U.S. Department of Education's Compliance With Improper Payment Reporting Requirements for Fiscal Year 2015

FINAL AUDIT REPORT

ED-OIG/A03Q0001
May 2016

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U.S Department of Education
Office of Inspector General
Washington, D.C.

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Statements that managerial practices need improvements, as well as other conclusions and recommendations in this report, represent the opinions of the Office of Inspector General. Determinations of corrective action to be taken will be made by the appropriate Department of Education officials.

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UNITED STATES DEPARTMENT OF EDUCATION
OFFICE OF INSPECTOR GENERAL

AUDIT SERVICES

May 10, 2016

Memorandum

TO: Tim Soltis
Delegated to Perform the Functions and Duties of the Chief Financial Officer
Office of Chief Financial Officer
Lead Action Official

James W. Runcie
Chief Operating Officer
Federal Student Aid

FROM: Patrick J. Howard /s/
Assistant Inspector General for Audit

SUBJECT: Final Audit Report
"U.S. Department of Education's Compliance with Improper Payment Reporting Requirements for Fiscal Year 2015"
Control Number ED-OIG/A03Q0001

Attached is the subject final audit report that covers the results of our review of the Department's compliance with improper payment reporting requirements from October 1, 2014, through September 30, 2015. We conducted our review at Federal Student Aid's offices in Washington, D.C. An electronic copy has been provided to your audit liaison officers. We received your comments concurring with the findings and mostly concurring with the recommendations in our draft report.

Corrective actions proposed (resolution phase) and implemented (closure phase) by your office will be monitored and tracked through the Department's Audit Accountability and Resolution Tracking System (AARTS). The Department's policy requires that you develop a final corrective action plan for our review in the automated system within 30 calendar days of the issuance of this report. The corrective action plan should set forth the specific action items, and targeted completion dates, necessary to implement final corrective actions on the findings and recommendations contained in this final audit report.

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We appreciate the cooperation given us during this review. If you have any questions, please call Bernard Tadley at (215) 656-6279.

Enclosure

cc: John Hurt, Chief Financial Officer, FSA

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EXECUTIVE SUMMARY

The audit objectives were to (1) determine whether the U.S. Department of Education (Department) complied with the Improper Payments Elimination and Recovery Act of 2010 (IPERA); (2) evaluate the accuracy and completeness of the Department's improper payments reporting; (3) evaluate the Department's performance in reducing and recapturing improper payments; and (4) for the high-priority programs (Federal Pell Grant Program and the William D. Ford Federal Direct Loan Program): (a) evaluate the quality of the Department's improper payment estimate and methodology, (b) evaluate the Department's assessment of the level of risk associated with the high-priority programs, and (c) review the oversight and financial controls described by the Department to identify and prevent improper payments.

We found that the Department did not comply with IPERA because the fiscal year (FY) 2015 improper payment rate did not meet the reduction target for the William D. Ford Federal Direct Loan Program (Direct Loan). The Department established a FY 2015 reduction target of 1.49 percent for the Direct Loan program; however, the improper payment rate for the Direct Loan program was 2.63 percent after the Department recalculated this rate to correct for the formula execution errors we identified. Therefore, the Department failed to meet one of IPERA's six compliance requirements.

The Department's estimation methodologies rely significantly on program reviews. The Department's ability to address the root causes of improper payments is limited because primarily relying on program reviews leads to root causes that vary from year to year. Even though we recommended last year for the Department to analyze root causes of improper payments and determine whether its internal controls can be implemented, intensified, or expanded, the Department is limited in its ability to assess progress over time due to these year-to-year changes.

We also found that the Department's improper payment methodologies for the Federal Pell Grant (Pell) and Direct Loan programs were flawed for the following reasons:

- The estimation methodologies did not include all program reviews that could identify improper payments.
- The estimation methodology for the Pell program excluded sources of improper payments (such as the Free Application for Federal Student Aid/Internal Revenue Service Data Statistical Study, and fraud).[1]
- The estimation methodologies resulted in volatile improper payment estimates that could be significantly influenced by a single program review.
- The estimation methodologies did not include all improper payments from ineligible programs or locations identified in program reviews.

[1] In response to our prior audits, the Department has formed a work group to determine whether its estimation methodologies can account for improper payments identified in program reviews and improper payments resulting from inaccurate self-reported income on the FAFSA by Pell and Direct Loan recipients.

Using the Office of Management and Budget (OMB)-approved methodology that includes the flaws listed above, and after the Department's recalculations to correct the errors we identified, the improper payment rate for the Pell program was 1.52 percent. This recalculated rate was below the 2.15 percent reduction target. However, we could not conclude that the Department actually met its reduction target for the Pell program due to the flaws listed above. Specifically, the Free Application for Federal Student Aid (FAFSA)/Internal Revenue Service Data Statistical Study reported an improper payment rate for the Pell program of 2.26 percent, which is above the reduction target.

The Department's recalculated estimated improper payments in the Direct Loan program increased more than $1 billion in FY 2015 compared to FY 2014, and its recalculated estimated improper payments in the Pell program declined almost $227 million. Again, however, due to the flaws listed above we could not determine whether the Department reduced or increased improper payments. We did not evaluate the Department's performance in recapturing improper payments because the Department determined, OMB concurred, and we agreed that it was not cost-effective to conduct a payment recapture audit program.

For FY 2015, OMB classified the Pell and Direct Loan programs as high-priority programs, which are subject to additional reporting requirements. We found that for these two high-priority programs, the Department adequately assessed improper payment risks and described its oversight to identify and prevent improper payments.

We found that the Department's reported improper payment estimates for both the Pell and Direct Loan programs were inaccurate and unreliable. Specifically, spreadsheet formulas used in the calculations were incorrect, and the calculations deviated from the OMB-approved methodologies in the following ways:

- The Department proposed that schools with risk scores assigned to the schools by Federal Student Aid's Program Compliance - School Eligibility Service Group would be assigned to one of two risk categories (lower risk schools and higher risk schools). However, in the spreadsheets the Department used to classify these schools for purposes of calculating improper payment estimates, the Department entered an incorrect formula that resulted in lower risk schools being assigned to the higher risk category and higher risk schools being assigned to the lower risk category.
- The Department did not use the correct risk score when assigning schools to a risk category.
- The Department did not distribute schools not assigned a risk score proportionally across the three categories of schools. The Department assigned all of these schools to one risk category.
- The Department excluded completed, applicable program reviews from the improper payment estimates.

Correcting for these formula execution errors,[2] the Department's recalculated improper payment rate for the Direct Loan program was 2.63 percent, rather than the initially reported rate of 1.30 percent; the recalculated improper payment rate for the Pell program was 1.52 percent, rather than the initially reported rate of 1.88 percent.

[2] The formula execution errors are the first three errors noted above.

To address the improper payment rates, we recommend that the Chief Financial Officer for the Department, in conjunction with the Chief Operating Officer for Federal Student Aid—

- Analyze all available sources that identified improper payments for root causes of such improper payments and evaluate FSA's existing controls to determine whether additional controls can be implemented, intensified, or expanded to reduce or prevent improper payments.
- As required by IPERA, if the Director of OMB determines that additional funding is needed to help the agency become compliant with IPERA, take the necessary steps to implement OMB's recommendation.

In addition, we recommend that the Chief Financial Officer for the Department, in conjunction with the Chief Operating Officer for Federal Student Aid, require the Chief Financial Officer for Federal Student Aid to:

- Revise the improper payment estimation methodologies to include all improper payments in the calculation of the improper payment estimates, such as improper payments resulting from recipients submitting inaccurate self-reported income on the Free Application for Federal Student Aid, all improper payments resulting from schools disbursing Pell and Direct Loan funds to students enrolled in ineligible programs or students attending ineligible locations, and other improper payments not identified in program reviews.
- Revise the improper payment estimation methodologies to mitigate the potential for volatility that a single program review can have on the improper payment estimate.
- Disclose in its annual reporting how the methodologies are sensitive to a single observation (such as student or school), either by providing examples or noting how results are weighted in arriving at the final improper payment estimates.
- Revise the improper payment estimation methodologies to account for the program reviews that do not reach the program review report stage in time for inclusion in that fiscal year's estimated improper payment rates.
- Publish the FY 2015 recalculated improper payment rates, notify OMB and Congress of any changes, and explain the basis for the revisions in the FY 2016 Agency Financial Report.
- Develop, implement, and monitor the effectiveness of internal controls for (1) the contractor's calculation of the improper payment estimates and (2) the Department's oversight and review of the work provided by the contractor.
- Develop, implement and monitor the effectiveness of internal controls to ensure that all applicable program reviews issued prior to the documentation acceptance date are included in the improper payment estimates.

In response to the draft audit results, the Department concurred with all three findings and concurred or partially concurred with all recommendations. We did not make any changes to the report based on the Department's comments. We provide the full text of the Department's comments in Enclosure 2.

BACKGROUND

The Improper Payments Elimination and Recovery Act and Programs Susceptible to Significant Improper Payments

The Improper Payments Elimination and Recovery Act of 2010 (Public Law 111-204), which amended the Improper Payments Information Act of 2002 (IPIA) (Public Law 107-300), requires Federal agencies to reduce improper payments and to report annually on their efforts. The Office of Management and Budget (OMB) issued government-wide guidance on the implementation of IPERA on October 20, 2014, which is contained in OMB Circular A-123, Appendix C.[3]

IPERA requires each agency, in accordance with guidance prescribed by OMB, to periodically review all programs and activities that the agency administers and identify all programs and activities that may be susceptible to significant improper payments. Significant improper payments are defined as gross annual improper payments (the total amount of overpayments plus underpayments) in the program exceeding (1) both 1.5 percent of program outlays and $10 million of all program or activity payments made during the fiscal year reported, or (2) $100 million (regardless of the improper payment percentage of total program outlays). For each program and activity identified as susceptible to significant improper payments, the agency is required to produce a statistically valid estimate, or an estimate that is otherwise appropriate using a methodology that OMB approved, of the improper payments made by each program and activity and include those estimates in the accompanying materials to the agency's annual financial reports.

IPERA also requires each agency's Inspector General to determine the agency's compliance with the statute for each fiscal year. As specified in the OMB guidance, compliance with IPERA means that the agency has met all six of the following requirements:

- published a Performance and Accountability Report or Agency Financial Report (AFR) for the most recent fiscal year and posted that report and any accompanying materials required by OMB on the agency's Web site;
- conducted a program-specific risk assessment for each program or activity that conforms with IPERA (if required);
- published improper payment estimates for all programs and activities identified as susceptible to significant improper payments under its risk assessments (if required);
- published programmatic corrective action plans in the Performance and Accountability Report or AFR (if required);
- published, and met, annual reduction targets for each program assessed to be at risk and measured for improper payments; and

[3] Under Section 2(g)(2) of IPIA, as amended, an "improper payment" is any payment that should not have been made or that was made in an incorrect amount. Under OMB Circular A-123, Appendix C, improper payments also include any payment lacking sufficient documentation.

- reported a gross improper payment rate of less than 10 percent for each program and activity for which an improper payment estimate was obtained and published in the Performance and Accountability Report or AFR.

If an agency does not meet one or more of these requirements, then it is not compliant with IPERA.

As part of the Inspector General's review of the agency's compliance with IPERA, the Inspector General should also evaluate the accuracy and completeness of the agency's reporting and performance in reducing and recapturing improper payments.

The Improper Payments Elimination and Recovery Improvement Act and High-Priority Programs

The Improper Payments Elimination and Recovery Improvement Act of 2012 (IPERIA) (Public Law 112-248), requires the Director of OMB to identify a list of high-priority programs for greater levels of oversight.[4] OMB has designated the Pell program and Direct Loan program as high-priority programs. OMB issued government-wide guidance on the implementation of IPERIA on October 20, 2014, which is contained in OMB Circular A-123, Appendix C. The OMB-established threshold for high-priority program determinations for FY 2015 reporting, and for subsequent years, is $750 million in estimated improper payments as reported in an agency's AFR or Performance and Accountability Report, regardless of the improper payment rate estimate. IPERIA and OMB guidance require each agency with a high-priority program to report to its Inspector General and make available to the public, (1) any action that the agency has taken or plans to take to recover improper payments and (2) any action the agency intends to take to prevent future improper payments. According to IPERIA and OMB guidance, the agency Inspector General must review the assessment of the level of risk associated with any high-priority program and the quality of the improper payment estimates and methodology; determine the extent of oversight warranted; and provide recommendations, if any, for modifying the agency's methodology, promoting continued program access and participation, or maintaining adequate internal controls.

[4] IPERIA codifies the requirements from Executive Order 13520, "Reducing Improper Payments," issued November 20, 2009. OMB Circular A-123, Appendix C implements these requirements.

AUDIT RESULTS

We found that the Department did not comply with IPERA because the FY 2015 improper payment rate did not meet the reduction target for the Direct Loan program. The Department met the remaining five IPERA compliance requirements. Under IPERA, if the Department does not meet one or more of the six compliance requirements, then it is not compliant with IPERA. We found that the Department's improper payment estimation methodologies and actual calculations of the improper payment rates for the Pell and Direct Loan programs were flawed, resulting in estimates that were incomplete and unreliable. As a result, the Department could not accurately evaluate its performance in reducing improper payments for the Pell and Direct Loan programs.

Based on our review of the Department's consolidated risk assessment performed in FY 2014, we found that the Department adequately assessed improper payment risks for the Pell and Direct Loan programs. The Department's risk assessment concluded that these two programs had high improper payment risk assessment ratings. In addition, we found that the Department adequately described its oversight and controls to identify and prevent improper payments through the program review process, increasing the usage of the Internal Revenue Service (IRS) Data Retrieval Tool, enhanced verification procedures, system edits and data matches, and compliance audits.

The Department met five of the six compliance requirements of IPERA, as described in the following.

1. **Published an Annual Financial Report**

   The Department complied with the requirement to publish an AFR. Under Section 3(a)(3)(A) of IPERA, the Department is required to publish on its Web site its AFR and any accompanying materials required under OMB guidance. The Department published its AFR, "FY 2015 Improper Payment Estimation Methodologies," and its accompanying materials on November 13, 2015.

2. **Conducted a Risk Assessment**

   The Department complied with the requirement to conduct a risk assessment. Under Section 3(a)(3)(B) of IPERA, if required, an agency must conduct a program-specific risk assessment of all programs and activities to determine which ones are susceptible to significant improper payments. In FY 2014, the Department performed risk assessments of all Federal Student Aid (FSA) managed programs and the Department's administrative payments (salary, locality pay, travel, purchase card, and transit benefits). In FY 2013, the Department performed risk assessments of contract payments and all non-FSA programs.

3. Published Improper Payment Estimates

The Department complied with the requirement to publish improper payment estimates. Under Section 3(a)(3)(C) of IPERA, if required, an agency must publish improper payment estimates for programs it identified as being susceptible to significant improper payments. As required, the Department published improper payment estimates for programs it identified as susceptible to significant improper payments—the Pell and Direct Loan programs. The Department also reported an estimated improper payment rate for Title I, Part A of the Elementary and Secondary Education Act of 1965, as amended (Title I).[5]

4. Published Report on Actions to Reduce Improper Payments (Corrective Action Plans)

The Department complied with the requirement to report on its actions to reduce improper payments in programs susceptible to significant improper payments: the Pell and Direct Loan programs. Under Section 3(a)(3)(D) of IPERA, the Department is required to report on its actions to reduce improper payments for programs it deemed susceptible to significant improper payments. The Department also reported on its efforts to recapture improper payments in these programs, including reporting that it worked with Title IV program participants to resolve and to recover potential improper payments identified in compliance audits, Office of Inspector General (OIG) audits, and Department-conducted program reviews. The Department submitted to OMB an analysis that explained why conducting payment recapture audits for grants, contracts, and the Title IV programs would not be cost-effective. On September 21, 2015, OMB approved the Department's analysis.

5. Reported Improper Payment Rate of Less Than 10 Percent

The Department complied with the requirement to report improper payment rates of less than 10 percent for all applicable programs. Under Section 3(a)(3)(F) of IPERA, the Department is required to report estimated improper payment rates of less than 10 percent for each program identified as being susceptible to significant improper payments for which an improper payment estimate is published. The Department reported estimated improper payment rates of 1.88 percent in the Pell program and 1.30 percent in the Direct Loan program. For reasons discussed in detail below, the Department recalculated the improper payment rates for these two programs, and the recalculated rates were 1.52 percent and 2.63 percent, respectively. These estimated improper payment rates were significantly below the 10 percent threshold.

[5] The Department was not required to report on the Title I program under IPERA because it was not identified as a program susceptible to significant improper payments. As a result, we did not perform additional work related to the accuracy and completeness of the Department's estimation methodology for this program. In February 2016, the Department submitted a request to OMB for relief from reporting improper payment estimates for the Title I program.

FINDING NO. 1 – The Department Did Not Comply with IPERA Because it Did Not Meet the Reduction Target for the Direct Loan Program

The Department did not comply with IPERA because the improper payment rate (which it recalculated after we identified errors in its original calculation) did not meet the reduction target for the Direct Loan program. Using the OMB-approved methodology that includes the flaws detailed in Finding 2 and after the Department's recalculations to correct the formula execution errors we identified in Finding 3, the improper payment rate for the Direct Loan program was 2.63 percent which exceeded the reduction target of 1.49 percent. The recalculated improper payment rate for the Pell program was 1.52 percent. This recalculated rate was below the 2.15 percent reduction target. However, the Free Application for Federal Student Aid (FAFSA)/IRS Data Statistical Study reported an improper payment rate for the Pell program of 2.26 percent, which is above the reduction target. As a result, we could not conclude that the Department actually met its reduction target for the Pell program.

Under Section 3(a)(3)(E) of IPERA, an agency is required to report, and meet, improper payment reduction targets when a program was identified as susceptible to significant improper payments. To meet a reduction target, the improper payment rate for a program in the current year must fall within plus or minus 0.1 percentage points of the reduction target set in the previous year's AFR. In its FY 2014 AFR, the Department reported for the Direct Loan program a reduction target of 1.49 percent for FY 2015. Although the Department reported in its FY 2015 AFR an improper payment rate of 1.30 percent, we identified errors in its original calculation. The Department recalculated the improper payment rate for the Direct Loan program as 2.63 percent. We reviewed the calculation and verified that the recalculated estimates addressed the formula execution errors. The FY 2015 reduction target and the reported and corrected improper payment rates for the Direct Loan program are shown in Table 1.

Table 1. FY 2015 Direct Loan Reduction Target and Reported and Corrected Improper Payment Rates

Program	Reduction Target	Improper Payment Rate Calculated by the Department and Reported in FY 2015 AFR	Corrected Improper Payment Rate Recalculated by the Department	Reduction Target Met
Direct Loan Program	1.49%	1.30%	2.63%	No

The Department also reported in its FY 2015 AFR that the amounts of estimated improper payments for the Direct Loan program decreased from $1.53 billion in FY 2014 to $1.28 billion in FY 2015; however, the corrected estimated FY 2015 amounts increased to $2.60 billion.

In its FY 2015 AFR, the Department reported that the root causes of the improper payments included the failure to verify financial data and administrative or process errors made by other parties, such as schools. These errors include incorrect awards based on expected family

contribution,[6] incorrect processing of student data, student account data changes not applied or processed correctly, incorrectly calculated return record, and satisfactory academic progress not achieved. Errors associated with Direct Loan consolidations include incorrect processing of a loan verification certificate, processing duplicate loan verification certificates, and incorrect documentation provided by a servicer. The root causes of the improper payments reported by the Department have changed from year to year based on the causes of improper payments in program reviews. This limits the Department's ability to assess progress in addressing root causes.

In our FY 2014 audit of the Department's improper payments, we found that the Department did not meet the reduction target for the Direct Loan program. In accordance with section 3(c)(1) of IPERA, the Department submitted a remediation plan to Congress and OMB. Because the Department has again failed to meet its reduction target for the Direct Loan program, the Department is not in compliance with IPERA for a second fiscal year. Under Section 3(c)(2) of IPERA and OMB Circular A-123, Appendix C, if an agency is not in compliance with IPERA for two consecutive fiscal years for the same program or activity, the Director of OMB will review the program and determine whether additional funding would help the agency come into compliance.

Recommendations

We recommend that the Chief Financial Officer for the Department, in conjunction with the Chief Operating Officer for FSA—

1.1 Analyze all available sources that identified improper payments for root causes of such improper payments and evaluate FSA's existing controls to determine whether additional controls can be implemented, intensified, or expanded to reduce or prevent improper payments.

1.2 As required by IPERA, if the Director of OMB determines that additional funding is needed to help the agency become compliant with IPERA, take the necessary steps to implement OMB's recommendation.

Department Comments

The Department concurred with the finding and recommendations.

FINDING NO. 2 – The Department Needs to Improve the Quality of its Improper Payments Estimation Methodologies

We found that the estimation methodologies the Department used to calculate the improper payment rates for the Pell and Direct Loan programs were flawed, resulting in estimates that were incomplete and unreliable. As a result, the Department could not accurately evaluate its performance in reducing improper payments for the Pell and Direct Loan programs.

Under IPERA and OMB Circular A-123, Appendix C, agencies are required to prepare a statistically valid estimate of improper payments or an estimate that is otherwise appropriate

[6] The expected family contribution errors include (1) the inaccurate calculation of the expected family contribution amount and (2) incorrect award amount based on the student's expected family contribution.

using an alternative methodology that OMB approves. For FY 2015, rather than preparing a statistically valid estimate, the Department prepared its improper payment estimates for the Pell and Direct Loan programs using alternative methodologies. The Controller of OMB approved these alternative methodologies on October 20, 2015.

The Department's Estimation Methodologies Were Flawed

The Department's estimation methodologies used a cutoff date, which it refers to as the documentation acceptance date, for program reviews conducted during a fiscal year; therefore, not all programs reviews that could identify improper payments are included it its estimates, and some reviews will never be included. In addition, the Department's estimation methodologies primarily relied on the results of program reviews and excluded other sources of improper payments. The methodologies also can lead to volatile estimates because they could be significantly influenced by a single program review, allowing for a single school or even a student to significantly impact the improper payment rates. We also found the methodologies excluded some improper payments identified in program review reports.

The Department's Methodologies Do Not Include All Program Reviews That Could Identify Improper Payments

The Department based the improper payment estimates for the Pell program solely on program reviews, and for the Direct Loan program, primarily on program reviews that FSA conducted. The improper payment estimate for the Pell program was based on the results of 130 program reviews of schools that FSA's School Eligibility Service Group (SESG) conducted during FY 2014; the improper payment estimate was based therefore on the testing of disbursements made to 1,444 students for the 2012–2013 award year.[7] In FY 2014, 5,702 schools participated in the Pell program and Pell grants were disbursed to 8,954,468 recipients.

The improper payment estimate for the Direct Loan program was based on three components. The first component consisted of the results of 133 program reviews of schools that SESG conducted during FY 2014; this component of the improper payment estimate was based therefore on the testing of disbursements made to 1,635 students for the 2012–2013 award year. In FY 2014, 6,274 schools participated in the Direct Loan program and loans were disbursed to 10,163,311 borrowers. The second component consisted of testing a sample of 120 Direct Loan consolidations (from a universe of 3,362,246) to determine which were considered to be improper payments.[8] The third component consisted of testing a sample of 120 Direct Loan refund payments (from a universe of 387,242) to determine which were considered to be improper payments. The samples for the second and third component were drawn from payments made from July 2014 through June 2015. The Department then combined the estimated improper payments for all three components to estimate an overall improper payment rate for the Direct Loan program.[9]

[7] This methodology differed from the methodology FSA used before FY 2014. In prior years, FSA based the estimate on the FAFSA/IRS Data Statistical Study. That study used tax return and FAFSA data for a sample of students and parents to calculate an improper payment rate based on recalculated Pell awards where income figures reported on the tax return did not match those reported on the FAFSA.

[8] The Direct Loan consolidations include both overpayments and underpayments. The sampled payments were tested to determine which were actual improper payments.

[9] The Direct Loan program reviews account for 87.9 percent of the total disbursements used to estimate the Direct Loan program improper payment rate, while the Direct Loan consolidations and refunds account for a combined 12.1 percent.

In its OMB-approved methodology, the Department reported that to estimate improper payments for the Pell and Direct loan programs, it would perform 337 program reviews. The methodology also states that only a portion of these program reviews will be available to estimate the improper payment rates. Of the 337 program reviews, 52 were performed for reasons that would not identify improper payments (for example, reviews of campus crime, closed schools, or third-party servicers) and 285 were performed for reasons that could identify improper payments and therefore could be applicable to the improper payment estimates. Of the 285 program reviews that could identify improper payments, 240 reached the draft report stage before the documentation acceptance date.[10] The other 45 did not reach the program review report stage before the cutoff date and were excluded from the improper payment estimates. For 33 of those 45 program reviews, SESG made a preliminary determination that the level of findings identified during the program reviews represented serious deficiencies, very serious deficiencies, or fraud or abuse.[11] Under the Department's estimation methodologies, program reviews that are not considered by the Department in its improper payment estimates for one year are not considered in any subsequent year's improper payment estimates. Because those 45 program reviews were conducted in FY 2014, they will be excluded from next year's estimate, which will only consider program reviews conducted during FY 2015 (October 1, 2015 through September 30, 2016).

The Department's Methodology for the Pell Program Excludes Other Sources of Improper Payments

In prior years, we reported that the estimation methodology for the Pell program based on program reviews was flawed because it excluded other sources of improper payments, such as the results of the FAFSA/IRS Data Statistical Study, which focuses on inaccurate self-reported income on the FAFSA and fraud. [12]

While the Department's current methodology is approved by OMB, we again found that improper payment estimates may be understated by using program reviews as the primary source of information to estimate improper payments. For example, program reviews do not identify improper payments associated with recipients who do not use the IRS Data Retrieval Tool, who provide inaccurate self-reported income on the FAFSA, and who are not selected for income verification.[13]

Program reviews cannot identify inaccurate self-reported income on the FAFSA as a significant cause of improper payments. As a result, estimates of improper payments based solely on

[10] FSA reported that program reviews were excluded from the improper payment estimates for a variety of reasons, such as the supporting documentation was not available by the documentation acceptance date, and the award year subject to the program review was not 2012-2013.

[11] According to SESG, serious deficiencies represent findings that are more serious in nature, occur more frequently, and/or may lead to liabilities or fines; very serious deficiencies represent findings of serious failure to adhere to regulatory requirements and that usually result in a significant liability; and fraud or abuse represent findings that the school is suspected of using Federal funds for its own purposes and has purposely circumvented regulatory requirements.

[12] "U.S. Department of Education's Compliance with Executive Order 13520, 'Reducing Improper Payments' for Fiscal Year 2012 and 2013" (A03N0004); "U.S. Department of Education's Compliance with the Improper Payments Elimination and Recovery Act of 2010 for Fiscal Year 2012;" and "U.S. Department of Education's Compliance with Improper Payment Reporting Requirements for Fiscal Year 2014."

[13] The IRS Data Retrieval Tool enables financial aid applicants to transfer certain income tax information from an IRS Web site directly to their online FAFSA.

program reviews do not adequately measure all significant improper payments in the Pell program. Program reviews can identify multiple root causes of improper payments. In the Department's FY 2015 analysis of the root causes of Pell program improper payments, the two leading causes for improper payments were identified as a student's ineligibility for a Pell grant (about 38 percent of improper payments) and an incorrectly calculated Title IV return record (about 26 percent of improper payments). Neither of these causes is directly associated with Pell grant recipients who submit inaccurate self-reported income on the FAFSA. Furthermore, the Department did not identify inaccurate self-reported income on the FAFSA as a unique root cause of improper payments in the FY 2015 AFR. However, in FYs 2011, 2012, and 2013, the Department identified inaccurate self-reported income on the FAFSA as the most significant root cause of Pell program improper payments. In those fiscal years, the Department based its improper payment estimates for the Pell program solely on the FAFSA/IRS Data Statistical Study. In fact, as shown in Table 2, for award year 2012–2013, the Department estimated a higher improper payment rate based on the FAFSA/IRS Data Statistical Study than the rate it reported based on program reviews, which cover multiple root causes of improper payments (see Table 2).

Table 2. Pell Program Improper Payment Rates From Program Reviews and FAFSA/IRS Data Statistical Study

Source of Improper Payment Estimate	Award Year	Improper Payment Rate	Improper Payment Amount
Program Reviews	2012–2013	1.52 percent	$454.62 million
FAFSA/IRS Data Statistical Study	2012–2013	2.26 percent	$675.95 million

Note: The improper payment rate and amount from program reviews displayed in the table was recalculated by the Department to correct for the errors identified by the OIG. The improper payment amounts are based on the award-year outlays, multiplied by the improper payment rates. For 2012–2013, the Pell outlays were $29,909.28 million.

In response to our FY 2014 IPERA audit, the Department formed a work group to determine whether its estimation methodologies can account for improper payments identified in program reviews and improper payments resulting from inaccurate self-reported income on the FAFSA by Pell and Direct Loan recipients.

The Department's Estimation Methodologies Resulted in Volatile Improper Payment Estimates
The Department's estimation methodologies are based on SESG's FY 2014 Compliance Initiative plan for program reviews of schools. The plan identifies the percentage of program reviews that the Department will conduct in risk-based categories, which focus more on higher risk schools. For example, the FY 2014 plan indicates that at least 50 percent of program reviews would be conducted at higher risk schools, about 10 percent of the program reviews would be conducted at lower risk schools, and about 40 percent of the program reviews would be initiated based on other programmatic priorities.

Fewer program reviews are conducted at lower risk schools, but this category of schools accounts for a majority of the Direct Loan program disbursements. In the FY 2015 improper payment estimate for the Direct Loan program, the lower risk schools accounted for about

$80.70 billion (78 percent) of the total $103.25 billion of new Direct Loan disbursements. However, the estimate for the category of lower risk schools was based on the results of only 7 program reviews that sampled a total of 101 students. Although the disbursement amounts to these 101 students ($1,244,789) accounted for only about 7 percent of the total disbursement amounts to the 1,635 total students ($17,148,305) sampled for all three categories, their results were extrapolated to represent 78 percent of all Direct Loan disbursements. A similar imbalance exists for data supporting the Pell program improper payment estimate. Consequently, including fewer program reviews of lower risk schools can result in a significant impact on the improper payment estimates.

The disproportionate impact of the few program reviews at lower risk schools included in the estimates was compounded by the relatively small sample sizes of students tested for program reviews at each school. For program reviews that involve student-level testing, generally, 2 award years are reviewed with about 15 students sampled from each award year. To estimate an improper payment rate, the results of the student-level tests are first extrapolated to the entire school's disbursement amount, and that result is then extrapolated to the total disbursement amount for the risk category. Therefore, student-level test results for a small number of students, or even one student, can influence the improper payment estimates and introduce the volatility in the estimates, particularly when few program reviews are extrapolated to the majority of disbursed dollars for a program.

As an example of the volatility introduced by this methodology, we found that the Direct Loan program's improper payment rate was heavily influenced by the results of one program review, and in particular 1 of the 22 students sampled at that school. That student was associated with an improper payment of $4,703. To assess the single student's impact on the Direct Loan program's improper payment rate, we recalculated the improper payment rate after removing that student from the sample. As a result of removing this one student, the estimated improper payment rate would decrease from 2.63 percent to 1.51 percent, and the estimated total improper payment amount would decrease from $2.60 billion to $1.49 billion—a difference of $1.1 billion.

Another potential source of volatility is that improper payment estimates are based on the results of program reviews and are susceptible to changes in the composition of schools selected for a program review. For example, from one year to the next, FSA may change the selection of schools for program reviews by focusing on compliance areas that may not identify improper payments or would not result in improper payments.[14]

The Department's Estimation Methodologies Excluded Improper Payments Identified in Program Reviews

According to the Department's estimation methodologies, only improper payments associated with disbursements to sampled students would be included in the improper payment estimates. The Department's methodologies account only for disbursements to sampled students (that is, students who are a part of the program review sample) even though all students enrolled in an ineligible program or at an ineligible location are ineligible for Title IV funds and all disbursements to such students are considered improper payments in a program review.

[14] For example, program reviews on compliance with data reporting requirements would not identify improper payments.

We identified program reviews at two schools that were included in the Department's improper payment estimates that identified improper payments associated with findings of an ineligible location or an ineligible program. However, the Department did not include the improper payments associated with ineligible locations or ineligible programs in its calculations of the improper payment estimates for the Pell and Direct Loan programs because none of the sampled students reviewed were enrolled in the ineligible program or at an ineligible location. While the findings of an ineligible location or an ineligible program from these two program reviews were not included in the improper payment estimates, the program reviews reported Pell improper payments of $177,050 at one school and $37,646 at the other school. As a result of the Department's improper payment estimation methodologies not including all improper payments identified from program review findings associated with an ineligible location or an ineligible program, the improper payment rates for the Pell and Direct Loan programs are potentially understated.

Recommendations

We recommend that the Chief Financial Officer for the Department, in conjunction with the Chief Operating Officer for FSA, require the Chief Financial Officer for FSA to—

2.1 Revise the improper payment estimation methodologies to include all improper payments in the calculation of the improper payment estimates, such as improper payments resulting from recipients submitting inaccurate self-reported income on the FAFSA, all improper payments resulting from schools disbursing Pell and Direct Loan funds to students enrolled in ineligible programs or students attending ineligible locations, and other improper payments not identified in program reviews.

2.2 Revise the improper payment estimation methodologies to mitigate the potential for volatility that a single program review can have on the improper payment estimate.

2.3 Disclose in its annual reporting how the methodologies are sensitive to a single observation (such as student or school), either by providing examples or noting how results are weighted in arriving at the final improper payment estimates.

2.4 Revise the improper payment estimation methodologies to account for the program reviews that do not reach the program review report stage in time for inclusion in that fiscal year's estimated improper payment rates.

Department Comments

The Department concurred with the finding and recommendations.

FINDING NO. 3 – The Department Needs to Improve the Accuracy and Reliability of its Improper Payments Estimates

We found that the Department's reported FY 2015 improper payment estimates for the Pell and Direct Loan programs were inaccurate and unreliable because spreadsheet formulas used in its calculations were incorrect and the calculations deviated from the OMB-approved methodologies. As a result, the Department could not accurately evaluate its performance in reducing improper payments for the Pell and Direct Loan programs.

<u>The Department's Calculations of Improper Payment Estimates Deviated from the OMB-Approved Methodologies</u>

The Department's improper payment estimates for the Pell and Direct Loan programs were not accurate and deviated from the OMB-approved methodologies in four ways. First, the Department used an incorrect spreadsheet formula to assign schools to a risk category. Second, the Department did not use the correct risk score to assign schools to a risk category. Third, the Department did not distribute schools across the three categories as proposed. Fourth, the Department excluded completed, applicable program reviews from the improper payment estimates. As a result of these errors, the improper payment estimates were incorrect. After we brought the execution errors to the Department's attention, the Department recalculated the improper payment rates to address the first three errors; however, the Department did not recalculate the rates to address the excluded program reviews (see Table 3).

Table 3. Program Review Categories and Improper Payment Rates and Amounts, Based on the Incorrect Formula and the Department's Corrected Formula (Amounts in Millions)

Program Review Category	Direct Loan Program Incorrect Formula	Direct Loan Program Department's Corrected Formula	Pell Program Incorrect Formula	Pell Program Department's Corrected Formula
Lower Risk Disbursement Amount	$5,136.45	$80,696.62	$2,896.84	$23,192.19
Higher Risk Disbursement Amount	$85,351.39	$16,426.56	$26,933.45	$7,479.18
Other Reasons Disbursement Amount	$12,760.57	$6,125.23	$2,373.34	$1,532.26
Improper Payment Rates	1.30%	2.63%	1.88%	1.52%
Improper Payment Amount	$1,284.03	$2,597.69	$562.29	$454.62

Note: The improper payment amount is calculated by multiplying the outlays times the rate. In the Department's FY 2015 AFR, it reports that Pell outlays are $29,909.28 and Direct Loan outlays are $98,771.65.

The Department Used an Erroneous Formula to Assign Schools to a Risk Category

The OMB-approved methodologies describe how the Department will estimate improper payments for the Pell and Direct Loan programs. According to the methodologies, the Department leverages program reviews of schools for its calculations of the improper payment rates for these programs. SESG issues an annual Compliance Initiative plan that outlines its plan for the review year. The FY 2014 Compliance Initiative plan states that schools selected for program review are assigned to one of three separate categories: higher risk, lower risk, and other reasons (other programmatic reasons not based on risk scores).[15] SESG generated a risk

[15] The other reasons category includes schools selected for program review based on comprehensive compliance reviews, referrals, complaints, and self-reported violations. These schools were not selected based on their risk scores.

score for schools that participated in the Title IV programs in award year 2012-2013.[16] However, in the improper payment rate calculations, the Department's contractor used an incorrect formula that assigned schools to the opposite risk category: lower risk schools were assigned to the higher risk category and higher risk schools were assigned to the lower risk category. As a result of using an incorrect formula, the reported improper payment estimates were inaccurate, and significantly different from the Department's corrected improper payment estimates. This error had the most significant impact on the improper payment estimates.

We concluded that a data-entry error was the cause of the incorrect formula that the Department used to assign schools to a risk category. The Department's contractor acknowledged the data-entry error on its part, and the Department acknowledged its failure to identify the error. Schools that are assigned to an incorrect risk category cause its improper payment rates to be applied to the incorrect total disbursements for each risk category.

The Department Failed to Use the Correct Risk Score to Assign Schools to a Risk Category
The Department's improper payment calculations deviated from the OMB-approved methodologies for the Direct Loan and Pell programs by not using the modified risk score when assigning schools to a risk category. The OMB-approved methodologies indicate that the Department would use risk scores provided in the Compliance Initiative plan, which indicated that schools would be categorized using a modified risk score. However, when the Department assigned schools to a risk category for purposes of estimating improper payments, it used the total risk score and not the modified risk score. The Department's contractor stated that it never communicated with the Department specifically regarding the use of the total risk score to assign the schools to a risk category for the purpose of calculating improper payments.

The Department Failed to Distribute Schools Proportionally Across Categories
The Department's improper payment calculations deviated from the OMB-approved methodologies for accounting for schools not selected for program review and not assigned a risk score by SESG. According to the OMB-approved methodologies, these schools should be distributed proportionally across the three categories (lower risk, higher risk, and other reasons). However, all the schools that were not selected for program review and not assigned a risk score by SESG were assigned to the other reasons category. The Department's contractor stated that it decided to assign these schools to the other reasons category because it did not want to affect the results for the two risk categories determined by risk score (lower risk and higher risk). After we notified the Department of this deviation from the OMB-approved methodologies, the Department reviewed the schools incorrectly assigned to the other reasons category and identified for reassignment the 790 schools with Direct Loan disbursements and the 209 schools with Pell disbursements that were not selected for program review and not assigned a risk score and were not proportionally distributed across the three risk categories.[17]

[16] The FY 2015 improper payment estimates were based on program reviews started during FY 2014, and which reviewed Title IV disbursements for the 2012–2013 award-year.
[17] A total of 6,274 schools participated in the Direct Loan program and 5,702 schools participated in the Pell program.

The Department Excluded Completed, Applicable Program Reviews from its Improper Payment Estimates

The Department's Pell and Direct Loan improper payment estimates are incomplete because some program reviews that should have been included were excluded from the calculations. In our review of the program review reports, we identified 54 completed and applicable program reviews that the Department excluded because some or all supporting documentation[18] was not in the contractor's possession before the documentation acceptance date of October 5, 2015. These program reviews could have identified improper payments. We reviewed 16 of these 54 program reviews and found that for 13, sufficient supporting documentation was available. Therefore, these program reviews should have been included in the improper payment estimates. We reviewed the contractor's actions, consisting primarily of email communications, to obtain supporting documentation from SESG. The contractor was not able to obtain the specific information it needed to include the program reviews in the improper payment estimates. We found internal control weaknesses within the Department: FSA Finance did not ensure that the contractor actively and thoroughly requested the needed information from SESG. As a result, at least 13 applicable program reviews were excluded from the calculations of the FY 2015 improper payment estimates and may never be considered in any subsequent year's improper payment estimates.

Recommendations

We recommend that the Chief Financial Officer for the Department, in conjunction with the Chief Operating Officer for FSA, require the Chief Financial Officer for FSA to—

3.1 Publish the FY 2015 recalculated improper payment rates, notify OMB and Congress of any changes, and explain the basis for the revisions in the FY 2016 AFR.

3.2 Develop, implement, and monitor the effectiveness of internal controls for (a) the contractor's calculation of the improper payment estimates, and (b) the Department's oversight and review of the work provided by the contractor.

3.3 Develop, implement, and monitor the effectiveness of internal controls to ensure that all program reviews applicable and issued before the documentation acceptance date are included in the improper payment estimates.

Department Comments

The Department concurred with the finding and Recommendations 3.1 and 3.2. The Department partially concurred with Recommendation 3.3, stating that it is not feasible to include all program reviews applicable and issued before the documentation acceptance date in the improper payment estimates. In addition, the Department stated that it will evaluate the effectiveness of existing internal controls for timely obtaining program review documentation.

OIG Response

We disagree with the Department's comments on Recommendation 3.3. For the FY 2015 improper payment estimates, the documentation acceptance date was October 5, 2015, which allowed the Department more than 3 weeks to obtain the necessary supporting documentation for

[18] The program review support documentation included an appendix with the sampled students listed and a recipient data spreadsheet that listed all disbursements at the student level.

all applicable and issued program reviews. The supporting documentation for a program review primarily consists of a list of sampled students and the Title IV disbursements made to these students (recipient data spreadsheet). It is a reasonable expectation that both documents should be available within 3 weeks of a program review's issuance date.

OBJECTIVES, SCOPE, AND METHODOLOGY

The audit objectives were to (1) determine whether the Department complied with IPERA; (2) evaluate the accuracy and completeness of the Department's improper payments reporting; (3) evaluate the Department's performance in reducing and recapturing improper payments; and (4) for the high-priority programs (Pell Grant and Direct Loan): (a) evaluate the quality of the Department's improper payment estimate and methodology, (b) evaluate the Department's assessment of the level of risk associated with the high-priority programs, and (c) review the oversight and financial controls described by the Department to identify and prevent improper payments.

Our audit covered the Department's improper payment measurement methodologies, reporting, and performance in reducing and recapturing improper payments for the Pell and Direct Loan programs from October 1, 2014, through September 30, 2015.

Our audit was for the limited purpose described and would not necessarily identify all deficiencies in internal controls. To accomplish our objectives, we gained an understanding of internal controls applicable to the Department's compliance efforts with IPERA and development of its improper payment rate estimates, as detailed below. We determined that control activities were significant to our audit objective. We reviewed and tested control activities pertaining to the Department's calculations of improper payment estimates, support for such calculations, and improper payment reporting. We identified deficiencies in the Department's control activities; we fully discuss these deficiencies in Finding 3 of this report. Specifically, we performed the following:

1. Reviewed background information about the Department and its programs susceptible to improper payments (Pell and Direct Loan programs).

2. Reviewed the following laws, regulations, and guidance to gain an understanding of the improper payment reporting requirements that the Department was required to follow:
    a. Improper Payments Elimination and Recovery Improvement Act of 2012;
    b. Improper Payments Elimination and Recovery Act of 2010;
    c. Improper Payments Information Act of 2002;
    d. OMB Circular A-123, Appendix C, "Requirements for Effective Estimation and Remediation of Improper Payments," October 20, 2014;
    e. Executive Order 13520, "Reducing Improper Payments," November 20, 2009;
    f. OMB Circular A-136, Section II.5.8., "IPIA (as amended by IPERA and IPERIA) Reporting Details," August 4, 2015; and
    g. Guidance developed by the U.S. Social Security Administration OIG for the Council of Inspectors General on Integrity and Efficiency for evaluating an agency's compliance with the improper payment requirements.

3. Reviewed the Department's FY 2015 Agency Financial Report, and specifically, the "Improper Payments Reporting Details" section, the "FY 2015 Alternative Improper Payment Estimation Methodologies," and the documentation supporting the

Department's improper payment measurement methodologies, reporting, and performance in reducing and recapturing improper payments.

4. Reviewed the Department's "FY 2014 Assessment of Improper Payments Risk Assessment Plan and Results" to determine compliance with improper payment reporting requirements.

5. Interviewed officials from FSA's Finance, Customer Experience, and Program Compliance – SESG groups, and FSA's designated contractor (PricewaterhouseCoopers) for its OMB Circular A-123, "Management's Responsibility for Internal Control Testing."

6. Reviewed prior OIG audit reports relevant to our audit objectives, including:
   a. "U.S. Department of Education's Compliance With Improper Payment Reporting Requirements for Fiscal Year 2014" (A03P0003);
   b. "Federal Student Aid's Oversight of Schools Participating in the Title IV Programs" (A03L0001);
   c. "U.S. Department of Education's Compliance with the Improper Payments Elimination and Recovery Act of 2010 for Fiscal Year 2013" (A19O0002);
   d. "U.S. Department of Education's Compliance with Executive Order 13520, 'Reducing Improper Payments' for Fiscal Year 2012 and 2013" (A03N0004);
   e. "U.S. Department of Education's Compliance with the Improper Payments Elimination and Recovery Act of 2010 for Fiscal Year 2012" (A03N0001);
   f. "U.S. Department of Education's Compliance with the Improper Payments Elimination and Recovery Act of 2010 for Fiscal Year 2011" (A03M0001); and
   g. "U.S. Department of Education's Compliance with Executive Order 13520, 'Reducing Improper Payments' for Fiscal Year 2011" (A03M0004).

7. We reviewed the Department's recalculated improper payment estimates that it provided based on the errors we identified. While we did not audit supporting documentation for the recalculated estimates, we reviewed the work provided by the Department and verified that the recalculated estimates addressed each error.

Sampling Methodology

Of the 337 program reviews performed by the Department during FY 2014, the Department reported that 240 were performed for reasons that could identify improper payments and were completed by October 5, 2015. Of the 240 program reviews, we judgmentally selected for review 21 program reviews and the associated supporting documentation.

We judgmentally selected 16 program reviews to determine whether the Department correctly excluded these program reviews from the improper payment estimates.

- From a population of 90 program reviews that were excluded from the improper payment estimates for reasons the Department cited, including 1) the supporting documentation was not available in time for the FY 2015 estimates, and 2) the program reviews were not applicable to the FY 2015 estimates, we selected a judgmental sample of 6 program reviews associated with the 5 schools with the highest Title IV disbursements for the 2012-2013 award year.

- We also selected 4 program reviews that had a deficiency related to an ineligible location or program. These 4 program reviews were included in the 90 program reviews excluded from the improper payment estimates.
- We selected 6 program reviews from a population of 7 program reviews that the Department identified as excluded from the improper payment estimates because all the supporting documentation was not available in time for the FY 2015 estimates. The seventh program review report and supporting documentation was not available for us to review.

Of the 240 program reviews, we judgmentally selected all 5 program reviews that were included in the improper payment estimates, that had a deficiency related to an ineligible location or program and where the improper payment estimates did not include any improper payments amounts associated with these deficiencies. We reviewed these to determine the improper payment amounts from deficiencies related to an ineligible location or program that the Department excluded from its improper payment estimates.

Because there is no assurance that the judgmental sample was representative of the entire universe, the results should not be projected over the universe of program reviews.

Data Reliability

Our use of computer-processed data for the audit was limited to documentation provided by the Department to support its improper payment rate estimates and progress in reducing and recapturing improper payments. We used the data to evaluate the accuracy and completeness of the Department's estimation methodologies for the Pell and Direct Loan programs. We assessed the reliability of this data by comparing reported data to data contained in the supporting documentation and by interviewing Department officials and its contractor knowledgeable about the data. Based on our analysis, we concluded that the computer-processed data were sufficiently reliable for the purposes of our audit.

We conducted onsite visits at the Department's offices located in Washington, D.C., on December 14–15, 2015, and February 16–18, 2016. We briefed Department officials on the results of our audit on April 4, 2016.

We conducted this audit 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.

Enclosure 1: Acronyms, Abbreviations, and Short Forms Used in This Report

AFR	Agency Financial Report
Department	U.S. Department of Education
Direct Loan	William D. Ford Federal Direct Loan
FAFSA	Free Application for Federal Student Aid
FSA	Federal Student Aid
FY	Fiscal Year
IPERA	Improper Payments Elimination and Recovery Act
IRS	Internal Revenue Service
OIG	Office of Inspector General
OMB	Office of Management and Budget
Pell	Federal Pell Grant
SESG	School Eligibility Service Group
Title I	Title I, Part A of the Elementary and Secondary Education Act of 1965, as amended

Enclosure 2: Auditee Comments

MEMORANDUM

DATE: April 20, 2016

TO: Pat Howard
Assistant Inspector General for Audit
Office of Inspector General

Bernard Tadley
Regional Inspector General for Audit
Office of Inspector General

FROM: Thomas P. Skelly
Delegated to Perform the Function and Duties of the Chief Financial Officer
Office of the Chief Financial Officer

James W. Runcie
Chief Operating Officer
Federal Student Aid

John W. Hurt, III
Chief Financial Officer
Federal Student Aid

SUBJECT: Response to OIG's Review of the Department's Improper Payment Reporting Requirements

We appreciate the opportunity to respond to the draft audit results of the Office of Inspector General's (OIG) Review of the Department's Improper Payment Reporting Requirements. We also appreciate the OIG's work identifying issues pertaining to the way we calculate, document, and report improper payments.

The Department is committed to preventing the occurrence of improper payments and detecting and recovering them when they do occur. In response to an OIG finding in FY 2015, the Department established a working group in FY 2016 with the goal of exploring ways to revise and strengthen improper payment estimation. The working group will determine the feasibility of and the associated burden, costs, and benefit of revising the estimation methodology to incorporate additional data sources for improper payments in the alternative sampling methodology. Changes to the alternative estimation methodology will be communicated to the Office of Management and Budget (OMB) for approval.

Federal Student Aid
830 First Street NE Washington DC 20202
StudentAid.gov

While the current OMB-approved alternative estimation methodology provides significant benefit, such as the consideration of an expanded number of risks from prior methodologies and the most efficient allocation of resources, we recognize the limitations inherent in using our risk-based alternative approach, including non-random relatively small sample sizes that may result in year-over-year volatility in estimates. To wholly replace our estimation methodology with one using a larger and statistically valid random sample to achieve a precise estimate would require significant investment and burden stakeholders. A precise estimate may reduce year-over-year variation and reduce the likelihood of missing an annual reduction target, but would not result in changes to our work to identify and fix the underlying causes of improper payments.

We agree that we were non-compliant with the Improper Payments Elimination and Recovery Act of 2010 (IPERA) in FY 2015 based on the recalculated Direct Loan improper payment rate.

Our responses to each of the draft findings and recommendations are included below.

Department's Response to Finding 1:

The Department concurs with this finding.

The Department concurs that it failed to meet the reduction target for the Direct Loan Program.

The Department also recognizes that there are several limitations of the OMB-approved alternative estimation methodology. As acknowledged in Finding 2, one of the key limitations of the Department's alternative estimation methodology, a non-statistical estimation methodology by definition, is the volatility of the improper payment estimates. Consequently, though the estimated Direct Loan rate increased, for example, that increase does not correlate with any actions, or inactions, taken by the Department. The Department continues to coordinate with stakeholders to assess the feasibility of updating the estimation methodology to address the reliability of the improper payment estimates along with other limitations of the estimation methodology. While the Department recognizes these limitations in the methodology, the Department disagrees that it cannot be determined whether it met the FY 2015 reduction target for Pell. As noted in the draft report, the Pell improper payment rate was recalculated in accordance with the OMB-approved estimation methodology, and the updated estimate of 1.52% was below the reduction target of 2.15%. We and the OIG both choose to use the estimated Direct Loan improper payment rate to conclude that we missed the target. Therefore, we agree that we are non-compliant with IPERA. However, to be consistent, we cannot then choose not to accept the same methodology for the Pell estimated improper payment rate, when the Department concludes that our estimate did, in fact meet the target.

While the Department acknowledges that root causes of improper payments may change from year to year based on the causes of improper payments in sampled program reviews, the Department disagrees that this limits its ability to assess progress in addressing root causes. Program reviews involve an expansive list of procedures including evaluating compliance with

federal student aid requirements for eligibility of the disbursed funds for a sample of students in each review. All findings identified during the FSA program reviews are tracked through resolution via the Postsecondary Education Participants System (PEPS).

Department's Response to Recommendation 1.1:

The Department concurs with this recommendation and continuously evaluates its controls to find opportunities to prevent the occurrence of improper payments and detect and recover them when they do occur. Here are specific example actions FSA is already taking to improve upon its controls over improper payments:

- Requiring that all Program Review findings are tracked through resolution via PEPS.
- Continuing to utilize the IRS DRT, which enables Title IV student aid applicants and as needed, parents of applicants, to transfer certain tax return information from the IRS website directly to their online FAFSA.
- For the 2017–18 award year, requiring applicants to complete their FAFSA using "prior-prior year" tax data. This is in contrast with the current "prior year" process where many applicants submit their FAFSAs before tax returns have been completed, resulting in the need to estimate income and tax information that subsequently needs to be corrected once the tax return is filed; or worse, waiting to complete their FAFSA until after the tax return has been filed. Also, applicants will be able to initiate their application earlier in the 2017–18 award year. The start of the FAFSA cycle for 2017–18 will move up from January 1 to October 1. Both of these changes will assist in preventing improper payments as the IRS DRT is anticipated to be used more and there is more time for effective verification procedures.
- Enhancing verification procedures and requiring selected schools to verify specific information reported on the FAFSA by student aid applicants.
- Expanding the use of data analytics to identify anomalies, trends, and patterns in application and disbursement data to help identify potential risk factors that may inform risk-based decisions regarding program oversight. FSA will further collaborate with OIG to receive and analyze fraud referrals and to identify potential fraud indicators for suspicious student activity. FSA has engaged contract support and established a fraud group to support OIG fraud referrals. The primary objective of initial activities includes the intake, analysis, and disposition of referrals. FSA will use this analysis to inform recommendations on data analytics and identify ways to improve controls.

Department's Response to Recommendation 1.2:

The Department concurs with this recommendation and will coordinate with OMB on whether additional funding is needed to help the agency become compliant with IPERA. However, as more fully described in Finding 2, the estimated rates cannot be directly linked to actions, or inactions, of the Department. The volatility of the improper payment estimates, based on the current OMB-approved alternative estimation methodology, is primarily due to the small number of low-risk program reviews available for improper payment testing. This results in a few low-risk program review reports being used to project the improper payment estimates for the corresponding population of Pell Grant and Direct Loan disbursements, which represent the majority of total disbursements. The only way to decrease the variability of the improper payment estimates is to significantly increase the number of lower risk reviews. In order to do that, the Department and OMB would have to make a resource allocation decision to either divert resources from higher-risk reviews or ask for taxpayers to pay for more lower-risk reviews (and not the higher-risk reviews) solely for the purpose of improving the improper payment estimate. In the view of the Department, increasing the number of lower-risk reviews by limiting or reducing the number of higher-risk reviews would not be the best use of agency resources.

Department's Response to Finding 2:

The Department concurs with this finding.

Re: The Department's Methodologies Do Not Include All Program Reviews That Could Identify Improper Payments

The Department acknowledges that not all program reviews conducted during a fiscal year that may identify improper payments are included in the Department's improper payment estimates due to timing. Per the OMB-approved estimation methodology, "Due to timing of testing and completion of reviews, it is not possible to include all Program Reviews in the annual estimation of improper payments." The Department will continue to evaluate the feasibility of revising the estimation methodology to increase the number of Program Reviews in the annual estimation of improper payments.

Re: The Department's Methodology for the Pell Program Exclude Other Sources of Improper Payments

The Department acknowledges that the current OMB-approved estimation methodology primarily relies on the results of program reviews. While the current program review-based estimation methodology accounts for significant sources of improper payments, the Department is currently coordinating with stakeholders to assess the program review test procedures, analyze

other sources of improper payments, and consider the costs and benefits of incorporating such sources of data to better account for improper payment risks.

The Department also acknowledges that the root cause of improper payments related to inaccurate self-reported income on the FAFSA identified through the program reviews may be identified as something other than inaccurate self-reported income within the program review reports due to the nature of the program review test procedures. However, the FY15 AFR does acknowledge, "incorrect self-reporting of an applicant's income which leads to incorrect awards based on Expected Family Contribution (EFC)" as a specific root cause. The Department will consider ways to further report on this root cause going forward.

The Department also acknowledges that program reviews may not identify inaccurate self-reported income on the FAFSA for a sub-population of applicants: Those who were not selected for verification and who did not use the IRS DRT. The Department is currently evaluating the feasibility and associated cost and benefit of revising the estimation methodology to better account for findings related to misreported income for this sub-population of applicants. The Department thanks the OIG for recognizing its current efforts to address this issue including formation of a working group.

Re: The Department's Estimation Methodologies Resulted in Volatile Improper Payment Estimates

The Department acknowledges that the OMB-approved estimation methodology may result in volatile improper payment estimates. Significantly reducing the volatility of the estimates would require a significant increase in the number of lower-risk reviews and, as noted above, result in the Department either diverting resources from higher-risk reviews or asking for taxpayers to pay for more lower-risk reviews, both of which the Department views as not the best use of agency resources. To help ensure that the lower-risk reviews are better represented, the Department is currently evaluating actions that can be taken to increase the number of those reviews available and applicable to improper payment testing, without increasing the number of reviews performed annually. The Department will continue with this evaluation.

Re: The Department's Estimation Methodologies Excluded Improper Payments Identified in Program Reviews

The Department acknowledges that the OMB-approved estimation methodology involves estimating total improper payments for the Pell Grant and Direct Loan programs using improper payments associated with disbursements to sampled students only. This may result in overstating or understating the improper payment rates, depending on whether sampled students identified within the program review reports are representative of the overall population of students who received Pell Grant and Direct Loan disbursements while attending ineligible locations/or programs. For the two program reviews that were included in the Department's improper payment estimates that identified improper payments associated with findings of an ineligible

location or an ineligible program, had the associated sampled students been identified as having attended the ineligible locations and/or programs within the program review reports, disbursements made to those students would have been deemed improper and used to project the improper payments of the sampled students to the total disbursements by the school to estimate the improper payment rate for the school.

Department's Response to Recommendation 2.1:

The Department concurs with this recommendation pending further analysis. Although school- and program-level findings, and findings associated with misreported income, are in part accounted for within the current estimation methodology, the Department is currently evaluating the feasibility and associated cost and benefit of revising the estimation methodology to better account for such findings. The Department will continue with this evaluation.

Department's Response to Recommendation 2.2:

The Department concurs with this recommendation, pending further analysis, and recognition that implementation of this recommendation should not divert resources from higher-risk reviews or require additional taxpayer dollars to perform more lower-risk reviews. The Department is currently assessing the feasibility of increasing the number of lower-risk reviews available and applicable to improper payment testing, without increasing the number of lower-risk reviews performed annually. One approach the Department is currently evaluating is revising the estimation methodology to review program review reports for a prior award year thereby increasing the number of program review reports, including lower-risk reviews, available for improper payment testing.

Department's Response to Recommendation 2.3:

The Department concurs with this recommendation. The Department will update its narrative in the AFR to disclose that the sensitivity of the estimates to a single observation is dependent on the program reviews available for improper payment testing.

Department's Response to Recommendation 2.4:

The Department concurs with this recommendation pending further analysis. As acknowledged within the OMB-approved alternative estimation methodology, not all program reviews are available due to timing of testing and completion of reviews. Due to this timing constraint, there are limited options to revise the improper payment estimation methodology to account for program reviews that do not reach the program review report stage in time for inclusion in that fiscal year's estimated improper payment rates. One of the few options is revising the estimation methodology to review program review reports for a prior award year, allowing for a larger number of program reviews to be included in

the annual estimation of improper payments. This revision would result in current year improper payments being estimated using older data. The Department will evaluate the feasibility of this option.

Department's Response to Finding 3:

The Department concurs with this finding.

Re: The Department Used an Erroneous Formula to Assign Schools to a Risk Category

The Department concurs and has revised the estimates accordingly.

Re: The Department Failed to Use the Correct Risk Score to Assign Schools to a Risk Category

The Department concurs and has revised the estimates accordingly.

Re: The Department Failed to Distribute Schools Proportionally Across Categories

The Department concurs and has revised the estimates accordingly. The decision to stratify the 790 schools with Direct Loan disbursements and 209 schools with Pell disbursements was due to a discrepancy between the Funding and Attendance Reports rather than "because the contractor did not want to impact the results for the two risk categories determined by risk score (lower risk and higher risk)." As a precaution, for these select schools, all risk scores were disregarded, and these schools were assigned the 'Other Reasons' stratum as it was decided that the most conservative approach would be to assign these schools to the Other Reasons stratum as this stratum includes schools selected due to complaints, referrals, and self-reported violations and may have a higher rate of improper payments than the other strata; however, the Department recognizes that per page 4 of the estimation methodology, these schools should be distributed proportionally across the three strata.

Re: The Department Excluded Completed, Applicable Program Reviews from its Improper Payment Estimates

The Department partially concurs. The Department acknowledges that 13 applicable program reviews had an issuance date prior to the final documentation acceptance cut-off date of October 5, 2015, which was extended to allow for receipt of additional program review reports. Of the 13 program review reports, several were issued as few as two business days prior to the final documentation acceptance cut-off date. A program review report issuance date prior to October 5, 2015 does not imply that all program review documentation necessary for improper payment testing could be obtained by the cut-off date. Adequate time needs to be allotted for coordination between field teams performing the program reviews, those responsible for collecting program review documentation from all field teams, and those performing improper payment testing on the program review documentation.

Program reviews, conducted by FSA's Program Compliance – School Eligibility Service Group (SESG), were not originally intended to be used for improper payment estimation purposes, and therefore the program review report issuance data does not necessarily represent the date a program review report, including all required information for incorporation in the improper payment estimates, is available. After program review reports are issued, FSA and contractor personnel perform a review to determine if additional documentation necessary for incorporation in the improper payment estimates is required.

For all 13 program review reports, although the program reviews were applicable to the FY15 improper payment estimates, sufficient documentation was not available for improper payment estimation purposes before the final documentation acceptance date of October 5, 2015 and as a result, the program review reports could not be included in estimating the improper payment rates. The Department recognizes the need to expedite the process of obtaining all required program review documentation and will work to identify a reasonable time frame for obtaining this documentation from the formal issuance date of the program review reports.

The contractor team, with oversight by FSA personnel, closely tracked program review documentation to assess outstanding information, and followed a formal Prepared-By-Client (PBC) process that included an initial email request sent to stakeholders for all potentially in-scope documentation. The contractor team, with oversight by FSA personnel, continued to follow-upon program review reports and communicated documentation received and documentation that remained outstanding. The contractor's efforts did not solely consist of email communications. There were frequent communications, in-person and via phone, in addition to formal written requests, throughout the assessment. All program review report documentation received prior to the documentation acceptance cut-off date was reviewed by the contractor, with oversight by FSA personnel, to determine if it was relevant to the improper payment estimation.

Department's Response to Recommendation 3.1:

The Department concurs with this recommendation. The Department will publish the FY15 recalculated improper payment rates, notify OMB and Congress of any changes, and explain the basis for the revisions in the FY16 AFR.

Response to Recommendation 3.2:

The Department concurs with this recommendation. The Department has already developed and implemented internal controls for (a) the contractor's calculation of the improper payment estimates, and (b) the Department's oversight and review of the work provided by the contractor. The Department will re-assess these internal controls and monitor the effectiveness of these controls.

Response to Recommendation 3.3:

The Department partially concurs with this recommendation. Although it is not feasible to include all program reviews applicable and formally issued prior to the documentation acceptance date within the improper payment estimates, the Department will evaluate the effectiveness of existing internal controls for obtaining program review documentation in a timely manner. The Department will coordinate with stakeholders to verify a reasonable time frame for obtaining all program review documentation necessary for improper payment estimation purposes from the date of formal issuance of a program review report. This reasonable timeframe will account for time needed upon formal issuance of the program review report for coordination between field teams performing the program reviews, those responsible for collecting program review documentation from all field teams, and those performing improper payment testing on the program review documentation.

Once again, we appreciate the opportunity to review and respond to the report. If you have any questions or need additional information regarding this response, please contact Bill Blot at (202) 377-3097 or Jay Hurt at (202) 377-3453.

cc: Robert Janney