Federal Student Aid
FY 2014 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 working to strengthen improper payment analytics and estimation methodologies for FSA programs. Accurate improper payment estimation is essential to achieve these objectives and will continue to inform root cause analysis and corrective actions, some of which are described in the Fiscal Year (FY) 2014 Annual Financial Report (AFR).

As described in the FY 2013 AFR, FSA proposed new estimation methodologies, including for the Pell Grant Program, to correct for prior limitations. These methodologies have been further refined in FY 2014. In developing the new estimation methodologies, FSA leveraged its substantial investment in its existing internal control framework to include compliance and assessment functions, such as Program Reviews. Leveraging existing investments in the Program Review process avoids significant costs that would otherwise be required for separate testing at schools and institutions. This approach provides for a more efficient allocation of resources and may result in improvements to these core underlying processes over time as well as integrating the program into core functions. This increases the likelihood of a sustainable program despite limited out-year budget funding.

FY 2014 OMB Approval Status

In FY 2014, the Office of Management and Budget (OMB) approved the long-term estimation methodologies for all risk-susceptible programs (i.e., the Pell Grant Program, Direct Loan (DL) Program, and Federal Family Education Loan (FFEL) Program) described below.

Estimation Methodologies

Pell Grant Program

In FY 2011, OMB designated the Pell Grant Program a "high-priority" per Executive Order 13520 and OMB Circular A-123, Appendix C (as updated by OMB Memo M-10-13) because estimated FY 2010 improper payments of $1,005 million exceeded the FY 2010 program threshold of $750 million. The Department coordinated with OMB to establish and execute a plan to implement applicable high-priority program requirements including the designation of accountable officials and the establishment of improper payment measurements to be reported on PaymentAccuracy.gov.

In FY 2014, the Department obtained approval from OMB to report the results of the refined, alternative estimation methodology for the Pell Grant Program that continues to leverage the substantial investment in FSA's existing internal control framework, including Program Reviews. This methodology, which was a proposed estimation methodology described in the Department's FY 2013 AFR, was refined in FY 2014. The refinements allow for the identified improper payments to be weighted based upon each school's dollar amount disbursement. This methodology also allows for a better distribution of the school population by Program Review type.

The methodology is based on Program Reviews conducted by the Program Compliance – School Eligibility Service Group (SESG) between October 2012 and September 2013 at a sample of schools. FSA conducts Program Reviews at schools to assess a variety of compliance requirements of the Pell Grant Program. FSA identified individual transaction points of the Pell Grant Program that were deemed to pose the highest risk of improper payments. The Program Review schedule of schools to be reviewed each year is determined by an annual risk assessment performed by SESG. General Assessment or Focused Reviews are performed for high-risk institutions. Schools deemed as low or medium risk, or those that have not been reviewed in ten years, are subject to be selected for a Compliance Assurance Review (CAR).

The ratio of the errors identified to the total payments reviewed for all sampled students was extrapolated. Based on this analysis, the error rate for FY 2014 was 2.16 percent, or $682 million.

FY 2014 Pell Grant Estimate
Two-Stage Estimator

Point Estimate of Improper Payment (in millions) (a)	Point Estimate (as % of Population Total)	Standard Error (in millions)	Precision (in millions)	Precision Rate (as % of Population Total)	Lower Confidence Limit (in millions)	Lower Limit (as % of Population Total)	Upper Confidence Limit (in millions)	Upper Limit (as % of Population Total)
$735.2	**2.16%**	**$28.7**	**$47.2**	**0.14%**	**$ 688.0**	**2.02%**	**$782.4**	**2.30%**

(a) The FY 2014 Pell Grant overpayment improper payment rate estimate is $666MM or 2.11% and the underpayment improper payment rate estimate is $16MM or 0.05%.

The previous OMB-approved Pell Grant methodology was a statistical study with the IRS using FAFSA data to calculate an improper payment rate for the Pell Grant program. The IRS statistical study used application and disbursement level data to recalculate student awards where income figures were mismatched between tax returns and aid applications. The IRS study was based on interim data where not all of the applications expected to be processed for the cycle had been processed and moreover, additional corrections were still to be made by applicants to their original data. Therefore, the IRS data did not reflect subsequent corrections that were made nor did it reflect applicants for summer school of the second year who applied late. Finally, the study is limited to awards disbursed at the time of application, so other criteria, such as student eligibility based on academic performance is not considered. Due to these limitations in the study, FSA considers the IRS statistical study a supplemental secondary rate. For FY 2014, the preliminary rate from the IRS study is 1.94 percent which results in estimated improper payments of $612 million.

FSA also reviewed compliance audits as a supplemental estimate of improper payments. 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 Grant Program. Since the sampling methodology and size is rarely reported in A-133 compliance audits, it was assumed that 15 students were sampled in each compliance audit with a disbursement value that is equal to the average disbursement amount for the Pell Grant Program; 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. Findings related to improper payments were logged from a sample of 60 compliance audits and divided by an estimated sample value computed based on the assumed sample size and disbursement values. The resulting estimate was 0.51 percent.

Direct Loan Program

For FY 2014, the Department obtained approval from OMB to report the results of the refined, alternative estimation methodology. Similar to refinements noted above for the alternative estimation methodology for the Pell Grant Program, the refinements for the Direct Loan alternative methodology for FY 2014 include allowing for improper payments findings identified from the FY 2013 Program Reviews to receive a weight based on the dollar amount disbursement for each school as well as allowing for a better distribution of the school population by Program Review type.

The FY 2014 estimate was based on tests of the three components of the Direct Loan program: 1) Program Reviews conducted at a sample of schools for disbursements to students, 2) tests of loan consolidation overpayment and underpayment activity, and 3) tests of loan refund activity.

The first component was based on Program Reviews conducted by the Program Compliance – SESG at a sample of schools, as described in the Pell Grant section above. The estimate of improper payments made by schools to the students was calculated by the error rates of Direct Loan payments for 1,206 students sampled at 96 institutions where Program Reviews were conducted between October 2012 and September 2013. Based on this analysis, the Program Review component improper payment rate was 1.60 percent.

The second component was the loan consolidation improper payment estimate 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 2013 through June 2014 for a total sample size of 120. 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. Note that the sample selection methodology for loan consolidations was representative versus risk-based. Based on this analysis, the extrapolated loan consolidation component error rate was 0.20 percent at a 90 percent confidence level and 0.10 percent precision.

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. The calculation of the loan refunds improper payment estimate was computed by sampling 10 refunds, from the universe of all refund activity for each of the 12 months from July 2013 through June 2014 for a total sample size of 120. The sample selection was not risk-based, but rather representative-based. Based on this analysis, no improper payments were identified for the sample tested.

Direct Loan Sampling			
Payment Type	**Extrapolation Methodology**	**Number of Loans/ Grants Recipients**	**Number of Institutions**
Originations	Two-Stage	11,335,429	6,245
Refunds	PPS	288,030	N/A
Consolidation	PPS	553,663	N/A

The loan disbursement, consolidation, and refund rates were then applied to their representative FY 2014 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 come up with the overall Direct Loan improper payment rate of 1.50 percent, or $1,532 million.

FY 2014 Direct Loan Estimate Two-Stage Estimator								
Point Estimate of Improper Payment (in millions) (a)	Point Estimate (as % of Population Total)	Standard Error (in millions)	Precision (in millions)	Precision Rate (as % of Population Total)	Lower Confidence Limit (in millions)	Lower Limit (as % of Population Total)	Upper Confidence Limit (in millions)	Upper Limit (as % of Population Total)
$1,736.3	**1.50%**	**$122.0**	**$200.9**	**0.17%**	**$1.535.3**	**1.32%**	**$1,937.1**	**1.67%**

(a) The FY 2014 DL overpayment improper payment rate estimate is $1,491 million or 1.46% and the underpayment improper payment rate estimate is $41 million or 0.04%.

Similar to the Pell Grant Program, FSA also reviewed compliance audits as a supplemental estimate of improper payments for the Direct Loan program. Similar assumptions as the one made for the Pell Grant Program were made to guidelines of the sample methodology used in the General Assessment Program Reviews conducted by FSA, as sampling methodology and size is not reported in A-133 compliance audits. Findings related to improper payments were logged from a sample of 60 compliance audits and divided by an estimated sample value computed based on the assumed sample size and disbursement values. The resulting estimate was 0.40 percent.

FFEL Program

The improper payment estimate for the FFEL Program is composed of estimates of improper payments from the following activities: Special Allowance Payments (SAP), Interest Benefits (IB), conversions to repayments, deferments, and purchase sales and transfers to lenders, and reinsurance claims paid to Guaranty Agencies (GAs).

To encourage lenders to make student loans under the FFEL Program, the federal government guaranteed lenders a loan subsidy, referred to as SAP. This loan subsidy, which is tied to a financial market index, ensures that lenders receive, at a minimum, a statutorily specified rate of return on student loan investments. Negative SAP occurs when the special allowance formula results in a negative rate on a loan and the lender must remit the excess interest to the Department. Historically, SAP has been among the largest categories of payments to lenders and guarantors. However, the College Cost Reduction Act of 2007 reduced SAP rates which, combined with a historically low interest rate environment, resulted in a decrease in SAP payments and an increase in related collections (or Negative SAP).

In FY 2013, FSA reported an improper payment rate for the FFEL Program under the approved OMB methodology for FY 2013, as described in the FY 2013 AFR. For FY 2014, FSA refined the FY 2013 methodology to estimate the improper payment rate for the FFEL program by using additional Final Program Review Determinations (FPRDs) that were available.

In FY 2014, an estimated improper payment rate calculation was completed for the FFEL Program based on Program Reviews conducted by Program Compliance – Financial Institution Oversight Service (FIOS) Group for a sample of financial institutions holding or servicing commercially held FFEL loans. FSA developed an improper payment measurement for the FFEL program in FY 2014 that estimated improper payments based on transaction points posing the highest risk of improper payments, to include SAP and IB payments to lenders and reinsurance claim payments to GAs. The results from Program Reviews at nine servicers and fourteen GAs, where loan accounts were tested, were used to estimate improper payments for the FFEL program. Unserviced lenders were deemed not material to the overall population.

FFEL Sampling

Financial Institution Type	Extrapolation Methodology	Number of Loans/Grants Recipients	Number of Institutions
Lender/Servicers	Two-Stage	13,542,378	24
Guarantors	Two-Stage	595,886	34

The sample represents 354 loan accounts where SAP and IB were tested, and 223 reinsurance claims were used to estimate the improper payment rate for the FFEL program. Based on this analysis, the error rate was less than 0.001 percent, or $0.13.

FY 2014 FFEL Estimate
Two-Stage Estimator

Point Estimate of Improper Payment (in millions) (c)	Point Estimate (as % of Population Total)	Standard Error (in millions)	Precision (in millions)	Precision Rate (as % of Population Total)	Lower Confidence Limit (in millions)	Lower Limit (as % of Population Total)	Upper Confidence Limit (in millions)	Upper Limit (as % of Population Total)
(a)	**(b)**	**(a)**	**(a)**	**(b)**	**(a)**	**(b)**	**(a)**	**(b)**

(a) Value is less than $0.005
(b) Value is less than 0.0001%
(c) The FY 2014 FFEL overpayment improper payment rate estimate is less than $0.005MM, less than 0.0001%, and the underpayment improper payment rate estimate is $0.005MM, also less than 0.0001%.

Similar to the review of A-133 compliance audits used in the Pell Grant and Direct Loan estimate, supplemental estimates were calculated based on A-133 compliance audits. Findings related to improper payments were recorded from a sample of 10 compliance audits from for-profit FFEL servicers and GAs divided by an estimated sample value computed based on the assumed sample size and disbursement values. The resulting estimate was less than 0.01 percent.