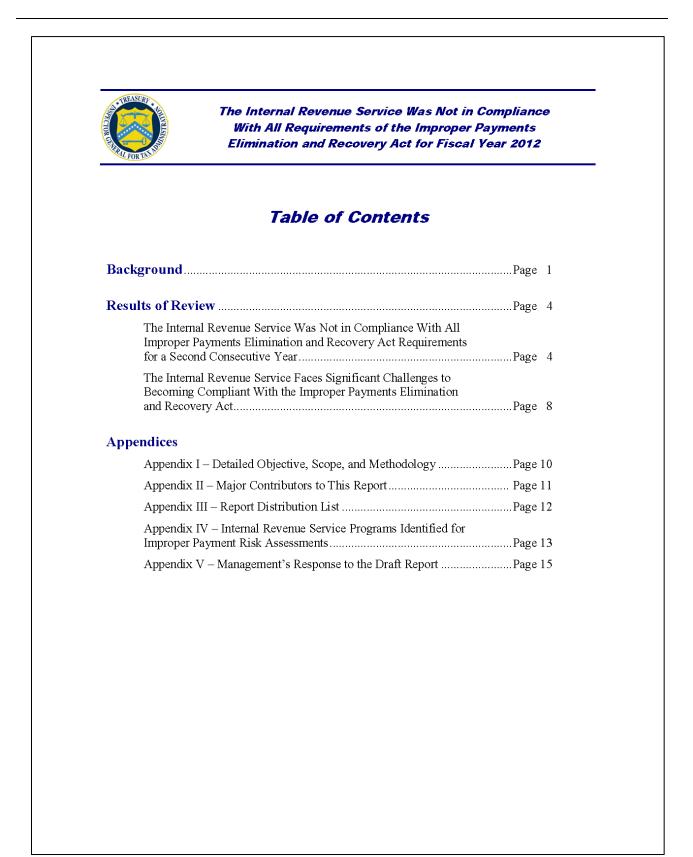
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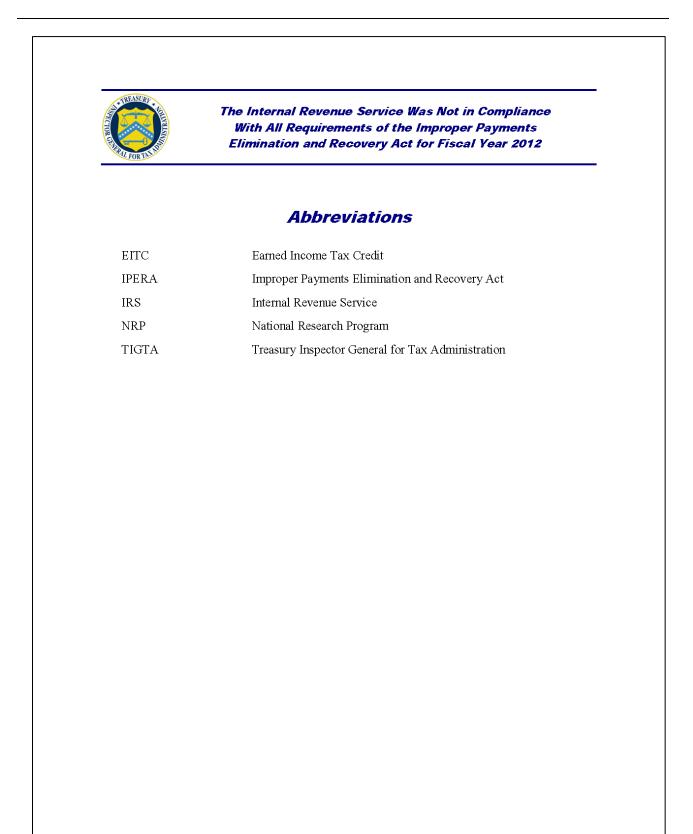
 E-mail Address
 / <u>TIGTACommunications@tigta.treas.gov</u>

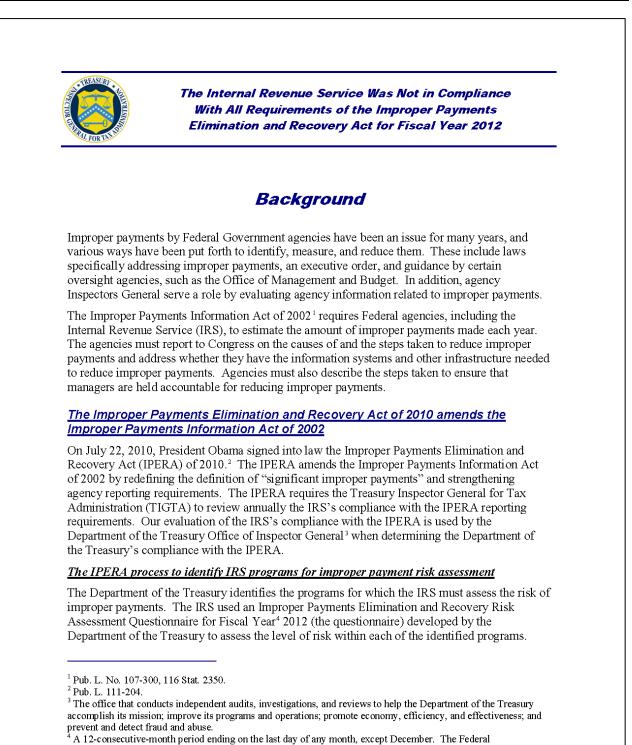
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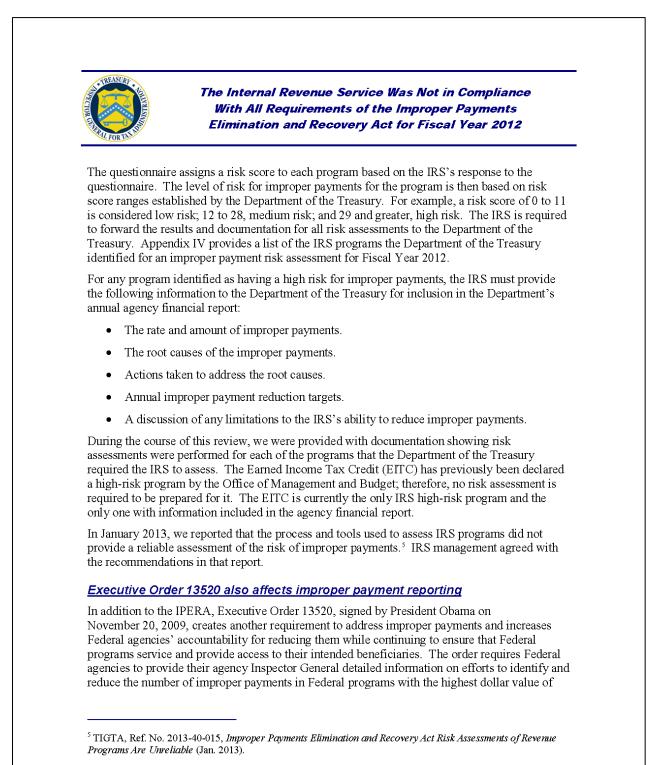
REASURY INSPECTOR GENER FOR TAX ADMINISTRATION	DEPARTMENT OF THE TREASURY WASHINGTON, D.C. 20220
	February 25, 2013
MEMORANDUM	FOR CHIEF FINANCIAL OFFICER
FROM:	Michael E. McKenney Acting Deputy Inspector General for Audit
SUBJECT:	Final Audit Report – The Internal Revenue Service Was Not in Compliance With All Requirements of the Improper Payments Elimination and Recovery Act for Fiscal Year 2012 (Audit # 201240045)
compliance with the IPERA requires the IRS's compliance	s the results of our review to assess the Internal Revenue Service's (IRS) the Improper Payments Elimination and Recovery Act (IPERA) of 2010. ¹ The te Treasury Inspector General for Tax Administration to review annually the with the IPERA reporting requirements. This audit is included in our Fiscal Audit Plan and addresses the major management challenge of Fraudulent ber Payments.
Management's cor	nplete response to the draft report is included as Appendix V.
you have any ques	rt are also being sent to the IRS managers affected by the report findings. If tions, please contact me or Augusta R. Cook, Acting Assistant Inspector (Returns Processing and Account Services).
¹ Pub. L. 111-204.	

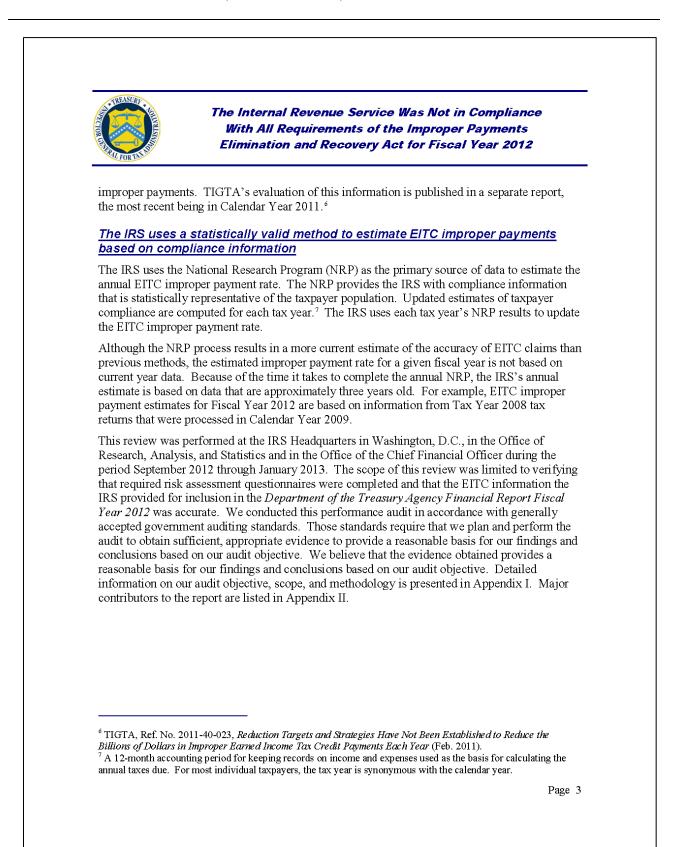


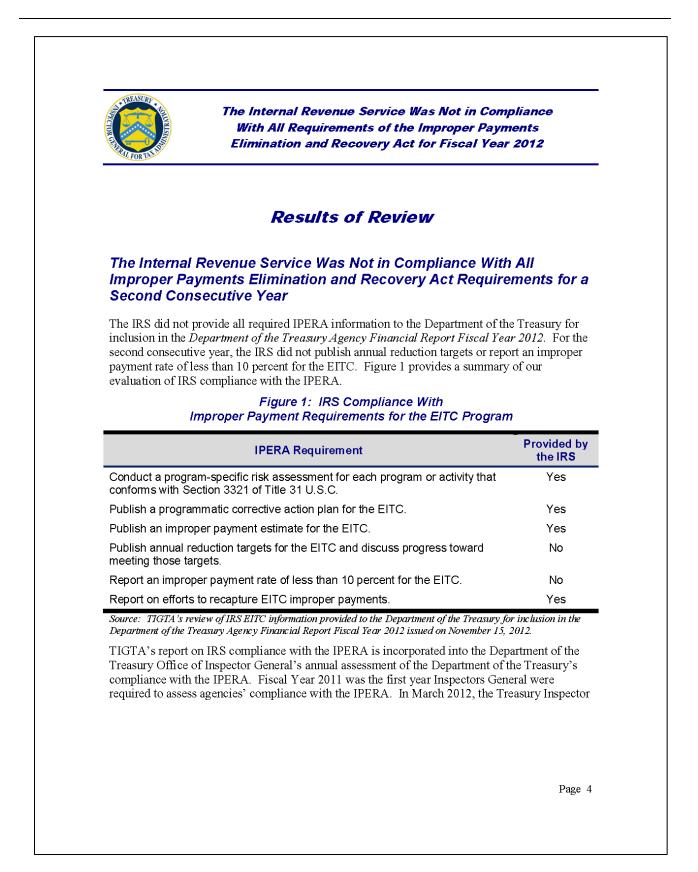


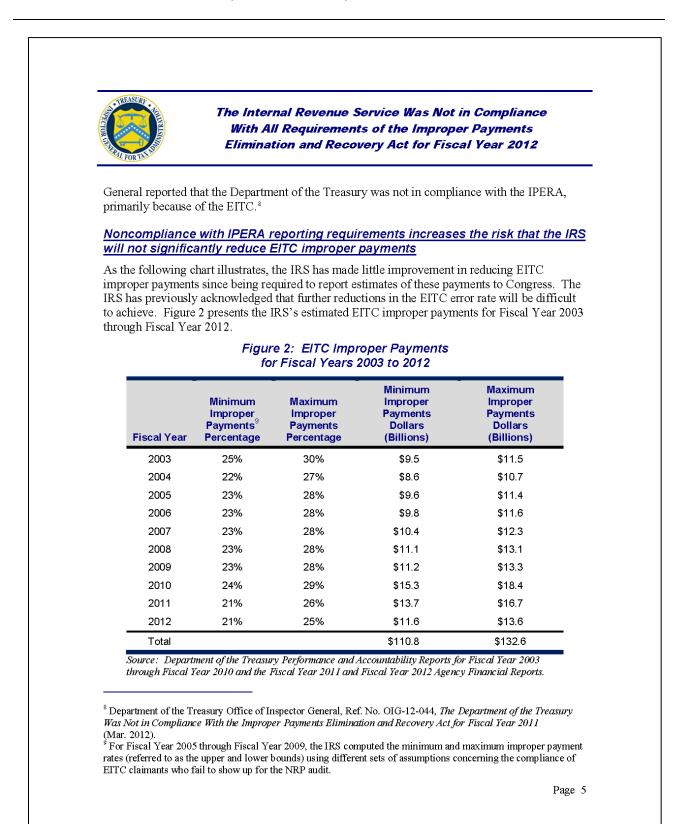


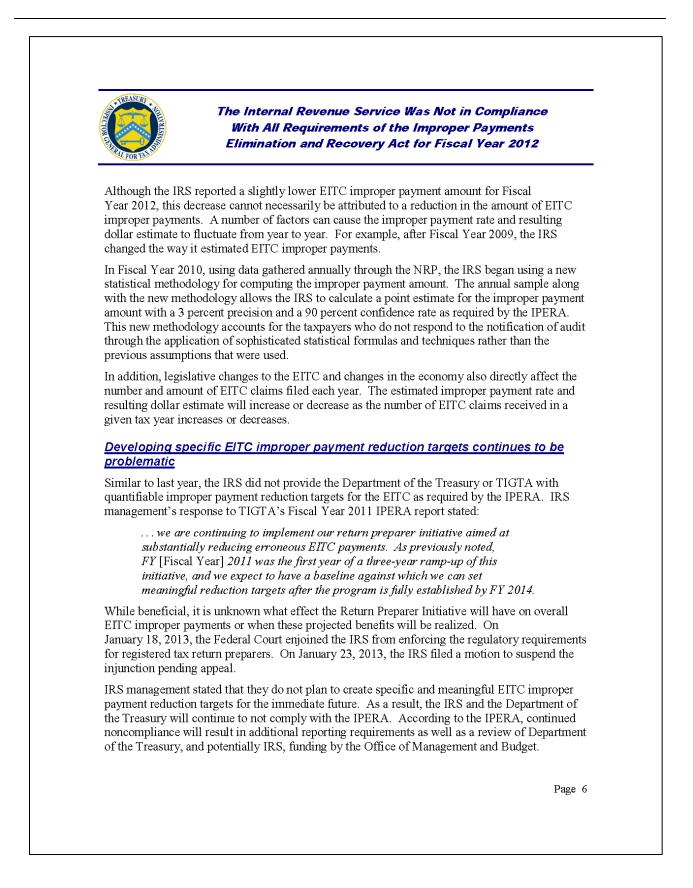
Government's fiscal year begins on October 1 and ends on September 30.

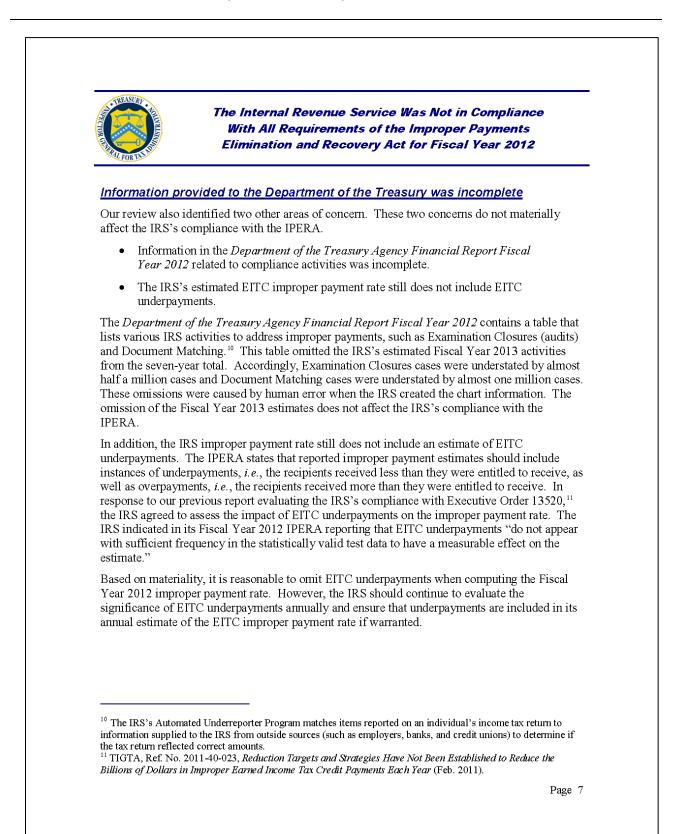


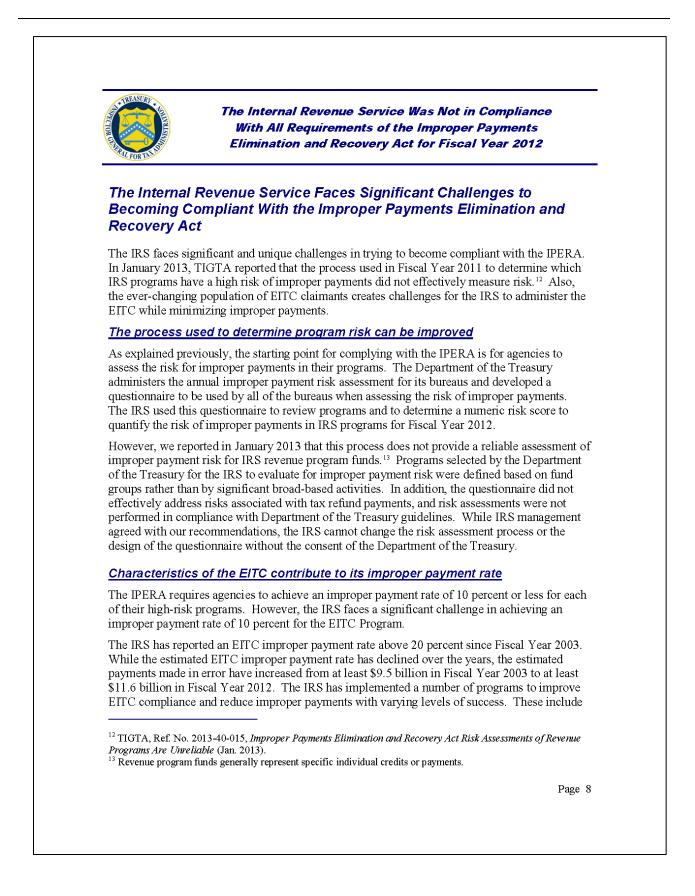


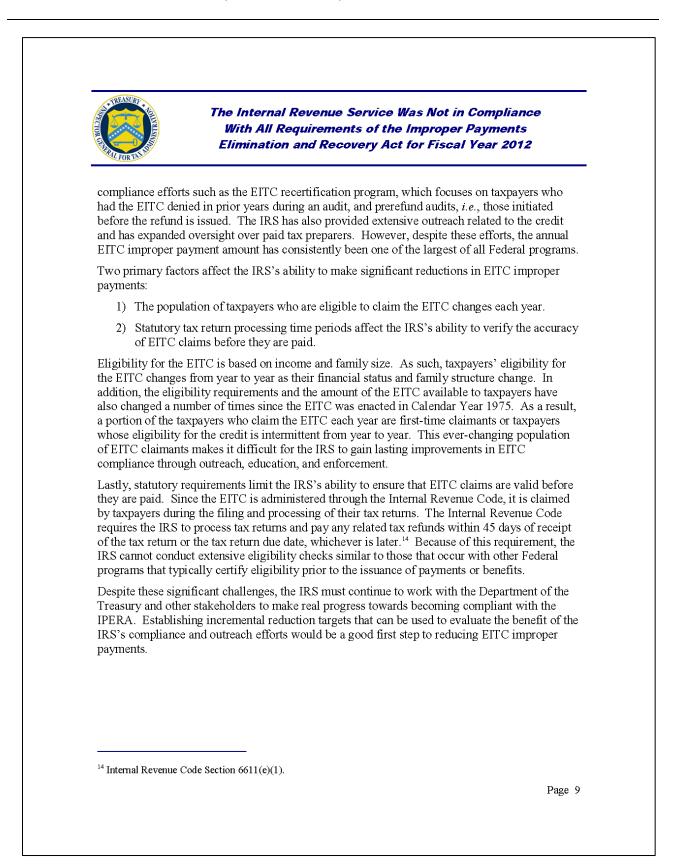


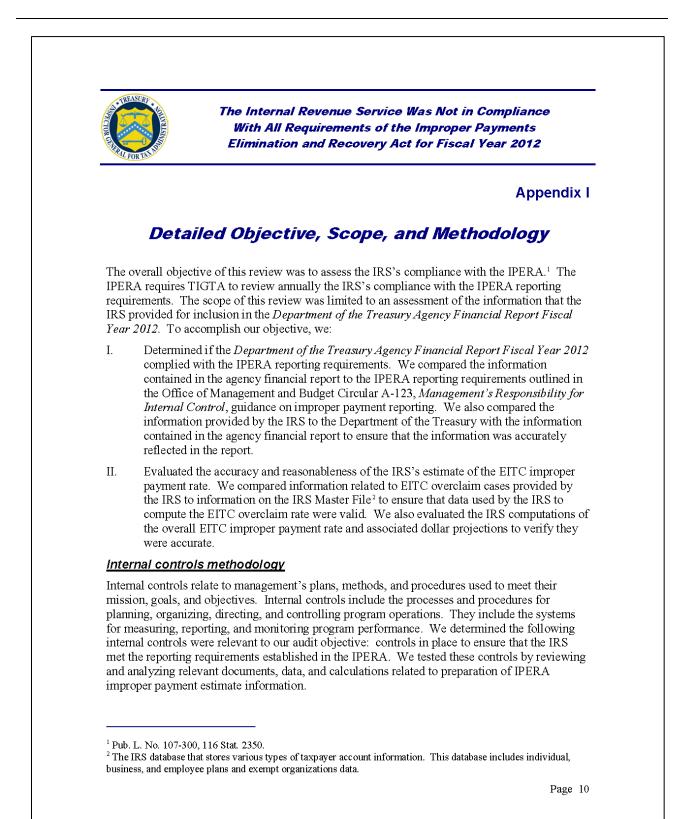


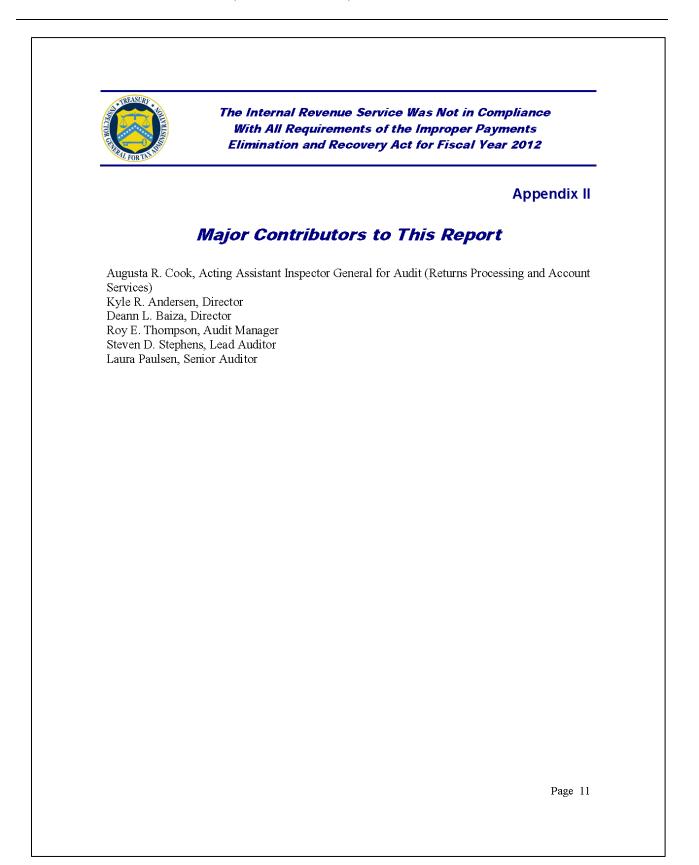


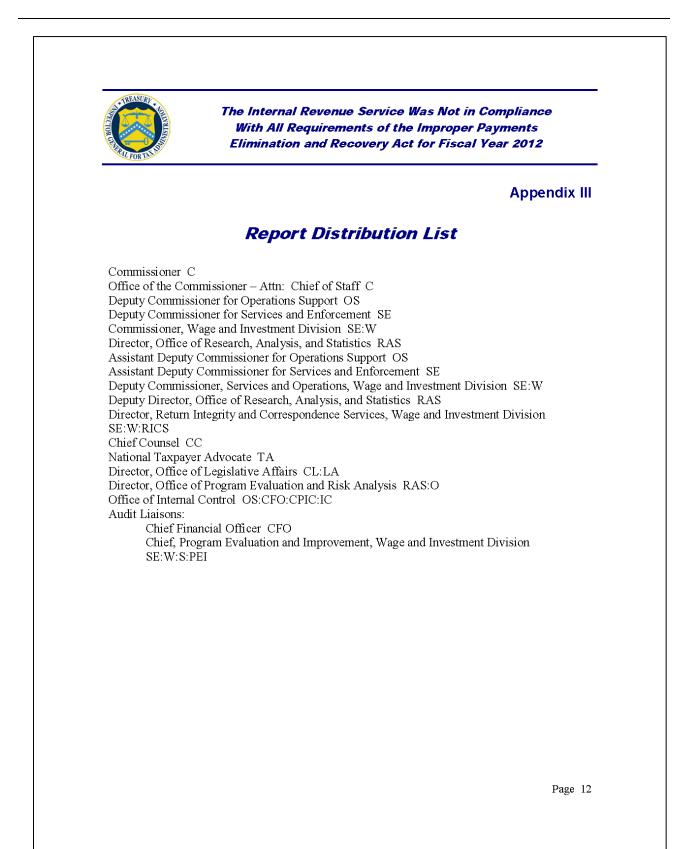


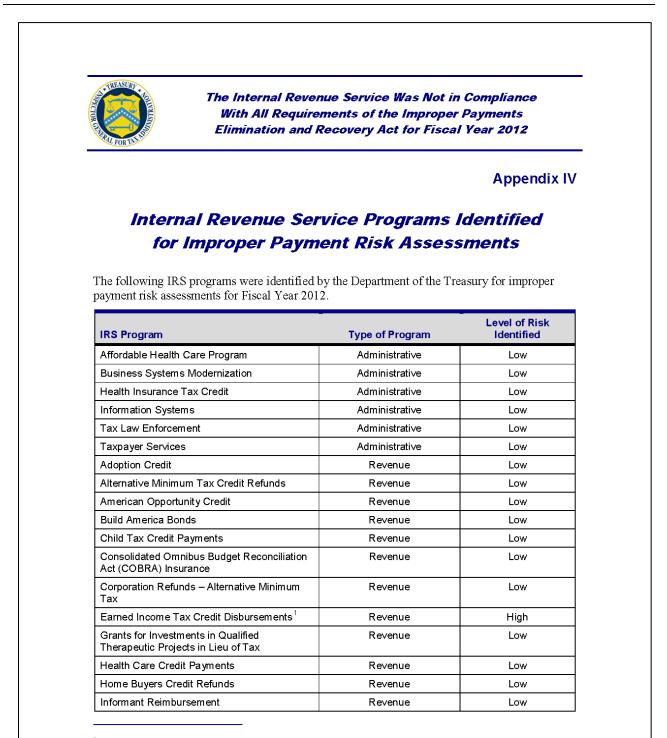




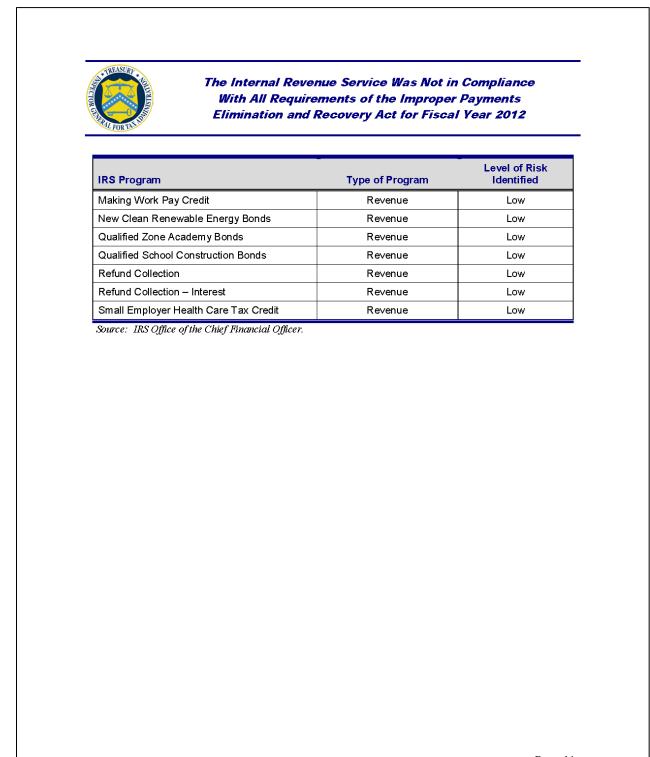


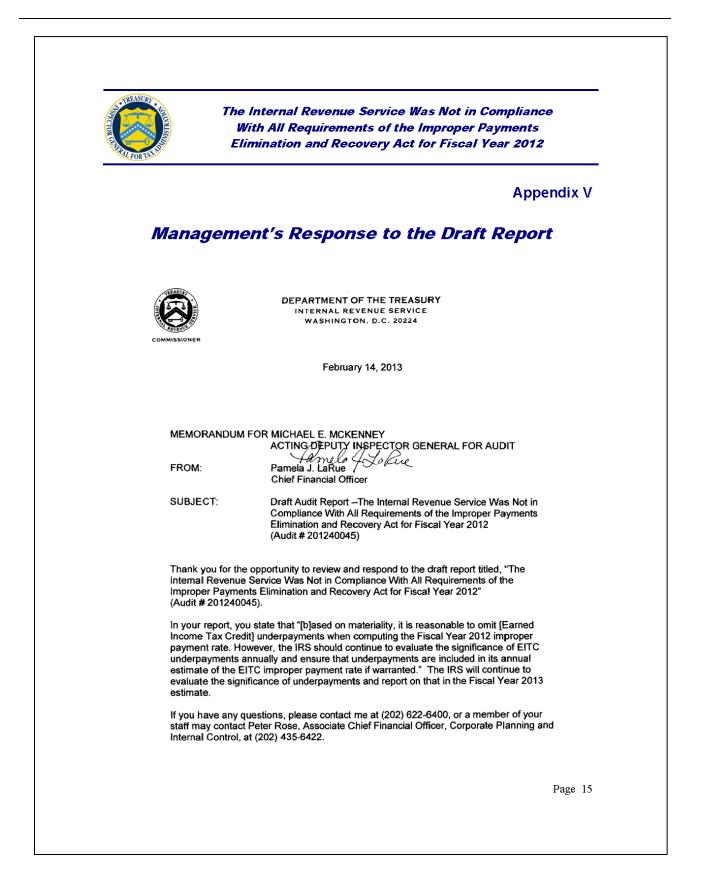






¹ The EITC Program has been declared a high-risk program for improper payments by the Office of Management and Budget; therefore, no formal risk assessment is required for it.





Appendix 3 Management Response

SISTANT SECRETARY MEMORANDI	DEPARTMENT OF THE TREASURY WASHINGTON MAR 1 4 2013 JM FOR MARLA A. FREEMAN
FROM:	ASSISTANT INSPECTOR GENERAL FOR AUDIT Nani A. Coloretti
	Assistant Secretary for Management Dorrice Roth Corrice Roth Deputy Chief Financial Officer
SUBJECT:	Management Response to Draft Report – The Department of the Treasury Was Not in Compliance With the Improper Payments Elimination and Recovery Act (IPERA) for Fiscal Year (FY) 2012
recognizes the in with the governm	ed the subject draft report and appreciate the opportunity to respond. Treasury apportance of achieving full compliance with IPERA, which includes complying ment-wide implementing guidance issued by the Office of Management and a Memorandum M-11-16, <i>Issuance of Revised Parts I and II to Appendix C of</i>
OMB Circular A Treasury worked recommendation Tax Credit (EITC targets. Addition EITC that are app	-123, and OMB Circular A-136, <i>Financial Reporting Requirements</i> . Last year, diligently to implement the Office of the Inspector General (OIG) FY 2011 s. Currently, Treasury is working with OMB, with respect to the Earned Income C), to require annual improper payment estimate updates instead of reduction ally, the IRS will work with OMB to develop supplemental measures for the propriate for gauging the impact of the compliance and outreach efforts in lieu or reduction targets.
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OMB Circular ATreasury workedrecommendationTax Credit (EITC)targets. AdditionEITC that are appof developing errIRS currently hasnumerous barrierlaw, and the structTreasury will alsothat bureaus and oTreasury will theAttached are ourany questions, plan	-123, and OMB Circular A-136, Financial Reporting Requirements. Last year, diligently to implement the Office of the Inspector General (OIG) FY 2011 s. Currently, Treasury is working with OMB, with respect to the Earned Income C), to require annual improper payment estimate updates instead of reduction ally, the IRS will work with OMB to develop supplemental measures for the propriate for gauging the impact of the compliance and outreach efforts in lieu or reduction targets.

Attachment

Recommendation 1: We recommend that the Deputy Chief Financial Officer ensure that Treasury submits a comprehensive plan to Congress that includes a description of the corrective actions it will take to remediate non-compliance with IPERA due to IRS's EITC improper payments reporting deficiencies.

Corrective Action 1-1: We agree with this recommendation. Treasury is working with OMB, with respect to the EITC, to require annual improper payment estimate updates instead of reduction targets. Additionally, the IRS will work with OMB to develop supplemental measures for the EITC that are appropriate for gauging the impact of the compliance and outreach efforts in lieu of developing error reduction targets.

IRS currently has corrective actions in place to reduce the improper payment rate, but there are numerous barriers, including authentication errors, verification errors, the complexity of the tax law, and the structure of the EITC.

These actions will help ensure that Treasury submits a comprehensive plan to Congress.

Implementation Date: September 30, 2013

Responsible Official: Assistant Secretary for Management

Recommendation 2:

- 1. Ensure that the current year total amounts of improper payments recovered and dispositions of recaptured funds are accurately reported in the PAR/AFR in accordance with OMB requirements.
- Ensure that Treasury reports in its PAR/AFR, all programs and activities where it has determined conducting a payment recapture audit program would not be cost-effective and a description of the justification and analysis supporting the decision.

Corrective Action 2-1: We agree with this recommendation. Treasury will enhance its IPERA implementation guidance to require bureau and office submission of the necessary improper payments information that Treasury will then aggregate and report in the PAR/AFR in accordance with OMB requirements.

Implementation Date: May 31, 2013

Responsible Official: Assistant Secretary for Management

Corrective Action 2-2: We agree with this recommendation. Treasury will enhance its IPERA implementation guidance and oversight to ensure complete and accurate reporting in the PAR/AFR of programs and activities where it has determined that conducting a payment recapture audit program would not be cost-effective, to include a description of the justification and analysis supporting the decision.

Implementation Date: November 15, 2013

Responsible Officer: Assistant Secretary for Management

Appendix 4 Major Contributors To This Report

Joel A. Grover, Deputy Assistant Inspector General for Financial Management and Information Technology Audit Michael Fitzgerald, Director, Financial Audit Catherine Yi, Audit Manager Myung Han, Audit Manager Kenneth Harness, Auditor-in-Charge Rufus Etienne, Senior Auditor Robert Hong, Auditor Colleen McElwee, Referencer Appendix 5 Report Distribution

The Department of the Treasury

Secretary of the Treasury Deputy Secretary of the Treasury Assistant Secretary for Management Deputy Chief Financial Officer Director, Risk and Control Group

Office of Management and Budget

Controller, Office of Federal Financial Management OIG Budget Examiner

United States Senate

Chairman and Ranking Member Committee on Homeland Security and Governmental Affairs

U.S. House of Representative

Chairman and Ranking Member Committee on Oversight and Government Reform

U.S. Government Accountability Office

Comptroller General of the United States