

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

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



February 28, 2013

**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-2013-005)

### Summary

The Improper Payments Information Act of 2002 (IPIA),<sup>1</sup> as amended by the Improper Payments Elimination and Recovery Act of 2010 (IPERA),<sup>2</sup> requires Federal agencies<sup>3</sup> periodically to 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 proper as a

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

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

<sup>3</sup> 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.

result of insufficient or lack of documentation, this payment must also be considered an improper payment.<sup>4</sup>

The IPIA, as amended by IPERA, also requires Inspectors General to determine whether the agency is in compliance with the statute each fiscal year (FY) and to submit a report to the head of the agency, Congressional oversight committees, the Comptroller General of the United States, and OMB, regarding such compliance.<sup>5</sup> The Federal Housing Finance Agency (FHFA), Office of Inspector General (FHFA-OIG) conducted a performance audit to assess FHFA's FY 2012 compliance with the IPIA. FHFA-OIG concludes that for FY 2012—although FHFA determined that much of IPIA, IPERA, and OMB M-11-16 are inapplicable to it—FHFA established internal controls to detect and prevent improper vendor payments.

## **Background**

### *In General*

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.<sup>6</sup> 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.<sup>7</sup>

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<sup>4</sup> 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).

<sup>5</sup> 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.

<sup>6</sup> OMB Memo M-11-16 at Appendix C, Part I(A)(7). M-11-16 provides 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 Part 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 Part I(A)(11).

<sup>7</sup> IPERA § 2(c).

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) and accompanying materials; to determine whether FHFA is in compliance with the IPIA; and to report its findings.<sup>8</sup> FHFA-OIG is expected to complete its review and determination within 120 days after FHFA's publication of its PAR.<sup>9</sup> In addition, as part of its review, FHFA-OIG should confirm that the agency:

- Published a PAR 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 its PAR (if required);
- Published and 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 the 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.<sup>10</sup> The plan shall include:

- Creation of measurable milestones to be accomplished in order to achieve compliance for each program or activity;
- Designation of a senior agency official who shall be accountable for the progress of the agency coming into compliance for each program or activity; and

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<sup>8</sup> IPERA § 3(b).

<sup>9</sup> FHFA issued its PAR on November 15, 2012.

<sup>10</sup> IPERA § 3(c)(1)(A).

- Establishment of an accountability mechanism, such as a performance agreement, with appropriate incentives and consequences tied to the success of the senior agency official who leads agency efforts to achieve compliance for each program and activity.<sup>11</sup>

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 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.

### *FHFA*

In its FY 2012 PAR, dated November 15, 2012, FHFA states that:

The Improper Payments Elimination and Recovery Act 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 them. The Act defines significant erroneous payments as the greater of 2.5 percent of program activities or \$10 million. FHFA, in the spirit of compliance and as part of a sound internal control structure, has established controls to detect and prevent improper payments. FHFA has identified no activities susceptible to significant erroneous payments that meet the Act’s thresholds.<sup>12</sup>

By a recent memorandum, FHFA clarified its statement of “in the spirit of compliance and as part of a sound internal control structure,” explaining that the IPIA and implementing guidance relating to the following statutory provisions are not applicable to FHFA:

- IPIA subsection 2(a), regarding periodically reviewing programs and activities that may be susceptible to significant improper payments;
- IPIA subsection 2(b), regarding estimating the amount of annual improper payments; and

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<sup>11</sup> *Id.* § 3(c)(1)(B).

<sup>12</sup> FHFA FY 2012 PAR p. 115.

- IPIA subsection 2(c), regarding reporting the estimates to Congress, including planned actions to reduce and recapture erroneous payments.<sup>13</sup>

FHFA notes that these sections are applicable to payments made with Federal funds, but that FHFA funds are not to be construed as government or public funds.<sup>14</sup> Hence, FHFA reasons that the payments FHFA makes, such as payments to vendors, are not transfers of Federal funds.<sup>15</sup> Also, because FHFA does not make “payments” with Federal funds, FHFA concludes 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 assessments.<sup>16</sup> 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 appropriations for its activities.<sup>17</sup>

## **Audit Objective**

FHFA-OIG’s audit objective was to determine whether FHFA is in compliance with the IPIA, as amended by 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 the 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, 2011, to September 30, 2012. To accomplish the audit objective, FHFA-OIG reviewed applicable statutes, executive orders, and other related compliance requirements related to improper payments; reviewed various Government Accountability Office (GAO) audit reports; interviewed key FHFA officials; obtained sufficient and appropriate evidence regarding compliance actions taken; and reviewed and assessed improper payment element requirements and related activities. FHFA-OIG concluded its field work and issued this report in time to ensure compliance with the OMB requirement for FHFA-OIG to review and make determinations on FHFA’s compliance with the IPIA, i.e., within 120 days of publication of the FHFA PAR.

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<sup>13</sup> See December 11, 2012, Isabella Sammons Memorandum to Debbie Olejnik.

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

<sup>15</sup> *Id.*

<sup>16</sup> *Id.* at 2. 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).”

<sup>17</sup> Sammons Memo at 2.

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 2012 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.

With respect to the three subsections of the IPIA that FHFA deemed inapplicable, FHFA has stated that it follows the spirit of those subsections because it has established and maintains internal controls to detect and prevent improper payments made to vendors.<sup>18</sup> 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. This information is also available to GAO, which provides an opinion on the effectiveness of FHFA's internal controls over financial reporting as of September 30th of each fiscal year. Thus, GAO determines whether such internal controls are properly designed and operating effectively.

GAO, in its most current *Management Report: Opportunities for Improvement in the Federal Housing Finance Agency's Internal Controls*, GAO-12-499R, dated May 16, 2012, found that “FHFA did not establish effective controls to assess the risk of errors by its payroll service provider [, National Finance Center (NFC),] and determine if any compensating controls were necessary to ensure the accuracy of payroll calculations.” GAO stated that this finding increased the risk to FHFA that misstatements in its financial statements may not be promptly detected and corrected. Also, errors in the calculation of its payroll amounts may not be identified.<sup>19</sup> In order to identify and address any NFC errors in processing FHFA payroll, GAO recommended that the FHFA Acting Director direct the Chief Financial Officer (CFO) to develop and implement a process to assess and address the risk to FHFA from any internal control issues at NFC including, as appropriate, any compensating controls commensurate with any identified risk.<sup>20</sup>

In response to GAO's recommendation, FHFA reported that it instituted a formal quality control process on payments prior to release to NFC and performed additional review of payroll transactions as part of annual internal control testing. FHFA-OIG followed up with agency representatives to determine the status of the recommendation and confirmed that it remained

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<sup>18</sup> Sammons Memo at 2.

<sup>19</sup> GAO-12-499R at 1 & 2. This report was issued by GAO to provide additional information on the internal control and accounting procedure issues that were identified during its audit of FHFA's FY 2011 financial statements and to provide recommendations to address those issues.

<sup>20</sup> *Id.* at 6.

open because GAO intends to retest payroll in the current year. Based on the results of its testing, GAO will assess the status of implementation of its recommendation.

Also, GAO, in its previous *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.<sup>21</sup> 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.<sup>22</sup> GAO recommended that FHFA include detailed instructions in its Invoice and Payment Desktop Procedures governing how to verify the accuracy of invoice amounts prior to payment.<sup>23</sup>

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.<sup>24</sup> On April 4, 2011, FHFA issued supplemental guidance on invoice approval procedures in anticipation of the GAO recommendation. FHFA-OIG confirmed with agency officials that this recommendation remained in an "In progress" status. FHFA-OIG also confirmed with GAO that it will include invoice payment processing in its FY 2013 audit as a follow up on this prior recommendation. FHFA-OIG will continue to monitor the status of this recommendation.

FHFA-OIG followed up on the implementation of GAO's recommendation to FHFA through review of GAO's reports on its audits of FHFA's financial statements. Specifically, GAO issued FHFA's FY 2012 and FY 2011 Financial Statements Audit Report(s), on November 15, 2012, and November 15, 2011, respectively. For both audits, GAO concluded for the audited year that: (1) FHFA's financial statements were fairly presented in all material respects; (2) FHFA had effective internal control over financial reporting as of the last day of the audit period; and (3) GAO found no reportable instances of noncompliance with the laws and regulations it tested.<sup>25</sup> In its reports, GAO stated that it noted matters involving FHFA's internal controls that were less significant than a material weakness or significant deficiency, but which nonetheless

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<sup>21</sup> GAO-11-398R at 1. This report was issued by GAO to provide additional information on the internal control and accounting procedure issues that were identified during its audit of FHFA's FY 2010 financial statements and to provide recommendations to address those issues.

<sup>22</sup> *Id.* at 5.

<sup>23</sup> *Id.*

<sup>24</sup> GAO-11-398R at 5.

<sup>25</sup> 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; and GAO-13-124R, *Federal Housing Finance Agency's Fiscal Years 2012 and 2011 Financial Statements* at 1 and 74.



merit management's attention.<sup>26</sup> GAO indicated it would report separately to FHFA management on these matters as appropriate<sup>27</sup> and has since issued GAO-12-499R as a follow up to its FY 2011 Financial Statements Audit Report.<sup>28</sup> With respect to the issues identified during the FY 2012 FHFA audit, GAO decided not to issue a formal report.

Although FHFA-OIG was not required by the IPIA and OMB Memorandum M-11-16 to assess compliance with FHFA's internal controls over payments to detect and prevent improper 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 coordinated with GAO to confirm its understanding of GAO's results.

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 conclusions included herein, based on the audit objectives.

### **FHFA-OIG Conclusions**

A summary of FHFA-OIG's conclusions on IPIA compliance by compliance element is given in the table below.<sup>29</sup> Generally, FHFA-OIG concludes that FHFA complied with the applicable provision (Letter A in the table below) of the IPIA, as amended by IPERA, and the additional reporting provision established in OMB Memorandum M-11-16 (Letter G in the table below). FHFA opined the remaining requirements are not applicable.

**Table 1. FHFA's Status of Improper Payments Information Act Compliance for FY 2012**

<b>Compliance Element</b>	<b>FHFA-OIG Conclusion</b>
(A) The agency has published an annual performance and accountability report (PAR) or financial statement for the most recent fiscal year and posted that report and any accompanying materials required under guidance of the Office of Management and	FHFA published the 2012 PAR and has included relevant information pertaining to improper payments.

<sup>26</sup> *Id.* at 6, and *Id.* at 75, respectively.

<sup>27</sup> *Id.*

<sup>28</sup> GAO-12-499R at 1.

<sup>29</sup> See OMB Memo M-11-16 at Appendix C, Part II(A)(4).

<b>Compliance Element</b>	<b>FHFA-OIG Conclusion</b>
Budget on the agency website.	
(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.
(D) The agency has published programmatic corrective action plans in the PAR (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.	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 reported 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

Compliance Element	FHFA-OIG Conclusion
	noted that FHFA-OIG can perform contract audits to determine if payments made to contractors are proper. <sup>30</sup>

FHFA-OIG recognizes that FHFA is acting to achieve the intent of the 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. For example, 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. On February 15, 2013, FHFA responded to a draft of this report offering no objection to its conclusions. FHFA's response is included in Appendix A of this report.

cc: Edward J. DeMarco, Acting Director, FHFA  
Alfred Pollard, Chief Counsel, FHFA  
Richard Hornsby, Chief Operating Officer, FHFA  
Bruce Crandlemire, Senior Advisor for IG Operations, FHFA  
John Major, Internal Controls and Audit Follow-up Manager, FHFA

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<sup>30</sup> See, e.g., FHFA-OIG, *FHFA's Oversight of Contract No. FHF-10-F-0007 with Advanced Technology Systems, Inc.*


## 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 – FY 2012  
(Audit Report No. AUD-2013-006)

DATE: February 15, 2013

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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 – FY 2012, Audit Report No. AUD-2013-006. 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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