Federal Student Aid
FY 2016 Alternative Improper Payment Estimation Methodology

Introduction

Simplifying and accelerating 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) 2016 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 and FY 2016. 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 2016 OMB Approval Status and Updates

On October 14, 2016, the OMB approved the alternative sampling plan and estimation methodology for FY 2016 reporting 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 and FY 2016. The FY 2016 refinements include expansion of the sample size to include Program Review Reports conducted in multiple FYs for the applicable award year (AY), incorporation of two additional sources of improper payments (i.e., improper payments resulting from recipients submitting inaccurate self-reported income on the FAFSA, and improper payments resulting from schools disbursing Pell Grant (Pell) and Direct Loan (DL) funds to students enrolled in ineligible programs or students attending ineligible locations), 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 initiated in FYs 2014, 2015 and 2016 and issued by August 5, 2016 by SESG at a sample of schools for aid received in AY 2013-2014 (i.e., July 1, 2013 to June 30, 2014). SESG conducts approximately 250-300 Program Reviews annually of the approximately 6,000 eligible Title IV schools (i.e., approximately 4-5.0% of schools are reviewed). 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 FY 2016 Pell and DL improper payment estimates, 396 and 404 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 reports issued by the documentation acceptance cut-off date that contain Pell and DL program disbursement data for the applicable award year.

Pell Grant Program Sampling				
Payment Type	**Sampling Methodology**	**Extrapolation Methodology**	**Estimated Number of Grant Recipients**[1]	**Number of Institutions**[2]
Originations	Risk-Based	Two-Stage Ratio Estimator	8,661,118	5,435

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 2016, 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.

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

[1] The source of this estimated population data is the Title IV Program Volume Report entitled “Award Year 2013-14 Recipient Summary” whose source is the Common Origination & Disbursement (COD) System. The data is as of January 2016.
[2] The source of this estimated population data is the Pell-DL Funding Report for AY 2013-2014 dated May 4, 2016.

Management. The stratification of schools based on Program Review triggers is intended to provide sample representation of the various risk-based groupings.

The schools included in the review and assigned to the Compliance Initiative and Other Reasons strata are manually selected into the sample based on their Program Review risk characteristics (that is, the selection and inclusion of these school is not random). The schools included in the CAR stratum are randomly selected for inclusion and review.

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 the modified total 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 trigger[3]. 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.

For Pell, to account for improper payments associated with Pell recipients who provided inaccurate self-reported income on the FAFSA and did not use the IRS Data Retrieval Tool (DRT) and who were not selected for income verification, the baseline estimate also includes incorporation of the Pell improper payment estimates from the FAFSA/IRS Data Statistical Study (Study). The Study includes Pell-specific estimated improper payment rates based on a comparison between information reported by applicants on the FAFSA and income details reported to the IRS. For those sampled students in the Program Review Reports not selected for income verification and who did not use the IRS DRT, the improper overpayment and underpayment rates from the Study were applied to the sample disbursements for the applicable AY to estimate improper payments due to misreported income. To avoid applying an improper payment rate twice to one disbursement, for those students whose entire Pell value was deemed improper through another procedure in the Program Review Report, the rate reported in the Study was not applied to these disbursements. Additionally, any overpayment or underpayment findings due to conflicting income information identified within the Program Review Reports were disregarded as these findings are accounted for by applying the Study rates to the sample disbursements for students who did not use the IRS Data DRT and who were not selected for income verification.

The sample obtained from SESG Program Reviews was extrapolated to the entire population of schools that disbursed Pell funding during the period under review. Prior to extrapolating estimated improper payments for sampled schools to total Pell disbursements, total Pell school- and program-level improper payments identified within Final Program Review Determinations were added to the total estimated improper payments for the corresponding school.

Based on this analysis, the Pell error rate for FY 2016 was 7.85 percent, or $2,212.80 million.

[3] The scores are provided via the FY 2016 Compliance Initiatives Report prepared by Program Compliance – SESG.

FY 2016 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)**
$2,212.80	$2,025.27	$187.53	7.85%

Direct Loan Program

The FY 2016 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).

To calculate the DL Program Review estimate, the sample obtained from SESG Program Reviews was extrapolated to the entire population of schools that disbursed DL funding during the period under review. Prior to extrapolating estimated improper payments for sampled schools to total DL disbursements, total DL school- and program-level improper payments identified within Final Program Review Determinations were added to the total estimated improper payments for the corresponding school.

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.

Direct Loan Program Sampling				
Payment Type	**Sampling Methodology**	**Extrapolation Methodology**	**Estimated Number of Loan Recipients**	**Number of Institutions**[4]
Originations	Risk-Based	Two-Stage Ratio Estimator	10,096,031[5]	5,876
Payment Type	**Sampling Methodology**	**Extrapolation Methodology**	**Estimated Number of Over/Under Payments**	**Number of Institutions**
Refunds	Random	PPS Estimator	295,554[6]	N/A
Consolidations	Random	PPS Estimator	340,120[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 2015 through June 2016 for a total sample size of 120. An

[4] The source of this estimated population data is the Pell-DL Funding Report for AY 2013-2014 dated May 4, 2016.
[5] The source of this estimated population data is the Title IV Program Volume Report entitled "Award Year 2013-14 Recipient Summary" whose source is the Common Origination & Disbursement (COD) System. The data is as of January 2016.
[6] The source of this estimated population data is the July – December 2015 total DL Refunds over and underpayments as reported by Business Operations – Internal Controls Division (i.e., 147,777). 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 AY 2015-2016. Intra-governmental transactions are excluded from these totals.
[7] The source of this estimated population data is the July – December 2015 total FFEL to DL Consolidations over and underpayments as reported by Business Operations – Internal Controls Division (i.e., 110,491 and 59,569, 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 2015-2016. Intra-governmental transactions are excluded from these totals.

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 2015 to June 2016 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 2016 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 3.98 percent, or $3,867.87 million.

FY 2016 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)
$3,867.87	$3,771.26	$96.61	3.98%

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 all available OIG audit reports of institutions that administered Pell and DL in AY 2013-14, excluding those institutions tested as part of the Pell and DL Baseline Estimates.

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 12.46 percent for Pell and 5.45 percent for DL.[8] 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.

[8] In FY 2016, 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).