

RISK ASSESSMENT FOR IMPROPER PAYMENTS

Background

The focus of this assessment is to identify the risks of making improper payments. The enactment of the "Improper Payments Information Act of 2002" (PL 107-300), requires certain informational requirements on improper (or erroneous) payments by all Federal agencies.¹

Agencies are required to review all programs and activities they administer and identify those which may be susceptible to significant improper payments. This includes payments from Federal awards made by recipients and sub-recipients subject to the Single Audit Act Amendments of 1996 as well as Federal grants and sub-grants expended by for-profit and non-U.S. based entities not subject to that Act. For all programs and activities where the risk of improper payments is significant in amount and determined to be high risk, agencies are to estimate the annual amount of improper payments, and report the estimates to the President and Congress with a progress report on actions to reduce improper payments. On May 21, 2003, the Director of OMB issued Memorandum M-03-13 providing guidance for implementing the Improper Payments Information Act of 2002. "Programs and activities" are defined in the OMB Guidance. The complete text of Memorandum M-03-13 can be accessed at:

<http://www.whitehouse.gov/omb/memoranda/m03-13.html>

OMB guidance prescribes a four step process leading to the required reporting for significant improper payments. Generally, the required reporting includes an estimate of the volume of improper payments, and the plans for and status of correcting control measures to minimize and recover improper payments where cost effective. The required reporting will begin with the FY 2004 Performance and Accountability Report. In brief, OMB's four step process:

Step 1: Review all programs and activities, and identify those which are susceptible to significant improper payments. For the purposes of this guidance, significant improper payments are defined as annual improper payments in the program exceeding **both 2.5 % of program payments and \$10 million.**

Step 2: For the programs and activities determined to be susceptible to significant improper payments, perform a statistically valid estimate of the annual amount of improper payments in

¹**Improper Payment** - means any payment that should not have been made or that was made in an incorrect amount under statutory, contractual, administrative, or other legally applicable requirement. Improper amounts are overpayments and under payments (including inappropriate denials of payment or service). An improper payment includes any payment that was made to an ineligible recipient or for an ineligible service. Improper payments are also duplicate payments, payments for services not received, late payment interest not earned and payments that do not take credit for appropriate discounts. The term "improper payment" and "erroneous payment" have the same meaning for these purposes.

programs and activities.

Step 3: For the programs and activities determined to be susceptible to significant improper payments, prepare and implement a plan to reduce improper payments.

Step 4: For the programs and activities determined to be susceptible to significant improper payments, report estimates of the annual amount of improper payments in these programs and activities and progress in reducing them in annual Performance and Accountability Reports.²

Requirements

The attached Risk Rating Worksheet is to be prepared for each Bureau Program/Activity meeting OMB's definition. It is the responsibility of each Bureau to prepare a Risk Rating Sheet summary for Programs/Activities that involve multiple field organizations. The Office of Financial Management requires a copy of the Bureau's Risk Assessment Program sheets (or summary sheets) for all programs/activities rated as a "high" risk **by March 31, 2004**. This is regardless of whether the OMB thresholds of 2.5% of program payments and \$10 million are exceeded. In addition to the documentation for high risk assessments -- documentation related to medium and low risk assessments is to be maintained by the bureau's management control official and retained for an appropriate period of time for further review should that become necessary.

In performing this risk assessment, managers or evaluators are to focus on management and internal control processes, and are to perform **risk identification** and **risk analysis** as objectively as possible for those processes. Listed below are some of the key factors to be considered when performing this assessment. The list of questions provided below is neither intended to be all-inclusive nor apply to all programs/activities within a bureau. Even though some of the functions and points for consideration may be subjective in nature and require the use of judgment, they are important considerations in performing a risk assessment.

Risk Identification

1. Does management identify risk factors using various methodologies as appropriate?

- A. Are qualitative and quantitative methods used to identify improper payments and determine relative risk rankings on a scheduled and periodic basis?
- B. Have the risk of improper payments been identified, ranked, analyzed and mitigated, and communicated to appropriate staff?
- C. Has the topic of improper payments been discussed at senior-level management meetings?

²Since Interior was not one of the original agencies listed in OMB Circular A-11 Section 57, it is not required to report the status on improper/improper payments in the FY 2003 Performance and Accountability Report but is required to report in FY 2004.

- D. Have improper payments been identified as a result of findings from audits, evaluations, or other assessments?

2. Do adequate mechanisms exist to identify the risk of improper payments arising from external factors?

- A. Technological advances?
- B. Changing expectations/requirements of Congress or other regulatory bodies?
- C. Possible natural catastrophes, criminal or terrorist actions?
- D. Business or economic changes?
- E. Major suppliers or contractors?

3. Do adequate mechanisms exist to identify the risk of improper payments arising from internal factors?

- A. Recent downsizing or reorganization of bureau operations or personnel?
- B. Business process re-engineering or redesign of operating processes?
- C. Disruption of information systems and the extent to which backup systems are available?
- D. Decentralized program operations?
- E. Lack of qualified personnel or the extent to which they have been trained?
- F. Heavy reliance on contractors or other sources (such as volunteers) to perform critical agency operations?
- G. Unusual employee access to vulnerable assets?
- H. Human capital-related matters, such as succession planning, retention of key personnel who can affect the ability of the program/activity to function effectively, and the adequacy of compensation programs to keep the program competitive with the private sector for labor?

4. Does management assess other factors that may contribute to or increase the risk exposure to improper payments?

- A. Past failures to meet program missions or objectives?
- B. A history of improper program expenditures, violations of funds control, or other statutory noncompliance?
- C. The inherent nature of a program, its significance and/or complexity?

Risk Analysis

1. After identification of the risk of improper payments by program/activity, has management undertaken a thorough analysis of their possible effect?

- A. Has management established a formal process to analyze improper payments?
- B. Have criteria been established for determining low, medium, and high risks?
- C. Are appropriate levels of management and employees involved in the risk analysis?
- D. Are the improper payments identified and analyzed objectively relative to the

corresponding program/activity?

- E. Does the risk analysis include estimating the risk significance?
- F. Does the risk analysis include estimating the likelihood and frequency of occurrence of each risk and determining whether it falls into the low, medium, or high-risk category?
- G. Has a determination been made on how best to manage or mitigate the risk, and what specific actions should be taken?

2. Has an approach for management control over improper payments been developed based on the amount of risk that can be prudently accepted?

- A. Is the approach designed to keep improper payments within levels judged to be appropriate and does management take responsibility for setting the tolerable risk level?
- B. Are specific control activities decided upon to manage or mitigate specific improper payments bureau-wide and at each activity level, and is their implementation monitored?

Risk Rating Worksheet - Improper Payments

On May 21, 2003, the Director of OMB issued Memorandum M-03-13 providing guidance for implementing the Improper Payments Information Act of 2002. There is a definition of "programs and activities" provided in the OMB Guidance. The complete text of Memorandum M-03-13 can be accessed at:

<http://www.whitehouse.gov/omb/memoranda/m03-13.html>

This Risk Rating Worksheet is to be prepared for each Bureau Program/Activity meeting OMB's definition. It is the responsibility of each Bureau to prepare a **summary** sheet for each Program/Activity that involves multiple field organizations. The Office of Financial Management requires **by March 31, 2004**, a copy of the Bureau's Risk Rating Worksheet (or summary worksheet) for all programs/activities rated as a "high" risk. This is regardless of whether the OMB thresholds of 2.5 % of program payments and \$10 million are exceeded. In addition to the documentation for high risk assessments -- documentation related to medium and low risk assessments is to be maintained by the bureau's management control official and retained for an appropriate period of time for further review should that become necessary.

PROGRAM TITLE _____

ANNUAL DOLLAR VOLUME \$ _____

ANNUAL ESTIMATED IMPROPER PAYMENTS \$ _____ % of Annual Volume _____%

RISK RATING: High _____ Medium _____ Low _____

Use separate sheets of paper as necessary to respond to each of the following:

1) PROVIDE THE CRITERIA USED TO DETERMINE THE RISK RATING.

2) LIST SIGNIFICANT WEAKNESSES.

3) SUMMARIZE THE RATIONALE/DECISIONS SUPPORTING THIS ASSESSMENT.

4) PROVIDE THE NAMES AND TITLES OF THE PRIMARY CONTRIBUTORS PREPARING THIS RISK ASSESSMENT.

5) BUREAU PROGRAM/ACTIVITY CONTACT: _____

Phone Number: _____