

Statement of

The Honorable Robert F. Hale
Under Secretary of Defense (Comptroller)

before the

Senate Committee on
Homeland Security & Governmental Affairs

Subcommittee on Federal Financial Management,
Government Information, Federal Services, and International Security

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Mr. Chairman, members of the Committee, thank you for the opportunity to discuss the actions we are taking to eliminate improper payments across the Department of Defense (DoD). Improving the quality of the financial information that we use to manage the Department, and moving toward audit readiness, represent two of my highest priorities as the Department's Chief Financial Officer. I regard our improper payments program as a cornerstone of this broader effort.

OVERALL ASSESSMENT

I am therefore pleased to report that DoD currently has a strong program to identify, report, eliminate, and recover improper payments. Improper payments occur when funds go to the wrong recipient, an ineligible recipient receives a payment, a recipient receives the incorrect amount of funds (including overpayments and underpayments), or documentation is not available to support a payment.

Based on our current reporting methods, we estimate that about one to two percent of our payments result in payments that are classified as improper. That is one to two percent too much. The only appropriate goal for improper payments is zero and, as I will indicate in this statement, we are taking steps to further improve our program. Nevertheless, our improper payment percentage is low in comparison to overall federal levels, and many of our improper payments are quickly resolved.

Our colleagues at the Office of Management and Budget (OMB) generally agree that DoD has in place a strong program to control improper payments. It is important to note that DoD improper payments are not on OMB's list of high-error programs. Indeed, OMB has

identified some of the techniques we use to combat improper payments as best practices that other agencies should consider as they seek to strengthen their programs.

Our success with improper payments is particularly noteworthy because of the size and complexity of the Department's payments. Last year the Defense Finance and Accounting Service (DFAS), which handles nearly 90 percent of our total payments, disbursed a total of \$578 billion. DFAS processed more than 168 million pay transactions, 8.1 million travel payments, and 11.4 million commercial invoices. It also handled 255 million General Ledger transactions and nearly \$500 billion in military retirement and health benefits funds. We are not only a huge organization; we are a highly complex organization. The contracts for major weapons are some of the most complex in the world and present significant payment challenges, such as those associated with progress payment terms that call for varying recoupment rates. Despite the volume and complexity of our activities, DFAS has worked hard and successfully to keep the incidence of improper payments in check. At the same time the organization has steadily reduced the cost of its operations in recent years by consolidating operations and improving productivity.

Our improper payment program can be made better. We will seek to do just that as we implement the Improper Payments Elimination and Recovery Act (IPERA) recently enacted by the Congress and take other steps to improve DoD financial management. Let me discuss each broad category of payments, including our approach to controlling improper payments and, where applicable, planned improvements.

ASSESSMENT BY CATEGORY

Commercial Payments

For commercial payments we make heavy use of prepayment screening, both automated and manual, to prevent improper payments. One especially important tool in the prevention of commercial improper payments is the Business Activity Monitoring (BAM) software program that was introduced in August 2008. BAM is an automated prepayment mechanism that uses business rules to flag, for human review, payments that may be improper. For example, BAM would flag two payments for review if they involved the same dollar amount within the same time frame. Likewise, it would flag an invoice number that is very close to a recently processed invoice. When coupled with diligent work by DFAS technicians, BAM has prevented more than \$3 billion in improper payments in little more than two-and-a-half years.

Indeed, BAM has proven to be so successful that, in our primary paying system for contract payments, only one duplicate payment has occurred since BAM became fully operational. That payment was for approximately \$7,000 and all funds were recovered. As a result of BAM's robust preventive actions and results, the Internal Review division at DFAS determined that annual audits for duplicate payments in this primary paying system are no longer necessary. Despite this record of success, however, management continues to seek reductions in payment errors through better technician training and by using payment error analyses to improve BAM's software logic. In fact, as a result of continuous BAM refinements, improper payments decreased 66 percent the first half of this year compared to the same time frame last year, for all the systems BAM polices.

Another tool used with commercial payments is the Improper Payments On-line Database (IPOD), a centralized repository that requires DFAS sites to report and explain improper payments and record amounts recovered or reconciled. IPOD then summarizes results by system. Its data sources include unsolicited refunds, internal and external audits, customer inquiries, and the contract close-out process. Though sometimes tedious, these entries allow for a number of detailed analyses. DFAS determines the reasons for these errors, identifies emerging trends, evaluates related training program content, and zeros in on problems that are traceable to a particular group. Thanks to IPOD we are turning mistakes into learning opportunities that will prevent future errors.

Because of these and other prepayment measures, we have historically not used post-payment statistical sampling for commercial payments. This summer we plan to expand on this approach, with an emphasis on systems not currently covered by the BAM tool, as part of our efforts to implement IPERA and supplementing prepayment measures. I think we can all agree that it is better to stop improper payments before they occur, rather than after the fact.

Civilian and Military Payroll

Random statistical sampling is used at the Service and Component levels to estimate, identify, report, eliminate, and recover improper payments associated with military and civilian pay. Errors that are identified are turned over to the relevant organizations for corrective action. For military and civilian pay, we find that post-payment statistical sampling provides an effective supplement to, and validation of, existing prepayment reviews.

Nearly two-thirds of military pay errors are underpayments to Reservists and Guardsmen that occur because of unreconciled and unpaid leave balances and incorrect reporting

of entitlements. DFAS collaborates with the Military Services to correct these problems. In the civilian pay area, improper payments often result from untimely or incorrect time and attendance or personnel data entries to the pay system that subsequently necessitate additional corrective actions. Many of these errors are quickly identified and fixed during the subsequent pay period.

Travel Payments

Travel payments are subject to monthly statistical sampling that has proven useful in identifying, minimizing, and correcting improper payments. We have also begun using automated file matching among our travel systems to prevent duplicate payments.

As with payroll disbursements, Component financial managers are notified of the need for corrective action on a quarterly basis. Corrective action includes any necessary recovery of overpayments or additional payouts for underpayments. The majority of our temporary duty travel payments are made through the Defense Travel System, and we have found that most improper travel payments made using this system are due to traveler input errors that are missed by the approving officials. Components that make travel payments through systems other than the Defense Travel System follow similar procedures and report their results.

Retired and Annuitant Pay

We use post-payment statistical sampling for retired and annuitant pay, with specific emphasis on recapturing payments to deceased retirees when notifications are not made in a timely manner. In addition to random statistical samplings of retiree and annuitant pay records, an automated search is conducted each month to identify and recapture any payments made to deceased individuals for retired and annuitant benefits. Periodic special reviews are undertaken

in potential high risk areas such as Combat-Related Special Compensation, Concurrent Receipt of Disability Payment, and new retiree and annuitant accounts.

In FY 2010, retirement and annuitant benefits totaled \$43.2 billion, with errors accounting for only 0.14 percent of the payments made, or \$58.5 million. Of that amount, 96 percent was recovered within 60 days.

Payments by Other Organizations

The five payment categories that I have just discussed are the largest ones in DoD and are handled primarily by DFAS. But payment operations occur in multiple organizations across the Department. And many of these organizations have implemented what we believe are strong programs to estimate, identify, report, eliminate, and recover improper payments.

Two noteworthy examples are the U.S. Army Corps of Engineers and the TRICARE Management Activity. The U.S. Army Corps of Engineers conducts statistical sampling for all commercial payments and a 100 percent review of all travel payments over \$2,500, as well as a statistical sampling of those below \$2,500. It has also used a recovery audit for FY 2010 that recaptured 99 percent of all overpayments.

At the TRICARE Management Activity, home of vital military health benefits programs, stringent contract performance standards are employed that involve stratified statistical sampling based on dollar amounts and payment types. The contractor actually making the payments is incentivized by contract terms to minimize any improper payments and penalized when performance standards are not met. In addition, the comprehensive annual post-payment audit by an external independent contractor established an improper payment rate of 0.42 percent for FY 2009, representing about \$49.1 million in improper payments.

RECENT AUDIT RESULTS

Despite what we consider a strong program to control improper payments, two recent audits have cast doubt on the efficacy of DoD's improper payments program. We believe both audits are overstated and, in some cases, misleading.

In March, the Department's Inspector General concluded that the Department is not complying with Executive Order 13520, specifically the President's order to identify high-dollar improper payments to individuals and entities. The Inspector General's conclusion was based in part on a claim that we did not review some \$167.5 billion in quarterly distributions. This conclusion is overstated and misleading for two primary reasons:

- \$73.1 billion of that amount involves routine annual transactions from the Treasury to the Military Retirement Fund and the Medicare-Eligible Retiree Health Care Fund accounts. These are fully supported, internal, automated transfers between government agencies. Because these payments are reviewed when individually disbursed, it would be redundant to review the larger transfers for improper payments.
- Another \$27.3 billion represents disbursements between agencies, most of which are processed via the Intragovernmental Payment and Collection system. Again, these are fully supported, internal, automated transfers between government agencies and, according to OMB guidance, are not subject to review for improper payments.

The remaining \$67.1 billion called into question by the DoD Inspector General comes from a variety of sources: Army Corps of Engineer outlays, TRICARE Management Activity

payments, overseas financial office disbursements, payments in support of contingency operations (including operations in Afghanistan), classified activities, and disbursements made by other agencies on DoD's behalf. I have already mentioned efforts by the Army Corps of Engineers and TRICARE to manage improper payments. Contingency payments over \$3,000 are subject to a thorough prepayment review when they are sent back to the DFAS center at Rome, New York, for review and disbursement. Classified payments, of course, are not disclosed publicly but are subject to review. Payments made by other agencies on the Department's behalf, such as those made in remote overseas locations by Department of State offices that cite DoD funds, are relatively small in dollar value but will be reviewed more closely to ensure that appropriate controls are in place.

We also are concerned about the conclusions of a 2009 report by the Government Accountability Office (GAO). The GAO concluded that the Department of Defense had failed to review more than \$300 billion in disbursements in the form of commercial payments. We did not concur with these findings. As I noted above, these payments are subjected to rigorous prepayment reviews, post-payment controls, and reporting – all of which were consistent with OMB guidance at the time. The GAO recommended that these commercial payments be subject to a risk assessment and post-payment statistical sampling. In view of the IPERA legislation, and more recent OMB guidance, we are taking the steps I noted above to initiate a statistical sampling program.

CONCLUSION

I have discussed our specific approaches to control improper payments. More generally, we have an aggressive program at DoD to improve financial information and move toward

meeting commercial audit standards. I believe this program, which we call the Financial Improvement and Audit Readiness program, will further reinforce our efforts to control improper payments, while also establishing an infrastructure that will allow us to do more in-depth analysis of source documentation where appropriate. We also cooperate fully with government-wide efforts to improve financial management. For example, we were recently asked by OMB and Treasury to participate in an upcoming pilot project scheduled for later this year, and we are happy to participate in this new effort. The pilot project will help identify ways we can further reduce improper payments by ensuring that people and entities who receive payments are eligible, and identifying fraud with the use of forensic technology.

During my tenure as DoD's Chief Financial Officer, I have stressed the need to improve financial management within DoD and have introduced several key initiatives. I assure you that efforts to continue to comply fully with IPERA, the Executive Order on improper payments, and other Presidential directives, constitute an important part of those initiatives.

I welcome your questions.