There’s light at the end of the tunnel in the fight against improper payments

KPMG Government Institute
Maryland Association of CPAs 2014
Government & Not For Profit Conference

Advisory

Today we will cover three issues

- Evolution of the focus on improper payments
  - Legislative framework
  - Presidential call for action
  - Results through fiscal year 2013
- Practical look at what government agencies can do and are doing to address the President’s call for action and the Improper Payments Elimination and Recovery Act of 2010 (IPERA) and the Improper Payments Elimination and Recovery Improvement Act (IPERIA) of 2012
- Questions to ask yourself to determine whether you are combat ready
Evolution of the focus on improper payments

- The Government Accountability Office's (GAO) High-Risk Series/Inspector General reports
- Initial financial statement audits at the Department of Health and Human Services and the Social Security Administration
- GAO's audit report on the consolidated financial statements
- Passage of the Improper Payments Information Act of 2002 (IPIA) and Office of Management and Budget (OMB) implementing guidance in Appendix C of Circular A-123 require that:
  - The causes of improper payments are determined
  - Actions are taken to cost-effectively reduce the risk of improper payments to an acceptable level
  - Improper payments are estimated, tracked, and reported.
- Presidential Executive Order, Reducing Improper Payments and Reducing Waste in Government Programs, November 23, 2009

Evolution of the focus on improper payments (continued)

- Passage of the Patient Protection and Affordable Care Act of 2010 and the Health Care Education and Reconciliation Act of 2010, March 23, 2010:
  - $65.7 billion, or 62% of the $106 billion in government-wide improper payments reported for fiscal year 2013
- Enactment of IPERA, July 22, 2010
- Enactment of IPERIA, January 10, 2013

Source: Department of Health and Human Service (HHS) 2013 Financial Report
Presidential Executive Order – Reducing Improper Payments and Eliminating Waste in Federal Programs

“When the Federal Government makes payments…, it must make every effort to confirm that the right recipient is receiving the right payment for the right reason at the right time… this order adopts a comprehensive set of policies, including transparency and public scrutiny of significant payment errors throughout the Federal Government; a focus on identifying and eliminating the highest improper payments; accountability for reducing improper payments among executive branch agencies and officials; and coordinated Federal, State, and local government action in identifying and eliminating improper payments.”

Presidential Executive Order, Reducing Improper Payments and Eliminating Waste in Federal Programs
November 23, 2010

Administration goals for 2010 – 2012

- Reducing improper payments by $50 billion by fiscal year 2012
- Recapturing $2 billion in actual overpayments by fiscal year 2012
- Increasing accountability and transparency for reducing improper payments, including:
  - Use of modern tools for the prevention and detection of improper payments
  - Incentives for states to reduce improper payments
  - Penalties for contractors who fail to disclose improper payments

Source: www.paymentaccuracy.gov
Improper Payments Elimination and Recovery Act of 2010

- The President in signing IPERA into law on July 22, 2010:
  - "The bipartisan bill I’m signing today will help ensure that our government serves as a responsible steward for the tax dollars of the American people, and builds on the efforts we’re taking to cut wasteful spending."
- Greatly expands on the provisions of IPIA
- Provides clarification
- Adds the force of law to the requirements in the Presidential Executive Order and the risk of being in legal violation

Improper Payments Elimination and Recovery Improvement Act of 2012

- Signed into law on January 10, 2013
- Adds to the IPERA provisions:
  - Requires OMB on an annual basis to identify high-priority programs and, in coordination with the agencies, to establish performance targets for those high-priority programs (adds legal teeth to the 2010 Presidential Executive Order requirement)
  - Requires agency to report to their Inspectors General (IGs) on all identified high-priority programs and to adhere to enhanced guidance for estimating improper payments (to be issued by OMB within six months of IPERIA’s enactment)
  - Reinforces and accelerates the Presidents “Do Not Pay List” initiative
Key requirements of the Executive Order

- Create an online dashboard of key indicators and statistics on improper payments
- Create and publicize a single mechanism for the public to report suspected incidences of fraud, waste, and abuse
- Require agencies to establish more frequent payment error reduction targets
- Issue recommendations on new internal techniques agencies can use to better detect and mitigate improper payments
- Require each agency to designate a current, Senate-confirmed appointee to be accountable to the President for meeting improper payment reduction targets
- For programs where targets for reducing improper payments are not met for two years in a row, require the agency head, the CFO, and the IG to report to the OMB Director on the likely causes of the failure and actions the agency will take to meet the reduction targets

More key requirements of the Executive Order

- Increase data-sharing among federal agencies and programs
- Where applicable, require state and local governments and other stakeholders to improve eligibility verification and prepayment scrutiny
- Require quarterly reporting on any high-dollar payment errors identified by the agency and on actions the agency will take to recover the improper payments and to prevent future improper payments
- Pursue administrative actions to provide incentives for reducing improper payments by state and local governments and nonprofit organizations that receive federal funds
- Seek to enhance contractor accountability through use of remedies, such as debarment, suspension, and financial penalties, for failing to disclose in a timely manner credible evidence of significant overpayments received on government contracts
Part III to OMB Circular A-123, Appendix C, March 10, 2010

- Significant components of the guidance include:
  - Specifying responsibilities of agency accountable officers
  - Determining high-priority programs
  - Defining supplemental measures and targets for high-priority programs
  - Establishing reporting requirements
  - Establishing procedures to identify entities with outstanding improper payments

Parts I and II to OMB Circular A-123, Appendix C, April 14, 2011, (OMB Memorandum 11-16)

- Describing alternative improper payment measurements
- Expanding payment recapture audits to all types of payments and activities with more than $1 million in annual outlays if cost effective
- Improving corrective action plans and incorporating lessons learned from the Recovery Act implementation
- Distributing funds recovered through payment recapture audits for authorized purposes
- Establishing compliance reviews and requirements for agencies deemed noncompliant
Other guidance

- Presidential Memorandum, Finding and Recapturing Improper Payments, March 10, 2010
- Presidential Memorandum, Enhancing Payment Accuracy through a “Do Not Pay List,” June 18, 2010

President Obama: “While identifying and recapturing improper payments is important, prevention of payment errors before they occur should be the first priority in protecting taxpayer resources from waste, fraud, and abuse. In those cases, where data available to agencies clearly shows a potential recipient of a Federal payment is ineligible for it, subsequent payment to that recipient is unacceptable. We must ensure such payments are not made.”

- Vice President Biden announced the expansion of a fraud mapping tool now being used by the Recovery Accountability Transparency Board, June 18, 2010
- OMB Memorandum 11-04, Increasing Efforts to Recapture Improper Payments by Intensifying and Expanding Payment Recapture Audits, November 16, 2010
- OMB Memorandum 12-11, Reducing Improper Payments Through the “Do Not Pay List,” April 2012

OMB Memorandum 12-11, Reducing Improper Payments Through the “Do Not Pay List,” April 2012

- Web-based, single entry access portal enabling access to data sources such as:
  - Death Master File
  - The Excluded Parties List System
  - Treasury’s Debt Check Database
  - List of Excluded
- Data analytics services, including other data bases, such as zip code data and prison information, and advanced data analytics for trends, risks, and patterns of behavior
- Recovery Accountability and Transparency Board “Fast Alert” system
  - Central portal to perform eligibility checks on federal awards
  - Recommendation for a centralized fraud framework to track and oversee federal spending
Agencies have reported progress for fiscal years 2010 to 2013

- Reported government-wide improper payment rates (goal $50 billion in savings for 2010 to 2012):
  - 2009: 5.42% (base year)
  - 2010: 5.29% (= $3 billion)
  - 2011: 4.69% (= $18 billion)
  - 2012: 4.35% (= $26 billion)
  - 2013: 3.53% (= $46 billion)
  - 2014: 3.19% (target)
  - 2015: 3.07% (target)

- Reported recoveries (goal $2 billion for 2010 to 2012):
  - 2010: $700 million
  - 2011: $1.2 billion
  - 2012: $2.5 billion
  - 2013: $22 billion

Source: www.paymentaccuracy.gov

High payment error programs – reported in 2013 financial reports

<table>
<thead>
<tr>
<th>Program</th>
<th>$ (Billions)</th>
<th>%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Medicare Fee-for-Service</td>
<td>36.0</td>
<td>10.1</td>
</tr>
<tr>
<td>Medicaid</td>
<td>14.4</td>
<td>5.8</td>
</tr>
<tr>
<td>Medicare Advantage</td>
<td>11.8</td>
<td>9.5</td>
</tr>
<tr>
<td>Earned Income Tax Credit</td>
<td>13.5</td>
<td>22.1</td>
</tr>
<tr>
<td>Unemployment Insurance</td>
<td>9.3</td>
<td>6.2</td>
</tr>
<tr>
<td>Supplemental Security Income</td>
<td>4.3</td>
<td>8.1</td>
</tr>
<tr>
<td>Retirement, Survivors &amp; Disability Insurance</td>
<td>2.5</td>
<td>0.3</td>
</tr>
<tr>
<td>Supplemental Nutrition Assistance Program</td>
<td>2.6</td>
<td>3.4</td>
</tr>
<tr>
<td>Medicare Prescription Drug (Part D)</td>
<td>2.1</td>
<td>3.7</td>
</tr>
<tr>
<td>National School Lunch Program</td>
<td>1.8</td>
<td>15.7</td>
</tr>
<tr>
<td>Rental Housing Assistance</td>
<td>1.3</td>
<td>4.3</td>
</tr>
<tr>
<td>Pell Grants</td>
<td>0.7</td>
<td>2.3</td>
</tr>
<tr>
<td>Children’s Health Insurance Program</td>
<td>0.6</td>
<td>7.1</td>
</tr>
</tbody>
</table>

Source: 2013 agency financial reports
A practical look at what government agencies can do

There is no silver bullet

- Commitment of the senior agency management
- Hard work and partnerships across the agency
- Significant changes in practices and processes for some federal programs
- Improved internal control
- Better leveraging of technology
- The application of techniques, such as continuous monitoring, that have a tested track record of success
- More and better communications and data-sharing among federal agencies, state and local governments, and other stakeholders that administer federal funds
- Adoption of an agency-wide, comprehensive fraud risk management program
Day-to-day responsibility for improper payments largely rests with program managers

Research performed by the KPMG Government Institute for the KPMG Executive Guide to High Performance in Federal Financial Management showed that high-performing finance organizations:

- Assist program managers in assessing risk and establishing cost-effective internal control
- Help develop benchmarks and performance metrics
- Support the development of a comprehensive fraud risk program
- Help keep abreast of emerging fraud schemes and new tools and techniques
- Treat this as much more than compliance
- Avoid “Pay and Chase” approach
- Promote strong preventive controls

President Obama: “While identifying and recapturing improper payments is important, prevention of payment errors before they occur should be the first priority in protecting taxpayer resources from waste, fraud, and abuse.”

At the heart of reducing improper payments: The role of risk management

- Establish and clearly communicate risk goals and objectives
- Back them up with well-designed policies and procedures
- Understand the higher degree of sophistication needed to make complex risk and cost trade-offs
- Establish a governance process and enforce accountability for results
- Be prepared to accept certain risks instead of setting up costly fail-safe systems to attempt to avoid all risks – appropriate level of control
- Expressly address information technology risks
- Establish a fraud risk management program – prevention, detection, and response
- Take timely and effective actions to remediate identified risks
- Consider this a continuous process, since risks can be ever-changing
Continuous monitoring: A key management ally in the fight against improper payments

- Automated, sustained feedback mechanism
- Proactive/Preventive vs. Retrospective/Detective
- Risk-based – business rules or criteria to test for noncompliance
- Large volumes of transactions
- Obscure relationships
- Trend analysis
- Sophisticated data mining (anomaly detection; clustering analysis; time sequencing; association rules; predicative modeling)
- Mapping
- Cost optimization
- Contract and payment management

Considering the benefits of continuous monitoring

What are the benefits of implementing continuous monitoring?

Continuous monitoring offers a broad range of potential benefits...

Greater Efficiency
- Reduction of work duplication
- Increased use of automation
- Enhanced ability to identify and correct errors
- More time for value-adding analysis instead of error correction
- Reduced travel costs by automation of testing and remote monitoring

Enhanced Controls
- Corrections of errors moved closer to the “source”
- Automated controls
- Control gaps and deficiencies can be monitored for circumvention and/or exploitation
- ERP system and/or business process limitations and deficiencies can be addressed
- Automated fraud prevention and detection activities

Earlier Information
- Improved speed of information delivery to agency management
- Reduced surprises, problems do not build up
- Better information for decision making
- Ability to perform root cause analysis for errors, policy violations, fraud, abuse, and misconduct

Reduced Complexity
- Greater visibility into how processes are functioning
- Appropriate setting and consistency of thresholds
- Legal and regulatory compliance can be monitored
- Ability to standardize process measures across locations
- Demonstrate good governance – use leading-edge approach

...which results in more focused time to add value to the mission operations.
Making the most of continuous monitoring

KPMG's Approach to Procurement Analytics

<table>
<thead>
<tr>
<th>Forensic Data Analysis</th>
<th>Approach or Red Flag</th>
<th>Scheme or Indicator</th>
</tr>
</thead>
<tbody>
<tr>
<td>Matching</td>
<td>Trace transactions from ordering to payment and identify inconsistencies</td>
<td>Overpayment for or under-delivery of goods or services</td>
</tr>
<tr>
<td></td>
<td>Duplication of invoices</td>
<td>Duplicate invoices or payments</td>
</tr>
<tr>
<td></td>
<td>Hidden links between employees and vendors (e.g., in bank accounts)</td>
<td>Collusion between staff and suppliers</td>
</tr>
<tr>
<td>Timing</td>
<td>Timing of transaction creation, approval, and payment (e.g., by time of day, day of week, or nonbusiness day)</td>
<td>Periods of time prone to fraudulent activity (e.g., outside of business hours)</td>
</tr>
<tr>
<td></td>
<td>Volume/value patterns</td>
<td>Unusual heightened activity out of correlation to business cycle</td>
</tr>
<tr>
<td>Amount &amp; Value</td>
<td>Statistical numerical distribution (including Benford's Law)</td>
<td>Number &quot;invention&quot; or manufactured transactions</td>
</tr>
<tr>
<td></td>
<td>Duplicate amounts or endings (e.g., 001, 002)</td>
<td>Concealment of transactions through splitting of amounts to defeat approval limits</td>
</tr>
<tr>
<td></td>
<td>Identification of clustering of expenses around unusual values</td>
<td>Unusual volume/activity/red flags indicating discovery of a new fraud scheme</td>
</tr>
<tr>
<td></td>
<td>Identification of expenses that are outside the norm for a given employee</td>
<td></td>
</tr>
<tr>
<td>Vendor Activity</td>
<td>Quantity of invoices</td>
<td>Ghost vendors</td>
</tr>
<tr>
<td></td>
<td>Identification of suspicious key words within specific text</td>
<td>Falsified volume or pricing</td>
</tr>
<tr>
<td></td>
<td>Unit jurisdiction clustering</td>
<td>Collusion – invoices below approval limits</td>
</tr>
<tr>
<td></td>
<td>Discounts not taken</td>
<td>Collusion – discounts earned but &quot;refused&quot;</td>
</tr>
<tr>
<td>User Activity</td>
<td>Unusual trends in volume, activity, or value</td>
<td>Users operating outside of authorized roles</td>
</tr>
<tr>
<td></td>
<td>Unauthorized users</td>
<td>Unauthorized activity</td>
</tr>
<tr>
<td></td>
<td>Segregation of duties breaches</td>
<td>Unmonitored transactions</td>
</tr>
</tbody>
</table>

Data-sharing can help reduce improper payments by enhancing business intelligence

- Phase 1: Creating "Fraud Intelligence"
- Phase 2: Sharing information across federal agencies:
  - Compatibility challenges and legal and program limitations
- Phase 3: Sharing Information with State and Local Governments and Other Administrators of Federal Funds:
  - Over $600 billion annually
  - Medicaid: $14.4 billion (5.8% rate) in reported overpayments for fiscal year 2013 (down 25% from $19.2 billion reported in 2012)

Source: HHS 2013 Financial Report
Going after wrong-doers

- Health Care Fraud Prevention and Enforcement Action Team: Justice and HHS
- Unequivocal message delivered by the Attorney General and the HHS Secretary – words backed by actions
  - Criminal indictments and prosecutions
  - Billions in reported recoveries
  - One case involved $375 million

Combat readiness: Can you answer these questions?

- Do you have a strong understanding of the portfolio of payment errors that exists within your programs?
  - Understanding root causes
  - Understanding your span of control of payment errors
  - Understanding ROI zones within error portfolios
- Are you using research-based methods when assessing the viability and effectiveness of new corrective actions?
  - Pilot testing test various solutions
  - Using control and test groups
  - Robust market research
Combat readiness: Can you answer these questions? (continued)

- Have you developed benchmarks and metrics that drive transformation and focus on the important issues?
  - Establishing goals and stretch goals
  - Arbitrary goals versus realistic/achievable
  - Embedded in the performance appraisals of both finance and program managers
- Do you have a good program in place to continuously assess your portfolio of errors?
- Do you foster a positive relationship with the inspector general (IG) and routinely leverage the IG's extensive knowledge, skills, abilities and work related to fraud, waste and abuse?
- Are you using payment recapture audits to identify and reclaim improper payments?
- Do you partner with state and local governments and non-profits administering federal funds to provide tools and incentives for reducing improper payments?
- Are you effectively implementing the “Do Not Pay List”?
- Are you meeting all relevant reporting requirements?

A few final thoughts

- Embrace the challenge of reducing improper payments at a time of budget shortfalls and ever-increasing demands for greater accountability and transparency
- Take a holistic approach that includes:
  - Strong risk management
  - A comprehensive fraud risk program
  - Advanced analytic tools to continually monitor payments with an eye to prevention
  - Data sharing
  - Enforcement and prosecution of wrong doers
- Leverage the Executive Order and the legislative framework to help address a long-standing problem, while demonstrating the highest level of public accountability and transparency
For your reference

- Improper Payments Information Act of 2002 (Public Law 107-300, November 26, 2002)
- Presidential Executive Order, Reducing Improper Payments and Eliminating Waste in Federal Programs, November 23, 2009
- Presidential Memorandum, Finding and Recapturing Improper Payments, March 10, 2010
- Presidential Memorandum, Enhancing Payment Accuracy through a “Do Not Pay List,” June 18, 2010
- Improper Payments Elimination and Recovery Act of 2010 (Public Law 111-204, July 22, 2010)
- OMB M-11-16, Issuance of Revised Parts I and II to Appendix C of OMB Circular A-123
- Strategies to Manage Improper Payments: Learning from Public and Private Sector Organizations, GAO-02-69G, October 21, 2001
- OMB M-12-11, Reducing Improper Payments Through the “Do Not Pay List,” April 2012
- Improper Payments Elimination and Recovery Improvement Act of 2012 (Public Law 112-248, January 10, 2013)

Available at kpmginstitutes.com/government-institute

- Fraud Risk Management: Developing a Strategy for Prevention, Detection and Response, KPMG white paper
- Continuous Auditing/Continuous Monitoring: Using Technology to Drive Value by Managing Risk and Improving Performance, KPMG white paper
- A Practical Look at How Government Agencies Can Reduce Improper Payments, KPMG Government Institute, March 2011
Available at kpmginstitutes.com/government-institute (continued)

- Smart Use of Data Mining Is Good Business and Good Government, AGA Journal of Government Financial Management, Spring 2012, Vol. 61, No. 1, Jeffrey C. Steinhoff, Executive Director, KPMG Government Institute, and Terry L. Carnahan, Managing Director, KPMG LLP, Federal Risk Consulting Practice
- Battle to Stop Improper Payments Off to a Good Start, Jeffrey C. Steinhoff and Terry L. Carnahan, Federal Times, May 2012
- Stop Improper Payments Before They Are Made, Jeffrey C. Steinhoff, Federal Times, March 2011

About the KPMG government institute

“The KPMG Government Institute was established to serve as a strategic resource for government at all levels and also for higher education, and nonprofit entities seeking to achieve high standards of accountability, transparency, and performance. The Institute is a forum for ideas, a place to share leading practices, and a source of thought leadership to help governments address difficult challenges, such as effective performance management, regulatory compliance, and fully leveraging technology.

For More Information: kpmginstitutes.com/government-institute
For further information

Jeffrey C. Steinhoff, CGFM, CPA, CFE, CGMA
Executive Director, KPMG Government Institute
Managing Director, Federal Advisory, KPMG LLP
703-286-8710
jsteinhoff@kpmg.com
kpmginstitutes.com/government-institute