



UNITED STATES DEPARTMENT OF EDUCATION

OFFICE OF THE INSPECTOR GENERAL

August 24, 2006

**CONTROL NUMBER
ED-OIG/A17F0011**

Lawrence Warder, Chief Financial Officer
Office of the Chief Financial Officer
United States Department of Education
Federal Building No. 6, Room 4E329
400 Maryland Avenue, SW
Washington, DC 20202

Dear Mr. Warder:

This **Final Audit Report**, entitled *Department of Education's (Department) Recovery Audit Efforts – Overpaid Interest Penalty*, presents the results of our audit. The objectives of our audit were to determine (1) the methodology used by the contractor to identify erroneous interest payments, (2) whether the identified exceptions were accurately assessed as overpayments, and (3) if the contractor delivered services as set forth in the contract. Our review covered fiscal years 2002-2004.

BACKGROUND

Section 831 of the Defense Authorization Act for Fiscal Year 2002 added a new subchapter to the U.S. Code (31 U.S.C. §§ 3561-3567) that requires agencies that enter into contracts with a total value in excess of \$500,000,000 in a fiscal year to carry out a cost-effective program for identifying errors made in paying contractors and for recovering amounts erroneously paid to the contractors. A required element of such a program is the use of recovery audits and recovery activities.

The Department obtained contract services from Connolly Consulting, Inc. (contractor) to audit the possibility of erroneous duplicate payments made to vendors. The results of this review identified only two duplicate payments totaling \$25,950. As a result of the low number and amount of duplicate payments found, the contractor refocused its efforts on overpaid interest penalties. As of July 2005, the contractor identified 184 vendors that were overpaid interest penalties by the Department totaling approximately \$269,094.

AUDIT RESULTS

Our audit revealed that the methodology used by the contractor in performing the recovery audit was not reliable in calculating interest penalties; the contractor did not correctly assess interest payments as overpayments or correctly calculate interest overpayments; and the contractor did not deliver all the services required by the contract.

In response to the draft audit report, the Office of the Chief Financial Officer (OCFO) concurred with the recommendations and provided a proposed corrective action plan to address each recommendation. The full text of OCFO's response is included as Attachment 1 to this audit report.

FINDING 1 - Contractor Inaccurately Calculated Interest Overpayments

The contractor inaccurately calculated interest overpayments for 13 of 22 invoices tested. Our testing identified three reasons why the contractor inaccurately calculated interest overpayments:

- The contractor did not examine supporting documents for any of the 22 invoices tested to establish the correct date the invoice was received, but relied on the data provided by the Department without validating its reliability. As a result, 8 of the 22 invoices tested had an incorrect receipt date.
- For 7 of the 22 invoices tested, the contractor calculated the interest penalty using the formula for simple interest in instances where the Prompt Payment Act called for compound interest.
- For 2 of the 22 invoices tested, the contractor did not take into account weekends and holidays when determining the invoice due date.

Consequently, the contractor overstated the recovery claims in the amount of \$1,400.46 for 7 of the 13 invoices; understated the recovery claims in the amount of \$4,034.42 for 3 of the 13 invoices; and erroneously recovered \$5,480 from vendors for 3 claims deemed to be overpayments when the Department paid the correct amount.

The Office of Management and Budget (OMB) Memorandum For Heads of Executive Departments and Agencies – M-03-07, *Programs to Identify and Recover Erroneous Payments to Contractors*, and the Statement of Objectives (SOO), state:

A Recovery Audit is a review and analysis of the agency's books, supporting documents, and other available information supporting its payments that is specifically designed to identify overpayments to contractors that are due to payment errors. It is not an audit in the traditional sense. Rather it is a control activity designated to assure the integrity of contract payments, and as such, it is a management function and responsibility.

The OMB Prompt Payment Final Rule, 5 C.F.R. Part 1315, specifies the rules for the Prompt Payment Act. The final rule provides that the received date for an invoice should be the “date a proper invoice is actually received by the designated agency office if the agency annotates the invoice with date of receipt at the time of receipt” or “the date placed on the invoice by the contractor, when the agency fails to annotate the invoice with date of receipt of the invoice at the time of receipt.” The applicable interest rate is that which is in effect on the day immediately following the due date.

The OMB Prompt Payment Final Rule, 5 C.F.R. Part 1315, provides that if a payment falls due on a weekend or holiday, payment may be made the following business day without accruing any interest.

5 C.F.R. § 1315.10 provides that interest will be compounded on a monthly basis for interest penalties that are unpaid after any 30-day period.

Recommendations

We recommend that the Chief Financial Officer:

- 1.1 Ensure that data used to support recovery auditing is accurate and reliable.
- 1.2 Ensure that the claims are verified as accurate before requesting recovery from vendors.
- 1.3 Require recovery audit contractors to review supporting documents, as described by OMB guidance, to ensure data validity.
- 1.4 Consider recouping fees paid to the contractor for claims that were erroneously collected.

OCFO Comments:

In response to the draft audit report, OCFO concurred with the recommendations and provided a proposed corrective action plan to address each recommendation. The full text of OCFO’s response is included as Attachment 1 to this audit report.

FINDING 2 – Lack of Effective Oversight of Recovery Audit Contract

The Department did not follow its own policy as it relates to contract monitoring. Specifically, the Department did not monitor the contract to the extent appropriate to provide assurance that the contractor performed the work called for in the contract; and did not develop a clear record of accountability for performance. The Department lacked written evaluations of the contractor’s monthly status reports and supporting evidence to determine the reliability of the reports. Finally, the Department was not aware that the contractor inaccurately calculated interest overpayments. The Department was unaware that the contractor had not performed in accordance with all aspects of the contract because the Contracting Officer’s Representative

(COR) assigned to the contract limited his monitoring oversight to processing the contractor's invoices and processing claims recovered from vendors.

The Department's *Administrative Communications System Departmental Directive OCFO: 2-108 Contract Monitoring For Program Officials* (Directive), dated September 16, 2004 states that the policy of the Department is to monitor every contract to the extent appropriate to provide assurance that the contractor performs the work called for in the contract; and to develop a clear record of accountability for performance. The Directive sets forth guidelines for the COR to monitor contracts through the use of performance reports in cases where reports may be required as deliverables. The Directive states the COR must make a written evaluation of each report and also from time to time should validate other monitoring efforts by obtaining supporting evidence to determine the reliability of the contractor's report.

Recommendations

We recommend that the Chief Financial Officer:

- 2.1 Ensure that Departmental policy is followed to monitor contracts to the extent appropriate to provide assurance that contractors perform work as called for in the contract.
- 2.2 Ensure development of an oversight plan as required by the Department's policies and procedures.
- 2.3 Develop a clear record of accountability for contract performance.

OCFO Comments:

In response to the draft audit report, OCFO concurred with the recommendations and provided a proposed corrective action plan to address each recommendation. The full text of OCFO's response is included as Attachment 1 to this audit report.

OBJECTIVES, SCOPE, AND METHODOLOGY

The objectives of our audit were to determine (1) the methodology used by the contractor to identify erroneous interest payments, (2) whether the identified exceptions of interest payments were accurately assessed as overpayments, and (3) if the contractor delivered services as set forth in the contract. To accomplish our objectives, we gained an understanding of the Department's recovery audit process. We reviewed the Prompt Payment Act, Federal Acquisition Regulation (FAR), OMB Memorandum 03-07, *Programs to Identify and Recover Erroneous Payments to Contractors* and applicable Departmental policies and procedures. We conducted interviews

with Office of the Chief Financial Officer/Contracts and Acquisition Management (OCFO/CAM) and Connolly Consulting, Inc. regarding the recovery audit process.

To achieve our objectives for reviewing claims to vendors, we relied, in part, on computer processed summary reports of overpaid interest penalty claims from the contractor's database, and details of claims by vendor. We verified the completeness of the data by comparing the detail and summary information to determine whether the total number of claims and the total dollar amounts agreed. The data provided contained 184 claims totaling \$269,094 that were related to 998 invoices. In addition, we verified the authenticity of the detailed claims to a data extract received from the Department for a prior audit.¹ Based on our assessment, we concluded that the data was sufficiently reliable for the purpose of our audit.

In selecting invoices to review, we obtained from the Department a list of claims to vendors for overpaid interest penalties. We also requested that the contractor provide us with the details of all claims made to vendors for the recovery of overpaid interest penalties for the fiscal years 2002-2004. In response to our request, the contractor provided data on 184 claims for overpaid interest penalty, totaling \$269,094 that were related to 998 invoices.

Using the detail claims, we tested a judgmental sample of 22 invoices totaling approximately \$14.6 million. We judgmentally selected a sample consisting of invoices paid under the immediate pay and net 30 categories, and outstanding recovery payment claims equal to or greater than \$1,000 to test whether the exceptions identified by the contractor were accurately assessed as overpayments. We traced sample items back to source documentation and recalculated interest payments using Treasury's on-line prompt payment calculator and found that 13 of the 22 sample items were in error for a total net over recovery of \$2,846. Because there is no assurance that the judgmental sample was representative of the entire universe, the results should not be projected over the unsampled claims.

As part of our review we gained an understanding of the internal control, policies and practices applicable to the Department's administration over recovery auditing.

Our audit focused on overpaid interest claims found as a result of the contractor's review of the Department's interest payments for fiscal years 2002-2004. We conducted fieldwork at the Department's offices located in Washington, DC, from August 23, 2005, through December 8, 2005. We held an exit conference with Department officials on March 13, 2006. We performed our audit in accordance with generally accepted government auditing standards appropriate to the scope of the review described above.

¹ Department of Education's Compliance with the Prompt Payment Act, ED-OIG/A17-E0008, September 2005.

ADMINISTRATIVE MATTERS

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. Department policy requires that you develop a proposed corrective action plan for our review in the automated system within 30 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.

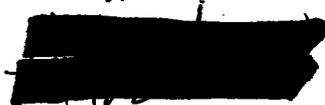
In accordance with the Inspector General Act of 1978, as amended, the Office of Inspector General (OIG) is required to report to Congress twice a year on the audits that remain unresolved after six months from the date of issuance.

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

In accordance with the Freedom of Information Act (5 U.S.C. § 552), reports issued by the OIG are available to members of the press and general public to the extent information contained therein is not subject to exemptions in the Act.

We appreciate the cooperation given us during this review. If you have any questions, please call Greg Spencer at (202) 245-6015. Please refer to the control number in all correspondence related to the report.

Sincerely,

A large black rectangular redaction box covers the signature of Helen Lew.

Helen Lew
Assistant Inspector General for Audit Service



UNITED STATES DEPARTMENT OF EDUCATION

OFFICE OF THE CHIEF FINANCIAL OFFICER

THE CHIEF FINANCIAL OFFICER

MAY 17 2006

MEMORANDUM

TO: Helen Lew
Assistant Inspector General for Audit

FROM: William McCabe [REDACTED]
Acting Chief Financial Officer

SUBJECT: **Draft Audit Report**
*Department of Education's (Department) Recovery Audit Efforts -
Overpaid Interest Penalty*
Control Number ED-OIG/A17F0011

I am pleased to have the opportunity to respond to the draft audit report entitled, *Department of Education's (Department) Recovery Audit Efforts - Overpaid Interest Penalty*. The Office of the Chief Financial Officer has no comment on the objectives, scope, methodology or findings in the report. We concur with the report's seven recommendations. Attached is the proposed Corrective Action Plan for implementing these recommendations.

If you have any questions regarding this response, please feel free to contact Glenn Perry at 202-245-6200.

Attachment: Proposed Corrective Action Plan

cc: Danny A. Harris, PhD
Deputy Chief Financial Officer

Glenn Perry
Director, Contracts and Acquisitions Management