

Federal Student Aid FY 2015 Alternative Improper Payment Estimation Methodologies

Introduction

Simplifying and speeding access to student aid dollars while minimizing errors and the potential for fraud remains a Department priority. To this end, Federal Student Aid (FSA) management is committed to improper payment prevention, mitigation, and reduction and continues to strengthen improper payment controls, and develop and enhance estimation methodologies and analytics to monitor FSA programs. Accurate improper payment estimation is essential to achieving these objectives and will continue to inform root cause analysis and corrective actions, as described in part in the [Fiscal Year \(FY\) 2015 Annual Financial Report \(AFR\)](#).

As described in the [FY 2014 AFR](#), the Department obtained approval from Office of Management and Budget (OMB) to use an alternative methodology for estimating improper payments for FSA programs susceptible to significant improper payment risk for FY 2014 and beyond. These methodologies were further refined in FY 2015. The estimation methodology utilized by FSA leverages the substantial investment in its existing internal control framework to include compliance and assessment functions, such as Program Reviews conducted by FSA's Program Compliance - School Eligibility Service Group (SESG). Leveraging existing investments in the Program Review process avoids significant costs that would otherwise be required for separate testing at schools and institutions. Further, our analysis of this rich data set helps inform tangible corrective actions in these programs. Although there are some statistical limitations with this alternative sampling plan and estimation methodology including reliance on non-random sampling, and limited sample size, this approach provides for a more efficient allocation of resources, improvements to the core underlying processes over time, and the integration of the program into core functions. This increases the likelihood of a sustainable program despite limited out-year budget funding.

FY 2015 OMB Approval Status and Updates

In FY 2015, the OMB approved the alternative sampling plan and estimation methodology for all risk-susceptible programs (i.e., the Pell Grant (Pell) Program and Direct Loan (DL) Program) described below. This alternative estimation methodology continues to leverage the substantial investment in FSA's existing internal control framework, including Program Reviews. This methodology, as described in the Department's FY 2014 AFR, was further refined in FY 2015. The refinements include clarification of sample sizes, updates to formulas, citations and references, and inclusion of justification of updates to the alternative methodology.

FSA Programs Susceptible to Significant Improper Payment Risk

The Department submitted, with OIG concurrence, a request to reclassify FFEL as a low risk program in FY 2015. On August 4, 2015 OMB granted approval for the FFEL Program to be excluded from the annual estimation process. No annual estimate for FFEL improper payments are required if the program remains low risk and no significant legislative or program changes occur, as well as no significant funding increases and/or any change that would result in substantial program impact. As a result, the proposed alternative sampling and estimation methodology covers the Pell and DL programs only.

Alternative Estimation Methodology

Pell Grant Program

Both the Pell and DL estimation methodologies include evaluation of Program Reviews conducted by the Program Compliance –School Eligibility Service Group (SESG) between October 2013 and September 2014 at a sample of schools for aid received in award year 2012-2013 (i.e., July 1, 2012 to June 30, 2013). SESG conducts approximately 300 Program Reviews annually of the approximately 6,000 eligible Title IV schools (i.e., approximately 5.0% of schools are reviewed; 336 Program Reviews for the purposes of the FY15 improper payment estimate calculations). Only a portion of the total Program Reviews performed annually are available for calculating the annual estimation of improper payments, as reports for only a portion of the reviews may be issued at the time of calculation of the improper payment estimates (i.e., not reached the draft program review report stage), and of those draft or final reports that have been issued, only a portion may be applicable to Pell or DL improper payments. For the FY15 Pell and DL improper payment estimates, 130 and 133 Program Review Reports were available for inclusion in the sample, respectively. Those reports included in the sample selection for the Pell and DL improper payment estimates represent available reports at the time of the improper payment estimate calculations that contain Pell and DL program disbursement data for the applicable award year from Program Reviews performed in the applicable fiscal year.

Pell Grant Program Sampling				
Payment Type	Sampling Methodology	Extrapolation Methodology	Estimated Number of Loans/ Grants Recipients ¹	Number of Institutions ²
Originations	Risk-Based	Two-Stage Ratio Estimator	8,954,468	5,702

Per SESG Program Review Procedures, Program Reviews can be initiated by FSA management as a result of one or more of the following:

- Compliance Initiatives / Management Mandates
- Referrals or Complaints
- Comprehensive Compliance Review (CCR)
- Self-Reported Violations
- Compliance Assurance Review (CAR)

For purposes of calculating the improper payment estimates for FY 2015, the schools identified from the five Program Review triggers were treated as separate strata and grouped as follows:

- Compliance Initiatives;
- CARs; and
- CCR, Referrals, Complaints, and Self-Reported Violations.

¹ The source of this estimated population data is the Common Origination & Disbursement (COD) Briefing published as of June 22, 2015.

² The source of this estimated population data is the Pell-DL Funding Report for award year 2012-2013 dated May 3, 2015.

Each population (Compliance Initiatives, CARs, and other Program Review triggers) were treated as a separate stratum. A selection of schools was made from each stratum, based on instructions from SESG Management. The stratification of schools based on Program Review triggers is intended to provide sample representation of the various risk-based groupings.

Schools selected by SESG for program review were stratified based on the designated risk trigger. Schools not selected for program review (i.e., not assigned a risk trigger) were objectively assigned to a stratum using scores assigned to the schools by SESG at the beginning of the program selection process. The scores support SESG’s selection of program reviews to be performed and are a proxy for the risk trigger³. In some instances, schools not selected by SESG for program review may not receive a score by SESG as part of the program selection process. These schools were distributed proportionally across the three strata.

The baseline estimates for Pell and DL are based on the institutions and disbursements selected and tested via the existing SESG Program Review process. The sample obtained from SESG Program Reviews was extrapolated to the entire population of schools eligible to receive Pell and DL funding during the period under review. Based on this analysis, the Pell error rate for FY 2015 was 1.88 percent, or \$562.29 million.

FY 2015 Pell Grant Estimate			
Two-Stage Estimator			
Point Estimate of Improper Payment (in millions)	Over-Payment Improper Payment Estimate	Under-Payment Improper Payment Estimate	Point Estimate (as % of Population Total)
\$562.29	\$457.59	\$104.70	1.88%

Direct Loan Program

The FY 2015 DL improper payment estimate was based on tests of the three components of the DL program: 1) Program Reviews conducted by the Program Compliance – SESG at a sample of schools for disbursements to students, as described in the Pell Grant section; 2) tests of loan consolidation overpayment and underpayment activity; and 3) tests of loan refund activity. Improper payment estimates were calculated for the three components (student disbursements (loan originations), consolidations, and refunds). The DL Program Review estimate was combined with two independent statistical sample estimates derived from the sampling of DL loan consolidations and refund payments. One overall estimate was then calculated which combined the three separate estimates as if they were cumulative.

³ The scores are provided via the Compliance Initiatives Report prepared by Program Compliance – SESG.

Direct Loan Program Sampling				
Payment Type	Sampling Methodology	Extrapolation Methodology	Estimated Number of Loans/ Grants Recipients	Number of Institutions ⁴
Originations	Risk-Based	Two-Stage Ratio Estimator	10,163,311 ⁵	6,250
Refunds	Random	PPS Estimator	387,242 ⁶	N/A
Consolidations	Random	PPS Estimator	3,362,246 ⁷	N/A

The loan consolidation component of the DL improper payment estimate was computed by sampling five overpayments and five underpayments, from the universe of all underpayment and overpayment activities for each of the 12 months from July 2014 through June 2015 for a total sample size of 120. An independent sample of FFEL to DL consolidation overpayment and underpayment activity was selected using a Probability Proportional to Size (PPS) technique based on dollar amount to draw the sample to reduce the probability that small DL consolidations are selected. After selecting the monthly samples, each overpayment and underpayment was tested to determine which of these transactions are considered improper payments. Any improper payments found in the sample were extrapolated to create a 90 percent statistical confidence interval range of the overall improper payment rate for loan consolidation activity. The absolute value of improper payments divided by the aggregate absolute value of the samples comprises the baseline rate for DL consolidation.

The third component was the test of loan refund activity. A refund on a borrower's account can occur when a payment is received for more than the amount due, resulting in a credit balance. In the case that the credit balance is less than \$5, the account is closed out and written up to zero, unless the borrower requests a refund. A refund can also occur when a payment resides in an unapplied state in suspense and cannot be matched to a borrower's account. An independent sample of DL refund activity was selected using a PPS technique to reduce the probability of selecting transactions that are deemed not material. The PPS sample of DL refunds was based on samples of 10 refunds for each month from July 2014 to June 2015 for a total of 120 sample items. FSA's Financial Management System (FMS) was queried and 10 refunds from the refunds population were selected for each month. Once monthly samples are selected, each refund was tested to determine if the samples were considered improper payments. The value of improper payments divided by the aggregate value of the samples comprises the baseline rate for DL refunds.

The loan disbursement, consolidation, and refund rates were then applied to their representative FY 2015 balances. The aggregate estimated improper payment amount for all three components was then applied to the total disbursement activity for the Direct Loan program to determine the overall Direct Loan improper payment rate of 1.30 percent, or \$1,284.03 million.

⁴ The source of this estimated population data is the Pell-DL Funding Report for award year 2012-2013 dated May 3, 2015.

⁵ The source of this estimated population data is the Common Origination & Disbursement (COD) Briefing published as of June 22, 2015.

⁶ The source of this estimated population data is the July – December 2014 total DL Refunds over and underpayments as reported by Business Operations – Internal Controls Division (i.e., 193,621). The population data for the last available six month period has been used to estimate the total number of DL Refunds over and underpayments for award year 2014-2015.

⁷ The source of this estimated population data is the July – December 2014 total FFEL to DL Consolidations over and underpayments as reported by Business Operations – Internal Controls Division (i.e., 786,572 and 894,551, respectively). The population data for the last available six month period has been used to estimate the total number of DL Refunds over and underpayments for award year 2014-2015.

FY 2015 Direct Loan Estimate			
Two-Stage Estimator			
Point Estimate of Improper Payment (in millions)	Over-Payment Improper Payment Estimate	Under-Payment Improper Payment Estimate	Point Estimate (as % of Population Total)
\$1,284.03	\$1,122.51	\$161.52	1.30%

Supplemental Non-Statistical Estimate

FSA has developed a process for evaluating the quality of the improper payment estimates using the alternative methodology described above. This process involves preparing a supplemental non-statistical estimate based on the review of compliance audit findings. Given the risk-based process governing selection of the Program Reviews, the Program Review institution selections for Pell and DL may produce a group of institutions with higher risk of compliance. To assess the reasonableness of the baseline estimate, a supplemental improper payment estimate is calculated for the Pell and DL programs by evaluating an independent, simple random sample of institutions from OMB Circular A-133 (A-133) compliance audits and OIG audit reports.

Public and private schools that receive more than \$500,000 of Title IV funds must submit compliance audits in accordance with OMB Circular A-133, *Audits of States, Local Governments and Non-Profit Organizations*. Proprietary institutions must submit compliance audits in accordance with the Department of Education’s Office of Inspector General Audit Guide, *Audits of Federal Student Financial Assistance Programs at Participating Institution Servicers (2000)*. Thus, both A-133 audits and annual compliance audits of proprietary schools were used as the basis for the supplemental estimates. The Department randomly sampled 60 A-133 compliance audits of the total population of schools participating in the Pell and another 60 A-133 compliance audits of the total population of schools participating in DL Program, along with all available in-scope OIG audit reports. Since the sampling methodology and size is rarely reported in A-133 compliance audits and OIG audits, it was assumed that 15 students were sampled in each audit; the assumption of 15 students was made to compare to guidelines of the sample methodology used in the General Assessment Program Reviews conducted by FSA.

The substantive monetary findings were extracted from the reports for these independent samples and used to mathematically estimate the improper payment percentage rate for the Pell and DL programs. Findings related to improper payments were logged and divided by an estimated sample value computed based on the assumed sample size and disbursement values. The resulting supplemental estimates were 1.45 percent for Pell and 0.78 percent for DL⁷. These estimates are not statistical. Further, they are not intended to replace or override the baseline estimate. A comparison was made between the baseline estimates and the supplemental non-statistical estimates. The supplemental non-statistical estimates were used as a point of comparison against the baseline to determine if the baseline estimates seemed unduly high or low.

⁷ In FY2015, the Supplemental Estimate was calculated using a weighted projection of the sample results to account for the difference in the number of students at each school (and thereby the weight of each improper payment should be given).