



UNITED STATES DEPARTMENT OF EDUCATION

OFFICE OF THE CHIEF FINANCIAL OFFICER

Mr. Daniel Werfel  
Controller  
Office of Management and Budget  
1650 Pennsylvania Avenue  
Room 536  
Washington, DC 20503

Dear Mr. Werfel:

The purpose of this correspondence is to submit the U.S. Department of Education's (Department) FY 2011 Report on Improper Payments Elimination and Recovery Act (IPERA) Payment Recapture Audits. The enclosed report was prepared in accordance with OMB's revised Parts I and II to Appendix C of OMB Circular A-123, issued April 14, 2011 (M-11-16).

The report provides an update to the Department's payment recapture audit plan submitted on January 14, 2011. Additionally, it describes the Department's current efforts to recapture improper payments and presents the Department's perspective on the cost-effectiveness of conducting recovery audits for all programs with more than \$1 million in annual outlays. IPERA requires recovery audits for all programs exceeding this threshold if conducting such audits would be cost-effective. The Department continues to implement the efforts and improvements described in the attached report to recover and prevent future improper payments.

If you have any questions, please contact me or Hugh Hurwitz at (202) 245-8144.

Sincerely,

Thomas P. Skelly  
Delegated to Perform Functions  
and Duties of the Chief Financial Officer

Enclosure

cc: Honorable Joseph I. Lieberman  
Chairman, Committee on Homeland Security and Governmental Affairs

550 12th St. S.W., WASHINGTON, DC 20202  
[www.ed.gov](http://www.ed.gov)

*The Department of Education's mission is to promote student achievement and preparation for global competitiveness by fostering educational excellence and ensuring equal access.*

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Ranking Member, Committee on Homeland Security and Governmental Affairs

Honorable Darrell E. Issa  
Chairman, Committee on Oversight and Government Reform

Honorable Elijah E. Cummings  
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Office of Management and Budget

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Kathleen Tighe  
Inspector General, U.S. Department of Education



## **Report on the Department of Education's Payment Recapture Audits in Accordance with the Improper Payments Elimination and Recovery Act (IPERA)**

The purpose of this report is to describe the U.S. Department of Education's (Department) efforts regarding payment recapture audits conducted in accordance with OMB's revised Parts I and II to Appendix C of Office of Management and Budget (OMB) Circular A-123, issued April 14, 2011 (M-11-16). The Department of Education submitted an improper payment recapture audit plan on January 14, 2011. The plan reflects a three-tier approach to payment recapture audits based on risk and cost effectiveness: grant programs, contracts, and Federal Student Aid (FSA). Below is an update on current efforts and the results of an analysis of the cost-effectiveness of conducting recovery audits for all grant programs with more than \$1 million in annual outlays.

### ***Tier 1: Grant Programs***

As described in detail below, the Department does not plan to conduct payment recapture audits of grant programs because our analysis has determined that it would not be cost-effective, per OMB memo M-11-16. The Department plans to continue using A-133 Single Audit reports, reports from Education's Office of the Inspector General (OIG), and various grant and payment monitoring efforts to reduce or eliminate improper payments. OIG and A-133 Single Audits represent a significant investment of Federal resources to identify improper payments in grant programs. The Department plans to strengthen its use of audit data to better identify and address the root causes of improper payments. In addition, the Department is already leveraging continuous monitoring technology to help prevent improper payments, and is pursuing actions that could create incentives for States to conduct payment recapture audits.

At this point in time, the Department does not plan to conduct payment recapture audits of grant programs for the following reasons:

- 1. Results from a Request for Information (RFI) indicate that vendor compensation for recovery audits would likely exceed actual recoveries.**

The Department published a RFI on February 17, 2011 to seek information from potential contractors to conduct recovery audits in accordance with IPERA. The Department received seven proposals. Two of

the vendors proposed a fee structure that requires the Department to compensate them beyond 25 percent of recoveries. Four of the vendors proposed a fee structure that requires payments regardless of the amount the Department may recover. One vendor proposed reasonable compensation, but specializes only in contract recovery audits. Based on the proposals we received in response to this RFI we conclude that, for the Department, vendor compensation for recovery audits would likely exceed actual recoveries.

- 2. Based on a review of actual recoveries from audits of grantees (A-133 and OIG audits), recoverable amounts due to improper payments would be less than the cost of a payment recapture audit effort.**

In 2010, pursuant to an interagency agreement, the Oak Ridge National Laboratory (ORNL) reviewed key data elements in the Department's Audit Accountability and Resolution Tracking System (AARTS), which contains all findings from audits of external entities. Based on this analysis, the ORNL developed a report on the Department's improper payments estimates for ESEA, Title I, and by major program area (apart from Title I, each program area contains multiple individual programs). Monetary audit findings in audits are reported as questioned costs. In general, questioned costs include expenditures which lack supporting documentation or that were expensed in the wrong accounting period, as well as improper expenditures. Based on these questioned costs, ORNL estimated the rate and total dollar amount of improper payments for each major program area. Every major program area included in this analysis was well under the statutorily defined threshold for "significant improper payments," which is defined as exceeding both 2.5 percent and \$10 million.

The Department conducted additional analyses in order to determine the likely cost-effectiveness of a recovery audit effort. The analyses focused on the amount of funds actually recovered from individual grantees in those 7 programs with the highest estimated rates and total dollar amounts of improper costs, including Title I which is the Department's second largest program next to Pell Grants. Out of the total expended amount of \$16.2 billion for these programs in FY 2008, total questioned costs were estimated at \$26.0 million. The actual recovered amount of improper payments was \$13,515.

Although there are several likely explanations this large gap between total questioned costs and actual recoveries, we believe that the high burden of proof for collections established in the General Education Provisions Act (GEPA) is the key reason that the Department generally recovers such a small percentage of the original questioned costs contained in audits. The GEPA, 20 U.S.C. 31 Subchapter IV § 1234a, requires the Department to establish a prima facie case for the recovery of funds, including an analysis reflecting the value of services obtained. In accordance with 20 U.S.C. 31 Subchapter IV § 1234b, any amount returned must be proportionate to the extent of harm the violation caused to "an identifiable Federal interest." These requirements only apply to the Department. Other Federal agencies may face other challenges, but the GEPA standard that applies to the Department can make it extremely difficult and time-consuming for this agency to establish a collection. Consistent with OMB's interim guidance for implementing payment recapture programs (included in OMB memo M-11-4, dated November 16, 2010), the Department plans to engage OMB in a discussion about whether additional OMB guidance or legal authority is needed for the Department to pursue certain categories of improper payments.

Under the GEPA standard, for example, the Department is routinely unable to collect certain questioned costs that may, in fact, be unallowable expenditures and that also meet OMB's definition of "improper payment." It is difficult to quantify the additional cost and effort that would be needed to successfully meet the GEPA evidentiary standard and recover funds identified through an audit program, but potential recoveries are likely to be far lower than the amount necessary to cover these additional costs. Thus, as we indicated could be the case in our improper payment recapture audit plan submitted to OMB on January 14, 2011, available evidence and our analysis suggests that recoverable amounts due to improper payments would be less than the cost of a payment recapture audit effort.

**3. The Department plans to pursue actions to provide incentives to States to conduct recovery audits of sub-grantees.**

Considering that many of the Department's major grants programs are State administered formula-funded grant programs, States need to be engaged as partners in this process, but the IPERA provides incentives only for Federal agencies to conduct payment recapture audits. The Department began conversations with our own OIG, and plans to engage OMB to develop incentives for State governments that administer Education-funded programs to conduct their own payment recapture audits to identify and recover overpayments, payments for ineligible goods or services, excess interest earned on advances, and other types of improper payments. In 2005, the OIG noted that, in programs for which most of the funds are passed-through the State Educational Agency to Local Educational Agencies or other sub-recipients, in general there is a lower risk of improper payments at the State level than at the local level where the services are delivered. Under OMB Circular A-133 and other Federal grants management requirements, States are responsible for conducting programmatic and fiscal monitoring of sub-grantees at the local level. States are also responsible for addressing most A-133 Single Audit findings pertaining to sub-grantees.

As an example, one specific area the Department has started to explore relates to excess interest earned on advances made by States to sub-recipients at the local level. This issue comes up frequently in recent OIG audits, particularly OIG audits of ARRA grantees where substantial amounts of excess interest may have been earned on large advances. However, there are outstanding legal questions that must be resolved before significant audits and recoveries of such interest would be feasible. For example, it is not currently clear whether or not excess interest earned on advances is subject to the recovery processes and standards contained in GEPA. The Department is working with OMB to determine the best way to provide an enhanced framework of incentives for States, and to work more collaboratively with our State partners in recovering potential improper payments.

**4. The Department recently awarded a contract to acquire continuous monitoring software to identify and prevent improper payments before they occur.**

In addition to these efforts, the Department recently acquired continuous monitoring software. This new tool is designed to help detect anomalies and flag potential issues in agency financial data prior to payment. The Department is currently staffing a team to follow-up when anomalies are identified,

aggressively investigate root causes of improper payments when they do occur, and develop corrective action plans to address any systemic weaknesses. This new tool will be used to examine payment records and identify problems such as duplicate payments, payments for services not rendered, overpayments, and fictitious vendors before payments are actually made. This software will allow the Department to shift our focus from traditional retrospective/detective activities to proactive/preventive activities, thereby assisting the Department in reducing the risk of improper payments. To the best of our knowledge, the Department will be the first agency to monitor 100 percent of payments, including grants, contracts, loans, and all other payments.

### ***Tier 2: Contracts***

The Department's findings from payment recapture audits of contracts have been consistently insignificant; however, the Department continues exploring new approaches to recovery audits. For FY 2004-2006, the Department hired an independent CPA firm to conduct payment recapture audits for the Department's contracts and purchase orders, which totaled approximately \$1.5 billion annually. Due to the amount the firm recovered, which is less than one percent (.0025%) for the entire contract period, the Department decided not to continue the work for FY 2007. The Internal Control Evaluation Group (ICEG) within the Department has been conducting payment recapture audits of contracts annually since FY 2007 as part of the A-123 review process. The findings from these reviews have consistently demonstrated the low risk of improper payments in contracts.

Given recent advances in the use of data mining technologies to identify and prevent improper contract payments, the Department plans to reconsider the use of an independent firm to conduct recovery audits in this area. Vendor submissions in response to the Department's February RFI suggested that a contingency-fee based payment recapture audit program focused solely on contracts may be cost-effective. In addition, such a program would help validate the effectiveness of the Department's use of continuous monitoring software to prevent duplicate and other forms of improper payments.

### ***Tier 3: Federal Student Aid***

In FY 2011, Federal Student Aid awarded a contract for support in planning and implementing an improper payment program responsive to all new and existing requirements, including support for identifying and recapturing improper payments. Federal Student Aid continues to leverage critical monitoring and assessment efforts while a new approach to payment recapture auditing is considered, but previous payment recapture audits were not cost-effective. Any successful new approach must be grounded in a statistically valid estimate of, or other comprehensive measurement approach for, improper payments.

Federal Student Aid has targeted FY 2012 for the implementation of new, long-term estimation methodologies now in development for risk-susceptible programs. The Department has coordinated this approach with OMB and obtained waivers for applicable requirements. These new estimation methodologies will include improper payment identification processes and, for any overpayment identified, related recovery activities.

While these new methodologies are being developed, the Department continues using program reviews, A-133 audit reports, reports from the OIG, and various monitoring and assessment efforts to reduce or eliminate improper payments. Federal Student Aid incorporates recovery efforts into the day-to-day monitoring activities of the Program Compliance office and in other internal assessment efforts. As part of these activities, Program Compliance reviews the A-133 Single Audits and OIG Audits, and conducts Program Reviews of schools that participate in Title IV programs, including the risk-susceptible Pell, Federal Family Education Loan (FFEL) and Direct Loan (DL) programs. Similar to the process at the Department for non-Title IV grants, Federal Student Aid works with schools to resolve amounts of improper payments identified in A-133 Single Audits, OIG Audits, and the Program Reviews. Last, a robust and mature A-123 Appendix A program has been implemented at Federal Student Aid to assess internal controls over financial reporting, which has included an assessment of disbursement processes over significant Title IV programs, including Pell and other grant programs, FFEL, and DL. Any improper payments identified through controls testing are recovered.

Until new improper payment estimation methodologies are developed, the Department does not plan to conduct payment recapture audits of Federal Student Aid programs. Prior analysis determined that such audits were not cost-effective. As noted in the January plan, Federal Student Aid's Financial Partner Eligibility and Oversight (now referred to as Financial Institution Oversight Service), a component of Program Compliance, focused Program Review efforts and resources during FY 2006 and into FY 2007 entirely on improper payments. Reviews were conducted of ED payments made to FFEL program lenders and guaranty agencies to determine if the payments made were proper and appropriate, and, determine an error rate in accordance with the Improper Payments Information Act of 2002. The amount of improper payments identified were minimal with an error rate of 0.218%, and it was determined that these payment recapture reviews were not cost-effective as a replacement or supplement to the existing A-133 Single Audits, OIG Audits, and standard Program Reviews performed.

Another component of the Program Compliance office, the School Eligibility Service Group (SESG), has performed assessments of improper payment risk in Title IV programs based on audit findings. SESG's computer systems currently track audit liabilities for individual audit deficiencies, but they do not track such liabilities by individual Title IV Federal Student Aid programs. For FY 2010, the maximum possible liabilities identified from these audits were \$2,594,590 out of \$36,377,126,580 in outlays resulting in a maximum possible percentage of liabilities (or improper payment error) of 0.0071%, well below the threshold for additional action under IPIA.