



U.S. Department of Agriculture



Office of Inspector General
Midwest Region

Audit Report

Rural Utilities Service's Progress To Implement the Improper Payments Information Act of 2002

Report No. 09601-0001-Ch
March 2006



UNITED STATES DEPARTMENT OF AGRICULTURE



OFFICE OF INSPECTOR GENERAL

Washington, DC 20250

DATE: March 7, 2006

REPLY TO
ATTN. OF: 09601-0001-Ch

TO: James M. Andrew
Administrator
Utilities Programs

THROUGH: John Dunsmuir
Acting Director
Financial Management Division

FROM: Robert W. Young /s/
Assistant Inspector General
for Audit

SUBJECT: Rural Utilities Service's Progress To Implement the Improper Payments Information Act of 2002

This report presents the results of our audit of the Rural Utilities Service's (RUS) fiscal year (FY) 2005 efforts to implement the Improper Payments Information Act (IPIA) of 2002.¹ Our audit of RUS was conducted as part of a Departmentwide effort to evaluate USDA's progress to implement the IPIA through additional guidance issued by the Office of the Chief Financial Officer (OCFO). Our review of the risk assessment for the Water and Waste Grant program—1 of the 11 RUS programs with estimated outlays of \$50 million or more—disclosed that portions of the risk assessment were inaccurate, incomplete, or unsupported, and that tests of transactions were not adequate to determine the extent of improper payments. As a result, we were unable to independently determine if RUS' low risk ranking for the program was supportable.

Based on the RUS response, dated January 23, 2006, we have not reached management decisions on Recommendations 1, 2, or 3. Management decisions on these recommendations can be reached once you have provided us with the additional information outlined in the report sections, OIG Position, following each recommendation.

¹ Public Law (P.L.) 107-300, November 26, 2002.

In accordance with Departmental Regulation 1720-1, please furnish a reply within 60 days describing the corrective actions taken or planned, and the timeframes for implementation of the recommendations. Please note that the regulation requires a management decision to be reached on all findings within a maximum of 6 months from report issuance, and final action to be taken within 1 year of each management decision.

BACKGROUND

In November 2002, the President signed the IPIA, Public Law (P.L.) 107-300, which requires the head of each agency to annually review all programs and activities the agency administers to identify those that may be susceptible to significant improper payments. For each program or activity identified, the agency is required to estimate the annual amount of improper payments. If the estimate is over \$10 million, the agency must report the estimate to Congress along with the actions the agency is taking to reduce those improper payments. In May 2003, the Office of Management and Budget (OMB) issued guidance to agencies for estimating and reporting improper payments. As the lead agency for coordinating and reporting the Department's efforts to implement the IPIA, OCFO provided additional instructions to agencies in August and October 2003.

In FY 2004, we performed audits of six agencies' programs, including RUS,² to determine whether the agencies performed risk assessments in compliance with the OMB and OCFO guidance for implementing the IPIA. Our review of RUS' risk assessments disclosed that the agency's ranking of risk factors was not always supported by the documentation provided, which did not list the internal controls in place to mitigate the risk. We also performed an audit of OCFO³ in FY 2004 to evaluate its actions to implement the IPIA—specifically, its effort to assess the Department's programs for the risk of improper payments. Based on the results of that audit and the conditions reported in the agency audit reports, we recommended that OCFO strengthen its guidance to agencies for performing risk assessments.

OCFO issued more prescriptive guidance in November and December 2004. The revised OCFO guidance included specific instructions for agencies to follow in order to meet IPIA requirements, focusing on those programs most likely to be at significant risk of improper payments. The guidance divided programs into 6 categories, ranging from programs with less than \$10 million in outlays to programs exceeding \$400 million in outlays. The guidance required that vulnerabilities to improper payments, including program, financial, budget, and performance management issues, be identified along with the internal controls in place to prevent improper payments. In addition, the OCFO guidance included instructions for the testing of transactions in each program. A key provision of the guidance, the tests of transactions process, provides quantitative evidence of the adequacy of internal controls, both in terms of design and functionality. The guidance states that a judgmental sample of transactions should be taken that is sufficiently large to support the agency's assertion that internal controls are working. To support their conclusions regarding programs' susceptibility to improper payments, agencies were to include the results of these tests in their risk assessments.

² Rural Development Compliance with the Improper Payments Information Act of 2002, Audit No. 04601-10-Ch, dated January 2005.

³ USDA Compliance with the Improper Payments Information Act of 2002, Audit No. 50601-8-Ch, dated January 2005.

The guidance also included key milestones for agencies to submit information so that OCFO and OMB could assess the agencies' progress in completing all risk assessments by the established deadline of April 30, 2005.

OBJECTIVE

The objective of the audit was to assess RUS' implementation of OCFO's revised guidance regarding improper payment reporting requirements, including (1) agency efforts to conduct risk assessments of its program and report results to OCFO, and (2) agency conclusions that the program was at low risk of improper payments.

SCOPE AND METHODOLOGY

We performed our audit of RUS' compliance with the IPIA at RUS Headquarters in Washington, D.C. We conducted our fieldwork from June through August 2005. The audit was performed in accordance with *Government Auditing Standards*.

Of the risk assessments submitted to OCFO as of April 30, 2005, we judgmentally selected RUS' Water and Waste Grant program, with total estimated outlays of \$253.6 million. We based our selection on our preliminary analysis of vulnerability criteria, outlay dollars, and the extent and adequacy of the risk assessment documentation provided to OCFO. This program represented 6 percent of the estimated outlays of the 11 RUS programs that fell into OCFO's top 3 categories for program outlays.

To accomplish our audit objectives, we interviewed the appropriate officials and reviewed the following documents:

- the IPIA, OMB guidance, and OCFO directives,
- regulations, program procedures, and handbooks,
- prior Government Accountability Office (GAO) and Office of Inspector General (OIG) audit reports,
- FY 2005 budget summaries, and
- agency risk assessments.

FINDING

RUS Needs to Improve Its Risk Assessment Process

RUS did not fully adhere to OCFO's guidance for conducting risk assessments. We found that although RUS officials defined improper payments in terms of program eligibility, the risk assessment, however, described only financial vulnerabilities and did not address the critical program vulnerabilities. In addition, the test of transactions performed was not adequate because the sample of files reviewed consisted of loans as well as grants, the procedures used to conduct the analysis of sampled transactions were not documented, and review results were not evaluated to determine their impact on improper payments.

We concluded that controls were not in place, as evidenced by inadequate identification of vulnerabilities, internal controls, and tests of transactions to provide reasonable assurance that the risk assessment process adheres to OCFO's guidance. As a result, RUS did not obtain and examine sufficient evidence to support its conclusions that the Water and Waste Grant program was at low risk for improper payments.

According to OCFO guidance, agencies should work with their program, financial, internal review, budget, and performance management staff to complete risk assessments;⁴ list the internal controls preventing improper payments for each of the vulnerabilities identified;⁵ and test a judgmentally selected sample of transactions "to determine the effectiveness of program design and internal controls in the prevention of improper payments."⁶

Significant Vulnerabilities and Internal Controls Missing

RUS officials did not include program eligibility among the vulnerabilities identified in the risk assessment, even though they had defined improper payments to include disbursements to "an ineligible recipient or for an ineligible service and payments for services not received." In fact, a recent audit⁷ of the Water and Waste Grant program, issued in September 2003, statistically estimated that RUS awarded \$85.5 million in grant money for the 4-year period 1997 through 2000 to 97 recipients unnecessarily. The loan portion of the recipients' financing package was available from commercial lending sources, making them ineligible for the grants they received from RUS.⁸ In discussions with us during the audit, RUS officials identified several internal controls that could have been included in the risk assessment but were not, including (1) State Internal Reviews (SIR), (2) comparison of manual files with the automated system, (3) verification of funds requested against contracts prior to payment, (4) use of resident inspectors that remain onsite during construction, and (5) program reviews (which RUS used as the test of transactions).

RUS focused on what they termed financial vulnerabilities and the internal controls in place to prevent them. They considered financial vulnerabilities, for example, "paper checks received from borrowers as loan payments or return of unused grant funds." RUS officials stated they considered program eligibility and use of grant funds as vulnerabilities, but they focused on these financial controls because they viewed them as the most vulnerable. RUS officials stated that they did not consider the results of the prior audit. They did not believe any improper payments were made; rather, they believed the problem was a lack of documentation in the files to support that those grantees could not obtain commercial credit. Nonetheless, the officials agreed that the risk assessment should include program vulnerabilities as well as financial vulnerabilities.

In its response dated January 29, 2006, (see exhibit A), RUS stated that it agreed program eligibility should be considered as part of the risk assessment, but feel that it is improper for OIG

⁴ USDA FY 2005 Risk Assessment Guidance Program Templates, dated November 10, 2004.

⁵ Purple Program Template, dated November 10, 2004.

⁶ USDA FY 2005 Tests of Transactions Guidance, dated December 8, 2004.

⁷ Rural Utilities Service Water and Waste Program Grant Eligibility, Audit No. 09601-6-KC, dated September 8, 2003.

⁸ RUS reached management decision with OIG. RUS issued a directive to field staff requiring all applicants that could obtain commercial credit, while maintaining reasonable user rates, to provide a credible proposal from an interested commercial lender prior to RUS providing funding.

to include an audit that has been resolved through management decisions and was completed in 2003. Although the audit was completed in 2003, management decisions were not reached until May 2004. Our discussion of the prior audit in this report was used only to show that eligibility had been recently found to be a vulnerable area and should have been included in the risk assessment. If corrective actions taken as part of the management decisions had mitigated the risk of this vulnerability, the assessment process would have verified this.

Tests of Transactions Insufficient

RUS' test of transactions was not sufficient to determine the adequacy of controls to prevent improper payments. The risk assessment listed a number of items used for testing, including reviews, audit reports, a review handbook, compilation reports, and summary reports. RUS officials told us, however, that only program reviews performed by National office staff were used as tests for the Water and Waste Grant program. The assessment reported that 560 Water and Waste Grant files were reviewed and noted that no improper payments were identified. However, our review of the support for the assertions in the risk assessment disclosed that RUS officials did not identify the universe of grants reviewed to put the test in perspective, nor did they provide any results of the reviews performed to support their conclusion that no improper payments were identified.

We also noted that the reported number of Water and Waste Grant files reviewed actually included both loans and grants (although the subject of the risk assessment was the Water and Waste Grant program) and that the total of 560 files reviewed could not be recreated. Additionally, the loan and grant files reviewed encompassed not only recent program reviews but also reviews conducted from FY 2001 through FY 2005 (to date). We reviewed the reports for the six program reviews completed in FY 2004 and found that they only contained lists of the files reviewed which did not identify the type of assistance provided. In some instances, it was not reported if the files reviewed were loans or grants. We noted that there were no written instructions to guide those performing the program reviews to ensure adequacy and consistency in what was reviewed. Although RUS officials stated that those performing the program reviews use the same checklists that Rural Development (RD) State offices use when performing SIRs, the program reviewers did not document their file reviews. Because there was no program review guide or any results of the program reviews available, we were unable to determine what controls were tested, if the controls were functioning as intended, and if there was any impact on improper payments.

SUMMARY

Without identifying actual risks to the Water and Waste Grant program, along with existing internal controls that would mitigate those risks, and without conducting an adequate test of transactions and analyzing its results, RUS officials could not support their conclusion that the program was at low risk for improper payments.

Recommendation 1:

Include key program factors such as “eligibility” as vulnerable areas and describe the internal controls to prevent improper payments.

Agency Position:

RUS concurred with the recommendation in its response, dated January 29, 2006 (see exhibit A), and stated that the Rural Development Utilities Programs (RDUP) will include key program, and financial vulnerabilities in future risk assessments.

OIG Position:

Although, the agency states it concurs with the recommendation, the response did not address the recommendation. To achieve management decision, agency officials need to provide a description of the internal controls that prevent improper payments and specify whether eligibility will be considered a key program vulnerability in future risk assessments and if not, why it is not considered vulnerable.

Recommendation 2:

Develop and implement procedures for tests of transactions to ensure the agency obtains and analyzes sufficient information to conclude as to the adequacy of internal controls to deter improper payments.

Agency Position:

RUS concurred with the recommendation in its response, dated January 29, 2006 (see exhibit A). RUS stated that the existing Management Control Review (MCR) and State Internal Review (SIR) procedures will be utilized in completing an acceptable test of transactions. They also stated that the State Program Review process will be formalized through a Staff Instruction and will be included as part of the test of transactions.

OIG Position:

In order to reach management decision, RUS needs to provide a timeframe for formalizing the Program Review process in a Staff Instruction.

Recommendation 3:

Strengthen controls over the risk assessment process to provide for adequate oversight to ensure that OCFO’s guidance is met.

Agency Position:

RUS concurred with the recommendation in its response, dated January 29, 2006 (see exhibit A), and stated it will work with the financial, internal control, budget and performance management staffs utilizing the OCFO guidance to provide adequate oversight.

OIG Position:

In order to reach management decision, RUS needs to provide a description of the process it will implement to provide adequate oversight by working with financial, internal control, budget and performance management staffs, to ensure OCFO guidance is met. They also need to provide a timeframe for implementation.

We appreciate the courtesies and cooperation extended to our staff during this review.



United States Department of Agriculture
Rural Development

JAN 29 2006

SUBJECT: Utilities Programs - Progress to Implement the
Improper Payments Information Act of 2002

TO: Robert W. Young
Assistant Inspector General
For Audit

Attached for your review is Utilities Programs response to the official draft for the subject audit.

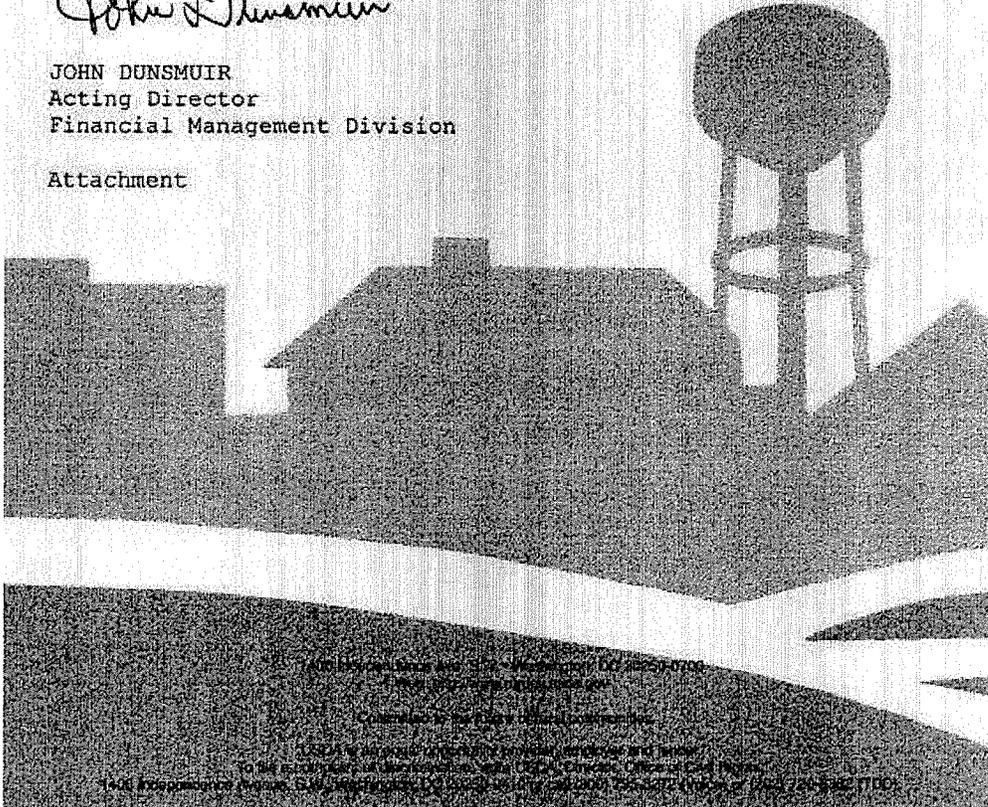
This response is being submitted for inclusion in the final report and your consideration to reach management decision on the recommendations.

If you have any questions, please contact **Arlene Pitter** of my staff at 202-692-0083.

A handwritten signature in black ink that reads "John Dunsmuir". The signature is written in a cursive, flowing style.

JOHN DUNSMUIR
Acting Director
Financial Management Division

Attachment



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United States Department of Agriculture
Rural Development

JAN 23 2006

SUBJECT: Utilities Programs' Progress to Implement the Improper Payments
Information Act of 2002 (OIG Audit No. 09601-001-CH)

TO: John M. Purcell
Director
Financial Management Division

ATTN: Arlene Pitter
Program Analyst

FROM: JAMES M. ANDREW
Administrator
Utilities Programs

A handwritten signature in black ink, appearing to read "James M. Andrew".

The draft report for the subject audit issued by the Office of Inspector General (OIG) raises three findings: 1) Rural Development Utilities Programs (RDUP) needs to improve its risk assessment process; 2) Significant vulnerabilities and internal controls missing; and 3) Tests of transactions insufficient. The audit is based upon RDUP's risk assessment completed in 2005 for the Water and Waste Disposal Grant program.

This was the first risk assessment completed for the program to comply with the Improper Payments Information Act (IPIA) of 2002. As part of finding number one, OIG states that RUS did not fully adhere to the Office of the Chief Financial Officer's (OCFO) guidance for conducting risk assessments. We disagree with this as the OCFO was an integral part in developing the risk assessment and held meetings with RUS to provide guidance. OIG's audit, USDA Compliance with the Improper Payments Information Act of 2002, Audit No. 50601-8-Ch, dated January 2005, recommended that OCFO strengthen its guidance to agencies. We also request that OCFO strengthen its guidance as the 2005 risk assessment was completed under their oversight.

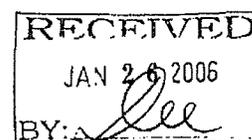
Finding number two utilizes a prior OIG audit, Rural Utilities Service Water and Waste Program Grant Eligibility, Audit No. 09601-6-KC, dated September 8, 2003, as supporting evidence that program eligibility is a significant vulnerability. As we prepare the 2006 risk assessment, we do not believe that program eligibility is a significant vulnerability. We agree that program eligibility should be considered as part of the risk assessment, but feel that it is improper for OIG to include an audit that has been resolved through agreed upon management decisions and was completed in 2003.

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Web: <http://www.rurdev.usda.gov>

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The audit summarizes that OIG was unable to independently determine if RUS' low-risk ranking for the program was supportable. The three recommendations made and our responses are as follows:

Recommendation No. 1. Include key program factors such as eligibility as vulnerable areas and describe the internal controls to prevent improper payments.

Agency response. RDUP will include key program and financial vulnerabilities in future risk assessments.

Recommendation No. 2. Develop and implement procedures for tests of transactions to ensure the agency obtains and analyzes sufficient information to conclude as to the adequacy of internal controls to deter improper payments.

Agency response. The existing Management Control Review and State Internal Review Procedures will be utilized in completing an acceptable test of transactions. The State Program Review process will be formalized through a Staff Instruction and will be included as part of the test of transactions.

Recommendation No. 3. Strengthen controls over the risk assessment process to provide for adequate oversight to ensure that OCFO's guidance is met.

Agency response. We will work with the financial, internal control, budget and performance management staffs utilizing the OCFO guidance to provide adequate oversight.

In summary, we have benefited from the information obtained during and from this review. Our risk assessments will be better documented and will support our finding of a low risk. Our goal is to reach a quick resolution and comply with the IPIA requirements.

Informational copies of this report have been distributed to:

Administrator, Rural Utilities Service Through: Director, Financial Management Division Operations and Management	4
U.S. Government Accountability Office	1
Office of the Chief Financial Officer Director, Planning and Accountability Division	1
Office of Management and Budget	1