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Office of Inspector General

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AUD-FM-18-40

Office of Audits

May 2018

Audit of Department of State FY 2017 Compliance With Improper Payments Requirements

FINANCIAL MANAGEMENT DIVISION

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OIG HIGHLIGHTS

AUD-FM-18-40

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OFFICE OF AUDITS
Financial Management Division

Audit of Department of State FY 2017 Compliance With Improper Payments Requirements

What Was Found

Kearney found that the Department was in compliance with improper payments requirements for FY 2017, as presented in Table 1.

What Was Audited

In FY 2017, improper Federal payments Government-wide totaled approximately \$141 billion. The Improper Payments Information Act (IPIA), as amended, requires Federal agencies to annually identify programs and activities at high risk of improper payments and estimate the amount of improper payments, among other requirements. In addition, Inspectors General are required to annually determine whether agencies are in compliance with improper payments requirements.

Acting on behalf of and under the direction of the Office of Inspector General (OIG), the independent public accountant Kearney & Company, P.C. (Kearney), conducted this audit to determine whether the Department of State (Department) was in compliance with IPIA, as amended, for FY 2017.

What OIG Recommends

In its May 2017 report *Audit of Department of State FY 2016 Compliance With Improper Payments Requirements* (AUD-FM-17-42), OIG made five recommendations to address the deficiencies identified during the audit. At the conclusion of fieldwork for this audit, one recommendation was closed and four recommendations were resolved pending further action. Because the recommendations have not been fully implemented and the related finding in this report has not significantly changed, OIG is not making new recommendations but will continue to track the Department's implementation of the four remaining recommendations through its audit compliance process. The Department's comments are included in this report as Appendix C.

Table 1: Compliance With Improper Payment Criteria

Improper Payment Criteria	Compliance
Conducted Risk Assessment	Yes
Published Agency Financial Report	Yes
Published Estimate	Not applicable*
Published Corrective Actions	Not applicable*
Published and Met Reduction Targets	Not applicable*
Published Error Rate Less than 10 percent	Not applicable*

* These requirements apply only to agencies that have identified programs susceptible to significant improper payments.

Source: Kearney prepared the table using criteria from Office of Management and Budget Circular A-123, Appendix C.

The Department performed the required program risk assessments in FY 2017. Specifically, the Department evaluated whether each program subject to IPIA had a significant legislative or funding change, identified programs requiring improper payments risk assessments, and performed risk assessments using required criteria (that is, risk factors) defined by Office of Management and Budget (OMB) Circular A-123 for all programs requiring evaluation. Furthermore, the Department also lowered its threshold for programs requiring evaluation from \$100 million to \$10 million, identified programs that fell above the new threshold that were not evaluated in FY 2016, and performed risk assessments using the criteria required by OMB.

In addition, the Department published its FY 2017 Agency Financial Report (AFR) on its website and the AFR included all the required improper payment disclosures. Although the Department included the required disclosures, some optional improper payment information identified outside of the payment recapture process was not included in the AFR. As previously recommended, because much of this information is available and would be beneficial to the users of the AFR, it should be included in the AFR and disclosed, even though it is not required.

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Audit of the Department of State FY 2017 Compliance With Improper Payments Requirements

Office of Inspector General
U.S. Department of State
Washington, D.C.

Kearney & Company, P.C. (Kearney), has performed an audit of the Department of State FY 2017 compliance with improper payments requirements. This performance audit, performed under Contract No. SAQMMA14A0050, was designed to meet the objective identified in the report section titled "Objectives" and further defined in Appendix A, "Purpose, Scope, and Methodology," of the report.

Kearney conducted this performance audit from January 2018 through April 2018 in accordance with *Government Auditing Standards*, 2011 Revision, issued by the Comptroller General of the United States. Those standards require that Kearney plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for the findings and conclusions based on the audit objectives. Kearney believes that the evidence obtained provides a reasonable basis for the findings and conclusions based on the audit objectives. The purpose of this report is to communicate the results of Kearney's performance audit and its related findings and recommendations.

Kearney appreciates the cooperation provided by personnel in Department of State offices during the audit.

A handwritten signature in blue ink that reads "Kearney & Company". The signature is written in a cursive, flowing style.

Kearney & Company, P.C.
Alexandria, Virginia
April 30, 2018

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OBJECTIVE

The objective of this audit was to determine whether the Department of State (Department) was in compliance with the Improper Payments Information Act of 2002¹ (IPIA), as amended, for FY 2017. To accomplish this objective, the independent public accountant Kearney & Company, P.C. (Kearney), acting on the Office of Inspector General's (OIG) behalf, evaluated whether the Department conducted a program-specific risk assessment for all programs covered by Office of Management and Budget (OMB) requirements and reviewed the Department's FY 2017 Agency Financial Report (AFR) to determine whether the Department complied with improper payments reporting requirements.

BACKGROUND

According to the Department of the Treasury, improper Federal payments Government-wide totaled approximately \$141 billion in FY 2017.² Improper payments are payments that should not have been made or that were made in an incorrect amount. Improper payments include overpayments and underpayments, duplicate payments, payments made to an ineligible recipient, payments for an ineligible good or service, payments for goods or services not received (except for such payments authorized by law), payments that do not account for credit for applicable discounts, and payments for which an agency cannot determine whether the payments were proper because of a lack of or insufficient supporting documentation.

The Federal Government has implemented safeguards to reduce improper payments. In 2002, Congress enacted IPIA, which required Federal agencies to annually identify programs and activities³ at high risk of improper payments, estimate the amount of improper payments in those programs, perform recovery auditing if program payments exceeded \$500 million, and report to Congress on steps taken to reduce improper payments.

In July 2010, the Improper Payments Elimination and Recovery Act⁴ (IPERA), which amended IPIA, was signed into law. IPERA strengthened IPIA by increasing requirements for identifying and reporting on improper payments. IPERA clarified the programs to be reviewed and expanded improper payments recapture activities. IPERA also required Inspectors General to annually determine whether agencies were in compliance with improper payments requirements and established additional requirements for agencies that were deemed noncompliant.

¹ Improper Payments Information Act of 2002, Public Law 107-300, §§ 1 and 2, November 26, 2002.

² Department of the Treasury, "Improper Payment Rates Across the Federal Government," April 16, 2018, <https://paymentaccuracy.gov/import/archive-spreadsheets/latest.xlsx>, Tab "All Program Results," Column S.

³ The term "program and activity" is referred to in this report as "program."

⁴ Improper Payments Elimination and Recovery Act of 2010, Public Law 111-204, §§ 2 and 3, July 22, 2010.

In January 2013, the Improper Payments Elimination and Recovery Improvement Act of 2012⁵ (IPERIA) was enacted. IPERIA further amended IPIA by redefining “payment” to include payments that were made to employees and requiring that OMB identify high-priority Federal programs for greater levels of oversight and review,⁶ provide guidance to agencies for improving estimates of improper payments, and establish a working system for prepayment and pre-award review.

In October 2014, OMB issued guidance for agencies implementing IPIA, IPERA, and IPERIA requirements as Appendix C, “Requirements for Effective Estimation and Remediation of Improper Payments,” of OMB Circular A-123, “Management’s Responsibility for Enterprise Risk Management and Internal Control.”⁷ The guidance, among other things, defines the programs and payments that agencies must assess for the risk of improper payments and provides requirements for determining whether the risk of improper payments is significant, developing an estimate of improper payments, performing recapture audit activities, and reporting improper payments activities.

Department of State Payments

The Department is the primary agency through which the U.S. Government conducts its diplomacy. The Department operates more than 270 embassies, consulates, and other posts worldwide. The Department provides policy guidance, program management, administrative support, and in-depth expertise in areas such as law enforcement, economics, the environment, intelligence, arms control, human rights, counternarcotics, counterterrorism, public diplomacy, humanitarian assistance, security, nonproliferation, and consular services.

Because of the nature and the extent of its programs, the Department makes significant payments to third-party vendors, contractors, grantees, and employees. During FY 2017, the Department made payments of approximately \$34.3 billion, of which \$27.3 billion was subject to IPIA⁸ requirements.⁹ The payments subject to IPIA requirements included payments to vendors and contractors; payments to employees; and Federal Financial Assistance payments, including

⁵ Improper Payments Elimination and Recovery Improvement Act of 2012, Public Law 112-248, §§ 1 through 5, January 10, 2013.

⁶ The Department of State does not have any high-priority programs, as identified by OMB.

⁷ OMB Circular A-123 was updated in July 2016; however, Appendix C of Circular A-123 (dated October 2014) remains in effect.

⁸ Unless otherwise indicated, the term “IPIA” implies “IPIA as amended by IPERA and IPERIA” in this report.

⁹ OMB Circular A-123, Appendix C, at 9, states that agencies are not obligated to review intra-Governmental transactions for improper payments unless directed to do so by OMB. Of the \$34.3 billion in Department payments, approximately \$7.0 billion were intra-Governmental and intra-Departmental payments.

grants, assessed contributions,¹⁰ and voluntary contributions.¹¹ The amount and volume of payments made by the Department, the Department's emphasis on expediting certain payments (for example, payments for necessary foreign financial assistance), and the decentralized nature of the Department's operations increase the Department's risk for improper payments.

The Bureau of the Comptroller and Global Financial Services (CGFS) has oversight responsibilities for the Department's financial management program. Financial management program responsibilities include establishing financial policy and procedure, analyzing and reporting financial information, managing financial information systems, and establishing management controls. Management controls, also known as "internal controls," are the processes designed and implemented by an organization to help it accomplish its goals or objectives. Important internal control activities include those aimed at ensuring that only proper payments are made. Within CGFS, the Office of Management Controls (CGFS/MC) is responsible for overseeing the Department's management control program and other financial management functions, such as administering compliance with IPIA.

AUDIT RESULTS

Kearney found that the Department complied with improper payments requirements.¹² The Department conducted risk assessments on programs that experienced a significant change in funding, which was all that was required by IPIA in FY 2017.¹³ The Department performed risk assessments using required criteria defined by OMB Circular A-123 for all programs requiring evaluation. The Department also published its AFR¹⁴ for FY 2017 and posted the AFR on the

¹⁰ Assessed contributions represent assistance provided to foreign countries, international societies, commissions, or proceedings or to projects that are lump sum, quota of expenses or fixed by treaty.

¹¹ Voluntary contributions represent discretionary financial assistance provided to foreign countries, international societies, commissions, proceedings, or projects.

¹² OMB Circular A-123, Appendix C, at 39, identifies six requirements that agencies must meet to be compliant with improper payment requirements: (1) publish an AFR for the most recent fiscal year and post the report and accompanying materials required by OMB to the agency website; (2) conduct a program-specific risk assessment for each program; (3) publish improper payment estimates for all programs identified as susceptible to improper payments, if required; (4) publish programmatic corrective actions plans in the AFR, if required; (5) publish and meet annual reduction targets for each program at risk for improper payments, if required; and (6) report a gross improper payment rate of less than 10 percent for each program for which an improper payment estimate was obtained and published in the AFR. Requirements 3 through 6 apply to agencies that have identified programs susceptible to significant improper payments in the year after a significant risk program has been identified. The Department has not identified any programs susceptible to significant improper payments. Therefore, only requirements 1 and 2 apply to the Department.

¹³ The Department also conducted risk assessments of programs, which had not been previously tested, that met a new lower threshold as recommended by the Government Accountability Office.

¹⁴ Federal agencies may publish their financial statements in either an AFR or a Performance Accountability Report. The Department has elected to use the AFR format.

Department's website. The AFR included the disclosures required by OMB. Although the Department included all required disclosures, some optional improper payment information identified and recovered outside the payment recapture efforts was not included in the AFR. As previously recommended in the FY 2016 IPIA compliance report,¹⁵ because much of this information is readily available and would be beneficial to the users of the AFR, it should be included in the AFR and disclosed, even though it is not required.

Finding A: Required Program Risk Assessments Were Performed

IPIA requires agencies to periodically review all programs and identify those that may be susceptible to significant improper payments. OMB Circular A-123, Appendix C,¹⁶ requires that agencies perform risk assessments for programs deemed at low risk of having significant improper payments at least once every 3 years. However, agencies are required annually to consider whether significant changes to either legislation or funding would affect each program's risk susceptibility.

The Department performed the required program risk assessments in FY 2017. Specifically, CGFS/MC evaluated whether each program subject to IPIA had a significant legislative or funding change, identified programs requiring improper payments risk assessments, and performed risk assessments using required criteria (that is, risk factors) defined by OMB Circular A-123¹⁷ for all programs requiring evaluation.¹⁸ In addition, CGFS/MC lowered its threshold for programs requiring evaluation from \$100 million to \$10 million,¹⁹ identified programs that fell above the new threshold that were not evaluated in FY 2016, and performed risk assessments using the criteria required by OMB.

Programs Requiring a Risk Assessment Were Identified

Of the 59 programs that the Department identified as being subject to IPIA requirements,²⁰ CGFS/MC identified 32 requiring improper payments risk assessments in FY 2017. These

¹⁵ OIG, *Audit of Department of State FY 2016 Compliance With Improper Payment Requirements* (AUD-FM-17-42, May 2017).

¹⁶ OMB Circular A-123, Appendix C, at 16.

¹⁷ Ibid, at 10.

¹⁸ The Department performed risk assessments of all programs in FY 2016. On the basis of the results of those assessments, the Department identified all its programs to be at low or moderate risk of significant improper payments. In accordance with requirements in OMB Circular A-123, Appendix C, FY 2017 and FY 2018 are interim years for assessing risk, which requires only an assessment of significant changes.

¹⁹ The Department lowered its threshold as a result of an audit finding from the Government Accountability Office report *Improper Payments: Most Selected Agencies Improved Procedures to Help Ensure Risk Assessments of All Programs and Activities* (GAO-18-36, November 2017).

²⁰ The number of programs subject to IPIA requirements increased from 35 programs in FY 2016 to 59 programs in FY 2017 (an increase of 40 percent) because CGFS/MC lowered its threshold for evaluation from \$100 million to \$10 million.

programs were selected either because of significant changes in funding (8 programs) or because the program exceeded CGFS/MC's new assessment threshold of \$10 million and was not evaluated in the previous year (24 programs).²¹ CGFS/MC defined a significant change in funding as either an increase in program expenditures from the previous year of at least \$100 million or an increase in program expenditures from the previous year of at least \$85 million and 50 percent.²² CGFS/MC identified all programs requiring a risk assessment for susceptibility to significant improper payments, in accordance with OMB requirements and Department criteria.

Improper Payments Risk Assessments Were Performed

OMB Circular A-123, Appendix C, requires that agencies perform a risk assessment of all programs for susceptibility to significant improper payments.²³ The Circular defines "significant improper payments" as gross annual improper payments in the program exceeding both 1.5 percent of program outlays and \$10 million of all program payments made during the fiscal year or \$100 million. Agencies must institute a systematic method of performing the risk assessments. An agency can perform a quantitative evaluation on the basis of a statistical sample, or it can perform a qualitative evaluation by considering risk factors likely to contribute to significant improper payments.

During FY 2017, CGFS/MC performed and documented a qualitative risk assessment of the 32 programs that it identified as requiring an assessment. To perform the risk assessments CGFS/MC developed a scorecard for each program, which included an evaluation of the nine risk

²¹ CGFS also reviewed the Congressional Budget Justification to identify existing programs that had significant legislative changes, as well as the Secretary of State's statements in the Congressional Budget Justifications, to identify changes in the Department's emphasis or focus that would significantly impact existing programs. On the basis of its review, CGFS/MC concluded that no programs experienced a change in legislation significant enough to require that an improper payments risk assessment be performed in FY 2017.

²² For example, if a program had \$190 million in expenditures in the current year and \$100 million in expenditures the prior year, it would not meet the first criterion for requiring a risk assessment in the current year, as the total program expenditures only increased by \$90 million. However, the percentage increase in expenditures is 90 percent, and it therefore meets the second criterion requiring a risk assessment in the current year, because the total program expenditures increased by more than \$85 million and 50 percent.

²³ In FY 2017, CGFS/MC determined that 32 of 59 programs required risk assessments. Of the 32 assessed, 8 (25 percent) had been assessed in the prior year, but had significant changes in funding that required a risk assessment in FY 2017, and 24 (75 percent) were not assessed in the prior year, but exceeded the new \$10 million threshold. The remaining 27 programs were assessed in FY 2016 and did not have changes significant to require re-assessment in FY 2017.

factors specified by OMB.²⁴ The scorecard comprised 11 criteria,²⁵ such as whether the program was new, the volume of payments made, and significant deficiencies identified in audit reports (for example, OIG and Government Accountability Office reports).

CGFS/MC obtained information for its scorecard evaluation by reviewing the Department's FY 2017 Congressional Budget Justification, information on internal and external websites, and information contained in internal and external reports and by having discussions with officials from the responsible bureaus and offices. On the basis of information obtained, CGFS/MC assigned a numerical rating of 1, 3, or 5 to each program for each scorecard criterion, with a rating of 1 representing low risk, 3 representing moderate risk, and 5 representing high risk. CGFS/MC then averaged the ratings for each program to determine the program's overall risk level.

As a result of an OIG recommendation OIG made in report AUD-FM-117-42,²⁶ CGFS/MC implemented new quality control procedures to improve the accuracy of conclusions reached in its risk assessment process. Specifically, CGFS/MC considered OIG questioned costs identified in all OIG reports issued in the past 5 years when assessing risk levels for one risk factor. Furthermore, the results of this new procedure were reviewed by a CGFS/MC supervisor to verify that all questioned costs were considered and that accurate conclusions of risk levels were reached.

The overall ratings showed that 30 of the 32 programs were at low risk for incurring significant improper payments and that 2 programs were at moderate risk. CGFS/MC performed an additional assessment of the two programs that were at moderate risk. This additional risk assessment considered factors such as the physical location in which the programs' costs were incurred and whether significant deficiencies in the programs' internal control had been previously identified. Neither program's overall risk was elevated to "high" as a result of the additional assessments; therefore, further evaluations were not necessary. CGFS/MC concluded that none of the Department's programs was susceptible to significant improper payments as defined by OMB Circular A-123, Appendix C.²⁷

²⁴ OMB Circular A-123, Appendix C, at 10.

²⁵ CGFS/MC has elected to split one risk factor required to be considered by OMB Circular A-123, Appendix C, at 10—" [r]esults from prior improper payment work"—into two criteria on its score card. Specifically, CGFS/MC considers the amount of identified improper payments from prior work and the number of identified improper payments from prior work as separate criteria. Furthermore, CGFS/MC considers one risk factor that is not required by the circular—significant increases in funding. Therefore, CGFS/MC has 11 total criteria for consideration in its risk assessments rather than the 9 specified by OMB.

²⁶ AUD-FM-17-42, May 2017, Recommendation 1.

²⁷ OMB Circular A-123, Appendix C, at 9.

Finding B: Agency Financial Report Was Published and Included Required Disclosures, but Some Optional Information Was Not Included

The Department published on its website its FY 2017 AFR, which included all the required improper payments disclosures. For example, CGFS disclosed its improper payments risk assessment process; all programs that were assessed for risk in the year; and recapture audit activities, results, and future targets. Although the Department included all required disclosures, optional improper payment information identified and recovered outside the payment recapture audit activities was not included in the AFR. As previously recommended in the FY 2016 IPIA compliance report,²⁸ because much of this information is readily available and would be useful to the users of the AFR, it should be included in the AFR and disclosed, even though it is not required.

Required Improper Payments Disclosures Were Made

IPERA²⁹ states that for an agency to be in compliance with the act, the agency must publish an AFR for the most recent fiscal year and post that report, with the information on improper payments required by OMB, on the agency's website. OMB Circular A-123, Appendix C,³⁰ requires an agency to disclose specific information relating to improper payments in its annual AFR in the format provided in OMB Circular A-136.³¹

The Department published its FY 2017 AFR on its website. The AFR included the required improper payments disclosures. For example, the AFR included summary information on improper payments; a description of the Department's improper payments risk assessment process, a listing of all programs assessed for risk in FY 2017, and a description of the Department's payment recapture audit program, including the results of recapture activities as well as recapture targets for future years.

Some Optional Information for One Disclosure Was Not Included

Although the Department included all required disclosures in its FY 2017 AFR, optional information on improper payments identified outside the payment recapture process was not included in the AFR. OMB Circular A-136 states that agencies should "report the . . . [improper payment] amounts recovered through sources other than payment recapture audits."³²

To fulfill this requirement, CGFS reported the amounts identified and recovered by the CGFS Office of Claims during post-payment reviews of vendor and employee payments, the amounts

²⁸ AUD-FM-17-42, May 2017.

²⁹ Public Law 111-204, § 3.

³⁰ OMB Circular A-123, Appendix C, at 16.

³¹ OMB Circular A-136, Revised, "Financial Reporting Requirements," August 15, 2017, at 108-111.

³² OMB Circular A-136, II.5.5, at 109.

identified and recovered by CGFS's Office of Global Compensation during post-payment reviews of American and Foreign Service National employee transactions, and amounts identified and recovered as a result of the CGFS Retirement Accounts Division's annuity payment reviews.

The circular further states that "agencies could report on [improper payments] identified through . . . agency post-payment reviews or audits; Office of Inspector General reviews; [and] Single Audit reports."³³ However, Kearney found that CGFS did not include improper payments identified in OIG reports; Defense Contract Audit Agency reports (DCAA); or improper payment reviews performed by other Department offices and bureaus during contract and grant oversight activities, such as contract and grant closeout procedures, management post-payment reviews, and grant compliance reviews. Although including this information in the AFR is not required, the Department would be providing useful information on improper payments if it included this information in the AFR. Furthermore, CGFS/MC has much of the information related to the identification of improper payments by other offices available for the purposes of reporting.

For example, CGFS/MC officials were aware of the amount of Department improper payments identified in OIG and DCAA reports. However, CGFS/MC officials elected not to include the information in the AFR because they did not have information related to the collection of those funds. However, existing OMB guidance³⁴ does not preclude reporting improper payments without the corresponding collection information. Furthermore, CGFS did not take action to determine the collection status of the resolution of the questioned costs identified by OIG or DCAA.

In addition, CGFS/MC did not obtain or report any improper payment information identified by the bureaus and offices during contract and grant oversight activities in the FY 2017 AFR.

By not including complete information in its AFR, the Department did not provide users of the report with all relevant information about its efforts to prevent and then identify and recover improper payments.

The report on the Department's FY 2016 compliance with IPIA³⁵ made four recommendations to address these deficiencies; consequently, OIG is not making new recommendations in this report. Each recommendation remains resolved pending further action. The most recent correspondence³⁶ between CGFS/MC and OIG regarding the four recommendations follows:

³³ Ibid.

³⁴ Ibid.

³⁵ AUD-FM-17-42, May 2017.

³⁶ Record email: No. 18MDA7812, *Compliance-Audit of Department of State FY2016 Compliance With Improper Payments Requirements* (AUD-FM-17-42, April 10, 2018).

Recommendation 2 (AUD-FM-17-42, May 2017). *OIG recommends that the Bureau of the Comptroller and Global Financial Services develop and implement a method to obtain information regarding the collection status of improper payments identified in OIG reports for the applicable fiscal year.*

Management Response (March 5, 2018). *Due to the substantial efforts by OMB to streamline the improper payments reporting requirements (which are still underway), combined with the optional nature of disclosing disallowed costs and corresponding payments identified outside of recapture audits, the Department did not actively pursue new ways to obtain and disclose amounts for the OIG, Bureaus, or DCAA costs.*

The Department focused on making mandatory disclosures only [due to the changes in OMB reporting requirements in A-136, as well as future expected changes]. Taking the regulatory environment changes into consideration, we request that you close these recommendations which were related to optional disclosures.

OIG Reply (April 10, 2018). *Based on the Bureau's response, OIG considers this recommendation resolved. This recommendation will be closed when OIG receives and accepts documentation showing that CGFS has developed and implemented a method to obtain information regarding the collection status of improper payments identified in OIG reports for the applicable fiscal year, or OMB issues new guidance that supersedes the criteria on which this recommendation was based. The recommendation cannot be closed based on prospective changes to guidance.*

Recommendation 3 (AUD-FM-17-42, May 2017). *OIG recommends that the Bureau of the Comptroller and Global Financial Services develop and implement a method to obtain information regarding the collection status of improper payments identified in Defense Contract Audit Agency reports for the applicable fiscal year.*

Management Response (March 5, 2018). *Due to the substantial efforts by OMB to streamline the improper payments reporting requirements (which are still underway), combined with the optional nature of disclosing disallowed costs and corresponding payments identified outside of recapture audits, the Department did not actively pursue new ways to obtain and disclose amounts for the OIG, Bureaus, or DCAA costs.*

The Department focused on making mandatory disclosures only [due to the changes in OMB reporting requirements in A-136, as well as future expected changes]. Taking the regulatory environment changes into consideration, we request that you close these recommendations which were related to optional disclosures.

OIG Reply (April 10, 2018). *Based on the Bureau's response, OIG considers this recommendation resolved. This recommendation will be closed when OIG receives and*

accepts documentation showing that CGFS has developed and implemented a method to obtain information regarding the collection status of improper payments identified in DCAA reports for the applicable fiscal year, or OMB issues new guidance that supersedes the criteria on which this recommendation was based. The recommendation cannot be closed based on prospective changes to guidance.

Recommendation 4 (AUD-FM-17-42, May 2017). *OIG recommends that the Bureau of the Comptroller and Global Financial Services develop and implement a method to obtain information on improper payments identified and recovered by other Department of State bureaus and offices through contract and grant oversight activities, such as contract and grant closeout procedures, during the applicable fiscal year.*

Management Response (March 5, 2018). *Due to the substantial efforts by OMB to streamline the improper payments reporting requirements (which are still underway), combined with the optional nature of disclosing disallowed costs and corresponding payments identified outside of recapture audits, the Department did not actively pursue new ways to obtain and disclose amounts for the OIG, Bureaus, or DCAA costs.*

The Department focused on making mandatory disclosures only [due to the changes in OMB reporting requirements in A-136, as well as future expected changes]. Taking the regulatory environment changes into consideration, we request that you close these recommendations which were related to optional disclosures.

OIG Reply (April 10, 2018). *Based on the Bureau's response, OIG considers this recommendation resolved. This recommendation will be closed when OIG receives and accepts documentation showing that CGFS has developed and implemented a method to obtain information regarding the collection status of improper payments identified by other Department bureaus and offices through contract and grant oversight activities, such as contract and grant closeout procedures during the applicable fiscal year or OMB issues new guidance that supersedes the criteria on which this recommendation was based. The recommendation cannot be closed based on prospective changes to guidance.*

Recommendation 5 (AUD-FM-17-42, May 2017). *OIG recommends that the Bureau of the Comptroller and Global Financial Services develop and implement a process to report all improper payments identified by sources outside payment recapture audits for the applicable period in the annual Agency Financial Report. The process should require the Bureau of the Comptroller and Global Financial Services to present this information even if corresponding collection information is not readily available, unless written instructions advising otherwise is obtained from the Office of Management and Budget.*

Management Response (March 5, 2018). *Due to the substantial efforts by OMB to streamline the improper payments reporting requirements (which are still underway), combined with the optional nature of disclosing disallowed costs and corresponding payments identified outside of recapture audits, the Department did not actively pursue new ways to obtain and disclose amounts for the OIG, Bureaus, or DCAA costs.*

We did take direct steps to resolve the OIG recommendation #5 by attempting to obtain written guidance from OMB. We spoke with OMB on this issue, and were asked to submit comments (for consideration to be added to the revisions of A-136) during the comment solicitation period in June 2017. We asked that OMB consider inserting the following language in their revisions to A-136: "If corresponding collection information of overpayments identified outside of a payment recapture audit can't be reasonably obtained, that agencies could exclude that source from reporting."

An updated A-136 was issued by OMB on August 15, 2017, which did not address our comments. In the past years, OMB has prepared slides for the Fall Town Hall meeting which provided additional guidance beyond A-136. We hoped to get answers at the September 2017 Town Hall, but OMB did not provide any further clarification.

In summary, the Department focused on making mandatory disclosures only. Taking the regulatory environment changes into consideration, we request that you close these recommendations which were related to optional disclosures.

OIG Reply (April 10, 2018). *Based on the Bureau's response, OIG considers this recommendation resolved. OIG recognizes CGFS efforts to address this recommendation by contacting OMB on two occasions to eliminate or change the requirement for reporting certain amounts recovered through sources other than payment recapture audits. However, the updated version of OMB Circular A-136, issued August 2017, did not eliminate or change the requirement, nor did OMB otherwise clarify that they requirement was not applicable to the Department. This recommendation will be closed when OIG receives and accepts documentation showing that CGFS has developed and implemented a process to obtain to report all improper payments identified by sources outside payment recapture audits for the applicable period in the annual Agency Financial Report, or that it has obtained written instructions advising otherwise is obtained from OMB.*

During this year's audit, a CGFS/MC official stated two primary reasons for not implementing the prior year's four recommendations. First, CGFS/MC had to dedicate much more of its resources toward performing risk assessments than initially anticipated. This was because CGFS/MC had lowered its threshold for evaluating programs from \$100 million to \$10 million, therefore increasing the number of programs subject to IPIA that were not evaluated in the prior year rather than performing risk assessments for programs with significant changes in legislation or

funding as it normally would during “interim” years. Second, because of feedback solicited by OMB from Federal agencies regarding improper payment requirements during FY 2017, CGFS/MC anticipated that the requirement to report improper payments identified by sources outside payment recapture audits might be changed or eliminated, either by the changes made to OMB Circular A-136 (which was released in August 2017)³⁷ or OMB guidance issued at an Improper Payments Town Hall (which was held in September 2017).³⁸ However, neither event changed or eliminated the requirement.

³⁷ OMB updates Circular A-136 annually to provide new or modified financial reporting requirements to agencies.

³⁸ OMB has held a “town hall” meeting with Federal agencies (both OIG and management) since 2015. The purpose of this town hall is to communicate updates to improper payments-related legislation and requirements, provide best-practice recommendations, answer questions from participants, and solicit feedback from Federal agencies.

APPENDIX A: PURPOSE, SCOPE, AND METHODOLOGY

The Improper Payments Elimination and Recovery Act of 2010¹ (IPERA), which amended the Improper Payments Information Act of 2002² (IPIA), requires the Office of Inspector General (OIG) to conduct an annual audit of the Department of State's (Department) compliance with improper payments requirements. In accordance with the IPERA requirement, an independent public accountant, Kearney & Company, P.C. (Kearney), acting on OIG's behalf, performed this audit to determine whether the Department was in compliance with IPIA, as amended.³

Kearney conducted fieldwork for this performance audit from January through April 2018 in the Washington, DC, metropolitan area. The audit was conducted in accordance with generally accepted government auditing standards. Those standards require that Kearney plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for the findings and conclusions based on the audit objective. Kearney believes that the evidence obtained provides a reasonable basis for the findings and conclusions based on the audit objective.

Kearney focused the scope of the audit on the following objectives: (1) to evaluate whether the Department conducted a program-specific risk assessment for all programs covered by Office of Management and Budget (OMB) requirements, (2) to determine whether the Department's FY 2017 Agency Financial Report (AFR) complied with improper payments reporting requirements, and (3) to reach a conclusion as to whether the Department was compliant with IPIA according to OMB guidance.⁴

To obtain background information, Kearney researched and reviewed Federal laws and regulations as well as prior OIG and Government Accountability Office audit reports. Kearney also reviewed the United States Code and OMB Circulars.

Kearney designed the audit to obtain insight into the Department's current processes, procedures, and organizational structure regarding compliance with IPIA requirements. To expedite the audit process, Kearney leveraged the results of its FY 2017 financial statement audit and audits of the Department's FYs 2011–2016 compliance with IPIA to confirm its understanding of the nature and profile of Department operations, IPIA standards, regulatory requirements, and supporting information systems and controls.

¹ Improper Payments Elimination and Recovery Act of 2010, Public Law 111-204, §§ 2 and 3, July 22, 2010.

² Improper Payments Information Act of 2002, Public Law 107-300, §§ 1 and 2, November 26, 2002.

³ Unless otherwise indicated, the term "IPIA" implies "IPIA, as amended by IPERA and the Improper Payments Elimination and Recovery Improvement Act of 2012 (Pub. L. No. 112-248)" in this report.

⁴ OMB Circular A-123, Appendix C, "Requirements for Effective Estimation and Remediation of Improper Payments," October 20, 2014, at 39.

Kearney conducted process walkthroughs and interviews with Department officials to obtain a sufficient understanding of the steps taken by the Department to assess the risk of improper payments, the Department's process of identifying significant improper payments, and the process of reporting improper payments information. Consistent with the fieldwork standards for performance audits, Kearney established performance criteria and identified sources of audit evidence to complete the testing phase.

During the testing phase, Kearney obtained and reviewed documentation supporting the Department's FY 2017 risk assessments and AFR disclosures. The testing phase provided Kearney with evidence to determine the findings of the report issued for the performance audit. The criteria determined in the planning phase served as the basis for assessing the Department's compliance with IPIA requirements. The testing phase included procedures to assess the Department's IPIA reporting process and the AFR disclosures. Specifically, Kearney performed procedures to ensure the completeness of the Department's listing of programs and activities subject to IPIA requirements. Kearney also evaluated the Department's risk assessment process for compliance with IPIA requirements, as well as reasonableness and objectivity. Finally, Kearney evaluated the Department's FY 2017 AFR disclosure against OMB Circular A-136⁵ requirements to determine whether all required disclosures were made.

During the reporting phase, Kearney formally communicated to the Department the conclusions reached and the findings and recommendations for the actions it should take to comply with IPIA requirements.

Prior Reports

In May 2017, OIG reported⁶ that the Department was in compliance with IPIA requirements. Specifically, the Bureau of the Comptroller and Global Financial Services (CGFS), Office of Management Controls, conducted a risk assessment for required programs. However, the method used for identifying programs with a significant change in funding may not have identified all programs with increased risks of significant improper payments. In addition, the Department published its AFR for FY 2016 with the disclosures required by OMB and posted the AFR on its website. However, one disclosure relating to improper payments identified and recovered outside the recapture audit process did not include optional information. In the report, OIG made five recommendations to CGFS to refine quality control procedures in the risk assessment process and to report optional information in the AFR.

⁵ OMB Circular A-136, "Financial Reporting Requirements," August 15, 2017, at 108-111.

⁶ OIG, *Audit of Department of State FY 2016 Compliance With Improper Payments Requirements* (AUD-FM-17-42, May 2017).

Work Related to Internal Controls

Kearney performed steps to assess the adequacy of internal controls related to the areas audited. Specifically, Kearney assessed the controls contained in the Department's policies and procedures for performing risk assessments and reporting improper payments information. Kearney tested relevant controls, such as the supervisory review of risk assessments and the compilation of improper payments information in the AFR, by re-performing the processes and ensuring that the results were consistent with those of the Department and in compliance with IPIA requirements. As reported in the Audit Results section, Kearney found that the CGFS Office of Management Controls risk assessment procedures were adequate. Kearney also found that the Department published an AFR and included required disclosures but did not include some optional information that would be beneficial to the users of the AFR.

Use of Computer-Processed Data

Kearney obtained computer-processed data from the CGFS Office of Management Controls to aid in determining whether the Department complied with IPIA. More specifically, these data provided evidence that the Department had taken steps to comply with IPIA. Kearney did not perform tests to validate the spreadsheet amounts because such testing was not necessary to accomplish the audit objective. However, Kearney assessed the data provided as sufficiently reliable on the basis of its understanding of the financial information gained during the audit of the Department's FY 2017 financial statements. Kearney's assessment was also based on a comparison of the programs and activities that the Department had used as its baseline for performing risk assessments with a universe of FY 2016 expenditure transactions that Kearney obtained from the Global Financial Management System, the Department's core financial system.⁷

⁷ The Global Financial Management System supports the Department's mission by effectively accounting for business activities and recording the associated financial information, including obligations and costs, performance, financial assets, and other data.

APPENDIX B: PRIOR OFFICE OF INSPECTOR GENERAL RECOMMENDATIONS

Table B.1 presents the status of the Office of Inspector General (OIG) recommendations from audits of the Department of State's compliance with improper payment requirements for FYs 2014–2016, that is, the three previous fiscal years.

Table B.1: Prior OIG Recommendations - FYs 2014–2016

Report Number	Fiscal Year	Number	Recommendation	Status
AUD-FM-15-26	2014	1	OIG recommends that the Bureau of the Comptroller and Global Financial Services expand its process to identify programs with significant funding changes to consider additional factors that may increase the risk of significant improper payments, including, at a minimum, the percentage increase of the change.	Closed
		2	OIG recommends that the Bureau of the Comptroller and Global Financial Services develop and implement a method to obtain information on improper payments identified and recovered by other Department of State offices and bureaus to ensure that the Agency Financial Report includes all amounts required by the Office of Management and Budget.	Closed
		3	OIG recommends that the Bureau of the Comptroller and Global Financial Services fully implement recapture audit procedures for all payment types, including annuity payments, grant payments made through the Payment Management System, employee salary and benefit payments, and other excluded payments.	Closed
AUD-FM-16-38	2015		<i>OIG restated Recommendations 1 and 2 from AUD-FM-15-26 and did not issue any new recommendations in this report.</i>	Not Applicable
AUD-FM-17-42	2016	1	OIG recommends that the Bureau of the Comptroller and Global Financial Services develop and implement additional quality control procedures requiring that a supervisor review determinations regarding the improper payments impact of audit	Closed

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Report Number	Fiscal Year	Number	Recommendation	Status
			findings and recommendations for the applicable fiscal year during the risk assessment process.	
		2	OIG recommends that the Bureau of the Comptroller and Global Financial Services develop and implement a method to obtain information regarding the collection status of improper payments identified in OIG reports for the applicable fiscal year.	Resolved, Pending Further Action
		3	OIG recommends that the Bureau of the Comptroller and Global Financial Services develop and implement a method to obtain information regarding the collection status of improper payments identified in Defense Contract Audit Agency reports for the applicable fiscal year.	Resolved, Pending Further Action
		4	OIG recommends that the Bureau of the Comptroller and Global Financial Services develop and implement a method to obtain information on improper payments identified and recovered by other Department of State bureaus and offices through contract and grant oversight activities, such as contract and grant closeout procedures, during the applicable fiscal year.	Resolved, Pending Further Action
		5	OIG recommends that the Bureau of the Comptroller and Global Financial Services develop and implement a process to report all improper payments identified by sources outside payment recapture audits for the applicable period in the annual Agency Financial Report. The process should require the Bureau of the Comptroller and Global Financial Services to present this information even if corresponding collection information is not readily available, unless written instructions advising otherwise is obtained from the Office of Management and Budget.	Resolved, Pending Further Action

Source: Prepared by Kearney & Company, P.C., using OIG compliance information.

APPENDIX C: BUREAU OF THE COMPTROLLER AND GLOBAL FINANCIAL SERVICES RESPONSE



United States Department of State
Comptroller
Washington, DC 20520

April 27, 2018

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MEMORANDUM

TO: OIG – Steve A. Linick
FROM: CGFS – Christopher H. Flagg

SUBJECT: Report on Audit of Department of State FY 2017 Compliance with Improper Payments Requirements (AUD-FM-18-XX, April 2018)

Thank you for the opportunity to comment on the Office of Inspector General's (OIG) Draft Report titled Audit of Department of State FY 2017 Compliance with Improper Payments Requirements (Report).

The Department, and the Office of Management Controls (CGFS/MC) in particular, has made significant efforts to comply with all requirements and guidance for the Improper Payments Information Act of 2002 (IPIA), Improper Payments Elimination and Recovery Act in 2010 (IPERA), and Improper Payments Elimination and Recovery Improvement Act in 2012 (IPERIA). As reflected in the Report, we are pleased that our program is “compliant” with IPIA, as amended. We recognize that improvements can be made and will continue doing so.

We appreciate the OIG decision to close Recommendation No. 1 and to also consider Recommendations No. 2, No. 3, No. 4, and No. 5 resolved pending further action. The Department takes the OIG recommendations very seriously, as demonstrated by our IPIA program accomplishments over the past several years. We will continue to attend to these recommendations and implement them to the extent they are a beneficial and cost-effective use of government funds.

We recognize that the IPIA, as amended, and related guidance has raised the bar on transparently accounting for and preventing improper payments for all Agencies, including the Department. We look forward to working with both the OIG and the Independent Auditor on further enhancements to our program in the coming year.

If you have any questions, please contact Carole Clay, Director of Management Controls (CGFS/MC), at (202) 663-2084.

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ABBREVIATIONS

AFR	Agency Financial Report
CGFS	Bureau of the Comptroller and Global Financial Services
CGFS/MC	Bureau of the Comptroller and Global Financial Services, Office of Management Controls
DCAA	Defense Contract Audit Agency
IPERA	Improper Payments Elimination and Recovery Act
IPERIA	Improper Payments Elimination and Recovery Improvement Act
IPIA	Improper Payments Information Act
OMB	Office of Management and Budget

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