UNITED STATES DEPARTMENT OF EDUCATION
OFFICE OF INSPECTOR GENERAL

AUDIT SERVICES

May 12, 2017

Control Number
ED-OIG/A04-Q0011

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Delegated to Perform the Functions and Duties of the Chief Financial Officer
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Dear Mr. Soltis and Mr. Hurt:

This final audit report, "U.S. Department of Education's Compliance with Improper Payment Reporting Requirements for Fiscal Year 2016," presents the results of our audit. The purpose of the audit was to (1) determine whether the U.S. Department of Education (Department) complied with the Improper Payments Elimination and Recovery Act of 2010 (IPERA); (2) evaluate the accuracy and completeness of the Department's improper payments reporting, estimates, and methodologies; (3) evaluate the Department's performance in reducing and recapturing improper payments; (4) evaluate the Department's assessment of the level of risk associated with the high-priority programs; and (5) review the oversight and financial controls described by the Department to identify and prevent improper payments. Our audit covered the Department's improper payment calculations, reporting, and performance in reducing and recapturing improper payments for the William D. Ford Federal Direct Loan (Direct Loan) program and the Federal Pell Grant (Pell) program from October 1, 2015, through September 30, 2016. The audit also covered the Department's corrective actions to reduce improper payments from October 1, 2013, through September 30, 2016.

BACKGROUND

The Improper Payments Elimination and Recovery Act and Programs Susceptible to Significant Improper Payments

The Improper Payments Elimination and Recovery Act of 2010 (Public Law 111-204), which amended the Improper Payments Information Act of 2002 (IPIA) (Public Law 107-300), requires Federal agencies to reduce improper payments and to report annually on their efforts. The Office of Management and Budget (OMB) issued government-wide guidance on the implementation of IPERA on October 20, 2014, which is contained in OMB Circular A-123, Appendix C.

IPERA requires each agency, in accordance with guidance prescribed by OMB, to periodically review all programs and activities that the agency administers and identify all programs and activities that may be susceptible to significant improper payments. Section 2(g)(2) of IPIA and OMB guidance defines an improper payment as any payment that should not have been made or that was made in an incorrect amount under statutory, contractual, administrative, or other legally applicable requirements. An improper payment also includes any payment that was made to an ineligible recipient or for an ineligible good or service, or payments for goods or services not received. OMB guidance expands the definition of an improper payment to include any payment lacking sufficient documentation. Significant improper payments are defined as gross annual improper payments (the total amount of overpayments plus underpayments) in the program exceeding (1) both 1.5 percent of program outlays and $10 million of all program or activity payments made during the fiscal year reported, or (2) $100 million (regardless of the improper payment percentage of total program outlays). For each program and activity identified as susceptible to significant improper payments, the agency is required to produce a statistically valid estimate, or an estimate that is otherwise appropriate using a methodology that OMB approved, of the improper payments made by each program and activity and include those estimates in the accompanying materials to the agency's annual financial reports.

IPERA also requires each agency's Inspector General to determine the agency's compliance with the statute for each fiscal year. As specified in the OMB guidance, compliance with IPERA means that the agency has met all six of the following requirements:

- published a Performance and Accountability Report or Agency Financial Report (AFR) for the most recent fiscal year and posted that report and any accompanying materials required by OMB on the agency's website;

- conducted a program-specific risk assessment for each program or activity that conforms with IPIA (if required);

- published improper payment estimates for all programs and activities identified as susceptible to significant improper payments under its risk assessments (if required);

- published programmatic corrective action plans in the Performance and Accountability Report or AFR (if required);

- published, and met, annual reduction targets for each program assessed to be at risk and measured for improper payments; and

- reported a gross improper payment rate of less than 10 percent for each program and activity for which an improper payment estimate was obtained and published in the Performance and Accountability Report or AFR.

If an agency does not meet one or more of these requirements, then it is not compliant with IPERA.

As part of the Inspector General's review of the agency's compliance with IPERA, the Inspector General should also evaluate the accuracy and completeness of the agency's reporting and performance in reducing and recapturing improper payments.

The Improper Payments Elimination and Recovery Improvement Act and High-Priority Programs

The Improper Payments Elimination and Recovery Improvement Act of 2012 (IPERIA) (Public Law 112-248), requires the Director of OMB to identify a list of high-priority programs for greater levels of oversight.[1] OMB has designated the Direct Loan and Pell programs as high-priority programs. OMB issued government-wide guidance on the implementation of IPERIA on October 20, 2014, which is contained in OMB Circular A-123, Appendix C. The OMB-established threshold for high-priority program determinations for fiscal year (FY) 2015 reporting, and for subsequent years, is $750 million in estimated improper payments as reported in an agency's AFR or Performance and Accountability Report, regardless of the improper payment rate estimate. IPERIA and OMB guidance require each agency with a high-priority program to report to its Inspector General and make available to the public, (1) any action that the agency has taken or plans to take to recover improper payments and (2) any action the agency intends to take to prevent future improper payments. According to IPERIA and OMB guidance, the agency Inspector General must review the assessment of the level of risk associated with any high-priority program and the quality of the improper payment estimates and methodology; determine the extent of oversight warranted; and provide recommendations, if any, for modifying the agency's methodology, promoting continued program access and participation, or maintaining adequate internal controls.

AUDIT RESULTS

We found that the Department did not comply with IPERA for FY 2016 because it did not meet two of IPERA's six compliance requirements. First, the Department reported improper payment rates for the Direct Loan and Pell programs that did not meet the FY 2016 reduction targets it established in its FY 2015 AFR. Second, the Department's risk assessments for its grant programs managed by offices

[1] IPERIA codifies the requirements from Executive Order 13520, "Reducing Improper Payments," issued November 20, 2009. OMB Circular A-123, Appendix C implements these requirements.

other than Federal Student Aid (FSA)[2] and contracting activities managed by FSA did not conform to Section 2(a) of the IPIA[3] and with OMB guidance. However, the qualitative risk assessment for contracts managed by the Department did conform with IPIA and OMB guidance. Under IPERA, if the Department does not meet one or more of the six compliance requirements, then it is not compliant with IPERA. This is the third consecutive year the Department did not comply with IPERA.

The Department met the remaining four IPERA compliance requirements, as described below.

1. **Published an AFR.** The Department complied with the requirement to publish an AFR. Under Section 3(a)(3)(A) of IPERA, the Department is required to publish on its website its AFR and any accompanying materials required under OMB guidance. The Department published its AFR, "FY 2016 Improper Payment Estimation Methodologies," and its accompanying materials on November 14, 2016.

2. **Published Improper Payment Estimates.** The Department complied with the requirement to publish improper payment estimates. Under Section 3(a)(3)(C) of IPERA, if required, an agency must publish improper payment estimates for programs it identified as being susceptible to significant improper payments. As required, the Department published improper payment estimates for programs it identified as susceptible to significant improper payments—the Direct Loan and Pell programs.

3. **Published Report on Actions to Reduce Improper Payments (Corrective Action Plans).** The Department complied with the requirement to report on its actions to reduce improper payments in programs susceptible to significant improper payments: the Direct Loan and Pell programs. Under Section 3(a)(3)(D) of IPERA, the Department is required to report on its actions to reduce improper payments for programs it deemed susceptible to significant improper payments. The Department's FY 2014 Report on IPERA Payment Recapture Audits submitted to OMB indicated that analysis showed conducting payment recapture audits for grants, contracts, and the Title IV programs would not be cost-effective. On September 21, 2015, OMB approved the Department's analysis.

4. **Reported Improper Payment Rate of Less Than 10 Percent.** The Department complied with the requirement to report improper payment rates of less than 10 percent for all applicable programs. Under Section 3(a)(3)(F) of IPERA, the Department is required to report estimated improper payment rates of less than 10 percent for each program identified as being susceptible to significant improper payments for which an improper payment estimate is published. The Department reported estimated improper payment rates of 3.98 percent for the Direct Loan program and 7.85 percent for the Pell program.

[2] These are grant programs managed by offices such as the Office of Elementary and Secondary Education, the Office of Innovation and Improvement, the Office of Special Education and Rehabilitative Services, and the Office of Postsecondary Education. Throughout the report, we will refer to these as "Department-managed programs." The Department's Office of the Chief Financial Officer (OCFO) performed a quantitative analysis on FYs 2013, 2014, and 2015 grant programs.
[3] The Improper Payments Information Act of 2002 (Public Law 107-300) was amended by the Improper Payments Elimination and Recovery Act of 2010 (Public Law 111-204) and the Improper Payments Elimination and Recovery Improvement Act of 2012 (Public Law 112-248).

We found that the Department's improper payment reporting, estimates, and methodologies were generally accurate and complete; however, we identified issues in all three areas. The Department needs to improve its policies and procedures over the Direct Loan and Pell programs' improper payment estimates. Specifically, from our judgmental sample of 46 of 415 program reviews included in the Direct Loan and/or Pell program improper payment calculations, we found errors with how the Department included the results of five program reviews in the improper payment calculations.[4] Specifically, for three program reviews, the objective of the review would not identify Direct Loan or Pell program improper payments, and for two program reviews, incorrect amounts were entered into the spreadsheets used to calculate the Direct Loan and Pell programs' improper payment estimates. However, we concluded that correcting for these two errors for the Direct Loan and Pell programs would have increased the FY 2016 improper payment rates by only 0.17 and 0.42 percent, respectively.[5] We also selected and tested a judgmental sample of 15 of 462 program reviews that the Department excluded from both the Direct Loan and Pell programs' improper payment calculations. We found that the Department properly excluded these program reviews from the calculations.

We also found the Department needs to clarify its methodologies for estimating improper payments. Specifically, the methodologies are not explicit regarding improper payments that are applicable to one award year that were identified through a sample of recipients drawn from another award year. For one program review, the Department calculated a 100 percent improper payment rate for the Direct Loan program for one school for the 2013–2014 award year. The rate was based on 3 of 19 sampled recipients from the 2012–2013 award year. It was not based on an actual sample of 2013–2014 award year recipients; therefore, it could overstate estimated improper payment rates.

We found two instances where the Department's improper payment reporting details in its FY 2016 AFR were incomplete or unsupported. First, the Department's FY 2016 AFR did not include all information for reporting improper payment corrective actions. Specifically, the Department did not report the results of four of the five implemented corrective actions for which it was required to report results.[6] Second, the Department's FY 2016 AFR contained unsupported information regarding improper payments related to contracts. Specifically, the Department reported that it "continues to experience an extremely low volume of improper payments in contracts." However, according to the Department's Office of the Chief Financial Officer (OCFO) Director of the Internal Controls Operations Group, the Department did not provide information on the amount of improper payments related to FSA-managed and Department-managed contracts due to system constraints.

Based on our review of the Department's performance in reducing and recapturing improper payments, we found that the Department recaptured more improper payments for FY 2016 ($20.35 million) than it did in FY 2015 ($14.69 million). In addition, the Department implemented corrective actions that could reduce improper payments for the Direct Loan and Pell programs. For example, the Department enhanced verification procedures to require schools to verify specific information that selected applicants

[4] We did not perform the same level of testing on all 46 program reviews. See the "Objectives, Scope, and Methodology" section of this document for testing details.

[5] We recalculated the improper payment rates correcting for errors described in this report and found the rate for the Direct Loan program would increase by 0.17 percent or $165 million (based on outlays of $97,182.77 million) and the rate for the Pell program would increase by 0.42 percent or $118 million (based on outlays of $28,188.55 million).

[6] From a population of 12 corrective actions, we sampled 8. Of the eight corrective actions sampled, we found that the Department had implemented five in fiscal years before 2016; therefore, the Department was required to report the results for those five implemented corrective actions.

reported on the Free Application for Federal Student Aid (FAFSA). The Department uses data-based statistical analysis to select for verification FAFSA applicants with the highest probability of error and the impact of such error on award amounts.

Based on our review of the Department's risk assessment performed in FY 2014, we found that the Department adequately assessed improper payment risks associated with its two high-priority programs: Direct Loan and Pell.

We also found that the Department adequately described its oversight and financial controls to identify and prevent improper payments. Specifically, FSA has an Improper Payment Working Group that informs decisions related to improper payment requirements, estimation, and controls; FSA's School Eligibility Service Group conducts program reviews to help identify improper payments; and FSA annually conducts a risk assessment that evaluates its financial controls.

In its response to the draft results, the Department partially concurred with Finding 1. Specifically, the Department agreed that it did not comply with IPERA because it did not meet established reduction targets and did not document how all nine required risk factors were considered as part of the risk assessments. However, the Department did not agree that its risk assessment indicated that the Rehabilitation Services Administration-Vocational Rehabilitation State Grants program is susceptible to significant improper payments. The Department concurred with three of the five recommendations associated with Finding 1, partially concurred with one, and did not concur with one.

The Department did not concur with Finding 2. The Department disagreed that the results of our judgmental sample of program reviews support the conclusion that the improper payment estimates are inaccurate or rise to the level of a finding. However, the Department acknowledged the two errors and agreed the estimation methodology can be updated and it is taking action to resolve the issues. Although the Department did not state whether it concurred that its reporting of corrective actions was incomplete, the Department did state that it "may improve its reporting of the results of actions taken to address [the] root causes as required by A-136." Also, the Department agreed that it can improve its reporting with regard to improper payments in contracting. The Department concurred with all five recommendations associated with Finding 2.

The Department's comments are summarized at the end of each finding. We made revisions to Finding 2 as a result of the Department's comments. The full text of the Department's response is included as Attachment 2 to this report.

FINDING NO. 1 – The Department Did Not Comply With IPERA Because it Did Not Meet Two of the Six Compliance Requirements

The Department did not comply with IPERA because the improper payment rates did not meet the reduction targets for the Direct Loan and Pell programs, and the Department's risk assessments for its Department-managed grant programs and its FSA-managed contracting activities did not conform with Section 2(a) of IPIA and with OMB guidance.

Reduction Targets

The Department reported improper payment rates for the Direct Loan and Pell programs that did not meet the FY 2016 reduction targets established in its FY 2015 AFR. The improper payment rate for the Pell program was 7.85 percent, which exceeded the reduction target of 1.87 percent. The improper payment rate for the Direct Loan program was 3.98 percent, which exceeded the reduction target of 1.29 percent. Under Section 3(a)(3)(E) of IPERA, an agency is required to report and meet improper payment reduction targets for programs identified as susceptible to significant improper payments. The FY 2016 reduction targets and the reported improper payment rates for the Direct Loan and Pell programs are shown in Table 1 below.

Table 1. FY 2016 Reduction Targets and Reported Improper Payment Rates

Program	FY 2016 Improper Payment Reduction Target Established in FY 2015 AFR (Percent)	FY 2016 Estimated Improper Payment Rate Reported in FY 2016 AFR (Percent)	Reduction Target Met?
Direct Loan	1.29	3.98	No
Pell Grant	1.87	7.85	No

In its FY 2016 AFR, the Department stated that the failure to meet the reduction targets was due to changes to and the imprecision of the estimation methodologies and was not due to a control failure or increase in actual improper payments in the Direct Loan and Pell programs.

This is the Department's third consecutive year of not meeting its reduction target for the Direct Loan program and its first year of not meeting its reduction target for the Pell program.

Rehabilitation Services Administration-Vocational Rehabilitation State Grants Risk Assessment

The Department's risk assessment for its Rehabilitation Services Administration-Vocational Rehabilitation State Grants (VR) program did not conform with Section 2(a) of IPIA and OMB guidance; as a result, the Department did not comply with IPERA. Under Section 3(a)(3)(B) of IPERA, an agency is required to conduct a program-specific risk assessment for each program or activity that conforms with section 2(a) of IPIA. According to IPIA and OMB Circular A-123, Appendix C, if improper payments in a program may have exceeded (i) $10 million of all program payments made during the fiscal year reported and 1.5 percent of program outlays or (ii) $100,000,000, the program may be susceptible to significant improper payments.

OMB Circular A-136 specifies that in its AFR, an agency must clearly identify the risk-susceptible programs (based on the statutory thresholds listed in OMB Circular A-123, Appendix C) and, for newly identified risk-susceptible programs, the agency must indicate the fiscal year in which it will report an improper payment rate and amount. OMB Circular A-123, Appendix C states that the rate and amount of improper payments for newly identified risk-susceptible programs should be reported in the fiscal year following the year in which the agency conducted the risk assessment. The Department's risk

assessment showed that the Department conducted a quantitative assessment of the VR program, and the program exceeded the statutory thresholds for risk-susceptible programs. However, the Department did not identify and report the VR program in its FY 2016 AFR as a program that may be susceptible to significant improper payments.

During FY 2016, the Department's OCFO Internal Controls Operations Group conducted an improper payment risk assessment of grant programs managed by Department offices such as the Office of Elementary and Secondary Education, the Office of Innovation and Improvement, the Office of Special Education and Rehabilitative Services, and the Office of Postsecondary Education. The Department-designed risk assessment used questioned costs identified in single audits[7] and the Office of Inspector General (OIG) audits for FYs 2013, 2014, and 2015. As stated in the OCFO's Improper Payment Risk Assessment FY 2016 White Paper,[8] the Department relied on questioned cost data in audits as a proxy to assess the risk of improper payments. The Department identified the VR program as the only program with single audit findings that identified annual questioned costs exceeding $10 million and 1.5 percent of program outlays for any of the three fiscals years reviewed. In fact, the single audits identified questioned costs for the VR program ranging from $31.1 million through $44.6 million, which are between 1.56 percent and 1.81 percent of program outlays for FYs 2013, 2014, and 2015. However, the Department did not conclude the VR program may be susceptible to significant improper payments and did not report the program as such in its FY 2016 AFR. The Department's questioned cost details for the VR program are shown in Table 2.

Table 2. Improper Payments for VR Program Grants to States as Identified in Single Audits

Fiscal Year	Questioned Costs	Expenditures	Percent of Program Expenditures	Exceeds Thresholds?
2015	$31,107,007	$1,992,940,190	1.56	Yes
2014	$38,790,819	$2,483,493,659	1.56	Yes
2013	$44,552,130	$2,459,732,946	1.81	Yes

According to OCFO's Improper Payment Risk Assessment FY 2016 White Paper, the Department's OCFO did not consider the VR program to be a program susceptible to significant improper payments because "(1) most of the grant program's questioned costs were related to a single auditee which had a history of unresolved questioned costs, (2) questioned costs of this type are rarely sustained through the audit resolution process, and (3) the program exceeded the 1.5 percent threshold by only a small margin." In addition, the Department OCFO's Director of the Internal Controls Operations Group stated that the questioned costs for the VR program identified in FYs 2013, 2014, and 2015 single audits are just a proxy for improper payments and that the Department is not able to determine whether these questioned costs really exist until these single audits are resolved.

[7] A single audit of a non-Federal entity that spends $750,000 or more of Federal funds in a year combines the annual financial statement audit with compliance audit coverage of federal funds. The single audit is intended to meet the basic audit needs of both the non-Federal entity and Federal awarding agencies.

[8] The Department reported in its Improper Payment Risk Assessment FY 2016 White Paper the risk assessment results of grant programs and contracting activities managed by Department offices other than FSA.

The Department omits important facts in its justification for not identifying and reporting the VR program as susceptible to significant improper payments. First, the questioned costs are related to two auditees, not one auditee. Second, while the audit resolution process may not have sustained the VR program questioned costs for FY 2013, it fully sustained the questioned costs for FY 2014. Sustained questioned costs from audits are payments that are not sufficiently documented or should not have been made. Under IPIA and OMB guidance, payments that should not have been made and payments that are not sufficiently documented are improper payments. The questioned costs for FY 2015 pertain to a different State auditee with different audit findings that had not been resolved as of November 14, 2016, when the Department published its FY 2016 AFR.[9] As a result, the Department could not assume that the FY 2015 questioned costs would not be sustained. Third, under IPIA and OMB guidance, programs with improper payments exceeding the thresholds ($10 million and 1.5 percent of program outlays) are to be identified as risk-susceptible programs; the law and guidance do not exclude programs that exceed the thresholds by only a small margin. Fourth, as discussed below, questioned costs are an appropriate component of an improper payments risk assessment or calculation.

In explaining why the VR program was not a program that may be susceptible to significant improper payments, the Director of the Internal Controls Operations Group for the Department's OCFO stated that not all questioned costs identified in audits are improper payments and will be sustained in audit resolution. We disagree that questioned costs identified in audits, whether sustained or not sustained, cannot be used to assess the risk of significant improper payments in a program. First, the definitions of improper payments and questioned costs are similar. OMB guidance defines an improper payment as any payment that should not have been made or that was made in an incorrect amount under statutory, contractual, administrative, or other legally applicable requirements. An improper payment also includes any payment that was made to an ineligible recipient or for an ineligible good or service, or payments for goods or services not received. In addition, under OMB guidance, when an agency is unable to discern whether a payment was proper as a result of insufficient or lack of documentation, this payment must also be considered an improper payment. The Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards (Uniform Requirements for Federal Awards) (Title 2 Code of Federal Regulations Section 200.84, January 1, 2016, edition) states, "Questioned cost means a cost that is questioned by the auditor because of an audit finding: (a) which resulted from a violation or possible violation of a statute, regulation, or the terms and conditions of a Federal award, including for funds used to match Federal funds; (b) where the costs, at the time of the audit, are not supported by adequate documentation; or (c) where the costs incurred appear unreasonable and do not reflect the actions a prudent person would take in the circumstances." The significant questioned costs for FY 2013 and FY 2014 were associated with personnel costs charged to the VR program that were not adequately supported. Second, in prior years, the Department estimated improper payments using questioned costs identified in audit reports, and FSA currently estimates improper payments using questioned costs in program reviews. Third, because of the time it takes the Department to resolve audits, it is not practical to wait for audit resolution before using sustained questioned costs for improper payment estimates.

The Department's quantitative risk assessment results showed the VR program may be susceptible to significant improper payments, but the Department did not report it in the AFR. As a result, the Department's risk assessment did not conform with Section 2(a) of IPIA and with OMB guidance.

[9] As of May 11, 2017, the audit has not been resolved.

Under Section 3(a)(3)(B) of IPERA, an agency is required to conduct a program-specific risk assessment for each program or activity that conforms with Section 2(a) of IPIA. Under the IPIA and OMB guidance, agencies perform risk assessments to identify programs that may be susceptible to significant improper payments. Section 2(a)(1) of IPIA requires agencies to identify all programs and activities that may be susceptible to significant improper payments, and whether improper payments may have exceeded certain statutory thresholds. OMB Circular A-136 requires an agency to identify in its AFR all risk-susceptible programs whether or not an improper payment estimate is reported. In addition, OMB Circular A-123, Appendix C specifies that an agency shall prepare an improper payment estimate for programs identified as susceptible to significant improper payments in the fiscal year following the fiscal year in which the risk assessment was performed.

The Department Did Not Consider Certain Required Factors in its Risk Assessments

The Department did not conduct improper payment risk assessments that conformed with Section 2(a) of IPIA or OMB guidance to determine whether Department-managed grant programs and FSA-managed contracting activities were susceptible to significant improper payments. As a result, the Department did not comply with IPERA. Under Section 3(a)(3)(B) of IPERA, an agency is required to conduct a program specific risk assessment for each program or activity that conforms with Section 2(a) of IPIA. The statute and OMB guidance together require agencies to consider a minimum of nine risk factors in their risk assessments. For the Department-managed grant programs, the Department did not consider two of the nine risk factors. For the FSA-managed contracting activities, the Department did not consider seven of the nine risk factors. FSA-managed contracting activities accounted for $1.88 billion (76 percent) of the Department's $2.46 billion in active contracts for FY 2016. Table 3 lists the nine improper payment risk factors required by statute and OMB guidance and whether the Department considered the risk factor when conducting risk assessments. Because the Department excluded seven of the nine risk factors in its risk assessment, the risk assessment did not conform with Section 2(a) of IPIA and OMB guidance. The risk assessments for Department-managed grant programs also did not conform to Section 2(a) of IPIA or OMB guidance; as a result, the Department failed to comply with IPERA. However, we found that the Department's conclusion that these grant programs, with the exception of the VR program, were not susceptible to significant improper payments was appropriate because (1) the Department's quantitative risk assessments showed that none of these grant programs had questioned costs that exceeded the thresholds for programs that may be susceptible to significant improper payments, and (2) the two risk factors not considered by the Department likely would not identify additional questioned costs or improper payments.

Table 3. Improper Payment Risk Factors

Risk Factor Number	OMB Circular A-123 Appendix C Required Risk Factor	Considered for Department-Managed Grants?	Considered for FSA-Managed Contracting Activities?
1	Whether the program or activity reviewed is new to the agency	Yes	No
2	The complexity of the program or activity reviewed, particularly with respect to determining correct payment amounts	No	No
3	Volume of payments made annually	Yes	Yes
4	Whether payments or payment eligibility decisions are made outside of the agency, for example, by a State or local government, or a regional Federal office	Yes	No
5	Recent major changes in program funding, authorities, practices, or procedures	Yes	No
6	The level, experience, and quality of training for personnel responsible for making program eligibility determinations or certifying that payments are accurate	Yes	No
7	Significant deficiencies in the audit reports of the agency including, but not limited to, the agency Inspector General or the Government Accountability Office audit report findings, or other relevant management findings that might hinder accurate payment certification	Yes	No
8	Inherent risks of improper payments due to the nature of agency programs or operations	No	No
9	Results from prior improper payment work	Yes	Yes

Risk factors 1 through 7 are included in Section 2(a) of IPIA and in OMB guidance, while risk factors 8 and 9 appear only in the OMB guidance.

The Improper Payment Risk Assessment FY 2016 White Paper describes the process the Department used in performing the risk assessments of the Department-managed grant programs. As part of this process, the Department reviewed improper payments identified in single audits and the OIG audit findings. The Department also performed risk assessments of Department-managed grant programs under OMB Circular A-123, Appendix A. The purpose of those risk assessments was to identify risks relevant to financial reporting; the purpose was not to determine whether a program or activity was susceptible to significant improper payments.

OCFO's Director of Internal Control Operations Group stated that in conducting the Department's risk assessment of FSA-managed contracting activities, it used results from the FY 2012 report regarding IPERA Payment Recapture Audits. The Director also stated that the Department planned to identify contract funds returned to the Department in FY 2016, which would have included both Department and FSA-managed contracting activities, but detailed contract overpayment data were not available. The Director stated that the Department was unable to identify contract overpayments due to system constraints.

This is the first year that the Department did not meet its reduction target for the Pell program. This is also the first year that the Department's risk assessments for Department-managed grant programs and FSA-managed contracting activities did not conform with Section 2(a) of IPIA and OMB guidance. Under Section 3(c)(1) of IPERA and OMB Circular A-123, Appendix C, if the Inspector General determines that an agency did not comply with IPERA for one fiscal year, the agency must submit a remediation plan to Congress and OMB within 90 days of the Inspector General's determination describing the actions that the agency will take to come into compliance for each program or activity. The remediation plan must also include measureable milestones, designate a senior official accountable for bringing the agency into compliance for each program or activity, and establish an accountability mechanism for the person designated to lead the efforts to bring the agency into compliance for each program.

This is the third consecutive year that the Department did not meet its reduction target for the Direct Loan program. Under OMB Circular A-123, Appendix C, if the Inspector General determines that an agency did not comply with IPERA for 3 or more consecutive fiscal years, the agency must submit to Congress within 30 days of the Inspector General's determination proposed statutory changes necessary to bring the program into compliance.

Furthermore, OMB may require agencies that do not comply with IPERA (for one, two, or three years in a row) to complete additional requirements beyond the measures listed in the guidance. For example, if a program does not comply with the law, OMB may determine that the agency must reevaluate or reprioritize its corrective actions, intensify and expand existing corrective action plans, or implement or pilot new tools and methods to prevent improper payments. OMB will notify agencies of additional required actions as needed.

RECOMMENDATIONS

We recommend that the Chief Financial Officer for the Department, in conjunction with the Chief Financial Officer for FSA—

1.1 Submit to Congress and OMB a plan describing actions the Department will take to bring the Pell program into compliance. The plan should also describe actions it will take to ensure that its risk assessments for the Department-managed grant programs and FSA-managed contract activities conform with Section 2(a) of IPIA and with applicable OMB guidance.

1.2 Submit to Congress proposed statutory changes necessary to bring the Direct Loan program into compliance.

1.3 Identify the VR program in the FY 2017 AFR as a program that may be susceptible to significant improper payments, produce and report a valid improper payment estimate for the program, identify its root causes, and implement corrective actions to reduce improper payments in the program.

1.4 Ensure that risk assessments conform with Section 2(a) of IPIA and OMB guidance when determining whether programs may be susceptible to significant improper payments. Specifically, develop improper payment risk assessment models that include all nine required risk factors and other factors, if appropriate, and identify all programs that may be susceptible to significant improper payments.

1.5 As required by OMB guidance, take any additional steps that OMB may recommend to the Department to assist it with becoming compliant with IPERA.

Department Comments

The Department partially concurred with the finding. The Department agreed that it did not meet reduction targets for the Direct Loan and Pell Grant programs and did not document how all nine risk factors were considered as part of the risk assessments for FSA-managed contracts and Department-managed grant programs. However, the Department did not concur that the risk assessment indicated that the VR program is a program that may be susceptible to significant improper payments and should be reported in its AFR. The Department stated that it appears from the finding that the OIG concluded that all questioned costs in single audits must always be treated as improper payments for the purpose of performing risk assessments of grant programs. The Department stated that the use of questioned costs as the sole proxy for improper payments is flawed. The significant reasons cited by the Department are that questioned costs may not be sustained and historically are often not; and that the Uniform Requirements for Federal Awards does not define questioned costs as improper payments.

The Department concurred with Recommendations 1.1, 1.2, and 1.5, partially concurred with Recommendation 1.4, and did not concur with Recommendation 1.3 for the reasons it noted above.

OIG Response

We did not conclude that all questioned costs in single audits must always be treated as improper payments for the purpose of performing risk assessments of grant programs. We also did not conclude the VR program "is" a program susceptible to significant improper payments. Our finding was based on the fact that the Department's quantitative risk assessment of its grant programs relied on questioned costs in single audits as a proxy for improper payments. We concluded the results showed the VR program "may be" susceptible to significant improper payments. While the Department, after the fact, debates the value of using questioned costs as a proxy for improper payments, it was the Department's decision to do so. Therefore, based on the results of that risk assessment, the Department should have reported in its AFR that the VR program may be susceptible to significant improper payments. Because it did not report these results, the Department did not comply with IPERA.

For the VR program, three single audits identified questioned costs that each exceeded thresholds. While the questioned costs identified in the single audit for FY 2013 were not sustained, the questioned costs identified in the single audit for FY 2014 were sustained but the Department chose not to recover them. The FY 2015 single audit is open for resolution and the Department cannot assume that the questioned costs will not be sustained. As noted on page 9, the definition of improper payments under IPIA and OMB guidance, and the definition of questioned costs under the Uniform Requirements for Federal Awards are similar. Questioned costs are an appropriate component of an improper payment risk assessment. In fact, the Department has used questioned costs from audits in its risk assessments for other Department-managed grant programs including Title I, and uses questioned costs from program reviews in its estimates of improper payments for the Direct Loan and Pell programs.

FINDING NO. 2 – The Department Needs to Improve Its Policies and Procedures Over Improper Payment Calculations and the Completeness of its Reporting

We found that the Department's improper payment reporting, estimates, and methodologies were generally accurate and complete; however, we identified issues in all three areas. The Department needs to improve (1) its policies and procedures over the Direct Loan and Pell programs' improper payment calculations, (2) the completeness of its improper payment corrective action reporting, and (3) the evidence or support for its AFR reporting. We tested a judgmental sample of 46 of 415 program reviews included in the Direct Loan and/or Pell program improper payment calculations. We designed our sample to focus on program reviews at greater risk for erroneous inclusion into the improper payment calculations or program reviews having characteristics related to changes introduced by the FY 2016 estimation methodology. Because the sample was judgmental, the results described pertain only to the selected reviews. We found errors with how the Department included the results of five program reviews in the improper payment calculations.[10] In addition, we found the Department needs to clarify its methodologies for estimating improper payments. Specifically, the methodologies are not explicit regarding improper payments that are applicable to one award year that were identified through a sample of recipients drawn from another award year. For one program review, the Department calculated a 100 percent improper payment rate for the Direct Loan program for one school for the 2013–2014 award year. The rate was based on 3 of 19 sampled recipients from the 2012–2013 award year. It was not based on an actual sample of 2013–2014 award year recipients; therefore, it could overstate estimated improper payment rates.

We found two instances where the Department's improper payment reporting details in its FY 2016 AFR were not complete or supported. First, the corrective actions section of the Department's FY 2016 AFR was incomplete because the Department did not report the results of four of the five corrective actions it implemented. Second, the Department reported that it "continues to experience an extremely low volume of improper payments in contracts." However, this statement was unsupported because the Department was not able to determine the amount of improper payments related to FSA-managed and Department-managed contracts.

Improper Payment Calculations

The Department needs to improve its policies and procedures over the improper payment calculations for the Direct Loan and Pell programs. The Department's improper payment calculations were based, in

[10] We did not perform the same level of testing on all 46 program reviews. See "Objectives, Scope, and Methodology" for testing details.

part, on improper payments identified in program reviews of schools for the 2013–2014 award year. FSA's School Eligibility Service Group conducted the program reviews during FYs 2014, 2015, and 2016. Program reviews can report on improper payments that are identified at the student level (specific to a sampled student), at the program level (specific to a program offered by a school), or at the school level (applicable to the entire school).

The improper payment estimate for the Direct Loan program was based on three components. The first component consisted of the results of 404 program reviews of schools that the School Eligibility Service Group conducted during FYs 2014, 2015, and 2016, which included the testing of $45,148,328 of disbursements made to 6,968 students for the 2013–2014 award year. The Department reported that during the 2013–2014 award year, 5,876 schools participated in the Direct Loan program and loans were disbursed to 10.1 million borrowers. The second component consisted of testing a sample of 120 Direct Loan consolidations overpayments and underpayments (from a universe of 376,357) totaling $2,141,208 to determine which of them were improper payments.[11] The third component consisted of testing a sample of 120 Direct Loan refund payments (from a universe of 404,009) totaling $2,649,026 to determine which of them were improper payments. The samples for the second and third components were drawn from payments made from July 2015 through June 2016. The Department then combined the estimated improper payment totals for all three components to estimate an overall improper payment rate for the Direct Loan program.[12]

For the Pell program, the methodology specified that the improper payment estimate was based on two components. The first component consisted of the results of 396 program reviews of schools that the School Eligibility Service Group conducted during FYs 2014, 2015, and 2016, which included the testing of $15,559,295 of Pell program disbursements made to 6,782 students for the 2013–2014 award year. The Department reported that during the 2013–2014 award year, 5,435 schools participated in the Pell program and grants were disbursed to 8.7 million recipients. The second component consisted of the results of the FAFSA/Internal Revenue Service (IRS) Data Statistical Study, which focuses on misreported income on the FAFSA. An improper overpayment rate of 2.01 percent and an improper underpayment rate of 1.25 percent, both due to misreported income, were applied to certain Pell disbursements that were included in the Pell program improper payment calculations. The Department then combined the estimated improper payments for both components to estimate an overall improper payment rate for the Pell program.

We selected and performed tests on a judgmental sample of 46 of 415 program reviews that the Department included in its Direct Loan and/or Pell programs improper payment calculations. We found two errors with how the Department included the results of five program reviews in the improper payment calculations. Specifically, (1) for three program reviews, the objective of the program review would not identify Direct Loan or Pell program improper payments; and (2) for two programs reviews, incorrect disbursement amounts or an improper payment amount were entered into the improper payment calculations.

[11] The Direct Loan consolidation universes include potential overpayments and underpayments. The sampled payments were tested to determine which were actual improper payments.
[12] The program reviews account for 90.4 percent of the total disbursements used to estimate the Direct Loan program improper payment rate, while the Direct Loan consolidations and refunds account for a combined 9.6 percent.

Of the three program reviews that would not identify Direct Loan or Pell program improper payments, two focused on the establishment of a bank branch on a school's campus; the other program review focused on a school's cohort default rate appeal. None of the three program reviews tested Direct Loan and Pell program disbursements; therefore, the program reviews would not identify improper payments and should not have been included. As a result of including these reviews in its improper payment calculations, the Department overstated disbursement amounts for both the Direct Loan and Pell program, thereby introducing errors into its improper payment calculations.

For one of the other two program reviews erroneously included in the improper payment calculations, the incorrect disbursement amounts were included in both the Direct Loan and Pell programs' improper payment calculations. Specifically, the Department included in the calculations the disbursement amounts for the school's main campus instead of the additional campus for which the program review was conducted. For the other program review, an incorrect improper payment amount was entered into the Direct Loan program calculation. For this review, instead of including in the calculation the actual improper payment amount identified in the program review, the Department entered the amount of the estimated loss[13] to the Department due to the improper payment. These errors resulted in the Direct Loan program's improper payment calculation including both an overstated disbursement amount and an understated improper payment amount. For the Pell program, the disbursement amount was overstated. We concluded that correcting for these two errors for the Direct Loan and Pell programs would have increased the FY 2016 improper payment rates by 0.17 and 0.42 percent, respectively. However, in future years, similar errors could have a greater or smaller effect on the calculated improper payment rates for these programs.

In addition, based on an issue we found with another program review, we determined the Department needs to clarify its methodologies for estimating improper payments. Specifically, the methodologies do not explicitly state how to handle improper payments that were identified through a sample of students drawn from a previous award year. According to FSA's Internal Controls Group, for program reviews included in spreadsheets for estimating improper payments using 2013–2014 award year data, the sampling column should include students who were sampled for the 2013–2014 award year. Additionally, in the improper payments column, the spreadsheet should include all Direct Loan or Pell program improper payments identified in the program reviews for the 2013–2014 award year. However, the Department's written methodology does not specify that samples must come from the award year for which it is estimating improper payments (in this case, 2013–2014). For one program review, the Department did not follow the process that FSA's Internal Controls Group identified. Specifically, the Department included in the spreadsheets three students sampled from the 2012–2013 award year because the program review identified 2013–2014 improper payments for these students. Because the Department used these three students with known improper payments instead of drawing a new sample for the 2013–2014 award year, the Department's calculations resulted in an improper payment rate of 100 percent for the Direct Loan program for the school. Treating those three students as a sample from the 2013–2014 award year resulted in the school's entire disbursement amount being considered as an improper payment in the calculation, which increased the Department's overall estimated improper payment rate for the Direct Loan program.

[13] The Department assesses a liability on a school for the estimated loss to the Department for ineligible Direct Loans disbursed, instead of the actual amount of the ineligible loan. This liability is based upon the total subsidy costs associated with the ineligible loans.

Under IPIA and OMB Circular A-123, Appendix C, agencies are required to prepare a statistically valid estimate of improper payments or an estimate that is otherwise appropriate using an alternative methodology that OMB approves. In addition, OMB guidance provides that, as part of the Inspector General's review of the agency's compliance with IPERA, the Inspector General may also evaluate the accuracy and completeness of the agency's reporting.

Within the Department, FSA's quality management process over the calculation of improper payment estimates includes Quality Assurance/Quality Control Checklists. The checklists are intended to help ensure a high degree of consistency, completeness, and accuracy of improper payment calculation results. The quality management process includes, in part, the following steps:

1. The contractor reviews relevant program review reports and creates a list of improper payment findings and associated improper payment amounts.
2. School Eligibility Service Group staff reviews the list of improper payment findings to confirm whether each finding and dollar amount listed is considered a Direct Loan or Pell program improper payment.
3. The contractor prepares the calculation spreadsheets, based in part on the results of program review reports.
4. The contractor requires three levels of review of the completed calculation spreadsheets for the Direct Loan and Pell programs, followed by one level of review by Department staff.

FSA's policies and procedures and quality control process over its improper payment calculations failed to identify and correct the improper payment calculation errors discussed in this report. If FSA does not revise its policies and procedures and quality control process to account for the improper payment calculation errors identified in this report, similar errors could occur in future years.

Incomplete AFR Reporting on Results of Corrective Actions

The Department did not include in its FY 2016 AFR the results of corrective actions it implemented to address root causes of improper payments. We judgmentally selected and reviewed a sample of 8 of 12 corrective actions the Department included in its AFRs for FYs 2014, 2015, and 2016.[14] We found that of the eight corrective actions we sampled, the Department reported that it implemented seven and was in the process of implementing one. Because five corrective actions were implemented in fiscal years before 2016, the Department was required to report on the results of those corrective actions in its FY 2016 AFR. The Department reported on the results for only one of the corrective actions and did not report the results for the other four. The Department reported results on the use and promotion of the IRS Data Retrieval Tool (DRT),[15] which allows applicants to have the IRS transfer tax return data from an IRS website directly to their online FAFSA.[16] The four corrective actions for which the Department

[14] Four of the 12 corrective actions were in the Department's AFRs for all three fiscal years we reviewed (2014, 2015, and 2016); four of the corrective actions were in the FY 2015 and FY 2016 AFRs only; one corrective action was in the FY 2015 AFR only; and three corrective actions were in the FY 2016 AFR only.

[15] On March 3, 2017, the IRS informed FSA the IRS DRT would be disabled later that day due to fraudulent activity. On May 3, 2017, the Department announced that the IRS DRT would remain unavailable for the 2016-2017 and 2017-2018 FAFSA cycles and that the IRS and FSA plan to reinstate the use of the IRS DRT for the 2018-2019 FAFSA cycle, which begins on October 1, 2017.

[16] The results were reported in the section of the AFR pertaining to supplemental measures for the Department's high-priority programs (the Direct Loan and Pell programs). For the Pell program, the supplemental measure was the total number of Pell

did not report results are related to the performance of institutional program reviews, the review and resolution of institutional compliance audits, the enhancement of verification procedures, and the establishment of a group that will focus on fraud referrals.

OMB Circular A-123, Appendix C states that for programs and activities reporting improper payment estimates that meet the statutory thresholds, agencies must follow all the improper payment reporting requirements included in OMB Circular A-136. OMB Circular A-136, Section II.5.8, lists the improper payment reporting details agencies must provide in their AFRs. OMB Circular A-136 requires an agency's reporting on corrective actions to include the results of actions taken to address root causes.

The Director of FSA's Internal Control Group stated that many of the Department's corrective actions reported in the AFR are ongoing annual processes and, therefore, the Department focused its AFR reporting on highlighting current efforts rather than results.

Unsupportable AFR Reporting on Improper Payments in Contracting

We found that the Department did not determine the amount of improper payments related to FSA-managed and Department-managed contracts, even though it reported in its FY 2016 AFR that it "continues to experience an extremely low volume of improper payments in contracts." The Department OCFO's Director of the Internal Controls Operations Group, who was partly responsible for the improper payments risk assessment of the contracting activity, stated that she did not know where to obtain a list of improper payments related to contracts. She also stated that the Internal Controls Operations Group had planned to identify contract payments that had been returned to the Department in FY 2016 to determine whether any were related to improper payments; however, the Department's Accounts Receivable group did not have a way to identify such payments. As a result, because the Department did not determine the amount of improper payments related to contracts, it is not clear how it supported the statement that there is an extremely low volume of improper payments in contracts.

RECOMMENDATIONS

We recommend that the Chief Financial Officer for the Department, in conjunction with the Chief Financial Officer for FSA—

2.1 Develop and implement policies and procedures that will ensure FSA includes in the improper payment estimation calculations the results of only those program reviews that can identify Direct Loan or Pell improper payments for the applicable award year.

2.2 Revise FSA's quality control process over the Direct Loan and Pell programs improper payment calculations to include controls that will ensure that (1) the disbursement amounts for school branch campuses are correctly included in the improper payment calculations and (2) the correct improper payment amounts are included in the improper payment calculations for program

grant-eligible applicants who used the IRS DRT as a percentage of the total number of Pell grant-eligible applicants who were eligible to use the IRS DRT. For the Direct Loan program, the supplemental measure was the total number of Direct Loan recipients who used the IRS DRT as a percentage of the total number of Direct Loan recipients who were eligible to use the IRS DRT.

reviews that contain a liability for the estimated loss to the Government instead of the total improper payment amount that the review identified.

2.3 Revise the methodology for estimating improper payments to clarify how it will incorporate improper payments that program reviews identified. Specifically, the methodology should include improper payments identified in a program review report if the improper payments are applicable to the award year for which the Department is calculating the improper payment estimate.

2.4 Ensure that the Department's annual reporting on improper payments include the results of the corrective actions it has implemented to address the root causes of improper payments.

2.5 Develop and implement policies and procedures that will enable the Department's OCFO to quantify improper payments related to contracts.

Department Comments

The Department did not agree with the finding. However, the Department acknowledged the two errors with how it included the results of five program reviews in the improper payment calculations and that the estimation methodology can be updated to further clarify how improper payments identified from program reviews are incorporated into the estimates. The Department stated that actions are being taken to resolve the issues. The Department also stated it may improve its reporting of the results of corrective actions. The Department agreed that it can improve its reporting with regard to improper payments in contracting. The Department agreed with all five recommendations.

The Department did not believe the issue "accuracy of improper payment calculations" supports the conclusion that the estimates are inaccurate and that the issue should be reported as a finding. It cannot be inferred from the two errors identified from the review of a judgmental sample of program reviews that the improper payment calculations are inaccurate. The Department stated that the two errors identified had almost no effect on the overall rates. The Department said that because the OIG used judgmental samples, the sample results pertain only to the program reviews sampled and cannot be projected to the entire universe of program reviews. The Department also said that there was no evidence to support the speculative statement "[i]n future years, similar errors could have a greater effect on the calculated improper payment rates for these programs." The Department asked that the OIG remove the finding and report it in an Other Matters section.

OIG Response

As noted on page 16, the errors we identified did impact the estimate, however we agree with the Department that our judgmental sampling approach and the small number of errors we found do not support a conclusion that the reported estimate was inaccurate. The Department agreed it made errors and agreed to make changes to ensure they do not occur again. We revised our report so it no longer states the estimates were inaccurate and to clarify our conclusion that the Department needs to revise policies and procedures over its improper payment calculations. However, the errors warrant a finding for reporting purposes and tracking corrective actions. Specifically, we revised the finding to focus on the quality control procedures that need to be improved to ensure that these specific kinds of errors do not occur in future years. We also

agree that similar errors in future years could not only result in a greater effect on improper payment estimates, but could also result in a smaller effect, so we revised our report accordingly. We also added information to the finding regarding our judgmental sample of program reviews.

OBJECTIVES, SCOPE, AND METHODOLOGY

The audit objectives were to (1) determine whether the Department complied with IPERA; (2) evaluate the accuracy and completeness of the Department's improper payments reporting, estimates, and methodologies; (3) evaluate the Department's performance in reducing and recapturing improper payments; (4) evaluate the Department's assessment of the level of risk associated with the high-priority programs; and (5) review the oversight and financial controls described by the Department to identify and prevent improper payments.

Our audit covered the Department's improper payment calculations, reporting, and performance in reducing and recapturing improper payments for the Direct Loan and Pell programs from October 1, 2015, through September 30, 2016. We also covered the Department's corrective actions to reduce improper payments from October 1, 2013, through September 30, 2016.

We gained an understanding of internal controls applicable to the Department's compliance efforts with IPERA and development of its improper payment rate estimates, as detailed below. We determined that control activities were significant to our audit objectives. We reviewed control activities pertaining to the Department's calculations of improper payment estimates, its improper payment risk assessments, and improper payment reporting. We also tested improper payment calculations for accuracy and completeness. Our audit was for the limited purpose described and would not necessarily identify all deficiencies in internal controls.

To gain an understanding of IPERA, the Department's IPERA compliance and related controls, and the grant programs for which an improper payment estimate was required, we:

- Reviewed laws, regulations, and guidance, including:
    - Improper Payments Elimination and Recovery Improvement Act of 2012;
    - Improper Payments Elimination and Recovery Act of 2010;
    - Improper Payments Information Act of 2002;
    - OMB Circular A-123, Appendix C, "Requirements for Effective Estimation and Remediation of Improper Payments," October 20, 2014;
    - Executive Order 13520, "Reducing Improper Payments," November 20, 2009; and
    - OMB Circular A-136, Section II.5.8., "IPIA (as amended by IPERA and IPERIA) Reporting Details," October 7, 2016;
- Reviewed background information about the Department and its programs susceptible to significant improper payments (Direct Loan and Pell programs);

- Reviewed prior OIG audit reports on the Department's compliance with IPERA;

- Interviewed officials from various FSA offices, including Financial Management Group, Internal Controls Group, Customer Experience, Program Compliance/School Eligibility Service Group, Central Services, Acquisitions, and FSA's designated contractor (PricewaterhouseCoopers) for calculating Direct Loan and Pell program improper payment estimates;

- Interviewed officials from various offices within OCFO, including Financial Improvement Operations, Financial Management Operations, Internal Controls Operations Group, Financial Internal Control and Policy Team, Contracts and Acquisition Management, and Payment Integrity Working Group; and

- Interviewed officials from the Office of Special Education and Rehabilitative Services' Rehabilitative Services Administration.

For our review of the Department's improper payment calculations and related controls, we:

- Reviewed the Department's OMB approved methodology for calculating improper payment estimates for the Direct Loan and Pell programs for FY 2016;

- Reviewed a sample of program reviews to determine whether the improper payments and related disbursements identified in the program reviews were accurately included in the Direct Loan and Pell program improper payment calculations (see "Sampling Methodology" for more details);

- Reviewed improper payment calculation spreadsheets for the Direct Loan program and the Pell program to determine whether the calculations performed and logic applied adhered to the Department's approved methodology; and

- Reviewed FSA's Standard Operating Procedures Over Direct Loan and Pell Program Improper Payment Calculations, and FSA's Improper Payment Extrapolation Workbooks Quality Assurance/Quality Control Procedures.

For our review of the Department's improper payment reporting, we:

- Reviewed the Department's FY 2016 AFR to ensure that it contained all the required components for improper payment reporting, including the results of the Department's improper payment risk assessment, improper payment estimates for required programs, reduction targets, root causes, corrective action plans to address the root causes, and results of corrective actions implemented;

- Verified data in the tables presented in the Department's FY 2016 AFR, including the Improper Payment Reduction Outlook table, the Improper Payment Root Cause Category Matrix, and the Overpayments Recaptured Outside of Payment Recapture Audits table;

- Verified the Department's corrective actions to address and reduce improper payment root causes for the Direct Loan and Pell programs, and determined whether the Department reported the

results of the implemented corrective actions in its FY 2016 AFR (see "Sampling Methodology" for more details); and

- Reviewed the Department's FY 2015 AFR to compare the improper payment reduction targets established for FY 2016 with the improper payment rates reported in the Department's FY 2016 AFR.

For our review of the Department's improper payment risk assessments for contracts and grant programs to ensure that it complied with IPERA and OMB guidance, we reviewed:

- The Department's OCFO's Improper Payment Risk Assessment FY 2016 White Paper;
- FY 2012 Report on the Department's Payment Recapture Audits in Accordance with IPERA;
- Documentation relating to the Department's OMB Circular A-123 Appendix A internal control process and risk assessment for contracts and grant programs not managed by FSA for FY 2016;
- The Department's OCFO's FY 2016 Improper Payment Grants Risk Assessment;
- Documentation of single audits with findings for VR program grantees relating to FYs 2013, 2014, and 2015;
- Payment Recapture and Credit Recovery Final Project performed on FYs 2007–2012 contract payments; and
- Support for how the Department assessed improper payment risks associated with its two high-priority programs, and for the oversight and financial controls to identify and prevent improper payments that the Department described in its FY 2016 AFR. Specifically, we reviewed FSA's FY 2016 Risk Assessment under OMB Circular A-123, Appendix C; FSA's Assessment of Internal Controls for School Eligibility Service Group Control Matrix and Results, conducted under OMB Circular A-123 Appendix A; Program Review Procedures Guide; Compliance Audit Procedures Guide; the Department's OCFO's Consolidated Catalog of Internal Controls; and the Department's OCFO's Payment and Integrity Workgroup processes and procedures.

Data Reliability of Computer-Processed Data

Because the Department used program review data contained in Postsecondary Education Payment System (PEPS) as a source to identify applicable program reviews, which it used as a component of the improper payment estimates, we performed data reliability testing on the PEPS data. Specifically, we compared PEPS data to data contained in the program review reports and supporting documentation. We also interviewed Department officials and contractors knowledgeable about the data. We reviewed the PEPS data for the 415 program reviews the Department included in its improper payment estimates and identified 40 program reviews for which PEPS indicated the scope did not include the 2013–2014 award

year.[17] We reviewed the program review reports for the 40 program reviews and found that the scope section of 30 program review reports stated that the review included the 2013–2014 award year. The scope section of the remaining 10 program review reports did not state that the review included 2013–2014 as an award year. For those 10 program reviews, we performed additional testing and found that supporting documentation for 8 of the program reviews did include award year 2013–2014 in its scope, while supporting documentation for the other 2 program reviews did not. Based on our review, we determined that the PEPS computer-processed data were not reliable for purposes of identifying program reviews applicable to a specific award year; therefore, we did not use PEPS to select our sample of program reviews. We also found that the Department did not rely solely on that data to perform its improper payment calculations. As a result, our use of computer-processed data for the audit was limited to the spreadsheets the Department used to calculate improper payments; the Department provided documentation to support the data in these spreadsheets and we found it to be sufficiently reliable for the objectives of our audit.

Sampling Methodology

We selected judgmental samples of program reviews to determine the accuracy and completeness of the Direct Loan and Pell program improper payment calculations. We also selected a judgmental sample of corrective actions the Department identified in its FYs 2014, 2015, and 2016 AFRs to address improper payment root causes. Because we used judgmental samples, the results from our testing pertain only to the program reviews or corrective actions sampled and cannot be projected to the entire universes of program reviews or corrective actions.

Samples of Program Reviews

Of the 877 program reviews initiated by the Department during FYs 2014, 2015, and 2016, 415 program reviews were included in the improper payment calculations for the Direct Loan program, Pell program, or both.[18] From these 415 program reviews, we judgmentally selected for review 46 reviews and the related supporting documentation. The remaining 462 of the 877 program reviews were not included in the Direct Loan and Pell program improper payment calculations. From these 462 program reviews, we judgmentally selected for review 15 reviews and the related supporting documentation. The sections below provide details on the sampling methodology for the two groups of program reviews.

Sample of Program Reviews Included in Improper Payment Calculations

We classified the 415 included program reviews into one of five categories and selected either all, the highest dollar, or random selections from each category as shown in Table 4 below. The categories represent program reviews that are at greatest risk for erroneous inclusion into the improper payment calculations or program reviews having characteristics related to changes introduced by the FY 2016 estimation methodology. This resulted in us selecting 30 program reviews.

[17] The FY 2016 improper payment estimates are based on disbursements made for the 2013–2014 award year.
[18] Of the 415 program reviews, 385 were included in both the Direct Loan and Pell program improper payment calculations, 19 were included in the Direct Loan program improper payment calculation only, and 11 were included in the Pell program improper payment calculation only.

Table 4. Universe Size and Sample Selected From Included Program Reviews

Category	Universe Count	Sample Count	Selection Method
Award years reviewed did not include 2013–2014, according to PEPS	40	10	All program reviews in which the scope of the report does not indicate award 2013–2014 as a year that was reviewed
No student disbursements were sampled, according to the improper payment calculation spreadsheets (a final program review determination letter had been issued for four of these reviews)	20	5	Highest disbursement school, plus four random selections
Amount of program or school level improper payment recorded in the improper payment calculations spreadsheets was less than $10,000	26	5	Highest disbursement school plus four random selections
Program review type recorded in PEPS is "Third Party Servicer" or "Reimbursement," but student disbursements are recorded in the improper payment calculation spreadsheets	16	5	Highest disbursement school plus four random selections
All other included reviews	313	5	Highest disbursement school plus four random selections
Total	**415**	**30**	

We supplemented the 30 program reviews (reflected in Table 4) with 16 additional judgmental selections, including the following:

- 2 program reviews in which the improper payment calculation spreadsheets show an improper payment amount for the Direct Loan program that was identical to the improper amount for the Pell program,
- 1 program review for which no student disbursements were sampled and no final program review determination letter had been issued, and
- 13 program reviews in which the total school disbursement amounts in the improper payment calculation spreadsheets appeared unusual or were manually entered into the spreadsheets,[19] or there were multiple reviews performed on the same school.

Therefore, the total number of program reviews included in the improper payment calculations that we sampled is 46.

[19] The majority of the total school disbursement amounts in the calculation spreadsheets were inputted via a formula that took the disbursement amount from a Pell-Direct Loan Funding Report. We identified some school disbursements that did not come from the Pell-Direct Loan Funding Report; instead, the amount was manually entered into the calculation spreadsheets.

We did not perform the same testing on all 46 program reviews. We tested 33 program reviews to determine whether the program review should have been included in the Direct Loan and/or Pell programs' improper payment calculations and whether the correct amounts of improper payments were recorded in the calculation spreadsheets.[20] We tested 13 program reviews to determine whether the correct amounts of total Direct Loan and Pell program disbursements for the schools were recorded in the calculation spreadsheets.[21]

Sample of Program Reviews Not Included in Improper Payment Calculations

We judgmentally selected 15 of the 462 program reviews that were not included in the Direct Loan and Pell program improper payment calculations. We selected program reviews from the following reasons the Department cited for excluding the reviews from the calculations:

1) the review was not completed by the documentation acceptance cutoff date; [22]
2) the review was not applicable to the 2013–2014 award year;
3) no students were sampled and the final program determination letter has not been issued (any findings resulting from these reviews would be program/school level findings; however, a final program determination letter has to be issued in order to be included in the improper payment calculations);
4) no students sampled received Pell disbursements;
5) the subject matter reviewed would not identify Direct Loan or Pell program improper payments; and
6) the review resulted in a settlement agreement.

We reviewed the sample of 15 program reviews to determine whether the Department correctly excluded these reviews from the Direct Loan and Pell program improper payment calculations. To make this determination, we reviewed the reports for the 15 program reviews and verified the reason the Department provided for excluding the reviews from the improper payment calculations.

Sample of Improper Payment Corrective Actions

The Department identified 12 corrective actions in its AFRs for FYs 2014, 2015, and 2016 that were to address the root causes of improper payments related to the Direct Loan and Pell programs. We judgmentally selected 8 of 12 corrective actions. Based on the Direct Loan program improper payment calculation, there is a relatively small amount of improper payments associated with Direct Loan consolidations and refunds; therefore, we excluded the four corrective actions that relate to improper payments associated with Direct Loan consolidations or refunds and selected the remaining eight corrective actions. We reviewed the sample of corrective actions to determine whether the Department implemented the corrective actions and whether FSA reported the results of the implemented actions in its FY 2016 AFR. To make these determinations, we interviewed Department officials responsible for the implementation of the eight corrective actions, reviewed documentation to support that the corrective

[20] These 33 program reviews include 30 program reviews from Table 4 and 3 of the 16 supplemental program reviews discussed in the paragraph below Table 4.
[21] These 13 program reviews are 13 of the 16 supplemental program reviews discussed in the paragraph below Table 4.
[22] The documentation acceptance cutoff date is August 5, 2016. The program review had to have a report issued by August 5, 2016, for FSA to consider including it in the Direct Loan and Pell program improper payment calculations.

actions had been implemented and or were in the process of being implemented, reviewed documentation to support the results of the implemented corrective actions, and reviewed the Department's FY 2016 AFR to determine whether the results of the implemented actions were included in the AFR.

We conducted onsite visits at the Department's offices located in Washington, D.C., on December 5 through 8, 2016; January 30 through February 2, 2017; and February 6 through 9, 2017. We held an exit conference with Department officials on March 27, 2017.

We conducted this audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

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. The Department's policy requires that you develop a final corrective action plan (CAP) for our review in the automated system within 30 calendar days of the issuance of this report. The CAP 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 OIG is required to report to Congress twice a year on the audits that remain unresolved after 6 months from the date of issuance.

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 Christopher Gamble at (404) 974-9417.

Sincerely,

/s/

Patrick J. Howard
Assistant Inspector General for Audit

Attachment 1

Acronyms, Abbreviations, and Short Forms Used in This Report

AFR	Agency Financial Report
Department	U.S. Department of Education
Direct Loan	William D. Ford Federal Direct Loan
DRT	Data Retrieval Tool
FAFSA	Free Application for Federal Student Aid
FSA	Federal Student Aid
FY	Fiscal Year
IPERA	Improper Payments Elimination and Recovery Act
IPERIA	Improper Payments Elimination and Recovery Improvement Act
IPIA	Improper Payments Information Act
IRS	Internal Revenue Service
OCFO	Office of the Chief Financial Officer
OIG	Office of Inspector General
OMB	Office of Management and Budget
Pell	Federal Pell Grant
PEPS	Postsecondary Education Payment System
Uniform Requirements for Federal Awards	Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards
VR	Vocational Rehabilitation State Grants

Attachment 2

Auditee Comments

UNITED STATES DEPARTMENT OF EDUCATION
OFFICE OF THE CHIEF FINANCIAL OFFICER

MEMORANDUM

DATE: April 28, 2017

TO: Pat Howard
Assistant Inspector General for Audit
Office of Inspector General

Christopher Gamble
Acting Regional Inspector General (Region IV)
Office of Inspector General

CC: Selina Boyd
Auditor in Charge
Office of Inspector General

FROM: Tim Soltis
Delegated to Perform the Function and Duties of the Chief Financial Officer
Office of the Chief Financial Officer

John W. Hurt, III
Chief Financial Officer
Federal Student Aid

SUBJECT: Response to OIG's Review of the Department's Compliance with the Improper Payments Elimination and Recovery Act of 2010 (IPERA) – A04Q0011

We appreciate the opportunity to respond to the draft audit results of the Office of Inspector General's (OIG) review of the Department's compliance with IPERA. The Department is committed to establishing effective internal controls to demonstrate payment integrity and to prevent, detect, and recover improper payments when they occur.

We also appreciate the OIG's recognition that FSA's quality management process over the improper payment estimate calculations helps ensure a high degree of consistency, completeness and accuracy of the calculations. Like FSA's internal control environment, which includes over 300 controls, FSA's quality management process over the improper payment calculations is robust. There will continue to be opportunities to improve the quality management process, and we appreciate the OIG's help in identifying these opportunities. Our responses are included below.

Overall Comments

We acknowledge the OIG's conclusion that based on existing criteria, we are non-compliant with IPERA in FY 2016 because the Direct Loan and Pell Grant program did not meet the FY 2016 reduction targets established in the FY 2015 Agency Financial Report (AFR) and because the risk assessments for FSA contracts and non-FSA grant programs did not clearly demonstrate how all nine statutory qualitative factors were considered.

We agree that we can improve the accuracy of our improper calculations and the completeness of our reporting in the AFR. However, we do not agree that we are non-compliant with IPERA because we failed to identify the Rehabilitative Services-Vocational Rehabilitation (VR) program as a program susceptible to improper payments. Our responses to each of the draft findings and recommendations are included below.

Department's Response to Finding 1:

The Department partially concurs with this finding. We agree that the Department did not meet established reduction targets for the Direct Loan and Pell Grant programs and did not document how all nine statutory qualitative factors were considered as part of the 2016 risk assessment for FSA contracting activities and non-FSA grant programs.

The Department does not concur with the OIG's conclusion that the risk assessment indicated that the VR program is a program susceptible to significant improper payments and should be reported as such in our AFR. We also disagree with the OIG's position that all questioned costs identified by Single Audits should be treated as improper payments.

The Department conducted risk assessments for its grant programs, in accordance with Section 2(a) of IPIA and OMB guidance. According to OMB Circular A-123, Part I, A. 9, the first step agencies must take is to determine whether the risk of improper payments is significant and to identify those programs that are susceptible to significant improper payments. "Significant" is defined as "gross annual improper payments (i.e., the total amount of overpayments and underpayments) in the program exceeding (1) both 1.5 percent of program outlays and $10,000,000 of all program or activity payments made during the fiscal year reported or (2) $100,000,000 (regardless of the improper payment percentage of total program outlays)."

It appears from the finding that the OIG has concluded that all questioned costs identified during Single Audits must always be treated as improper payments for the purpose of performing grant risk assessments. We disagree with that conclusion, as there no statutory or regulatory basis to support that conclusion. Additionally, it is unlikely that other federal grant making organizations treat all questioned costs as improper payments and for the Department to do so would overstate the improper risk to our grant programs and create inconsistency across the federal government. The use of questioned costs as the sole proxy for improper payments would be a flawed methodology for several reasons including:

- Questioned costs may represent potential improper payments, however significant improper payments, as defined by the OMB guidance does not use the word "potential;"
- Questioned costs may not be sustained and further analysis and historically are often not;

- Questioned costs identified at a grantee may not be related solely to ED programs and may reflect underlying internal control issues to the grantee, not increased risk susceptibility to ED programs;
- Because the Uniform Guidance does not define questioned costs as improper payments, auditors reporting questioned costs may not agree that we can re-define the meaning of questioned costs included in their report and call them improper payments;
- The judgment applied by auditors in identifying questioned costs may vary considerably and there may be a stronger correlation to the audit firm conducting the audit than to the questioned costs being sustained as improper payments; and
- Use of questioned cost data of program auditees alone does constitute a statistically valid approach to assessing risk to the program as a whole.

To determine if any of the Department's grant programs were susceptible to improper payments, we analyzed questioned cost data from Single Audits for the Department's grant programs as a critical indicator that improper payments may have occurred. For example, the first step in our risk assessment showed that the VR program questioned costs for FY's 2013 and 2014 exceeded 1.5% of total expenditures and $10,000,000 for the audit years reviewed. When questioned costs exceed the statutory thresholds, we do further analysis. Our analysis showed that the FY 2013 questioned costs related to a time and effort finding that was not sustained because FL had received permission from the Department to use a substitute time certification system. In FY 2014, the auditors presented no evidence that the VR personnel were paid improperly and none of the questioned costs were disallowed. This second important step in our risk assessment process is crucial because it focuses on identifying actual improper payments, which would be the basis for our improper payment estimate.

In FY 2015, the State of Tennessee exceeded the questioned costs threshold. The main finding involves a period of performance issue regarding the carryover and liquidation of grant funds. The auditor questioned almost the entire amount of grant funds awarded to the state because it was too difficult to determine the actual amount of unallowable costs. The program office is working with grantee to determine what – if any – costs will actually be considered improper. The audit remains open for resolution pending the final submission of data in May.

The draft report states that it is "not practical to wait for audits with questioned costs to be resolved to determine which questioned costs are eventually determined to be improper because of the period of time required by the Department to resolve audits." However, it is not prudent to report a program as risk susceptible to improper payment when it actually is not so speed in reporting may not be as important as accuracy. Nevertheless, we agree that the Department can improve its capacity and better document its risk assessment process and we are working to do that.

The Department concurs that it did not meet the reduction targets for the Direct Loan and Pell Grant programs. The increase in the estimated Pell Grant and Direct Loan improper payment rates are driven primarily by changes to the prior year estimation methodology, rather than programmatic changes, or control deficiencies. In FY 2016, the Department updated the estimation methodology to incorporate sources of improper payments that were not previously considered. For Direct Loan, these included: (1) improper payment estimates resulting from

schools disbursing funds to students enrolled in ineligible programs/locations. For Pell Grant, these included: (1) improper payment estimates resulting from schools disbursing funds to students enrolled in ineligible programs/locations; and (2) improper payments due to inaccurate self-reported income by recipients who were not selected for income verification and who did not use the Internal Revenue Service Data Retrieval Tool (IRS DRT) to transfer tax data to the Free Application for Federal Student Aid (FAFSA).

The Department continues to invest in maintaining a strong control framework to include internal controls over payments. In FY 2016, as part of its internal control framework, FSA documented and tested 1,002 business process and 2,043 Information Technology (IT) system internal controls across 38 business processes (and sub-processes) and 20 integrated IT systems, respectively, including 328 controls to prevent or detect improper payments. In FY 2016, 99.7% (i.e., 327 out of 328) of improper payment related controls were found to be designed effectively and 96.6% of those tested for operating effectiveness in FY 2016 (i.e., 172 out of 178) were operating effectively.

Despite continued maintenance and investment in a strong control framework to include internal controls over improper payments, the inherent variance in the Department's alternative improper payment estimation methodology may also contribute to the Department either making or missing its improper payment rate targets.1 In FY 2016, the Department took a number of steps to decrease the volatility of the estimates, by revising the estimation methodology to increase the population size (consisting of Program Review Reports conducted by the Department). Nevertheless, there continues to be variability in the improper payment estimates. For example, a single Direct Loan student-level finding accounted for 0.50% of the 3.98% FY 2016 Direct Loan rate and a single Pell Grant student-level finding accounted for 0.51% of the 7.85% FY 2016 Pell Grant rate. The inherent variance in the Department's alternative improper payment estimation methodology is largely due to fewer program reviews being conducted at lower-risk schools. This category of schools accounts for a large portion of the Direct Loan and Pell Grant program disbursements. As a result, as disclosed within the FY 2016 AFR, the potential exists for student-level test results of a single observation (such as a single student or school) at lower-risk schools to significantly influence the improper payment estimates, resulting in volatility of the model.

Department's Response to Recommendation 1.1:

As required by IPERA, submit a plan to Congress describing actions the Department will take to bring the Pell program into compliance. The plan should also describe actions it will take to ensure that its risk assessments for the Department-managed grant programs and FSA-managed contract activities conform with Section 2(a) of IPIA and with applicable OMB guidance.

The Department concurs with this recommendation. The Department will submit a plan to Congress describing actions the Department will take to bring the Pell Grant program

[1] An assessment of whether the student-level Compliance Assurance Review (CAR) findings, which individually accounted for a significant portion of the overall FY 2016 improper payment rates, contributed to the Department missing the targets cannot be fully assessed without performing more CAR reviews.

into compliance within 90 days of the date of this report in accordance with IPERA. This plan will also describe the actions the Department will take to ensure its risk assessments and documentation for Department-managed grant programs and FSA-managed contract activities conform with Section 2(a) of IPA and with applicable OMB guidance.

Department's Response to Recommendation 1.2

As required by IPERA, submit to Congress proposed statutory changes necessary to bring the Direct Loan program into compliance.

The Department concurs with this recommendation. The Department will submit to Congress any proposed statutory changes necessary to bring the Direct Loan program into compliance within 30 days of the date of this report in accordance with IPERA.

Department's Response to Recommendation 1.3

Identify the VR program in the FY 2017 AFR as a program that may be susceptible to significant improper payments, produce and report a valid improper payment estimate for the program, and implement corrective actions to reduce improper payments in the program.

The Department does not concur with this recommendation for the reasons noted above. Neither our analysis nor the OIG's work demonstrated that the VR program may be susceptible to significant improper payment risk. However, a joint OCFO-RMS initiative is already underway to review the statistical validity and efficacy of the existing improper payment estimation methodology for grants compared to various alternatives.

Department's Response to Recommendation 1.4

Ensure that risk assessments conform with Section 2(a) of IPIA and OMB guidance when determining whether programs are susceptible to significant improper payments. Specifically, the Department should (1) identify programs as susceptible to significant improper payments if the result of the Department's quantitative risk assessment shows that improper payments in these programs may have exceeded the statutory thresholds and (2) develop improper payment risk assessment models that include all nine required risk factors and other factors, if appropriate.

The Department concurs, in part, with this recommendation.

We agree that our risk assessment models can be improved to more clearly show how all nine required risk factors are considered, specifically with regard to FSA contracting activities and non-FSA grants. For FY 2017 estimation, we have already begun working on developing a matrix that aligns the nine required risk factors required by A-123 Appendix C with similar risk factors used in our risk assessments under A-123 Appendix A for our administrative payments risk assessment. We will develop a similar approach for our contracts and grants risk assessment.

We do not concur with the recommendation that we should identify programs as susceptible to significant improper payment risk solely based on questioned costs exceeding the improper payment statutory thresholds. As noted above, we cannot equate questioned costs with improper payments without additional analysis, as questioned cost data alone does not constitute a statistically valid estimate. Additionally, we believe that to do so would be inconsistent with how other federal grant making organizations treat questioned costs in their assessment of improper payment risk.

Department's Response to Recommendation 1.5

Take the necessary steps to implement any other actions OMB may recommend to assist the agency with becoming compliant with IPERA.

The Department concurs with this recommendation. The Department is currently working with OMB to identify and develop improvements to the estimation methodology. The Department will continue to work with OMB to address any additional requirements OMB may identify to assist the Department with becoming compliant with IPERA.

Department's Response to Finding 2:

The Department does not concur with the finding.

We acknowledge the two errors identified by the OIG with how the Department included the results of five program review reports in the improper payment calculations. We also agree that the estimation methodology can be updated to further clarify how improper payments identified from program reviews are incorporated into the estimates. We are taking action to resolve these issues and clarify these matters in our proposed 2017 methodology due to OMB by April 30, 2017. However, we do not believe the results of the judgmental sample described in the report support a conclusion that the estimates are inaccurate or rise to the level of a finding.

As noted in the report, the errors identified had almost no effect on the overall rates. In the draft audit results, it is noted that the OIG: "concluded that correcting for these two errors for the Direct Loan and Pell Grant programs would have increased the FY 2016 improper payment rates by less than 0.50 percent." Per the OIG's calculations, these two errors result in the improper payment rates being underreported by less than five tenths of one percentage point (two tenths of a percent for Direct Loan; four tenths of a percent for Pell).

It cannot be inferred from the two errors identified from the OIG's review of a judgmental sample of program reviews that the improper payment calculations are inaccurate. The two errors were not identified via a random sample of the 415 program reviews included in either the Direct Loan or Pell Grant program improper payment calculations, but rather were judgmentally selected. While not disclosed in Finding 2, the "Objectives, Scope and Methodology" section of the draft audit report notes that the program reviews selected were those that: "are at the greatest risk for erroneous inclusion into the improper payment calculations or program reviews having

characteristics related to changes introduced by the FY 2016 estimation methodology." Per the "Objectives, Scope and Methodology" section of draft audit report, because the OIG used judgmental samples, the results from its testing pertain only to the program reviews sampled and cannot be projected to the entire universe of program reviews. There is no evidence to support the speculative statement included in Finding 2 of the draft audit report that: "… in future years, similar errors could have a greater effect on the calculated improper payment rates for these programs" or that the two errors identified resulted in inaccurate reporting of the improper payment rates.

We ask that the OIG remove this finding from the audit report and move it to an Other Matter with a recommendation on how the Department can enhance its existing quality management process and estimation methodology.

Re: Accuracy of Improper Payment Calculations

The Department acknowledges that there were three Program Review Reports included in the improper payment calculations that would not identify Direct Loan or Pell Grant Program improper payments for the 2013-2014 award year. When preparing the improper payment estimates, it was incorrectly understood that these reports met all conditions for inclusion in the estimate. The Department will implement additional controls to help ensure that reports included in the estimates satisfy the requirement for inclusion per the OMB-approved estimation methodology.

The Department also acknowledges that incorrect disbursement or improper payment amounts were entered into the Direct Loan and/or Pell Grant programs' improper payment calculations for two program reviews. The Department will implement additional controls to help ensure that improper payments and disbursements are included in accordance with the estimation methodology.

The Department also acknowledges that the estimation methodologies can be updated to provide explicit clarification on to how to handle improper payments that are applicable to the in-scope award year that were identified through a sample of recipients drawn from an out-of-scope award year. The Department will update the FY 2017 estimation methodology to clarify how such situations are handled.

Re: Incomplete AFR Reporting on Results of Corrective Actions

The Department acknowledges that it may improve its reporting of "the results of actions taken to address [the] root causes" as required by A-136. Many of the corrective actions reported are on-going, annual processes that produce analyses that may be shared, at a high-level, to better inform the reader on the status of issue resolution.

For example, we may expand on the description of the program review process and Final Program Review Determinations (FPRDs) to note, as we did in the FY 2012 AFR, that common findings were identified and communicated to the school financial aid community and/or provide metrics on the status of findings and corrective actions tracked in the Postsecondary Education Participants System (PEPS). The FY 2016 AFR notes that FPRDs indicate the actions that individual institutions are required to take, that the dates for these institution-level corrective actions vary, and that they are tracked through resolution in PEPS, but does summarize or list individual corrective actions.

We may likewise expand on the description of verification processes or guidance to schools, to include metrics on the number of recipients verified and the results of that verification. The FY 2016 AFR notes that FSA enhanced its verification procedures, required schools to verify specific information reported by students on the FAFSA, and continued to perform statistical analysis to ensure applicants with the highest probability of error are selected for verification.

Although the Department does not attempt to quantify and report the impact of these processes or related activities or controls on the calculated improper payment estimate, the Department does monitor the performance and outcomes of these processes and can report such details. Additionally, effective with the update to OMB Circular A-136 for 2015, the Department included a section and table (i.e., table 3) describing the results of management's assessment of internal controls over improper payments, by GAO standard. Most of the corrective actions listed in FY 2016 relate to internal controls that are assessed for design and operating effectiveness as reported in this section. The Department will continue to report on the design and operating effectiveness of improper payment related controls in accordance with A-136.

RE: Unsupportable AFR Reporting on Improper Payments in Contracting

We concur that we can improve our reporting with regard to improper payments related to contract payments.

Department's Response to Recommendation 2.1:

Develop and implement policies and procedures that will ensure FSA includes in the improper payment estimation calculations the results of only those program reviews that can identify Direct Loan or Pell improper payments for the applicable award year.

The Department concurs with this recommendation. The Department will revise the quality control process over the Direct Loan and Pell Grant improper payment calculations to include additional controls to help ensure that only those program reviews that have the possibility of identifying Direct Loan or Pell Grant improper payments for the applicable award year are included in the estimates.

Department's Response to Recommendation 2.2

Revise FSA's quality control process over the Direct Loan and Pell programs improper payment calculations to include controls that will ensure that (1) the disbursement

amounts for school branch campuses are correctly included in the improper payment calculations and (2) the correct improper payment amounts are included in the improper payment calculations for program reviews that contain a liability for the estimated loss to the government instead of the total improper payment amount that the review identified.

The Department concurs with this recommendation. The Department will revise the quality control process over the Direct Loan and Pell Grant improper payment calculations to include additional controls to help ensure that disbursement amounts are correctly included in the improper payment calculations, and the correct improper payment amounts are included in the improper payment calculations for program reviews that contain a liability for the estimated loss to the government.

Department's Response to Recommendation 2.3

Correct the methodology for estimating improper payments to clarify how it will incorporate improper payments that program reviews identified. Specifically, the methodology should include improper payments identified in a program review report if the improper payments are applicable to the award year for which the Department is calculating the improper payment.

The Department concurs with this recommendation. The Department will update the estimation methodologies for FY 2017 to clarify that improper payments identified for the in-scope award year for students sampled for an out-of-scope award year are included in the estimates.

Department's Response to Recommendation 2.4

Ensure that the Department's annual reporting on improper payments include the results of the corrective actions it has implemented to address the root causes of improper payments.

The Department concurs with this recommendation. The Department will consider ways to improve its reporting of the results of actions taken to address the root causes of improper payments. The Department does not attempt to quantify and report the impact of on-going, annual processes and controls on the improper payment estimates, but will report the results of actions taken to address the root causes, such as a summary of the performance and outcomes of these processes for which the Department does actively monitor.

Department's Response to Recommendation 2.5

Develop and implement policies and procedures that will enable the Department's OCFO to quantify improper payments related to contracts.

The Department concurs with this recommendation. For FY 2017, we have begun to improve our procedures and processes for conducting contract risk assessments and we

plan to utilize both quantitative and qualitative information to assess the risk of improper payments related to contracts.

We appreciate the opportunity to review and respond to the report. If you have any questions, or need additional information regarding this response, please contact Bill Blot at (202) 377-3097 or Jay Hurt at (202) 377-3453 for matters involving FSA (i.e., on Pell Grant and/or Direct Loan estimation), or April Bolton-Smith at (202) 245-6345 for matters involving OCFO (i.e., risk assessments of and reporting on non-FSA grant programs and all contracts