

**FEDERAL HOUSING FINANCE AGENCY
OFFICE OF INSPECTOR GENERAL**

**FHFA's Controls to
Detect and Prevent Improper Payments**





OFFICE OF INSPECTOR GENERAL
Federal Housing Finance Agency

400 7th Street, S.W., Washington DC 20024

March 9, 2012

TO: Mark Kinsey, Chief Financial Officer

FROM: 
Russell A. Rau, Deputy Inspector General for Audits

SUBJECT: FHFA's Controls to Detect and Prevent Improper Payments
(Audit Report No. AUD-2012-002)

Summary

The Improper Payments Information Act of 2002 (IPIA),¹ as amended by the Improper Payments Elimination and Recovery Act of 2010 (IPERA),² requires Federal agencies³ to periodically review, estimate, and report programs and activities that may be susceptible to significant improper payments. Office of Management and Budget (OMB) Memorandum M-11-16, *Issuance of Revised Parts I and II to Appendix C of OMB Circular A-123*, dated April 14, 2011, defines an "improper payment" as follows:

An improper payment is any payment that should not have been made or that was made in an incorrect amount under statutory, contractual, administrative, or other legally applicable requirements. Incorrect amounts are overpayments or underpayments that are made to eligible recipients (including inappropriate denials of payment or service, any payment that does not account for credit for applicable discounts, payments that are for the incorrect amount, and duplicate payments). An improper payment also includes any payment that was made to an ineligible recipient or for an ineligible good or service, or payments for goods or services not received (except for such payments authorized by law). In addition, when an agency's review is unable to discern whether a payment was

¹ Public Law No. 107-300, 31 U.S.C. § 3321 note.

² Public Law No. 111-204, 31 U.S.C. § 3321 note.

³ FHFA is an executive agency and therefore subject to the IPIA. However, not all IPIA provisions are applicable to FHFA, for the reasons discussed herein.

proper as a result of insufficient or lack of documentation, this payment must also be considered an improper payment.⁴

The IPIA, as amended by IPERA, also requires Inspectors General to determine whether the agency is in compliance with the statute each fiscal year and submit a report to the head of the agency, Congressional oversight committees, the Comptroller General of the United States, and OMB, regarding such compliance.⁵ The Federal Housing Finance Agency (FHFA), Office of Inspector General (FHFA-OIG) conducted a performance audit to assess FHFA's 2011 compliance with the IPIA. This is the first FHFA-OIG improper payments report and covers fiscal year 2011. FHFA comments on a draft of this report are included in Appendix A.

Background

Federal agencies regularly make payments to program beneficiaries, grantees, vendors, and contractors or on behalf of program beneficiaries. Some of these payments are "improper" in one or more respects. For example, they may be made to the wrong recipients in the wrong amounts, at the wrong times, or for the wrong reasons. Therefore, per IPIA requirements, Federal agencies should intensify efforts to eliminate payment errors, waste, fraud, and abuse, including reducing and recapturing erroneous payments. In accordance with OMB Memorandum M-11-16, the head of each agency shall periodically review all programs and activities that the relevant agency head administers, and identify, estimate, report, and publish all programs and activities that may be susceptible to significant improper payments.⁶ Additionally, for improper payments estimated in excess of \$10 million, the agency must report the potential actions it is taking to reduce and recapture improper payments.⁷

To comply with IPIA requirements, each fiscal year, FHFA-OIG is required to review FHFA's improper payment reporting in its annual Performance and Accountability Report (PAR) or Annual Financial Report (AFR) and accompanying materials; to determine whether FHFA is in compliance with the IPIA; and to report its findings.⁸ FHFA-OIG is expected to complete its

⁴ OMB Memorandum M-11-16, *Issuance of Revised Parts I and II to Appendix C of OMB Circular A-123* (April 14, 2011) at Appendix C, Part I(A)(2).

⁵ IPERA § 3(b). Prior to enactment of IPERA, Executive Order 13520, *Reducing Improper Payments*, included requirements for agencies and Inspectors General. For purposes of this order, FHFA was not designated by OMB as operating a high-priority program that required additional agency reporting and Inspector General review.

⁶ OMB Memorandum M-11-16 at Appendix C, Part I(A)(7). M-11-16 provides that the amended IPIA requires agencies also to review vendor payments as part of their annual risk assessment process. *Id.* at Part I(A)(5) note 4. If these risk assessments determine that contract or vendor payments are susceptible to significant improper payments (as defined in Part I(A)(7) Step 1), then agencies are required to establish an annual improper payment measurement for these vendor payments (as required by I(A)(7), Step 2). However, agencies also have the opportunity to pursue alternative measurements of these contract or vendor payments and may follow the steps outlined in I(A)(11).

⁷ IPERA § 2(c).

⁸ IPERA § 3(b).

review and determination within 120 days after FHFA's publication of its PAR or AFR.⁹ In addition, as part of its review, the Inspectors General should confirm that the agency:

- Published a PAR or AFR for the most recent fiscal year and posted that report and any accompanying materials required by OMB on the agency website;
- Conducted a program specific risk assessment for each program or activity that conforms with section 2(a) of the IPIA (if required);
- Published improper payment estimates for all programs and activities identified under section 2(b) of the IPIA that have been found to be susceptible to significant improper payments by its risk assessment (if required);
- Published programmatic corrective action plans under section 2(c) of the IPIA in the PAR or AFR (if required);
- Published, and has met, annual reduction targets established under section 2(c) of the IPIA for each program assessed to be at risk and measured for improper payments;
- Reported a gross improper payment rate of less than 10% for each program and activity for which an improper payment estimate was obtained and published under section 2(b) of the IPIA; and
- Reported information on its efforts to recapture improper payments as provided in OMB Memorandum M-11-16.

In the event it is determined that an agency does not meet one or more of the requirements, then it is not compliant with IPIA. Agencies determined to be noncompliant are required to submit a plan to Congress describing the actions the agency will take to come into compliance.¹⁰ The plan shall include:

- Measurable milestones to achieve compliance for each program or activity;
- Designation of a senior agency official who shall be accountable for the progress in achieving compliance for each program or activity; and
- Establishment of an accountability mechanism, such as a performance agreement, with appropriate incentives and consequences tied to the success of the senior agency official in leading agency efforts to achieve compliance for each program and activity.¹¹

Further, OMB will notify agencies of additional required actions as needed based on the compliance level of each agency. OMB Memorandum M-11-16 provides detailed information

⁹ FHFA issued its PAR on November 14, 2011, and issued a correction to it on January 19, 2012.

¹⁰ IPERA § 3(c)(1)(A).

¹¹ *Id.* § 3(c)(1)(B).

on agency compliance planning and related efforts to become compliant. The IPIA and OMB Memorandum M-11-16 define the term “payment” as any payment or transfer of Federal funds (including a commitment for future payment, such as cash, securities, loans, loan guarantees, and insurance subsidies) to any non-Federal person or entity that is made by a Federal agency, a Federal contractor, a Federal grantee, or a governmental or other organization administering a Federal program or activity.

In its FY 2011 PAR, dated November 15, 2011, FHFA stated that:

The Improper Payments Information Act of 2002 requires that agencies: (1) review activities susceptible to significant erroneous payments; (2) estimate the amount of annual erroneous payments; (3) implement a plan to reduce erroneous payments; and (4) report the estimated amount of erroneous payments and the progress to reduce it. The Act defines significant erroneous payments as the greater of 2.5 percent of program activities or \$10 million. FHFA has implemented and maintains internal control procedures that ensure disbursement of Federal funds for valid obligations. FHFA has identified no activities susceptible to significant erroneous payments that meet the Act’s thresholds.¹²

However, by a recent memorandum, FHFA stated that the IPIA and implementing guidance relating to the following statutory provisions are not applicable to FHFA:

- IPIA subsection 2(a) regarding periodic reviews of programs and activities that may be susceptible to significant improper payments;
- IPIA subsection 2(b) regarding estimating the amount of annual improper payments; and
- IPIA subsection 2(c) on reporting the estimates to Congress, including planned actions to reduce and recapture erroneous payments.¹³

FHFA agreed that these sections are applicable to payments made with Federal funds, but noted that FHFA funds are not to be construed as Government or public funds.¹⁴ Hence, FHFA reasoned that the payments FHFA makes, such as payments to vendors, are not transfers of Federal funds.¹⁵ Also, because FHFA does not make “payments” with Federal funds, FHFA concluded further that it is not required to conduct program specific risk assessments even if the payments FHFA makes were to fall within the specified dollar thresholds that trigger program

¹² FHFA FY2011 PAR at 45.

¹³ See February 7, 2012 Isabella Sammons Memorandum to Debbie Olejnik (updated February 15, 2012) (hereinafter Sammons Memo).

¹⁴ Sammons Memo at 2, citing 12 U.S.C. § 4516(f).

¹⁵ *Id.*

assessments.¹⁶ FHFA contends that actions to achieve IPIA compliance involving requests to Congress for reprogramming, transfer, and reauthorization of programs and activities are not actions that are available to FHFA in light of its status as an independent regulatory agency that does not seek authorization or appropriations for its activities.¹⁷

Audit Objective

FHFA-OIG's audit objective was to determine whether FHFA is in compliance with the IPIA, as amended by the IPERA, as well as criteria established in OMB Memorandum M-11-16.

Scope and Methodology

This audit covered FHFA's efforts to comply both with IPIA as amended by IPERA and with OMB Memorandum M-11-16 as that memorandum pertains to actions taken to detect, prevent, and report improper payments during the period October 1, 2010 to September 30, 2011. To accomplish the audit objective, FHFA-OIG reviewed applicable statutes, Executive Orders, and other related compliance requirements on improper payments; reviewed various Government Accountability Office (GAO) audit reports; interviewed key FHFA officials; obtained sufficient and appropriate evidence on compliance actions taken; and reviewed and assessed improper payment element requirements and related activities. FHFA-OIG concluded its field work and issued its report in time to ensure compliance with the OMB requirement for Inspectors General to review and make a determination of the agency's compliance with IPIA within 120 days of publication of the FHFA PAR.

FHFA-OIG's review of FHFA's internal controls designed to comply with IPIA requirements was limited. FHFA-OIG reviewed FHFA's written documentation and legal opinions related to its determination that IPIA provisions – and therefore most improper payment compliance elements – are not applicable to FHFA. FHFA-OIG confirmed the posting of the 2011 PAR and accompanying materials on FHFA's external website in accordance with OMB guidance and the inclusion of appropriate language that FHFA has established and maintains internal control procedures for handling improper payments.

FHFA has stated that it follows the spirit of the three subsections of the IPIA that are not applicable to FHFA in that FHFA has established and maintains internal controls over payments to detect and prevent improper payments made to vendors.¹⁸ FHFA provided FHFA-OIG with relevant vendor invoice and payment desktop procedures that FHFA implemented to ensure that a system of internal controls is followed to mitigate the potential for fraud, misuse, and delinquency in payment. GAO provides an opinion on the effectiveness of FHFA's internal

¹⁶ *Id.* at 3. OMB guidance at Part II.A of Appendix C of OMB Circular A-123, states the agency should conduct "a program specific risk assessment for each program or activity that conforms with Section 3321 [note] of Title 31 U.S.C. (if required)."

¹⁷ Sammons Memo at 2.

¹⁸ Sammons Memo at 2.

control over financial reporting as of September 30 of each fiscal year. Thus, GAO determined whether such internal controls are properly designed and operating effectively. Specifically, GAO, in its *Management Report: Opportunities for Improvement in the Federal Housing Finance Agency's Internal Controls and Accounting Procedures*, GAO-11-398R, dated April 29, 2011, found that FHFA did not always properly verify vendor invoice amounts prior to payment.¹⁹ GAO indicated that deficiencies in controls over FHFA's invoice payment processing procedures can increase the risk of it making improper payments and misstating expenses in its financial statements.²⁰ GAO recommended that FHFA include detailed instructions in its Invoice and Payment Desktop Procedures on how to verify the accuracy of invoice amounts prior to payment.²¹

In response to GAO's recommendation, FHFA stated that it agreed that additional guidance needs to be given to invoice approvers/contracting officer technical representatives and cited actions it has taken, or intends to take, to address this internal control issue.²² On April 4, 2011, FHFA issued supplemental guidance on invoice approval procedures in response to the GAO recommendation.

Since the above audit dealt with FY 2010, FHFA-OIG also followed up on the implementation of GAO's recommendation with FHFA. GAO issued FHFA's FY2011 Financial Statements Audit Report, on November 15, 2011 and concluded that: (1) FHFA's FY 2011 financial statements are fairly presented in all material respects; (2) FHFA had effective internal control over financial reporting as of September 30, 2011; and (3) GAO found no reportable instances of noncompliance with the laws and regulations it tested.²³ In its report, GAO stated that it noted matters involving FHFA's internal control that were less significant than a material weakness or significant deficiency, but which nonetheless merit management's attention.²⁴ GAO indicated it would report separately to FHFA management on these matters but a report has not been issued.²⁵ FHFA-OIG confirmed with GAO that it included invoice payment processing in its FY 2011 audit and followed up on its prior recommendation.

Although FHFA-OIG was not required by IPIA and OMB Memorandum M-11-16 to assess compliance with FHFA's internal controls over payments to detect and prevent improper

¹⁹ GAO-11-398R at 4. This report was issued by GAO to provide additional information on the internal control and accounting procedure issues that were identified during their audit of FHFA's FY 2010 financial statements and to provide recommendations to address those issues.

²⁰ *Id.* at 5.

²¹ *Id.*

²² GAO-11-398R at 5.

²³ GAO-12-161, *Federal Housing Finance Agency's Fiscal Years 2011 and 2010 Financial Statements* (originally issued November 15, 2011, revised on November 29, 2011 and January 26, 2012) at 4-6.

²⁴ *Id.* at 6.

²⁵ *Id.*

payments made to vendors, FHFA-OIG reviewed and relied on the above work of GAO concerning the vendor invoice payment processing procedures as part of this audit.

FHFA-OIG conducted this performance audit in accordance with Generally Accepted Government Auditing Standards. Those standards require that audits be planned and performed to obtain sufficient, appropriate evidence to provide a reasonable basis for FHFA-OIG's findings and conclusions based on the audit objective. FHFA-OIG believes that the evidence obtained provides a reasonable basis for the findings and conclusions included herein, based on the audit objectives.

FHFA-OIG Conclusion

FHFA-OIG concluded that FHFA complied with applicable provisions of the IPIA, as amended by the IPERA, as well as criteria established in OMB Memorandum M-11-16. A summary of FHFA-OIG's conclusions on IPIA compliance by compliance element is given in the table below.²⁶

Table 1. FHFA's Status of Improper Payments Information Act Compliance for FY 2011

Compliance Element	FHFA-OIG Conclusion
(A) The agency has published an annual performance and accountability report (PAR) or financial statement for the most recent fiscal year (AFR) and posted that report and any accompanying materials required under guidance of the Office of Management and Budget on the agency website.	FHFA published the 2011 PAR and has included relevant information pertaining to improper payments.
(B) If required, the agency has conducted a program specific risk assessment for each program or activity that conforms with section 2(a) of the Improper Payments Information Act of 2002 (31 U.S.C. § 3321 note).	FHFA determined that section 2(a) of IPIA is not applicable because FHFA funds are not Federal funds for purposes of this provision.
(C) The agency has published improper payments estimates for all programs and activities identified as susceptible to significant improper payments under its risk assessment (if required).	FHFA determined that section 2(b) of IPIA is not applicable because FHFA funds are not Federal funds for purposes of this provision.

²⁶ See OMB Memorandum M-11-16 at Appendix C, Part II(A)(4).

Compliance Element	FHFA-OIG Conclusion
(D) The agency has published programmatic corrective action plans in the PAR or AFR (if required).	FHFA determined that section 2(c) of IPIA is not applicable because FHFA funds are not Federal funds for purposes of this provision.
(E) The agency published, and has met, improper payments reduction targets established under section 2(c) of the Improper Payments Information Act of 2002 (31 U.S.C. § 3321 note) in the accompanying materials to the annual financial statement for each program assessed to be at risk and measured for improper payments.	FHFA determined that section 2(c) of IPIA is not applicable because FHFA funds are not Federal funds for purposes of this provision.
(F) The agency has reported a gross improper payment rate of less than 10% for each program and activity for which an estimate was obtained and published in the PAR or AFR.	FHFA determined that section 2(b) of IPIA is not applicable because FHFA funds are not Federal funds for purposes of this provision.
(G) The agency has reported information on its efforts to recapture improper payments.	FHFA stated in its PAR that it has established and maintains internal control procedures for handling improper payments. Furthermore, FHFA stated it pursues the recovery of any improper payments with its vendors. Also, it should be noted that FHFA-OIG can perform contract audits to determine if payments made to contractors are proper.

FHFA-OIG recognizes that FHFA is acting to achieve the intent of IPIA, IPERA, and the related OMB Memorandum M-11-16, in spite of its determination that it is not required to do so. Specifically, in the spirit of compliance and as part of a sound internal control structure, FHFA has established controls to detect and prevent improper vendor payments. FHFA's invoice payment processing procedures include detailed instructions on properly verifying the accuracy of vendor invoice amounts prior to payment.

FHFA-OIG appreciates the courtesies and cooperation extended to us by FHFA staff during this audit. FHFA's response is included in Appendix A of this report.

Appendix A


FHFA's Comments on the Audit



Federal Housing Finance Agency

MEMORANDUM

TO: Russell A. Rau, Deputy Inspector General for Audits

FROM: Mark Kinsey, Chief Financial Officer 

SUBJECT: FHFA's Controls to Detect and Prevent Improper Payments
(Audit Report No. AUD-2012-004)

DATE: March 1, 2012

Thank you for the opportunity to respond to the Federal Housing Finance Agency-Office of Inspector General's (FHFA-OIG) draft audit report titled, FHFA's Controls to Detect and Prevent Improper Payments, Audit Report No. AUD-2012-004. This report presents the results of FHFA-OIG's performance audit to assess FHFA's compliance with the Improper Payments Information Act of 2002 (IPIA).

I am pleased that FHFA-OIG concluded that FHFA complied with the applicable provisions of the IPIA, as amended by the Improper Payments Elimination and Recovery Act of 2010 (IPERA), as well as criteria established in the OMB Memorandum M-11-16. The FHFA-OIG audit report recognized that in the spirit of compliance and as part of a sound internal control process, FHFA had established controls to detect and prevent improper vendor payments; and FHFA's invoice payment processing procedures include detailed instructions on properly verifying the accuracy of vendor invoice amounts prior to payment.

I would like to acknowledge the dedicated FHFA-OIG staff that worked with FHFA during this audit.

If you have any questions relating to our response, please do not hesitate to call me at (202) 649-3780.

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