New “Improper Payments” Law Likely to Increase the Government’s Audit and Investigation of Government Contractors

On July 22, 2010, the President signed into law the Improper Payments Elimination and Recovery Act of 2010. Directed at federal agencies, the Act requires agencies to (1) conduct periodic reviews of programs and activities susceptible to “significant improper payments;” (2) perform recovery audits for certain programs with a price tag of $1 million or more; and (3) report improper payments, including details of the actions the agencies are taking to reduce those improper payments. Under the Act, “improper payments” are broadly defined to include payments made to an ineligible recipient or for ineligible goods or services, duplicate payment or payments for goods or services never received, and payments that do not credit applicable discounts.

The Act, which passed unanimously in both the House and the Senate, is another in a string of laws, memoranda, and Executive Orders aimed at reducing improper payments by $50 billion by 2012. The Act passed on the heels of other recent actions that increase oversight of contractors and the payments they receive. *See* MLA Advisory, “Obama Administration Expands Payment Recapture Audit Program,” March 26, 2010; MLA Advisory, “More Focus on Improper Payments to Contractors Likely Means More Compliance and Reporting Requirements and Potential Cash Flow Impacts, Dec. 15, 2009. As it promised, the Obama Administration is continuing to pursue new policy and enforcement initiatives directed at the contractor community.

The Act requires agencies to review their programs at least once every three years to identify those that “may be susceptible to significant improper payments,” referring to improper payments which, in the aggregate, exceed either $100 million or $10 million plus 2.5% of program outlays. Contracts most likely to be scrutinized will involve programs or activities that are new to the agency; involve a high level of complexity; involve a high volume of payments or payment eligibility decisions made outside the agency (such as by state or local governments); are characterized by recent and major changes in program funding, authorities, practices, or procedures; are managed by personnel with less experience and quality of training; or have been identified with significant deficiencies in prior audit reports.

This new law, coupled with the Administration’s other initiatives to reduce and eliminate fraud, waste, and abuse in federal programs, will place contractors under yet more scrutiny. Internal agency reviews and audits that reveal “improper payments” will likely lead to related audits and investigations of government contractors who have received the payments in question. Firms holding government contracts – particularly those involving any of the characteristics described in the preceding paragraph – should be prepared for additional scrutiny of their contract files, payments, and financial records by government auditors and investigators who believe that the contractor has received an “improper payment.” Further, to the extent government auditors and investigators take the position that the contractor knew of an overpayment and failed to disclose it, or that the contractor’s conduct related to an overpayment was fraudulent, it could trigger possible False Claims Act liability, and create the potential for suspension or debarment, including under the mandatory disclosure rule (FAR § 3.1003). Therefore, contractors should closely review their compliance systems to ensure that they have in place the systems and controls to identify, disclose, and correct significant overpayments before they are identified by the new wave of government recovery audits. Contractors should also develop risk-mitigation strategies for handling audits and investigations related to alleged “improper payments.”