



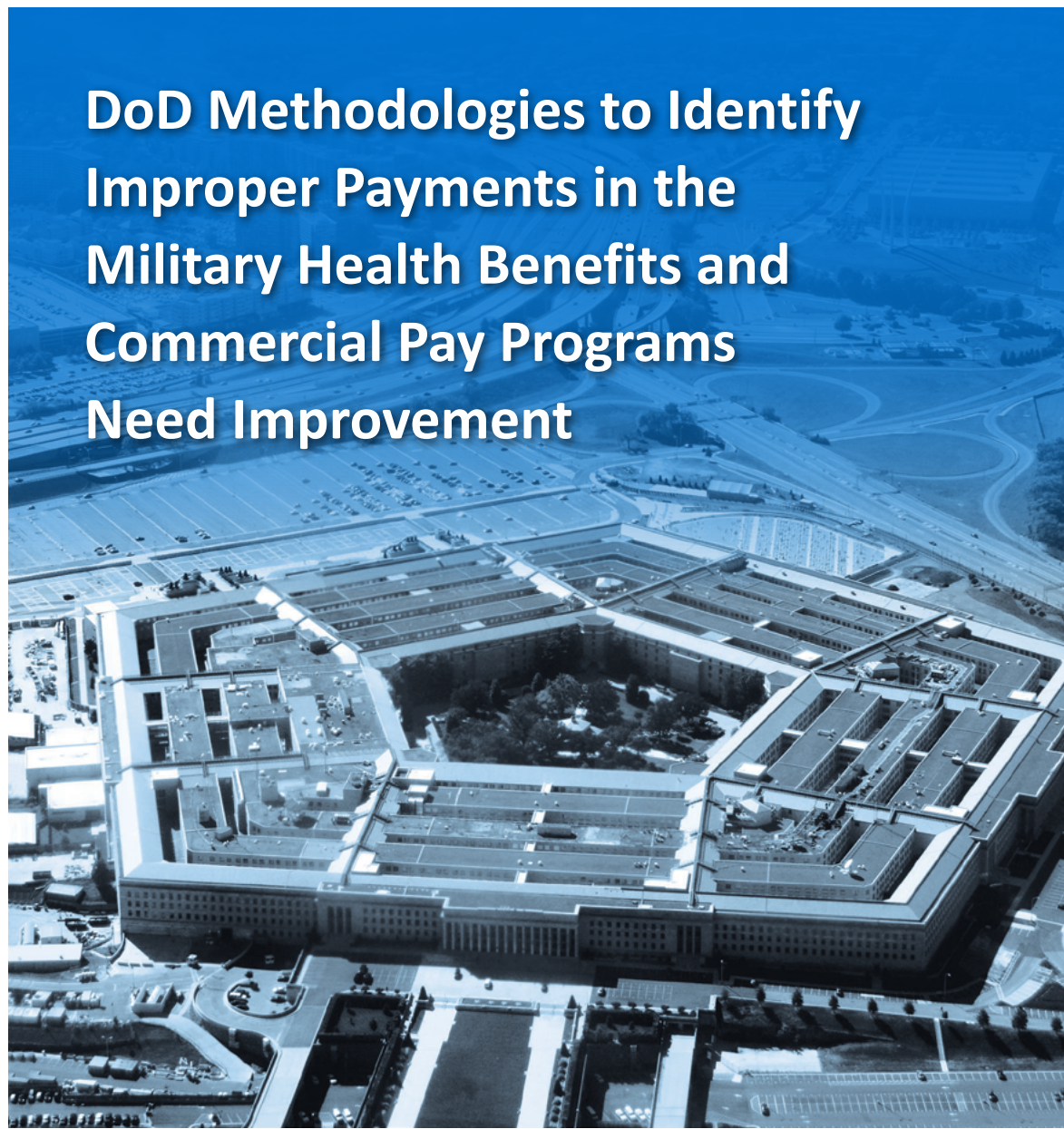
# INSPECTOR GENERAL

*U.S. Department of Defense*

JANUARY 14, 2015



## **DoD Methodologies to Identify Improper Payments in the Military Health Benefits and Commercial Pay Programs Need Improvement**



INTEGRITY ★ EFFICIENCY ★ ACCOUNTABILITY ★ EXCELLENCE

INTEGRITY ★ EFFICIENCY ★ ACCOUNTABILITY ★ EXCELLENCE

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# Results in Brief

## *DoD Methodologies to Identify Improper Payments in the Military Health Benefits and Commercial Pay Programs Need Improvement*

**JANUARY 14, 2015**

### Objective

We determined whether DoD methodologies for determining improper payment rates in the DoD Agency Financial Report capture improper payments because of error, fraud, waste, and abuse. Specifically, we reviewed the Defense Finance and Accounting Service (DFAS) Commercial Pay program and the Military Health Benefits program.

### Finding

Defense Health Agency (DHA) and DFAS developed methodologies that did not fully capture improper payment estimates and did not fully disclose recovered overpayments in the FY 2013 DoD Agency Financial Report.

DHA risk assessments did not properly identify and evaluate risks of improper payments because DHA did not consider all types of payments, based its risk assessment on statistically invalid estimates, did not consider the risk of medical payment fraud, and used a nonsystematic method to evaluate risk for some payments.

DHA and DFAS did not design improper payment testing to detect fraud because Office of Management and Budget (OMB) guidance did not specify whether agencies should test for fraud.

DHA did not properly calculate estimated improper payment rates because the rates were based on billed amounts instead of paid amounts and on statistically invalid results. Furthermore, DFAS rates could be improved by using a stratified sampling plan.

### Finding (cont'd)

DHA and DFAS methodologies did not include steps to fully disclose identified and recaptured overpayments because OMB guidance was unclear.

The inadequate methodologies resulted in unreliable improper payment estimates, and limit DoD's ability to identify and report improper payments, determine underlying weaknesses that cause the improper payments, and initiate corrective actions to reduce the improper payments.

### Recommendations

We recommend that the Director, DHA:

- Include all DHA health care payments when assessing risk and document the justification for excluding any program payments in the risk assessment and the Agency Financial Report.
- Develop a systematic risk-assessment methodology for all contracts that is not limited to prior-year sampling results and considers other risk factors, such as the risk of fraud.
- Develop procedures to calculate the improper payment error rate based on amounts paid. In addition, properly apply the stratified sample design and project the results to the sample universe.

We recommend that the Under Secretary of Defense (Comptroller)/Chief Financial Officer, DoD, review improper payment risk assessments, sampling plans, and input to the DoD Agency Financial Report for conditions cited in this report. In addition, we recommend he coordinate with OMB to obtain guidance on the testing and reporting requirements of fraudulent payments or indicators of potentially fraudulent payments.

### Management Comments and Our Response

Comments from the Deputy Chief Financial Officer, DoD, and the Director, Business Support Directorate, DHA, addressed all specifics of the recommendations except for Recommendation 1.b. We request the Director, DHA, reconsider Recommendation 1.b and provide additional comments to this report. Please see the Recommendations Table on the back of this page.

## ***Recommendations Table***

Management	Recommendations Requiring Comment	No Additional Comments Required
Under Secretary of Defense (Comptroller)/ Chief Financial Officer, DoD		2.a.(1), 2.a.(2), 2.a.(3), 2.a.(4)., and 2.b
Director, Defense Health Agency	1.b	1.a, 1.c, 1.d

Please provide Management Comments by February 11, 2015.





**INSPECTOR GENERAL  
DEPARTMENT OF DEFENSE**  
4800 MARK CENTER DRIVE  
ALEXANDRIA, VIRGINIA 22350-1500

JANUARY 14, 2015

MEMORANDUM FOR UNDER SECRETARY OF DEFENSE (COMPTROLLER)/  
CHIEF FINANCIAL OFFICER, DOD  
ASSISTANT SECRETARY OF DEFENSE (HEALTH AFFAIRS)  
DIRECTOR, DEFENSE FINANCE AND ACCOUNTING SERVICE  
DIRECTOR, DEFENSE HEALTH AGENCY

SUBJECT: DoD Methodologies to Identify Improper Payments in the Military Health Benefits  
and Commercial Pay Programs Need Improvement (Report No. DODIG-2015-068)

We are providing this report for review and comment. Defense Health Agency and Defense Finance and Accounting Service developed methodologies that did not fully capture improper payment estimates and did not fully disclose recovered overpayments in the FY 2013 DoD Agency Financial Report. The inadequate methodologies resulted in unreliable improper payment estimates and limit DoD's ability to identify and report improper payments, determine underlying weaknesses that cause the improper payments, and initiate corrective actions to reduce the improper payments. We conducted this audit in accordance with generally accepted government auditing standards.

We considered comments on a draft of this report. DoD Directive 7650.3 requires that recommendations be resolved promptly. Comments from the Deputy Chief Financial Officer, DoD, and from the Director, Business Support Directorate, Defense Health Agency, addressed all specifics of the recommendations except for Recommendation 1.b. We request additional comments on this recommendation from the Director, Defense Health Agency, by February 11, 2015.

Please send a PDF file containing your comments to [audyorktown@dodig.mil](mailto:audyorktown@dodig.mil). Copies of your comments must have the actual signature of the authorizing official for your organization. We cannot accept the /Signed/ symbol in place of the actual signature. If you arrange to send classified comments electronically, you must send them over the SECRET Internet Protocol Router Network (SIPRNET).

We appreciate the courtesies extended to the staff. Please direct questions to me at (703) 604-9187.

A handwritten signature in blue ink, reading "Michael J. Roark", is positioned above the printed name.

Michael J. Roark  
Assistant Inspector General  
Contract Management and Payments

# Contents

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## Introduction

Objective	1
Background	1
Review of Internal Controls	3

## **Finding. DoD Can Improve Methodologies to Identify Improper Payments in the Military Health Benefits and Commercial Pay Programs**

DHA Risk Assessment Did Not Fully Identify and Evaluate Risks, and DFAS Met Intent of IPERA	5
Fraud Was Not Considered In Payment Testing Procedures	7
Estimated Improper Payment Rates Need Improvement	8
Identified and Recaptured Overpayments Were Not Fully Reported	10
Oversight and OMB Guidance Clarification is Needed	11
Unreliable Estimates and Limited Ability to Reduce and Recapture Improper Payments	12
Management Comments on the Finding and Our Response	13
Recommendations, Management Comments, and Our Response	14

## Appendix

Scope and Methodology	18
Use of Computer-Processed Data	19
Use of Technical Assistance	19
Prior Coverage	20

## Management Comments

Under Secretary of Defense (Comptroller)/Chief Financial Officer, DoD	21
Defense Health Agency	23

## Acronyms and Abbreviations

# Introduction

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## Objective

Our objective was to determine whether DoD methodologies for determining improper payment rates in the DoD Agency Financial Report (AFR) capture improper payments<sup>1</sup> because of error, fraud, waste, and abuse. Specifically, we reviewed the Defense Finance and Accounting Service (DFAS) Commercial Pay program and the Military Health Benefits program.

## Background

On July 22, 2010, the President signed Public Law 111-204, “Improper Payments Elimination and Recovery Act of 2010” (IPERA), which amended the “Improper Payments Information Act of 2002.” The Office of Management and Budget (OMB) issued OMB Circular No. A-123, Appendix C, “Requirements for Effective Measurement and Remediation of Improper Payments,” Parts I and II, April 14, 2011, as guidance for agencies to implement the requirements of IPERA.

## *IPERA Requirements*

IPERA requires each agency, in accordance with OMB Circular A-123:

- to periodically review all programs and activities to identify programs and activities susceptible to significant improper payments;
- while conducting program reviews, to take into account those risk factors that are likely to contribute to a susceptibility to significant improper payments;
- to estimate improper payments made by each program or activity by producing a statistically valid estimate or an estimate that is otherwise appropriate using a methodology approved by OMB; and
- to submit a report on all actions the agency is taking to recover identified improper payments.

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<sup>1</sup> According to Office of Management and Budget Circular No. A-123, Appendix C, “Requirements for Effective Measurement and Remediation of Improper Payments,” Parts I and II, April 14, 2011, an “improper payment” is any payment that should not have been made or was made in an incorrect amount under statutory, contractual, or administrative, or other legally applicable requirements. Incorrect amounts are overpayments or underpayments made to eligible recipients (including inappropriate denials of payment or service, and payment that does not account for credit of applicable discounts, payments that are for an incorrect amount, and duplicate payments). Improper payments also include payments made to ineligible recipients or for ineligible goods or services, or payments for goods or services not received (except for such payments authorized by law). In addition, improper payments include payments that an agency’s review is unable to determine whether the payments were proper as a result of insufficient or lack of documentation.

OMB Circular A-123 lists potential causes of improper payments, such as errors, lack of information, and fraud. The guidance states that agencies must examine the risk of improper payments in all programs and activities they administer—including contract and vendor payments—and that agencies may decide to focus their sampling or testing on individual components or transaction points of their programs for the areas posing the highest risk of improper payments. This decision and subsequent actions should be documented by agencies in their AFRs and approved by OMB before implementation.

OMB Circular A-136<sup>2</sup> provides for agency- and Government-wide financial reporting. This guidance requires agencies to report the results of payment recapture audits and improper payments identified and recovered through sources other than payment recapture audits.

The FY 2013 DoD AFR provides an overview of the Department's financial information and performance goals and priorities. DoD published and posted the FY 2013 AFR on the Office of the Under Secretary of Defense (Comptroller) website on December 16, 2013. The AFR included information on improper payments in the following nine programs:

- Military Health Benefits,
- Military Pay,
- Civilian Pay,
- Military Retirement,
- DoD Travel Pay,
- DFAS Commercial Pay,
- U.S. Army Corps of Engineers Travel Pay,
- U.S. Army Corps of Engineers Commercial Pay, and
- Navy Enterprise Resource Planning Commercial Pay.

This audit focused on the DFAS Commercial Pay and the Military Health Benefits programs, as implemented by the Director, DFAS, and the Director, Defense Health Agency (DHA). The FY 2013 DoD AFR is based on FY 2013 DFAS Commercial Pay data and FY 2012 Military Health Benefits data.

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<sup>2</sup> OMB Circular No. A-136, "Financial Reporting Requirements," October 21, 2013.



## Review of Internal Controls

DoD Instruction 5010.40, “Managers’ Internal Control Program Procedures,” May 30, 2013, requires DoD organizations to implement a comprehensive system of internal controls that provides reasonable assurance that programs are operating as intended and to evaluate the effectiveness of the controls. We identified weaknesses in DoD’s improper payment methodologies that limit its ability to identify and report improper payments, determine underlying internal control weaknesses that cause the improper payments, and initiate corrective actions to reduce the improper payments. We will provide a copy of the report to the senior official responsible for internal controls for the Under Secretary of Defense (Comptroller)/Chief Financial Officer, DoD, and the Director, DHA.

## Finding

### DoD Can Improve Methodologies to Identify Improper Payments in the Military Health Benefits and Commercial Pay Programs

DHA and DFAS developed methodologies that did not fully capture improper payment estimates and did not fully disclose recovered overpayments in the FY 2013 DoD Agency Financial Report.

- DHA risk assessments<sup>3</sup> did not properly identify and evaluate the risk of improper payments in the Military Health Benefits program<sup>4</sup> because DHA did not consider all types of health care payments, based its risk assessment on statistically invalid estimates, did not consider the risk of medical payment fraud, and used a nonsystematic method to evaluate risk for some payments. The DFAS risk assessment met the intent of IPERA.
- DHA and DFAS did not design procedures to test for potentially fraudulent improper payments because OMB Circular A-123 did not specify whether agencies should test for fraud.
- DHA did not properly calculate estimated improper payment rates because rates were based on billed amounts instead of paid amounts and on statistically invalid results. Also, DFAS rates could be improved by using a stratified sampling plan.
- DHA and DFAS methodologies did not include steps to fully disclose identified and recaptured overpayments because OMB guidance was unclear.

In addition, oversight by the Under Secretary of Defense (Comptroller)/Chief Financial Officer, DoD, is necessary to help ensure that similar problems do not exist in the DoD payment programs not reviewed during this audit.

The inadequate methodologies resulted in unreliable improper payment estimates, and limit DoD's ability to identify and report improper payments, determine underlying weaknesses that cause the improper payments, and initiate corrective actions to reduce the improper payments.

<sup>3</sup> Risk assessment is the identification and analysis of relevant risks associated with achieving agency objectives and forming a basis for determining how risks should be managed.

<sup>4</sup> The term "program" includes activities or sets of activities recognized as programs by the public, OMB, or Congress, including program management and all types of procurements.

## DHA Risk Assessment Did Not Fully Identify and Evaluate Risks, and DFAS Met Intent of IPERA

DHA did not consider all health care payments in its FY 2013 risk assessment, based its risk assessment on statistically unreliable results, did not consider the risk of medical payment fraud, and used a nonsystematic method to evaluate risk for some payments. The FY 2013 DFAS risk assessment met the intent of IPERA. OMB Circular A-123 requires agencies to examine the risk of improper payments and institute a systematic method of reviewing all programs to identify those susceptible to significant improper payments. The systematic method could be a quantitative evaluation based on a statistical sample, or it could take into account risk factors likely to contribute to significant improper payments.

### ***All Health Care Payments Were Not Considered***

DHA did not include all types of health care payments in its risk assessment in accordance with OMB Circular A-123; therefore, DHA does not have assurance that it is testing components of the Defense Health Program with the highest risk of improper payments. OMB guidance allows agencies to focus IPERA testing on components of the program that pose the highest risk of improper payments but requires agencies to include all payment programs in the risk assessment.



DHA inappropriately excluded approximately \$13.1 billion in health care expenditures from its risk assessment.

DHA inappropriately excluded approximately \$13.1 billion in health care expenditures from its risk assessment.

It limited its risk assessment for the Military Health Benefits program to health care benefits, valued at approximately \$22.1 billion, processed under 10 health care contracts and one Supplemental Food program. In its FY 2013 Report to Congress,<sup>5</sup>

DoD reported FY 2012 health care expenditures of approximately \$35.2 billion. A DHA official stated that other vendor and contract payments were scrutinized

and that DHA was willing to include them in the risk-management process for payment accuracy in future risk assessments. DHA did not identify in its FY 2013 risk assessment and the DoD FY 2013 AFR which payments it excluded. DHA should include all DHA health care payments when assessing risk and document the justification for excluding any type of program payments from IPERA reporting in the risk assessment and the Agency Financial Report.

<sup>5</sup> "Evaluation of the TRICARE Program: Access, Cost, and Quality. Fiscal Year 2013 Report to Congress," February 28, 2013.

### ***DHA Risk Assessment Was Based on Statistically Invalid Estimates***

DHA based its risk assessment in part on statistically invalid improper payment estimates. For the seven contracts subject to sampling for IPERA reporting, DHA relied on the results of prior years' statistical sampling as the basis for its risk determination. However, as discussed later in this finding, DHA excluded certain payments from the sampling universe but projected the results to the entire universe, and did not properly project the results of the stratified sample. Therefore, the rates were unreliable as a measure of improper payments. Unreliable sample results will not provide the necessary information to assess the risk of significant improper payments.

### ***High Risk of Medical Payment Fraud Was Not Considered***

The DHA risk assessment approach also did not consider the inherently high risk of fraud in medical claims payments. OMB Circular A-123 states that management should consider previous findings when identifying risks and analyze the identified risks for their potential impact on the agency. According to the DoD FY 2013 AFR, fraudulent medical claims were a significant contributor to improper health care payments, with medical fraud in the top five categories of Defense Criminal Investigative Service cases in FY 2013. According to the Federal Bureau of Investigation,<sup>6</sup> approximately 3 to 10 percent of all health care billings are fraudulent.

### ***Systematic Method Was Not Used for Three Contracts and One Program***

DHA did not use a systematic method to evaluate risk for three contracts and one program, valued at over \$1.5 billion, included in the risk assessment but not included in IPERA reporting. OMB Circular A-123 states that when using a systematic method of risk assessment, agencies consider risk factors likely to contribute to significant improper payments, such as program complexity, volume of payments, whether payments or payment eligibility decisions are made outside the agency, and whether significant deficiencies have been identified in Office of Inspector General audit reports. DHA used statistical sampling as its systematic method to evaluate risk for seven contracts. DHA stated it based the assessment for the three contracts and one program on payment reconciliations or Defense

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<sup>6</sup> "Financial Crimes Report to the Public, Fiscal Years 2010-2011."

Contract Audit Agency audits. However, DHA included no quantitative data or analyses of other risk factors to support its determination that the three contracts and one program were at low risk. Therefore, DHA should develop a methodology to assess risk for all contracts that is not limited to prior years' sampling but also takes into account likely risk factors, including the risk of fraud.

### ***DFAS Risk Assessment Met the Intent of IPERA***

DFAS considered all payments from the 15 entitlement systems to be at risk for improper payments. According to DFAS personnel, an entitlement system ensures all documentation is in order before a disbursement takes place. Although the DFAS FY 2013 approach met the intent of the IPERA, DFAS modified the way it assessed risk in FY 2014. As a result of GAO Report No. GAO 13-227, "Significant Improvements Needed in Efforts to Address Improper Payment Requirements," May 13, 2013, DFAS modified its approach by assessing each of the 15 entitlement systems. The FY 2014 DFAS risk assessment determined that three systems were susceptible to significant risk of improper payments, and four additional systems were susceptible to improper payments based on their volume of payments.

### **Fraud Was Not Considered In Payment Testing Procedures**

DHA and DFAS designed payment testing procedures to identify payment errors but not potentially fraudulent payments. OMB Circular A-123 states that Federal agencies should take all necessary steps to ensure the accuracy and integrity of Federal payments and cites potential causes of improper payments, such as errors, lack of information, and fraud.

DHA designed procedures to detect errors made by contractor personnel during claims processing but excluded procedures to identify potentially fraudulent payments. DHA used an external independent contractor to test payment samples to detect and validate contractor compliance with TRICARE requirements. DHA also used the external contractor's results to meet IPERA reporting requirements. However, a DHA official stated that there was no significant effort by the external independent contractor to evaluate the potential for fraudulent activity. OMB Circular A-123 includes direction on reporting indicators of fraudulent activity identified during improper payment audits. However, the audit guidelines used by the TRICARE Claims Review Services contractor do not discuss the subject of fraud or include requirements for reporting fraud indicators. DHA relies on its Office of



Program Integrity to detect and prevent fraud and abuse. In addition, as discussed later in this report, DHA did not disclose improper payments identified as a result of Program Integrity activities in the DoD FY 2013 AFR.

DFAS Commercial Pay improper payment sample testing included procedures to identify errors but did not include procedures to identify potentially fraudulent payments. DFAS internal procedures<sup>7</sup> included a checklist with 15 questions to assess the validity of the payment. This checklist required the site postpay review team to review vouchers and compare invoice amounts to contracts and receiving reports. Testing for potentially fraudulent payments is discussed further under “Oversight and OMB Guidance Clarification Is Needed.”

## **Estimated Improper Payment Rates Need Improvement**

DHA did not base FY 2013 estimated improper payment rates on total payments as required by OMB Circular A-123. In addition, the results from DHA’s stratified sample were statistically invalid. The DFAS FY 2013 sampling plan to estimate improper payments could be improved by using a stratified sampling plan. A stratified sampling plan would divide the population of payments into dollar amount ranges, which would ensure that payments from all ranges are sampled for improper payments and result in a more precise estimate.

### ***Incorrect Payment Rate for Military Health Benefits Program***

DHA calculated the improper payment rate based on the total amount billed rather than the total paid. OMB Circular A-123 states that agencies should only use the amount paid improperly with their annual estimation of improper payments and are required to determine an annual estimate that is a gross total of both over and underpayments. Agencies are required to determine the estimated improper payment rate by dividing the amount of improper payments by total program payments. Because DHA used the billed amount to determine its improper payment rate, the improper payment estimates reported in the DoD FY 2013 AFR were incorrect.<sup>8</sup> DHA acknowledged the error and agreed to change the calculation for FY 2014 reporting. DHA should develop procedures to calculate the improper payment error rate based on amount paid in accordance with OMB guidance.

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<sup>7</sup> DFAS “Standard Operating Procedure for Postpay Review & Analysis Contract and Vendor Pay Fiscal Year 2013,” October 31, 2012.

<sup>8</sup> This error was also reported by the Government Accountability Office in Report No. GAO-13-227, “Significant Improvements Needed in Efforts to Address Improper Payment Requirements,” May 13, 2013.

## ***Sample Results for Military Health Benefits Were Statistically Invalid***

DHA excluded certain payments from the sampling universe but projected the results to the entire universe, producing a statistically invalid improper payment rate. For the 7 contracts DHA used to calculate its improper payment rate, it excluded over 72 million claims, representing over \$2 billion in payments, from sampling—37 percent of the total claims universe.<sup>9</sup> According to the DHA sampling plan, most of the excluded claims were low-dollar claims DHA intentionally excluded to achieve a more efficient use of contractor resources. Additionally, a DHA official stated that audit software was programmed to exclude claims previously identified for audit, and that DHA also projected the results to three contracts and one program that were not subject to sampling. Although OMB approved the DHA FY 2013 sampling methodology, the methodology did not disclose the volume or value of the excluded payments or that the improper payment rate would be projected to the excluded payments.

The DHA estimated improper payment rate was also statistically invalid because DHA did not properly project the results of the stratified sample. As a result, DHA understated its FY 2013 estimated improper payment total by over \$145 million. DHA designed a stratified sample to allow more emphasis on high-dollar claims. According to our Quantitative Methods Division analysts, sampling weights should be used in a stratified sample design to calculate the proper error rates, but DHA only added the sample results from all strata to determine the error rate. We used the sample results provided by DHA to calculate the error rate using appropriate weighting and included only records that were subject to sampling, and determined an actual DHA error rate of about 1.09 percent, or a total of about \$213.3 million. Therefore, the DHA improper payment rate of 0.32 percent and estimated improper payment total of \$67.6 million reported in the DoD FY 2013 AFR were significantly understated. DHA should develop procedures to properly apply the stratified design and project the results only to the sampling universe.



As a result, DHA understated its FY 2013 estimated improper payment total by over \$145 million.

<sup>9</sup> According to DHA, the universe included seven health care contracts with a total of 195,560,554 claims and approximately \$21.6 billion in claims paid.

***DFAS Commercial Pay Sampling Plan Could Be Improved***

The DFAS FY 2013 sampling plan to estimate improper payments could also be improved by using a stratified sampling plan. DFAS designed the FY 2013 sampling plan so a \$10 million payment had the same chance of being selected for testing as a \$100 payment. DoD acknowledged in the DoD FY 2013 AFR that a stratified design will “provide confidence” and planned to implement the new methodology in FY 2014. During the audit, we confirmed that DFAS implemented a stratified sampling methodology for FY 2014. We are not making recommendations because of management actions during 2014.

**Identified and Recaptured Overpayments Were Not Fully Reported**

The DHA and DFAS IPERA methodologies did not include steps to fully determine and report identified and recaptured overpayments in accordance with OMB guidance. This was caused by unclear guidance from OMB on how to report fraudulent improper payments, as discussed further under “Oversight and OMB Guidance Clarification is Needed.” OMB Circular A-123 states agencies must report annually on their payment recapture audit program in the AFR. In addition, OMB Circular A-136 requires agencies to report overpayments identified and recovered outside of payment recapture audits. Sources could include overpayments identified through statistical sampling, post-payment reviews or audits, Office of Inspector General reviews, self-reported overpayments, or reports from the public.

***Military Health Benefits Overpayments Were Underreported***

DHA did not report overpayments identified or recovered from all sources as required by OMB Circular A-136. In the DoD FY 2013 AFR, DHA reported that it identified \$8.7 million in overpayments and recovered \$19.5 million in the current reporting year. DHA identified and recovered these payments as a result of Annual Health Care Cost audits on three health care contracts. However, the DHA 2012 Program Integrity Operational Report and the DHA FY 2013 Report to Congress stated approximately \$251.8 million in overpayments were identified in 2012; these overpayments should have been included in the DoD FY 2013 AFR. DHA also did not report over \$2.7 million in FY 2012 overpayments identified by its external independent contractor during IPERA sample testing. By excluding improper payments identified and recovered through all sources, DHA understated

its identified and recovered overpayments. In addition, DHA did not include recaptured payments resulting from fraud or other settlements. For comparative purposes, we reviewed the Department of Health and Human Services FY 2013 AFR and found that the results of post-payment reviews, program integrity activities, and error-rate measurements were included in AFR overpayment reporting.

### ***DFAS Commercial Pay Recoveries Were Underreported***

DFAS did not report improper payments identified and recaptured from fraud or other settlements in the DFAS Commercial Pay program. DFAS procedures used to complete DoD FY 2013 AFR Table 9, "Overpayments Recaptured Outside of Payment Recapture Audits," did not include identifying and reporting overpayments and recovery amounts from fraud and other settlements. DFAS subsequently documented the procedures in DFAS standard operating procedure, "Identifying Improper Payment and Recovery Amounts in Support of AFR and IPERA Reporting Requirements;" however, the standard operating procedure also did not require the inclusion of recoveries from fraud or other settlements.

### **Oversight and OMB Guidance Clarification is Needed**

Under Secretary of Defense (Comptroller)/Chief Financial Officer, DoD, oversight is necessary to adequately identify, recover, and report improper payments throughout the other DoD payment programs not reviewed during this audit. According to DoD regulation,<sup>10</sup> the Deputy Chief Financial Officer, DoD,<sup>11</sup> designates an Improper Payment Project Officer who is responsible for reviewing the Department's statistical sampling plans to ensure they meet or exceed the minimum requirements on an annual basis. This officer is also responsible for reviewing annual IPERA reports to ensure DoD meets the reporting requirements, preparing the Department-wide IPERA results and related information for submission to OMB, and publishing in the AFR. The Under Secretary of Defense (Comptroller)/Chief Financial Officer, DoD, is the focal point for IPERA compliance and reporting in the DoD AFR. Oversight by this office is necessary to help prevent the conditions discussed in this report from occurring in the other DoD payment programs. Under Secretary of Defense (Comptroller)/Chief Financial Officer, DoD, should review improper payment risk assessments, sampling plans, and input to the DoD AFR for the DoD payment programs not discussed in this report to ensure risk assessments include all program payments, systematic methodologies

<sup>10</sup> DoD Regulation 7000.14-R, "DoD Financial Management Regulation," Volume 4, Chapter 14: "Improper Payments."

<sup>11</sup> Reports to the Under Secretary of Defense (Comptroller)/Chief Financial Officer, DoD.

are developed that consider known risks, improper payments error rates are based on total payments, and sample designs and projections are properly applied. The review should make sure the programs fully comply with policy requirements and ultimately achieve the full benefits from identifying and reducing improper payments.

Although a payment is considered improper because of error, fraud, waste, and abuse, OMB Circular A-123, Appendix C, did not specify whether an agency should evaluate sampled payments to identify fraud or indicators of fraud. In addition, although OMB Circular A-136 requires the reporting identified and recovered overpayments from all sources, guidance was not clear on the extent to which Federal departments should identify and report the recovery of fraudulent payments or other judgments. Inconsistent reporting of recoveries by DoD and the Department of Health and Human Services indicate clarification is needed. Under Secretary of Defense (Comptroller)/Chief Financial Officer, DoD, should coordinate with OMB to obtain guidance on the testing and reporting requirements of fraudulent payments or indicators of potentially fraudulent payments and issue Department-wide guidance.

## **Unreliable Estimates and Limited Ability to Reduce and Recapture Improper Payments**

Inadequate methodologies resulted in unreliable improper payment estimates. Additionally, the inadequate methodologies limit DoD's ability to reduce and recapture improper payments. The value of the IPERA process results from identifying and correcting the breakdown in internal controls that allowed the improper payments to be processed. Methodologies that allow at-risk payments to be excluded from consideration increase the risk that improper payments may not be identified, the underlying internal control weaknesses will not be determined, and corrective actions will not be made to reduce improper payments. Increased identification of improper payments will potentially result in increased recoveries of overpayments.



## Management Comments on the Finding and Our Response

### *Management Comments on the Finding*

The Director, Business Support Directorate, DHA, responding for the Director, DHA, stated that although DHA concurs in general with the report findings there were several areas of the report that may require clarification. Specifically, the Director stated that use of the term “inadequate” to describe DHA methodologies was misleading when describing the changes DHA made to its sampling plan and the improvement made to the risk assessment plan. The Director stated the DHA error rate was 1.09 percent after applying changes to the formula, which is below the OMB policy standard of 1.5 percent. He further stated that the prior sampling methodology did not obscure any underlying weaknesses or root causes of error. Additionally, the Director stated that improper payment reporting does not extend to fraudulent health care claims because reporting of such payments could expose pending investigations and litigation to public disclosure. He further explained that DHA has a dedicated Program Integrity Division that is solely responsible for reporting fraudulent activities. Finally, the Director stated that the three contracts and one program excluded from improper payment reporting are considered low risk because of annual audits conducted by the Defense Contract Audit Agency. He further stated that low-dollar claims are excluded from some contracts in accordance with OMB guidance to carry out a cost-effective program, and that low-dollar claims historically contain very few errors.

### *Our Response*

The use of the term “inadequate” to describe DHA improper payment methodologies is appropriate and supported by the findings in this report. As stated in this report, DHA did not comply with OMB guidance when calculating its improper payment estimates, and applied their methodology in a manner that resulted in a statistically invalid result. Although the recomputed error estimate of 1.09 percent is still below the OMB 1.5 percent threshold, the recomputed estimated improper payment total of about \$213.3 million places DHA’s estimated improper payment total over the OMB dollar threshold of \$100 million, classifying DHA as susceptible to significant improper payments.

Additionally, the risk of fraud in medical claims payments is inherently high and DHA should consider this risk in its risk assessment. Assessing fraud risk and the effectiveness of controls related to fraud does not expose specific acts of potential fraud to public disclosure. OMB guidance for improper payment risk assessments do not differentiate between improper payments because of

fraudulent activity or improper payments made for any other reason. Also, a new requirement in OMB Circular A-123, issued on October 20, 2014, states agencies at a minimum shall take into account risk factors likely to contribute to improper payments, such as inherent risks of improper payments due to the nature of agency programs or operations.

Finally, although the Director stated that some contracts are low risk, and that some low-dollar payments contain very few errors, the DHA risk assessment did not provide any data or analyses to support these determinations.

## Recommendations, Management Comments, and Our Response

### **Recommendation 1**

**We recommend that the Director, Defense Health Agency:**

- a. Include all Defense Health Agency health care payments when assessing risk and document the justification for excluding any type of program payments in the risk assessment and the Agency Financial Report.**

#### *Director, Defense Health Agency Comments*

The Director, Business Support Directorate, DHA, responding for the Director, DHA, agreed with the recommendation, stating that DHA will include all health care payments when assessing risk and document the justification for any exclusions.

#### *Our Response*

Comments from the Director addressed all specifics of the recommendation, and no additional comments are required.

- b. Develop a methodology to assess risk for all contracts that is not limited to prior year sampling results but also considers other risk factors, such as the risk of fraud.**

#### *Director, Defense Health Agency Comments*

The Director, Business Support Directorate, DHA, responding for the Director, DHA, disagreed with the recommendation that fraudulent activities should be considered as a risk factor when developing a methodology to assess risk for improper payments. He further stated that OMB Circular A-123, Part III, states that payments based on fraudulent claims that may be referred to the Department of Justice for litigation are distinct from improper payments and should be handled differently.

### *Our Response*

OMB Circular A-123 requires that management consider previous findings when identifying risks and analyze the risks for potential impact on the agency. Additionally, a new requirement in the OMB Circular, issued on October 20, 2014, states agencies at a minimum must take into account risk factors likely to contribute to improper payments, such as inherent risks of improper payments due to the nature of agency programs or operations. The OMB citation referred to by the Director applies only to excluding outstanding improper payment and recipient data from the Agency Quarterly High-Dollar Report to the Inspector General when an agency anticipates referring the payment to the Department of Justice. Because the citation applies to a specific report on referred payments and not to the statutory improper payment requirements, DHA should still consider the inherent fraud risk of health care payments in its risk assessment. For example, DHA can include in the risk assessment that it considered and addressed the risk of health care fraud through the DHA Program Integrity Division. We request the Director, DHA, reconsider his position on Recommendation 1.b and provide comments on the final report.

- c. Develop procedures to calculate the improper payment error rate based on amount paid in accordance with Office of Management and Budget guidance.**

### *Director, Defense Health Agency Comments*

The Director, Business Support Directorate, DHA, responding for the Director, DHA, agreed with the recommendation, stating that DHA developed procedures to calculate the improper payment error rate based on amount paid, to be implemented for the FY 2014 DoD AFR.

### *Our Response*

Comments from the Director addressed all specifics of the recommendation, and no additional comments are required.

- d. Develop procedures to properly apply the stratified sample design and project the results only to the sample universe.**

### *Director, Defense Health Agency Comments*

The Director, Business Support Directorate, DHA, responding for the Director, DHA, agreed with the recommendation, stating that DHA developed procedures to apply the stratified sample design and project sample results to the sample universe, to be implemented for the FY 2014 DoD AFR.

### *Our Response*

Comments from the Director addressed all specifics of the recommendation, and no additional comments are required.

## **Recommendation 2**

**We recommend that the Under Secretary of Defense (Comptroller)/Chief Financial Officer, DoD:**

- a. Review improper payment risk assessments, sampling plans, and input to the DoD Agency Financial Report for the DoD payment programs not discussed in this report. The review should ensure that DoD Components:**
  - (1) Include all types of program payments when assessing risk and document the justification for excluding any type of program payment in the risk assessment and the Agency Financial Report.**
  - (2) Develop systematic methodologies to assess risk that consider known risks, such as potential for fraud or programs with high improper payment rates.**
  - (3) Compute improper payment error rates based on total payments and not billed amounts.**
  - (4) Properly apply sample designs and project the results only to the sample universe.**

### *Under Secretary of Defense (Comptroller)/Chief Financial Officer, DoD, Comments*

The Deputy Chief Financial Officer, responding for the Under Secretary of Defense (Comptroller)/Chief Financial Officer, DoD, agreed with the recommendations. The Deputy Chief Financial Officer also stated Recommendations 2.a.(1), 2.a.(3), and 2.a.(4) have been implemented and that Recommendation 2.a.(2) will be implemented by March 31, 2015.

### *Our Response*

Comments from the Deputy Chief Financial Officer addressed all specifics of the recommendations, and no additional comments are required.

- b. Coordinate with the Office of Management and Budget to obtain guidance on the testing and reporting requirements of fraudulent payments or indicators of potentially fraudulent payments and issue Department-wide guidance.**

*Under Secretary of Defense (Comptroller)/Chief Financial Officer,  
DoD, Comments*

The Deputy Chief Financial Officer, responding for the Under Secretary of Defense (Comptroller)/Chief Financial Officer, DoD, agreed, stating his office will work directly with OMB personnel to establish a target date for the required guidance. He provided an estimated completion date of March 31, 2015.

*Our Response*

Comments from the Deputy Chief Financial Officer addressed all specifics of the recommendation, and no additional comments are required.



## Appendix

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### Scope and Methodology

We conducted this performance audit from February 2014 through November 2014 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

### ***Review of Documentation and Interviews***

We reviewed the DFAS Commercial Pay and Military Health Benefits program methodologies for determining improper payment rates in the DoD FY 2013 AFR to determine whether the methodologies captured improper payments because of error, fraud, waste, and abuse. We obtained and reviewed the “Improper Payment and Payment Recapture Programs” report in Addendum A, “Other Accompanying Information,” of the DoD FY 2013 AFR. We obtained and reviewed Public Law 107-300, “Improper Payments Information Act of 2002,” November 26, 2002; Public Law 111-204, “Improper Payments Elimination and Recovery Act of 2010,” July 22, 2010; and Public Law 112-248, “Improper Payments Elimination and Recovery Improvement Act of 2012,” January 10, 2013. We also reviewed implementing guidance from OMB, including:

- OMB Circular A-123, Appendix C, “Requirements for Effective Measurement and Remediation of Improper Payments,” Parts I and II, April 14, 2011;
- OMB Circular A-123, Appendix C, “Requirements for Implementing Executive Order 13520: Reducing Improper Payments,” Part III, March 22, 2010; and
- OMB Circular A-136 Revised, “Financial Reporting Requirements,” October 21, 2013.

We also reviewed DoD Regulation 7000.14-R, “DoD Financial Management Regulation,” to obtain implementing guidance within DoD.

We interviewed personnel from the Office of the Under Secretary of Defense (Comptroller)/Chief Financial Officer, DoD; DFAS; and DHA. We requested information during our review of methodologies used to identify

and report the estimated and actual improper payments in the DoD FY 2013 AFR. We gathered and reviewed the FY 2013 documentation used to support DFAS Commercial Pay and Military Health Benefits programs for reducing and recapturing improper payments as reported in the DoD FY 2013 AFR. For our review of the DFAS methodology, we reviewed and analyzed the DFAS FY 2013 risk assessment, DFAS Commercial Pay improper payment sampling and estimates for the DoD FY 2013 AFR, and FY 2013 sampling plan for improper payments. We also reviewed DFAS “Standard Operating Procedures for Postpay Review & Analysis Contract and Vendor Pay Fiscal Year 2013,” the “Centralized Offset Program,” the “Accounts Payable–Accounts Receivable Handoff (The Recognition and Reporting of Erroneous Payments),” and “Identifying Improper Payment and Recovery Amounts In Support of AFR and IPERA Reporting Requirements.” For our review of the DHA methodology, we reviewed DHA risk assessments for FY 2013, the FY 2012 TRICARE Program Integrity Operational Report, and the TRICARE FY 2013 Report to Congress to identify 2012 improper payment recoveries. We reviewed and analyzed data provided by DHA to identify the volume and value of claims subject to IPERA sampling and determine which claims were excluded from sampling.

We compared the DoD and the Department of Health and Human Services FY 2013 agency financial reports to determine the consistency of presenting recoveries of fraudulent improper payment.

## **Use of Computer-Processed Data**

We did not rely on computer-processed data to perform this audit.

## **Use of Technical Assistance**

We received technical assistance from DoD Office of Inspector General Quantitative Methods Division to determine whether DHA applied its sampling methodology in a manner that resulted in a statistically valid improper payment estimate. Quantitative Methods Division analysts reviewed sample and universe data provided by DHA and determined that DHA’s results were statistically invalid because DHA projected the improper payment rate to records that were not included in the sampling universe, and DHA did not use sampling weights to properly project the results of its stratified design. The recommendations in this report will improve the reliability of DHA’s improper payment estimates.

## Prior Coverage

During the last 5 years, the Government Accountability Office (GAO) and the Department of Defense Inspector General (DoD IG) issued five reports discussing improper payment identification and reporting requirements. Unrestricted GAO reports can be accessed at <http://www.gao.gov>. Unrestricted DoD IG reports can be accessed at <http://www.dodig.mil/pubs/index.cfm>.

### **GAO**

Report No. GAO-13-227, “Significant Improvements Needed in Efforts to Address Improper Payment Requirements,” May 13, 2013

### **DoD IG**

Report No. DODIG-2014-059, “DoD Efforts to Meet the Requirements of the Improper Payments Elimination and Recovery Act in FY 2013,” April 15, 2014

Report No. DODIG-2013-054, “DoD Efforts to Meet the Requirements of the Improper Payments Elimination and recovery Act in FY 2012,” March 13, 2013

Report No. DODIG-2012-065, “DoD Compliance With the Requirements of the Improper Payments Elimination and Recovery Act,” March 15, 2012

Report No. D-2011-050, “DoD Needs to Improve High Dollar Overpayment Review and Reporting,” March 16, 2011

## Management Comments

### Under Secretary of Defense (Comptroller)/Chief Financial Officer, DoD



COMPTROLLER

OFFICE OF THE UNDER SECRETARY OF DEFENSE  
1100 DEFENSE PENTAGON  
WASHINGTON, DC 20301-1100

DEC 10 2014

MEMORANDUM FOR PROGRAM DIRECTOR, CONTRACT MANAGEMENT AND  
PAYMENTS, DOD OFFICE OF INSPECTOR GENERAL

SUBJECT: Response to DoD Inspector General Draft Report, "DoD Methodologies to Identify  
Improper Payments in the Military Health Benefits and Commercial Pay Programs  
Need Improvement"

Thank you for the opportunity to provide our response to your report recommendations. As seen from your field work, you are aware of the changes that the Defense Finance and Accounting Service made to its commercial pay sampling methodology. These changes were made in response to a broader set of recommendations from the Government Accountability Office (GAO) report GAO-13-227, published May 13, 2013.

We appreciate that you have acknowledged positive management actions in response to the GAO report and view your recommendations as an opportunity to further strengthen documentation and estimation methodologies. In fact, we have already implemented corrective actions for most of your recommendations.

My office will continue to work closely with the Defense components, as well as with your staff, to ensure that DoD's improper payment rates remain low and that reported information is properly documented. Should you need further information, you may contact

[REDACTED]

Mark E. Easton  
Deputy Chief Financial Officer

Attachment:  
As stated

cc:  
Deputy Director, Operations, Defense Finance and Accounting Service

## Under Secretary of Defense (Comptroller)/Chief Financial Officer, DoD (cont'd)

### OFFICE OF THE UNDER SECRETARY OF DEFENSE (COMPTROLLER) (OUSD(C)) RESPONSES TO RECOMMENDATIONS

#### DOD INSPECTOR GENERAL DRAFT REPORT, “DOD METHODOLOGIES TO IDENTIFY IMPROPER PAYMENTS IN THE MILITARY HEALTH BENEFITS AND COMMERCIAL PAY PROGRAMS NEED IMPROVEMENT” (PROJECT NO. D2014-D000CJ-0105.000)

##### Recommendation 2

We recommend that the Under Secretary of Defense (Comptroller)/Chief Financial Officer, DoD:

- a. Review improper payment risk assessments, sampling plans, and input to the DoD Agency Financial Report for the DoD payment programs not discussed in this report. The review should ensure that DoD Components:

- (1) Include all types of program payments when assessing risk and document the justification of excluding any type of program payment in the risk assessment and the Agency Financial Report.

**OUSD(C) Response:** Concur. This recommendation has already been implemented.

- (2) Develop systematic methodologies to assess risk that consider known risks, such as potential for fraud or programs with high improper payment rates.

**OUSD(C) Response:** Concur. Estimated completion date (ECD) March 31, 2015. DoD has only one program reporting an error rate greater than 1.5 percent, the Office of Management and Budget (OMB) risk-susceptibility standard, and that is DoD Travel Pay. It is currently under a mandated remediation program to reduce payment errors.

- (3) Compute improper payment error rates based on total payments and not billed amounts.

**OUSD(C) Response:** Concur. This recommendation has already been implemented.

- (4) Properly apply sample designs and project the results only to the sample universe.

**OUSD(C) Response:** Concur. This recommendation has already been implemented.

- b. Coordinate with the Office of Management and Budget to obtain guidance on the testing and reporting requirements of fraudulent payments or indicators of potentially fraudulent payments.

**OUSD(C) Response:** Concur. We will work directly with appropriate personnel at OMB to establish a target date for the required guidance. ECD March 31, 2015.

Attachment



## Defense Health Agency



### THE ASSISTANT SECRETARY OF DEFENSE

1200 DEFENSE PENTAGON  
WASHINGTON, DC 20301-1200

DEC - 4 2014

#### HEALTH AFFAIRS

MEMORANDUM FOR [REDACTED] PROGRAM DIRECTOR, CONTRACT  
MANAGEMENT AND PAYMENTS, DODIG

SUBJECT: Department of Defense Inspector General Draft Report, "Audit of DoD Methodologies for Determining Improper Payment Rates Under the Improper Payments Elimination and Recovery Act"

Thank you for the opportunity to review and comment on the Department of Defense draft report, Project No. D2014, "Audit of DoD Methodologies for Determining Improper Payment Rates Under the Improper Payments Elimination and Recovery Act," dated November 13, 2014.

My specific comments to Recommendation 1 are attached for your consideration to incorporate into the Final Report. For the most part, I concur with the Draft Report's findings and conclusions. DHA continues to strive for achieving appropriateness in the identification and reporting of improper payments. DHA welcomes the findings as a method for identifying areas of potential weakness and a means for improving operational procedures. Though DHA concurs in general with the report findings, there are several areas of the report which may require clarification.

The report indicates the methodologies used by the DHA for determining improper payment rates were inadequate and resulted in unreliable improper payment estimates as reported in the FY 2013 DoD Agency Financial Report. The report concluded the DHA's risk assessments did not consider all types of health care payments, based its risk assessment on statistically invalid estimates, did not consider the risk of medical payment fraud, and used a non-systematic method to evaluate risk for some payments. As a result, these inadequacies limited the DHA's ability to identify and report improper payments, determine underlying weaknesses that caused the improper payments, and initiate corrective actions to reduce the improper payments.

DHA reiterates the use of the term "inadequate" is misleading when describing the minimal changes that DHA made in its sampling plan and the overall improvement made to its risk assessment plan. While the payment error rate increased after using paid amounts as the denominator and applying a weighted extrapolation formula, after these changes, DHA's error rate was 1.09%, still far below the agency's contractual performance standard of 2.0%, and OMB's policy guidance beginning with fiscal year 2013 of 1.5%. The prior sampling methodology did not obscure any underlying weaknesses nor shield any root causes of error that would have led to incomplete corrective actions.

It is the DHA's sustained position that Improper Payment reporting requirements do not extend to health care claims which are fraudulently submitted. OMB Circular A-123, Part III clarifies that under the improper payment reporting requirements, payments based on fraudulent


## Defense Health Agency (cont'd)

claims that may be referred to the Department of Justice for litigation are separate and distinct from improper payments and should be handled differently. The primary basis for this belief rests in an understanding that reporting of such information could and would expose investigative and litigation pending actions to public disclosure, to include the person(s) of interest who are committing fraud.

To address medical payment fraud, the DHA has a separate division within the organization responsible for investigating anti-fraud and abuse activities. The DHA Program Integrity (PI) Division is the central coordinating office for managing allegations of fraud and abuse within the Defense Health Program and is solely responsible for reporting fraudulent activities. DHA PI develops and executes anti-fraud/abuse policies and procedures; provides oversight of contractor program integrity offices and activities; develops fraud/abuse cases for criminal prosecutions and civil litigation; coordinates investigative activities and exchanges information with the Department of Justice, law enforcement agencies, state and federal agencies, and private plans; and initiates administrative remedies to enforce provisions of law, regulations and policy.

DHA's FY 2013 risk assessment identified the three contracts and one program excluded from its improper payment computations and explained that these areas were excluded because payment reconciliation, price and policy compliance, and beneficiary eligibility audits are conducted annually by the Defense Contract Audit Agency (DCAA) resulting in a Low Risk assessment. Furthermore, these contracts and program are executed on an annual enrollment fee premium per beneficiary rather than on a fee-for-service basis, thus reducing the potential for improper payments. In addition, low-dollar claims (i.e., less than \$100) are excluded from audits of some contracts based on OMB's guidance directing agencies to carry out a cost-effective program for identifying errors. Historical review of low-dollar claims have proven these claims contain very few errors resulting in a negative return on investment.

Please feel free to direct any comments to my action officers on this topic. [REDACTED]

  
Joseph B. Marshall, Jr.  
Director, Business Support Directorate

Attachment:  
As stated

## Defense Health Agency (cont'd)

DEPARTMENT OF DEFENSE OFFICE OF THE INSPECTOR GENERAL  
DRAFT REPORT – DATED NOVEMBER 13, 2014  
PROJECT NO. D2014-D000CJ-0105.000  
“AUDIT OF DOD METHODOLOGIES FOR DETERMINING IMPROPER PAYMENT RATES UNDER  
THE IMPROPER PAYMENTS ELIMINATION AND RECOVERY ACT”

MILITARY HEALTH BENEFITS COMMENTS  
TO THE RECOMMENDATIONS

**RECOMMENDATION 1:** We recommend the Director, Defense Health Agency:

- a. Include all Defense Health Agency health care payments when assessing risk and document the justification for excluding any type of program payments in the risk assessment and the Agency Financial Report.
- b. Develop a methodology to assess risk for all contracts that is not limited to prior-year sampling results but also considers other risk factors, such as the risk of fraud.
- c. Develop procedures to calculate the improper payment error rate based on amount paid in accordance with Office of Management and Budget guidance.
- d. Develop procedures to properly apply the stratified sample design and project the results only to the sample universe.

**DHA RESPONSE:**

- a. Concur. DHA will include all health care payments when assessing risk and will clearly document and justify any type of contract or program payment(s) excluded in the risk assessment and the Agency Financial Report.
- b. Non-concur. DHA emphatically disagrees fraudulent activities should be considered as a risk factor/category when developing a methodology to assess risk for improper payments. DHA reiterates Improper Payment reporting requirements do not extend to health care claims which are fraudulently submitted. OMB Circular A-123, Part III clarifies under the improper payment reporting requirements; payments based on fraudulent claims that may be referred to the Department of Justice for litigation are separate and distinct from improper payments and should be handled differently.
- c. Concur. DHA developed procedures to calculate the improper payment error rate based on amount paid in accordance with Office of Management and Budget guidance. These procedures have been implemented and will be used to estimate the Military Health Benefits error rate for the FY2014 AFR.
- d. Concur. DHA developed procedures to apply the stratified sample design and project the results to the sample universe. These procedures have been implemented and will be used to estimate the Military Health Benefits error rate for the FY2014 AFR.

## Acronyms and Abbreviations

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<b>AFR</b>	Agency Financial Report
<b>DFAS</b>	Defense Finance and Accounting Service
<b>DHA</b>	Defense Health Agency
<b>IPERA</b>	Improper Payments Elimination and Recovery Act
<b>OMB</b>	Office of Management and Budget

# **Whistleblower Protection**

## **U.S. DEPARTMENT OF DEFENSE**

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