UNITED STATES DEPARTMENT OF STATE
AND THE BROADCASTING BOARD OF GOVERNORS

OFFICE OF INSPECTOR GENERAL

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Audit of Department of State FY 2012 Compliance With Improper Payments Requirements

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PREFACE

This report is being transmitted pursuant to the Inspector General Act of 1978, as amended, and Section 209 of the Foreign Service Act of 1980, as amended. It is one of a series of audit, inspection, investigative, and special reports prepared as part of the Office of Inspector General's (OIG) responsibility to promote effective management, accountability, and positive change in the Department of State (Department) and the Broadcasting Board of Governors.

This report addresses the Department's FY 2012 compliance with improper payments requirements. The report is based on interviews with Department employees and officials and a review of applicable documents.

OIG contracted with the independent public accountant, Kearney & Company, P.C. (Kearney), to perform this audit. The contract required that Kearney perform its audit in accordance with guidance contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Kearney's report is included.

Kearney identified three areas in which improvements could be made: risk assessment process, recapture audits, and improper payments disclosures.

OIG evaluated the nature, extent, and timing of Kearney's work; monitored progress throughout the audit; reviewed Kearney's supporting documentation; evaluated key judgments; and performed other procedures as appropriate. OIG concurs with Kearney's findings, and the recommendations contained in the report were developed on the basis of the best knowledge available and were discussed in draft form with those individuals responsible for implementation. OIG's analysis of management's response to the recommendations has been incorporated into the report. OIG trusts that this report will result in more effective, efficient, and/or economical operations.

I express my appreciation to all of the individuals who contributed to the preparation of this report.

Harold W. Geisel
Deputy Inspector General

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Audit of Department of State FY 2012 Compliance With Improper Payments Requirements

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

Kearney & Company, P.C. (referred to as "we" in this letter), has performed an audit of the Department of State's (Department) FY 2012 compliance with the Improper Payments Information Act of 2002, as amended by the Improper Payments Elimination and Recovery Act of 2010. We evaluated the Department's performance in complying with the requirements set forth by the Office of Management and Budget. This performance audit, performed under Contract No. SAQMMA09D0002, was designed to meet the objectives identified in the report section titled "Objective" and further defined in Appendix A, "Scope and Methodology," of the report.

We conducted this performance audit from December 2012 through February 2013 in accordance with *Government Auditing Standards*, issued by the Comptroller General of the United States. We communicated the results of our performance audit and the related findings and recommendations to the U.S. Department of State Office of Inspector General.

We appreciate the cooperation provided by personnel in Department offices during the audit.

Kearney & Company

Kearney & Company, P.C.
Alexandria, VA
March 14, 2013

Acronyms

AFR	Agency Financial Report
CBJ	Congressional Budget Justification
CGFS	Bureau of the Comptroller and Global Financial Services
CGFS/DCFO/MC	Bureau of the Comptroller and Global Financial Services, Deputy Chief Financial Officer, Office of Management Controls
CGFS/F/C	Bureau of the Comptroller and Global Financial Services, Office of Claims
CGFS/OMA	Bureau of the Comptroller and Global Financial Services, Office of Management and Analysis
FAH	*Foreign Affairs Handbook*
IPERA	Improper Payments Elimination and Recovery Act of 2010
IPIA	Improper Payments Information Act of 2002
OIG	Office of Inspector General
OMB	Office of Management and Budget

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Executive Summary

Federal agencies reported an estimated $108 billion in improper payments in FY 2012. Over the past decade, the Federal Government has implemented safeguards to reduce improper payments. In 2010, the Improper Payments Elimination and Recovery Act[1] (IPERA), which amended the Improper Payments Information Act of 2002[2] (IPIA), was signed into law. IPERA strengthened IPIA by increasing requirements for identifying and reporting on improper payments. In April 2011, the Office of Management and Budget (OMB) issued guidance to implement IPERA.

IPIA requires agencies' Offices of Inspector General (OIG) to annually assess compliance with improper payments requirements. In accordance with this requirement, Kearney & Company, P.C. (Kearney), an external audit firm acting on OIG's behalf, conducted the first annual audit of the Department of State's (Department) FY 2011 compliance and reported in 2012[3] that although the Department had taken steps to comply with IPIA, the Department had not implemented all requirements for identifying and reporting improper payments. OIG recommended that the Department develop policies and standard procedures for complying with IPIA, as amended by IPERA.[4]

Kearney conducted this second annual audit to assess the Department's FY 2012 compliance with IPIA. Kearney found that the Department performed program-specific risk assessments for programs that experienced significant changes. The Department had also developed risk assessment policies and procedures and expanded and refined its risk assessment methodology to include the qualitative risk factors included in OMB's guidance. Although the Department made improvements in its risk assessment methodology during FY 2012, the methods it used to identify significant changes and perform qualitative assessments need improvement. In addition, the Department had not performed a baseline risk assessment of all programs, but a Department official indicated that the risk assessments would be performed during FY 2013. Before it performs baseline risk assessments in FY 2013, the Department should improve its definition of a "program" as well as its process for identifying programs.

Kearney also found that the Department had implemented a program of internal control to prevent, detect, and recapture improper payments and identified $11.1 million in improper payments during FY 2012. However, the Department excluded a significant amount of payments from its recapture audits, and the audits were focused on payments rather than on programs. Although the Department was analyzing ways to perform recapture audits over excluded payment types, it had not completed that analysis at the time of this audit. The Department had included most of the required improper payments disclosures in its FY 2012 Agency Financial Report (AFR); however, some disclosures were omitted or were inaccurate.

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[1] Pub. L. No. 111-204.
[2] Pub. L. No. 107-300.
[3] *Audit of Department of State Compliance With the Improper Payments Information Act* (AUD/FM-12-31, March 2012).
[4] Unless otherwise indicated, the term "IPIA" means "IPIA, as amended by IPERA," in this report.

Based on the actions that the Department has taken since the 2012 report, OIG is closing the three recommendations in the 2012 report upon issuance of this report. However, OIG is making three new recommendations for the Department to improve the risk assessment process, expand recapture audits, and disclose all required improper payments information.

In its March 13, 2013, response (see Appendix B) to the draft report, the Bureau of the Comptroller and Global Financial Services (CGFS) concurred with all of the report's recommendations. Based on the response, OIG considers each recommendation resolved, pending further action. Management's responses and OIG's replies to those responses are included after each recommendation.

Background

According to OMB, Federal agencies reported an estimated $108 billion in improper payments, funded by taxpayer dollars, that were issued to individuals, organizations, and contractors during FY 2012. 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 could not determine whether the payments were proper because of insufficient documentation or lack of supporting documentation.

Over the past decade, the Federal Government has implemented safeguards to reduce improper payments. IPIA, as initially enacted in 2002, required Federal agencies to annually identify programs and activities[5] 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, IPERA, which amended IPIA, was enacted in an effort to further reduce improper payments. IPERA clarified the programs to be reviewed and expanded improper payments recapture activities. IPERA also required Inspectors General to determine whether an agency was in compliance and established additional requirements for agencies that were deemed noncompliant.

In 2011, OMB issued Government-wide guidance on the implementation of IPERA as Revised Parts I and II to Appendix C of OMB Circular A-123, *Management's Responsibility for Internal Controls*.[6] 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, for developing an estimate of improper payments, for performing recapture audit activities, and for reporting improper payments activities.

[5] The term "program and activity" is referred to in this report as "program."

[6] OMB Circular A-123, Appendix C, Revised Parts I and II, will be referred to in this report as OMB Circular A-123, Appendix C.

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, and grantees. During FY 2012, the Department made payments of approximately $28 billion, of which $14.6 billion was subject to IPIA requirements.[7] Of the $14.6 billion, payments of approximately $7.4 billion were to vendors and contractors and payments of $7.2 billion were for Federal Financial Assistance, including grants, assessed contributions,[8] and voluntary contributions.[9] 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.

CGFS has oversight responsibilities for the Department's financial management program. Financial management program responsibilities include establishing financial policy and procedure, financial reporting and analysis, management of financial information systems, and 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 that are aimed at ensuring that only valid, proper payments are made.

Within CGFS, the Office of Claims (CGFS/F/C) is the central domestic paying agent of the Department. The Office of Oversight and Management Analysis (CGFS/OMA) is responsible for, among other things, ensuring compliance with financial laws, policies, and procedures and for performing internal control and quality control reviews. The Deputy Chief Financial Officer, Office of Management Controls (CGFS/DCFO/MC), is responsible for overseeing the Department's management control program and other financial management functions, such as administering compliance with OMB Circular A-123, Appendix C.

[7] OMB Circular A-123, Appendix C, states that agencies may, but are not obligated to, review payments to employees and intragovernmental transactions for improper payments unless directed to do so by OMB. Of the payments of $28 billion, payments of approximately $7.4 billion were to employees and payments of $6 billion were intragovernmental and intradepartmental transactions.

[8] Assessed contributions represent financial assistance to foreign countries, international societies, commissions, proceedings, or projects that are agreed to as part of a treaty or other agreement.

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

Prior OIG Reports

In 2012, OIG reported[10] that although the Department had taken steps to comply with IPIA, the Department's improper payments risk assessment methodology was insufficient, recapture audit activities were not performed for all types of improper payments or all payments, and some improper payments disclosures required to be included in the AFR were omitted or were inaccurate. OIG recommended that the Department develop policies and standardized procedures for performing improper payments risk assessments and recapture audit activities and for reporting information relating to improper payments in its AFR. These recommendations remained resolved but open at the time of the fieldwork for this audit.

Objective

The overall objective of this audit was to determine whether the Department was in compliance with IPIA. To accomplish this objective, Kearney

- Evaluated whether the Department conducted a program-specific risk assessment for all programs.
- Evaluated the Department's performance in preventing, detecting, and recapturing improper payments.
- Determined whether the Department reported the required improper payments information in its 2012 AFR.

Audit Results

Finding A. Program Risk Assessments Were Performed, but Methodology Needs Refinement

During FY 2012, the Department performed program-specific risk assessments for programs that experienced significant changes. Specifically, CGFS/DCFO/MC identified programs with significant legislative changes or significant funding changes, which CGFS/DCFO/MC identified as changes over $100 million, from FY 2010 to FY 2011. CGFS/DCFO/MC performed a qualitative risk assessment of these programs, in accordance with OMB Circular A-123, Appendix C. CGFS/DCFO/MC had also developed risk assessment policies and procedures and expanded and refined its risk assessment methodology. However, the methods used to identify programs with significant changes and to perform the qualitative risk assessments need improvements.

Although CGFS/DCFO/MC performed a risk assessment of the programs that it defined as having significant changes, CGFS/DCFO/MC had not performed a baseline risk assessment of all programs as required by IPIA. During FY 2011 and FY 2012, only nine programs were assessed. CGFS/DCFO/MC stated that it did not perform a full baseline risk assessment in FY

[10] AUD/FM-12-31, March 2012.

2012 because of resource limitations and its focus on developing formal policies and procedures. According to a CGFS/DCFO/MC official, all significant programs will be evaluated during the FY 2013 risk assessment. In addition, during FY 2012, CGFS/DCFO/MC defined "program" as a combination of allotments and function codes; however, it had not applied the definition consistently. Without a full baseline risk assessment and a consistent definition of program, the Department may not have ensured that all programs at risk for significant improper payments were identified and adequately assessed.

Programs With Significant Changes Were Identified

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, defines "significant improper payments" as gross annual improper payments in the program exceeding (1) both 2.5 percent of program outlays and $10 million of all program payments made during the fiscal year or (2) $100 million. The Circular requires that agencies review all programs for susceptibility for significant improper payments in FY 2011 and every 3 years thereafter for programs deemed not risk susceptible. However, if a program experiences significant legislative or funding changes, the program must be reassessed during the next annual cycle.

In FY 2012, CGFS/DCFO/MC performed risk assessments for programs that experienced significant legislative or funding changes from FY 2010 to FY 2011. For risk assessment purposes, CGFS/DCFO/MC elected to identify its programs using a combination of financial accounting codes–the allotment and function codes. CGFS/DCFO/MC defined a significant change in program funding as an increase of over $100 million.

To identify programs that had significant changes in legislation, CGFS/DCFO/MC reviewed the Department's FY 2011 Congressional Budget Justification (CBJ). The CBJ noted that the primary increase in funding and activity for the year was due to war efforts in Iraq, Afghanistan, and Pakistan, with particular emphasis on Iraq. Based on this information, CGFS/DCFO/MC selected Iraq Overseas Contingency Operations for further evaluation. CGFS/DCFO/MC determined that the most significant function codes for Iraq Overseas Contingency Operations were the following: Bodyguard and Armed Escort, Non-Residential Local Guard Program, All Other Guard Service, Armored Vehicles, Perimeter and Internal Security, and Security Training Programs.

To identify programs with significant increases in funding, CGFS/DCFO/MC obtained the FY 2011 and FY 2010 expenditures[11] subject to IPIA from its domestic financial management system. CGFS/DCFO/MC then grouped the expenditures for each year by function code and calculated the change in spending from FY 2010 to FY 2011 for each function code. Based on this calculation, CGFS/DCFO/MC identified four function codes as having experienced significant, over $100 million, funding changes:

- UN Organization Mission in the Democratic Republic of the Congo
- Bodyguard and Armed Escorts

[11] For its analysis, CGFS/DCFO/MC used expenditures rather than funding.

- Promote the Rule of Law and Administration of Justice
- Civilian Police Programs

CGFS/DCFO/MC grouped the payments from two of the four function codes identified as having experienced significant funding changes into other programs. Specifically, the UN Organization Mission in the Democratic Republic of the Congo payments were for assessed contributions. CGFS/DCFO/MC determined that, because of the unique nature of assessed and voluntary contributions, it would perform risk assessments for these entire payment categories. Therefore, Democratic Republic of the Congo payments were incorporated into the Assessed Contribution program. In addition, as noted, CGFS/DCFO/MC grouped Bodyguard and Armed Escorts payments into Iraq Overseas Contingency Operations, since the Bodyguard and Armed Escorts function code was identified as significant to that program.

Based on its analysis, CFGS/DCFO/MC selected the following five programs for FY 2012 risk assessments:

- Assessed Contributions
- Voluntary Contributions
- Promote the Rule of Law and Administration of Justice
- Civilian Police Programs
- Iraq Overseas Contingency Operations

The payments for the function codes grouped within these five programs amounted to $5.5 billion, or almost 38 percent, of the $14.6 billion in payments subject to IPIA.

Qualitative Assessments Were Performed

OMB Circular A-123, Appendix C, requires that agencies institute a systematic method of performing risk assessments. An agency can perform a quantitative evaluation based on a statistical sample, or it can perform a qualitative evaluation by considering risk factors likely to contribute to significant improper payments. For qualitative evaluations, the Circular lists eight risk factors that should be considered: the age of the program; the complexity of the program; the volume of payments made annually; a determination as to whether payment eligibility decisions were made outside of the agency; recent major changes in the program; the level, experience, and quality of training of certain personnel; significant deficiencies identified in audit reports; and results from prior improper payment work.

During FY 2012, CGFS/DCFO/MC performed and documented a qualitative risk assessment of each of the five selected programs. To perform the assessment, CGFS/DCFO/MC developed a scorecard for each program that included an evaluation of the eight risk factors specified by OMB. CGFS/DCFO/MC obtained information for its evaluation by reviewing the CBJ, Web sites, and external and internal reports. Based on the information obtained, CGFS/DCFO/MC assigned a numerical rating of 1 (low risk), 2 (moderate risk), or 3 (high risk) for each risk factor and averaged the ratings to determine an overall risk level for each program. The overall ratings for each program assessed indicated that three programs had low risk and two programs had moderate risk. Based on the qualitative risk assessment, CGFS/DCFO/MC concluded that none of the programs assessed were deemed susceptible to significant improper payments as defined by OMB Circular A-123, Appendix C.

Risk Assessment Methodology Was Improved, but Methods To Identify the Significant Changes Threshold and Perform Qualitative Assessments Need Refinement

Kearney found that the Department made improvements during FY 2012 to address the issues relating to its risk assessment methodology identified during the audit of the Department's FY 2011 compliance with IPIA. CGFS/DCFO/MC documented formal policies and procedures for the risk assessments. It also expanded and refined its risk assessment methodology. Specifically, CGFS/DCFO/MC defined a "program," incorporated the required OMB risk factors into its qualitative assessments, and correctly calculated the significant improper payment threshold for each of the five programs for which an assessment was performed. However, the methods used to identify programs with significant changes and perform the qualitative assessments need refinements to ensure that all programs at risk for significant improper payments are identified and adequately assessed.

Significant Changes Threshold

The method used to identify programs with significant funding changes needed refinement. The use of the $100 million threshold may not have identified all programs that had increased risks because of increased funding. Specifically, Kearney identified function codes with increases in expenditures of less than $100 million, CGFS/DCFO's threshold for assessment. However, the increases represented large percentage increases in spending. For example:

- The Aviation Support function code had payments of $123.9 million in FY 2010 and $210.7 million in FY 2011, an increase of $86.68 million, or 70 percent.
- The Program Development and Support function code had payments of $72.6 million in FY 2010 and $156.6 million in FY 2011, an increase of $83.9 million, or 116 percent.
- The Public Diplomacy Program Direction function code had payments of $53.3 million in FY 2010 and $123.8 million in FY 2011, an increase of $70.5 million, or 132 percent.

While these programs saw expenditure increases below CGFS/DCFO's threshold, each program had significant increases in spending over their FY 2010 baseline expenses. Programs that have large spikes in spending are at risk for making improper payments. Although larger programs that incur billions of dollars in spending a year may be able to handle the increased workload that an additional $100 million in payments entails, a smaller program that sees spending double in a fiscal year may not have sufficient resources or an adequate control structure in place to handle dramatic increases in program spending.

Qualitative Assessments

Kearney also identified areas for improvement in the qualitative assessments. Specifically,

- CGFS/DCFO/MC performed the qualitative risk assessments without obtaining input from the bureaus or offices that had oversight of the programs.[12] Bureau program personnel are the best source for information about their respective programs and associated risks. Without input from program managers, CGFS/DCFO/MC may not be aware of factors that could increase or decrease a program's risk. In addition, the use of outdated or inaccurate information obtained from a Web site or outdated reports may lead to an incorrect assessment of program risk. This issue was first reported in the 2012 report on the Department's FY 2011 compliance with IPIA.

- Although CGFS/DCFO/MC developed objective, quantitative definitions of the risk level for six of the eight risk factors evaluated, it did not do so for two risk factors. For example, for the risk factor "complexity of the program," the scorecard defined high complexity as being at high risk. In addition, for the risk factor "level, experience, and quality of training of personnel," the scorecard defined low risk as "in compliance" and high risk as "not in compliance." No additional details were provided on how these factors should be judged.

- For the risk factor "volume of payments made," CGFS/DCFO/MC analyzed the dollar value of payments instead of the number or frequency of payments.

Baseline Programmatic Risk Assessments Were Not Performed

Although CGFS/DCFO/MC performed a risk assessment of the programs that it defined as having significant changes, as of the end of fieldwork for this audit CGFS/DCFO/MC had not performed an assessment of all programs as required by IPIA. During the audit of the Department's FY 2011 compliance with IPIA, Kearney found that CGFS/DCFO/MC did not conduct full baseline risk assessments of all programs. In FY 2011, CGFS/DCFO/MC assessed only four programs: Construction, Retirement, African Union-United Nations Hybrid Mission in Darfur, and Near East Refugee Programs.

CGFS/DCFO/MC also did not conduct the baseline risk assessments of all programs in FY 2012. At the time of this audit, CGFS/DCFO/MC had assessed a total of nine programs for the risk of significant improper payments–five in FY 2012 and four in FY 2011. Kearney identified 14 function codes that each had payments in FY 2011 of over $100 million that were not assessed in FY 2011 or FY 2012. For example, the Fulbright Program (function code 2300), with payments of $257 million in FY 2011, and Maintenance and Repair of Short Term Leases for Residential Facilities (function code 7340), with payments of $313.5 million in FY 2011, had never been assessed.

Further, CGFS/DCFO/MC defined "significant programs" as those programs with over $100 million in payments. Therefore, function codes with payments of less than $100 million were not assessed. Kearney identified over 600 function codes with total payments of less than $100 million in FY 2011. Additional analyses of these function codes may identify

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[12] Although CGFS/DCFO/MC did not obtain input during its initial qualitative risk assessments, Kearney noted that the risk assessment policy requires that CGFS/DCFO/MC obtain input from bureaus and offices for programs that are identified as high risk during the initial assessment.

programmatic groups that would meet the Department's $100 million significant programs threshold.

A CGFS/DCFO/MC official stated that a full baseline risk assessment was not performed in FY 2012 because of resource limitations and the focus on developing formal policies and procedures. CGFS/DCFO/MC's analysis indicated that programs of over $100 million that had not been subjected to risk assessment totaled only $2.5 billion, or 16.9 percent of total net expenditures. A CGFS/DCFO/MC official stated that all significant programs would be evaluated during the FY 2013 risk assessment.

Without a baseline risk assessment of all programs, CGFS/DCFO/MC may not have identified all programs with the risk of significant improper payments. A strong risk assessment process is the starting point for any successful improper payments reduction and recapture program. The information developed during a risk assessment forms the foundation upon which management can determine the nature and type of controls in place and identify control improvements to reduce risks and ultimately reduce improper payments.

Program Definition and Identification Need Improvement

Before CGFS/DCFO/MC performs its baseline risk assessments in FY 2013, it should improve its definition of a "program" as well as its process for identifying programs. During the audit of the Department's FY 2011 efforts to comply with IPIA, Kearney identified concerns with how the Department defined and selected programs for its risk assessment process. OMB Circular A-123, Appendix C, states that for improper payment risk assessment procedures, a program includes "activities or sets of activities recognized as programs by the public, OMB, or Congress, as well as those that entail program management or policy direction." In FY 2011, CGFS/DCFO/MC initially identified programs by expense category and then grouped some expenses into subcategories. Based on the audit findings, in its 2012 report OIG recommended that CGFS develop a comprehensive definition of programs.

During FY 2012, CGFS/DCFO/MC developed policies that included a definition of a program. Specifically, the guidance stated that for risk assessment purposes, "The Department has elected to define its programs as a combination of allotments and functions codes, depending on their materiality." According to the *Foreign Affairs Handbook* (FAH),[13] an allotment code is used to designate the bureaus, offices, or posts that are responsible for funds. For example allotment code 1024 is the Bureau of Consular Affairs. The FAH[14] states that function codes show the purpose of the payment and are used to meet the Department's requirements for identifying and classifying the programs under the Department's appropriation. For example, the Department has function codes for activities such as Arms Control and the Africa Refugee Program.

Although the guidance stated that CGFS/DCFO/MC would use a combination of allotment and function codes to identify programs, initially CGFS/DCFO/MC identified programs with significant changes only by assessing function codes. However, based on a

[13] 4 FAH-1 H-310, "Allotment Authority and Allotment and Operating Allowance Codes."
[14] 4 FAH-1 H-510, "Function Classification Structure."

qualitative consideration of factors such as common internal control environments, CGFS/DCFO/MC elected to combine certain function codes within the five programs it selected for assessments: Assessed Contributions, Voluntary Contributions, Promote the Rule of Law and Administration of Justice, Civilian Police Programs, and Iraq Overseas Contingency Operations. Not all of these programs were allotments or function codes, which was inconsistent with CGFS/DCFO/MC policies.

In addition, CGFS/DCFO/MC did not always ensure that payments associated with each program were related to that program. For example, CGFS/DCFO/MC grouped all Department expenditures for six function codes under Iraq Overseas Contingency Operations, even though some of these expenditures were made in other locations, including Afghanistan and Pakistan. Although the programs identified by CGFS/CCFO/MC for risk assessments in FY 2012 may have been relevant, without a clear, consistently applied definition of a program, CGFS/DCFO/MC cannot document that it had grouped payments with similar risk profiles and that the programs chosen had met the intent of IPIA.

In addition to refining the definition of a program, CGFS/DCFO/MC also needs to develop a methodology to extract payments related to the identified programs in a cost-effective and timely manner. According to Department officials, one of the reasons for defining programs by allotment and function code was that the data was readily available within the financial management system.[15] Although Kearney believes that it is reasonable for CGFS/DCFO/MC to consider the availability of financial data as one factor when determining the definition of a program, the availability of financial data should not be the only consideration. CGFS/DCFO/MC should also have a strategic perspective when identifying programs. For example, CGFS/DCFO/MC could coordinate with the functional bureaus to identify key Department programs.

Before performing the baseline risk assessments, it is essential for CGFS/DCFO/MC to establish and consistently implement a methodology to define and identify a standard list of programs for risk assessment purposes. Flexibility exists for CGFS/DCFO/MC to define programs in a manner that is meaningful to the Department, but refinements are needed in the current process.

The 2012 report on the Department's FY 2011 compliance with IPIA included a recommendation relating to the Department's improper payments risk assessment as follows:

Recommendation 1 (AUD/FM-12-31). OIG recommends that the Bureau of Resource Management[16] develop policies and standard procedures for performing an improper payments risk assessment. The policies and procedures should include, but not be limited to, the following:

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[15] Kearney reported a control deficiency related to the process used by the Department to identify and allocate costs in its Statement of Net Cost in the *Independent Auditor's Report on the U. S. Department of State 2012 and 2011 Financial Statements* (AUD-FM-13-08, Nov. 2012).

[16] Since the 2012 report was issued, the Bureau of Resource Management was restructured. CGFS assumed all financial management services, programs, and systems activities.

- *A comprehensive definition of the programs to be assessed.*
- *A method to ensure that all program costs are identified.*
- *A description of the quantitative and qualitative factors to be considered.*
- *A method to obtain input from the bureaus and offices responsible for the programs.*

CGFS/DCFO/MC has developed policies and standard procedures for performing an improper payments risk assessment. Therefore, OIG is closing this recommendation upon the issuance of this report. However, the policies and procedures do not address all OMB Circular A-123, Appendix C, requirements. Refinements to the improper payments risk assessment methodology are needed to ensure that all programs with the risk of significant improper payments are identified and assessed.

Recommendation 1. OIG recommends that the Bureau of the Comptroller and Global Financial Services

- Conduct full baseline risk assessments for all programs.
- Refine its definition of a program in accordance with guidance from the Office of Management and Budget and identify programs for risk assessments consistently, using that definition.
- Refine its definition of significant changes in funding to include a consideration of programs with significant percentage changes.
- Refine the risk assessment process to provide additional guidance for rating each risk factor.
- Implement a method to obtain input from the bureaus and offices responsible for the programs.

CGFS Response*:* CGFS concurred with the recommendation, stating that it will "implement corrective actions as appropriate." CGFS also stated that it will "work closely with the OIG" to refine its "definition of programs and conduct full baseline risk assessments in FY 2013."

OIG Reply: OIG considers the recommendation resolved. This recommendation can be closed when OIG reviews and accepts documentation showing that the Department has conducted a baseline risk assessment for all programs, refines its definition of a program and of significant changes, provides additional guidance on risk factors, and obtains information from bureaus and offices that are responsible for the programs.

B. Controls Successfully Implemented To Prevent, Detect, and Recapture Improper Payments but Need To Be Strengthened

The Department has implemented a program of internal control to prevent, detect, and recapture improper payments. Specifically, the Department had policies and procedures for prepayment reviews to prevent improper payments, post-payment reviews to detect improper payments, and recapture audits to recover improper payments. The Department's post-payment reviews and recapture audits have identified and recovered improper vendor payments totaling over $60.5 million since FY 2007.[17]

However, the Department excluded a significant amount of payments from its recapture audits without performing and documenting cost-benefit analyses to support the exclusions. In addition, the recapture audit process was focused on payments without a consideration of program factors that could increase or decrease the risk of improper payments, and recapture audits were limited to identifying duplicate payments. Although CGFS/OMA was analyzing ways to perform recapture audits over excluded payment types, it had not completed that analysis at the time of this audit. The recapture audit exclusions and focus have limited the Department's ability to identify and recover all improper payments and target recapture activities on the highest risk programs.

Prepayment Reviews Were Performed

OMB Circular A-123, Appendix C, states that when implementing a payment recapture audit program, agencies "shall have a cost-effective program of internal control to prevent, detect, and recover overpayments." Prevention activities are designed to prevent improper payments from occurring.

The Department had controls in place to help prevent improper payments from occurring. For payments to vendors, vendors must submit invoices to either the Department's financial service centers or to the foreign post that procured the good or service. For an invoice to be paid, an approved official must certify that the good or service was received and ensure that the invoice is valid and accurate. Once the invoice is approved, two Department personnel, a voucher examiner and a certifying officer, are required to process the payment. The voucher examiner enters the transaction into the Department's accounting system and ensures that all supporting documentation has been submitted. The certifying officer reviews the transaction and verifies that the supporting documentation is complete and the accounting data is correct. The Department's financial accounting systems have automated controls that also verify certain payment-related information. For example, the domestic financial management system does not process payments with duplicate invoice numbers from one vendor.

The Department uses other systems and processes to disburse payments for other activities (for example, grant payments or payments to pensioners). The Department had prepayment controls in place for these payments as well. For example, grantee eligibility and compliance with grant covenants on prior awards were reviewed prior to disbursement of grant payments. Pension payments were reviewed prior to disbursement against the "Do Not Pay" Social Security listing to ensure payments were not made to deceased individuals.

Post-Payment Reviews Were Performed as Part of Routine Payment Process

OMB Circular A-123, Appendix C, states that detection activities occur subsequent to payment and are intended to detect improper payments that may have occurred. These actions

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[17] Amount represents payment recapture audit recoveries and CGFS/F/C recoveries as disclosed in the Department's FY 2007-2012 AFRs.

test the accuracy of payment processes and identify improper payments made during those processes. For example, routine payment verification or quality control would review a universe of payments using criteria different than those used during prepayment reviews to detect potential improper payments.

The Department performed post-payment reviews as part of its routine payment process. Specifically, CGFS/F/C selected random samples of payments on a monthly basis and reviewed the sampled items for adequate support, proper approval, and the validity and accuracy of the amounts disbursed. This process would identify payments made to individuals who should not have received them, payments made in incorrect amounts, and payments that should not have been made. CGFS/F/C also used data-matching techniques to identify potential duplicate payments disbursed in the current fiscal year.

On a monthly basis, CGFS/F/C prepared a monthly Quality Management report that summarized the improper payments identified. This report tracked improper payments identified against key metrics, including improper payments as a percentage of total payments issued. Based on its analysis of the improper payments, CGFS/F/C identified the root causes and trends of improper payments and reported the improper payments by office responsible, vendors paid, and bureau.

During FY 2012, CGFS/F/C identified $11.1 million in overpayments through its post-payment reviews. Of the $11.1 million in overpayments identified, CGFS/F/C recovered $10.9 million. CGFS/F/C also recovered additional improper payments, totaling $700,000, that were identified during post-payment reviews in previous years.

Recapture Audit Process Had Been Implemented

IPIA requires agencies to conduct recovery audits (also known as "recapture audits") if conducting such audits would be cost effective. According to OMB Circular A-123, Appendix C, a recapture audit is a review and analysis of accounting and financial records, supporting documentation, and other information supporting payments that is specifically designed to identify overpayments.

The Department had implemented a recapture audit process. CGFS/OMA performed recapture audit activities by auditing domestic payments on a monthly basis. Specifically, CGFS/OMA extracted a data file of payments made during the previous month from the domestic financial management system and imported the file into a data analysis tool. CGFS/OMA then performed a search for potential duplicate payments by comparing the invoice number and dollar amount of each payment in the monthly data file against the payments made during the previous 3 years. Payments with the same invoice number and dollar amount were extracted into a separate file of potential duplicate payments. CGFS/OMA provided the potential duplicate payments to CGFS/F/C for review.

As reported in the Department's FY 2012 AFR, CGFS/OMA identified $35,357 in actual duplicate payments made during FY 2012. Of this amount, the Department recovered $35,141, with only $216 outstanding at the time of this audit.

Post-Payment Review and Recapture Audit Results

Together, the Department's post-payment reviews and improper payments recapture audits identified improper payments totaling approximately $60.5 million from FY 2007 to FY 2012. Of that amount, the Department recovered approximately $57.5 million, as shown in Table 1.

Table 1. Improper Payments Identified and Recovered From FY 2007 to FY 2012

Fiscal Year	Amount Identified (in millions)	Amount Recovered During FY (in millions)
2012	$11.1	$11.6
2011	16.6	15
2010	8.1	7.9
2009	3.9	3.8
2008	15.4	14.3
2007	5.4	4.9
Total	**$60.5**	**$57.5**

Source: Department AFRs from FY 2007 to FY 2012.

Recapture Audit Methodology Needs Improvement

Although CGFS/OMA performed recapture audits, it excluded a significant amount of payments from the audits without conducting cost-benefit analyses to support these exclusions, as was required. In addition, CGFS/OMA focused its recapture audits on payments rather than on programs, and the audits were limited to one type of improper payments–duplicate payments. At the time of this audit, CGFS/OMA was analyzing ways to perform recapture audits over excluded payment types. The recapture audit exclusions and focus limited the Department's ability to identify and recover all improper payments and target recapture activities on the highest risk programs.

Recapture Audit Exclusions

OMB Circular A-123, Appendix C, states that agencies may exclude payments from certain programs from payment recapture audit activities if the agency determines that payment recapture audits are not a cost-effective method for identifying and recapturing improper payments. If an agency excludes a program that expends more than $1 million, the agency must notify OMB and OIG of this decision and include any analysis used by the agency to reach this decision.

The Department's FY 2012 recapture audit process did not include a significant amount of payments. Specifically, CGFS/OMA excluded, from payment recapture audits, the payments that were made outside the CGFS/F/C payment process. For example, CGFS/OMA excluded overseas payments amounting to approximately $1.9 billion. These payments were processed by the Department's overseas financial management system. CGFS/OMA also excluded grant payments amounting to approximately $1.8 billion that were made through the Payment

Management System,[18] which processes the majority of the Department's financial assistance-related payments. In addition, CGFS/OMA excluded pension annuity payments amounting to approximately $874 million[19] that were processed by CGFS's Retirement Accounts Division. CGFS/OMA excluded these payments for a variety of operational reasons. For example, the overseas financial management system does not require that the invoice number, which is used by CGFS/OMA to identify duplicate payments, be entered for overseas payments, and in some cases, multiple invoices may be entered and the payments may be made with one disbursement.

CGFS/OMA also excluded certain payments that were processed by CGFS/F/C from the recapture audits. The excluded payments included, but were not limited to, bulk payments, which included purchase card payments; shipping payments; and certain travel payments. These bulk payment exclusions exceeded $378 million in FY 2012.

As a result of the exclusions, the Department's FY 2012 recapture audit activities did not cover approximately $3.6 billion in payments subject to IPIA requirements. Although CGFS/OMA excluded a significant amount of payments, it did not perform and document a cost-benefit analysis supporting the basis for these exclusions, as was required.

Recapture Audit Focus

IPIA requires agencies to conduct payment recapture audits for each program that expends $1 million or more annually if conducting such audits would be cost effective. OMB Circular A-123, Appendix C, requires all programs exceeding the $1 million threshold, including grant, benefit, loan, and contract programs, to be considered during the payment recapture audits. Agencies are required to review their different types of programs and prioritize conducting payment recapture audits on those categories that have a higher potential for overpayments and recoveries.

CGFS/OMA's recapture audits focused on payments rather than on programs. CGFS/OMA's approach enabled it to include a large number of payments in the recapture audits. Although performing recapture audit activities based on payments is a beneficial internal control, using a payment approach alone does not consider specific program characteristics that may increase or decrease the risk for improper payments. For example, payments made for programs that have a large number of disbursements and limited oversight resources, such as programs in war zones or at some hardship posts, received the same level of review as payments for programs that have a small number of disbursements and adequate resources. In addition, although the amount of improper payments identified during recapture audits may appear to be insignificant to the Department as a whole using the payment approach, the amount of improper payments identified for a specific program may be significant to the program. A more program-focused approach would enable CGFS/OMA to identify the programs that have a high rate of improper payments, target future recapture audit activities more efficiently on those programs, and identify and correct the circumstances that led to improper payments in those programs.

[18] The Payment Management System is a grant payment system maintained by the U.S. Department of Health and Human Services.
[19] The amount disbursed to beneficiaries was disclosed in the Department's FY 2012 AFR, Note 10.

The Department's recapture audits were also limited to a search for duplicate payments. The audits did not search for other types of improper payments. For example, the audits were not designed to identify overpayments or underpayments and were not designed to identify payments for goods and services not received, payments to ineligible recipients, fraudulent payments, or payments that lacked adequate support.

Limited Ability To Identify and Recover Improper Payments

The issues relating to recapture audit exclusions and focus were first reported in the 2012 report on the Department's FY 2011 compliance with IPIA. Since that report was issued, CGFS/OMA had not modified its recapture audit process. However, at the time of this audit, CGFS/OMA was analyzing ways to perform recapture audits over excluded payment types. Specifically, CGFS/OMA was exploring ways to perform sampling of overseas payments. CGFS/OMA was also gaining an understanding of the payment controls over excluded grantee and retirement payments to determine whether it would be possible to construct a cost-effective recapture audit program over those payments.

Without a sufficient cost-effective recapture audit program, the Department may have made but had not identified and recovered all improper payments. A well-designed recapture audit process targets areas most susceptible to improper payments and leverages the latest technologies. Although traditionally used as a technique to identify improper payments already made, recapture auditing results can also be used to identify trends in improper payments and improve controls to prevent improper payments.

The 2012 report on the Department's FY 2011 compliance with IPIA included a recommendation relating to the Department's recapture audit activities as follows:

Recommendation 2 (AUD/FM-12-31). OIG recommends that the Bureau of Resource Management develop policies and standard procedures for its recapture audit activities. These policies and procedures should include, but not be limited to, the following:

- *Program, as well as payment, audit activities to help target recapture audits on programs or payment types that are deemed higher risk.*
- *Alternative procedures to audit payments occurring outside the Global Financial Management System.*
- *Analytics and other proven recapture audit techniques (for example, predictive modeling, additional forensic accounting tools, additional data matches, and financial incentives) that address improper payments types other than duplicate payments.*
- *Requirements for performing a cost-benefit analysis for programs and payment types excluded from recapture audit activities and communicating the exclusions to the Office of Management and Budget and OIG.*

CGFS/OMA has developed policies and procedures for its recapture audit activities. Therefore, OIG is closing this recommendation upon issuance of this report. However, the policies and procedures do not address all OMB Circular A-123, Appendix C, requirements. CGFS/OMA should continue its efforts to identify ways to expand its audit coverage over currently excluded payments and refocus its recapture activities on programs with a higher potential for overpayments and recoveries, as required by OMB Circular A-123, Appendix C.

Recommendation 2. OIG recommends that the Bureau of the Comptroller and Global Financial Services revise existing policies and standard procedures for its recapture audit activities to ensure compliance with all Office of Management and Budget requirements. These revised policies and procedures should include, but not be limited to, the following:

- Program, as well as payment, audit activities to help target recapture audits on programs or payment types that are deemed higher risk.
- Alternative procedures to audit payments occurring outside the domestic financial management system.
- Analytics and other proven recapture audit techniques (for example, predictive modeling, additional forensic accounting tools, additional data matches, and financial incentives) that address improper payments types other than duplicate payments.
- Requirements for performing a cost-benefit analysis for programs and payment types excluded from recapture audit activities and communicating the exclusions to the Office of Management and Budget and Office of Inspector General.

CGFS Response*:* CGFS concurred with the recommendation, stating that it will "implement corrective actions as appropriate."

OIG Reply: OIG considers the recommendation resolved. This recommendation can be closed when OIG confirms that the Department has revised its existing policies and procedures related to recapture audit activities.

C. Most Improper Payments Disclosures Were Made, but Some Were Omitted or Were Inaccurate

The Department's FY 2012 AFR included improper payments disclosures that provided a high-level understanding of the Department's IPIA risk assessment process and recapture audit activities and results. However, the AFR did not include all OMB-required disclosures, and other disclosures were inaccurate. By not including complete and accurate information in its AFR, the Department is not providing users with complete information about its efforts related to improper payments.

Most Improper Payments Disclosures Were Made

IPIA states that for an agency to be in compliance with the Act, the agency must publish an annual financial statement for the most recent fiscal year and post that report, with the information on improper payments required by OMB, on the agency's Web site. OMB Circular A-123, Appendix C, requires an agency to disclose specific information relating to improper payments in its annual AFR in the format provided in OMB Circular A-136, Revised, *Financial Reporting Requirements*.

The Department published its FY 2012 AFR on its Web site. The AFR included most of the required improper payments disclosures. For example, the AFR included summary information on improper payments, a general description of the Department's risk assessment process, and a description of the Department's payment recapture audit program. The information reported in the AFR provided a high-level understanding of the Department's IPIA risk assessment process and recapture audit activities and results.

Some Required Disclosures Were Omitted or Were Inaccurate

Although the Department included most of the required disclosures in its AFR, several disclosures were omitted. For example, OMB Circular A-136 requires that an agency provide a brief description of its progress on eliminating and recovering improper payments in the Management's Discussion and Analysis section of its AFR. OMB Circular A-123, Appendix C, requires that an agency report the basis for its groupings of programs in the AFR and provide a description and justification of the classes of payments excluded from payment recapture audits. The Department did not make these disclosures in its FY 2012 AFR. These issues were first reported in the 2012 report on the Department's FY 2011 compliance with IPIA.

In addition, the Department's payment recapture tables in the AFR did not follow the format provided in OMB Circular A-136, and the Department did not include all required information in the tables. Specifically, the tables did not include columns to identify the programs for which recapture audits were performed, as was required. Further, the recapture tables did not include complete information on the payments identified and recovered through sources other than payment recapture audits. The Department included the amounts identified and recovered by CGFS/OMA during recapture audit activities and by CGFS/F/C during post-payment reviews as well as OIG recoveries. However, the Department did not track and assess information on payments identified and recovered in other Department offices and bureaus, such as contract closeout recoveries, recoveries resulting from grant compliance reviews, and pension overpayment recoveries. This issue also was first reported in the 2012 report.

Kearney also identified some information in the AFR that may be misleading. In its description of the recapture audit analysis, the Department stated that the domestic payment file used during the analysis "presently includes the majority of payments subject to IPERA requirements such as most domestic vendor payments and grant payments." However, CGFS/OMA did not include grant payments made through the Payment Management System in its recapture audits. These payments make up the majority of grant payments made by the Department. Further, the recapture tables include a column for identifying the type of payment included in the payment recapture audit. In the Department's payment recapture tables, this column indicated that all payments were subject to the review. However, as discussed in Finding B, CGFS/OMA excluded, from its payment recapture audits, certain payment types, including overseas payments, Payment Management System grant payments, pension annuity payments, and bulk payments. These issues also were reported in the 2012 report.

By not including all required information in its AFR, the Department did not provide users with relevant and reliable information about its efforts to prevent and identify and recover improper payments. AFRs play a key role in fulfilling the Government's duty to be accountable for the use of public funds, and AFRs can be used to assess an agency's efficiency and effectiveness in performing activities such as identifying and recapturing improper payments. The results of an agency's actions related to improper payments should be available not only to Congress and agency management but also to the general public.

The 2012 report on the Department's FY 2011 compliance with IPIA included a recommendation relating to the Department's improper payments reporting as follows:

Recommendation 3 (AUD/FM-12-31). OIG recommends that the Bureau of Resource Management develop policies and standard procedures that ensure that the improper payments information included in the Department of State Agency Financial Report is complete and accurate.

CGFS/DCFO/MC has developed formal policies and standard procedures for preparing the disclosures since the 2012 report. Therefore, OIG is closing this recommendation upon issuance of this report. However, because the policies and procedures did not ensure that all required improper payments disclosures were made, CGFS should improve its controls over improper payments reporting.

Recommendation 3. OIG recommends that the Bureau of the Comptroller and Global Financial Services enhance existing policies and standard procedures to ensure that the improper payments information included in the Department of State Agency Financial Report is complete and accurate.

CGFS Response: CGFS concurred with the recommendation, stating that it will "implement corrective actions as appropriate."

OIG Reply: OIG considers the recommendation resolved. This recommendation can be closed when OIG confirms that the Department has enhanced its policies and procedures for including improper payments information in the Agency Financial Report.

List of Recommendations

Recommendation 1. OIG recommends that the Bureau of the Comptroller and Global Financial Services

- Conduct full baseline risk assessments for all programs.
- Refine its definition of a program in accordance with guidance from the Office of Management and Budget and identify programs for risk assessments consistently, using that definition.
- Refine its definition of significant changes in funding to include a consideration of programs with significant percentage changes.
- Refine the risk assessment process to provide additional guidance for rating each risk factor.
- Implement a method to obtain input from the bureaus and offices responsible for the programs.

Recommendation 2. OIG recommends that the Bureau of the Comptroller and Global Financial Services revise existing policies and standard procedures for its recapture audit activities to ensure compliance with all Office of Management and Budget requirements. These revised policies and procedures should include, but not be limited to, the following:

- Program, as well as payment, audit activities to help target recapture audits on programs or payment types that are deemed higher risk.
- Alternative procedures to audit payments occurring outside the domestic financial management system.
- Analytics and other proven recapture audit techniques (for example, predictive modeling, additional forensic accounting tools, additional data matches, and financial incentives) that address improper payments types other than duplicate payments.
- Requirements for performing a cost-benefit analysis for programs and payment types excluded from recapture audit activities and communicating the exclusions to the Office of Management and Budget and Office of Inspector General.

Recommendation 3. OIG recommends that the Bureau of the Comptroller and Global Financial Services enhance existing policies and standard procedures to ensure that the improper payments information included in the Department of State Agency Financial Report is complete and accurate.

Appendix A

Scope and Methodology

The Improper Payments Elimination and Recovery Act of 2010[1] (IPERA), which amended the Improper Payments Information Act of 2002[2] (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 external audit firm, 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 by IPERA.[3]

Kearney conducted this performance audit from December 2012 through February 2013 in Washington, D.C., and at the Office of Global Financial Services in Charleston, South Carolina. Kearney planned and performed the audit in accordance with performance audit requirements in the Government Accountability Office's *Government Auditing Standards*, December 2011 Revision. Those standards required that Kearney obtain sufficient, appropriate evidence to provide a reasonable basis for findings and conclusions. The sufficiency and appropriateness of evidence needed and tests of evidence related directly to the objective and scope of the audit.

Kearney focused the scope of the audit on the following areas: (1) evaluating whether the Department conducted a program-specific risk assessment for all programs; (2) evaluating the Department's performance in preventing, detecting, and recapturing improper payments; and (3) determining whether the Department reported the required improper payments information in its 2012 Agency Financial Report (AFR).

Kearney designed the audit to obtain insight into the Department's current processes, procedures, and organizational structure with regard to compliance with IPIA requirements. To expedite the audit process, Kearney leveraged the results of its FY 2012 financial statement audit and audit of the Department's FY 2011 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.

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; its process of identifying significant improper payments; the steps taken to prevent, reduce, and recapture improper payments; and the process of reporting improper payments. Consistent with the fieldwork standards for performance audits, Kearney established performance criteria and identified sources of audit evidence to complete the testing phase.

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

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[1] Pub. L. No. 111-204 §3(b).
[2] Pub. L. No. 107-300.
[3] Unless otherwise indicated, the term "IPIA" means "IPIA, as amended by IPERA," in this report.

bases for assessing the Department's compliance with IPIA requirements. The testing phase included procedures to assess the Department's IPIA reporting process, the recapture audit process, and the AFR disclosures.

During the reporting phase, Kearney formally communicated the conclusions reached and the findings and recommendations.

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 making payments, performing risk assessments, reviewing payments, and reporting improper payments information. However, Kearney did not perform testing of these controls because it was beyond the scope of this audit.

Use of Computer-Processed Data

Kearney obtained computer processed data (that is, spreadsheets) and reporting packages to aid in determining whether the Department had 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 audit objectives. However, Kearney assessed the data provided as reasonable based on its understanding of the financial information gained during the audit of the Department's FY 2012 financial statements.

Appendix B

United States Department of State
Comptroller
1969 Dyess Avenue
Charleston, SC 29405

MAR 13 2013

UNCLASSIFIED

MEMORANDUM

TO: OIG – Harry W. Geisel

FROM: CGFS – James L. Millette

SUBJECT: Draft Report on Audit of Department of State FY 2012 Compliance With the Improper Payments Requirements

Thank you for the opportunity to comment on the Office of Inspector General's (OIG) Draft Report titled Audit of Department of State FY 2012 Compliance with the Improper Payments Requirements.

This compliance audit is relatively new in only its second year of required reporting to OMB and Congress for FY 2012. Significant amendments have been made in the past few years regarding IPIA, with the passage of IPERA (Improper Payments Elimination and Recovery Act) and most recently IPERIA (Improper Payments Elimination and Recovery Improvement Act). The Department has made significant efforts to comply with all guidance in a manner that also leverages the good stewardship of government funds and ensures our initiatives are cost-effective. We take pride that our program is compliant with IPIA, but we recognize that more improvements can be made and will continue doing so. As such, we concur with the OIG recommendations. The Department takes the OIG recommendations very seriously, as demonstrated by the accomplishments noted in the report. We will carefully evaluate the new recommendations made and implement them to the extent they are a beneficial and cost-effective use of government funds. After we have fully evaluated the recommendations, we will implement corrective actions as appropriate. In particular, we will work closely with the OIG as we refine our definition of programs and conduct full baseline risk assessments in FY 2013.

As acknowledged in the Draft Report, the Department employs numerous preventative and identification methods to support IPIA requirements. We have dedicated considerable resources to prevent improper payments from occurring, and take pride in our track record of success based on the low volume of actual improper payments identified and recovered each year. Prior IPIA regulatory guidance was geared toward high-risk programs and activities that were deemed susceptible to significant improper payments. Despite having no programs or activities susceptible to significant improper payments, as previously defined, the Department uses risk assessment and recapture initiatives to assist in identifying improper payments and related payment issues. With the implementation of our Global Financial Management System in 2007, we fully integrated acquisitions into the financial system at the line level, significantly enhancing the integrity of our payments. In addition, we are strengthening our payment internal controls through our efforts under OMB's Do Not Pay initiative. For example, the Department has already implemented procedures to compare our payments to Foreign Service annuitants against the Social Security Administration's master death file.

We recognize that the IPERA, IPERIA and related guidance has raised the bar on transparently accounting for and preventing improper payments for all Agencies, including the Department. We are committed to meeting these compliance requirements in a reasoned manner. We look forward to working with both the OIG and the Independent Auditor on further enhancements to our existing programs in the coming year.

If you have any questions concerning this status summary, please contact Carole Clay (CGFS/DCFO/MC) at 202-663-[redacted].

FRAUD, WASTE, ABUSE, OR MISMANAGEMENT OF FEDERAL PROGRAMS HURTS EVERYONE.

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