Other Accompanying Information

Improper Payments Reporting Details

The *Improper Payments Elimination and Recovery Act of 2010 (IPERA)* (Public Law 111-204), which amends the *Improper Payments Information Act of 2002* (*IPIA*) (Public Law 107-300), and the Office of Management and Budget's (OMB) Circular A-123, Appendix C, Requirements for Effective Measurement and Remediation of Improper Payments, define requirements to reduce improper payments made by the federal government. OMB also has established specific reporting requirements for agencies with programs that possess a significant risk of improper payments and for reporting on the results of recovery auditing activities. Agencies are required to annually review and assess all programs and activities to identify those susceptible to significant improper payments. The guidance in OMB Circular A-123, Appendix C, defines a significant improper payment as those in any particular program that exceed both 2.5 percent of program payments and $10 million annually or that exceed $100 million. For each program identified as susceptible to significant improper payments and determined to be at risk, agencies are required to report to the President and the Congress the annual amount of estimated improper payments, along with steps taken and actions planned to reduce them.

The Department has divided its improper payment activities into the following segments: Student Financial Assistance Programs; ESEA Title I, Part A Program; Other Grant Programs; and Recovery Auditing.

Student Financial Assistance Programs

Risk Assessment

As required by the IPERA, Federal Student Aid (FSA) inventoried its programs during FY 2011 and, for each program, assessed the risk of improper payments. See the table below for the Grant, Loan, and Work-Study Programs identified.

Programs
Grant Programs
Federal Pell Grant
Academic Competitiveness Grant (ACG)
National Science and Mathematics Access to Retain Talent Grant (SMART)
The Teacher Education Assistance for College and Higher Education Grant (TEACH)
Federal Supplemental Educational Opportunity Grant (FSEOG)
Leveraging Educational Assistance Partnership (LEAP)/Special Leveraging Educational Assistance Partnership (SLEAP)
Iraq and Afghanistan Service Grant (IASG)
Loan Programs
Federal Perkins Loan Program
Federal Direct Loan Program
Federal Family Education Loan Program (FFEL)
Work - Study Programs
Federal Work - Study Program

For each program, risk assessment meetings were held with program owners, key personnel, and other designees to discuss the following ten risk factors to determine susceptible risk within the programs: Volume of Payments; Prior Improper Payments Reporting Results; Newness of Program or Transactions; Complexity of Program or Transactions; Level of Manual Intervention; Changes in Program Funding Authorities, Practices, or Procedures; History of Audit Issues; Human Capital Management; Nature of Program Recipients; and Management Oversight.

A risk rating was assigned to each factor based on risk factor criteria established and consensus from the participants in the meetings. Weighted percentages were assigned to each risk factor rating based on probability of an improper payment. An overall risk score was then computed for each program, calculated by the average of the sum of the weighted scores for each risk factor and overall rating scale.

In addition to the A-123 guidance, another criteria for determining susceptible risk within the programs were programs that were previously required to report improper payment information under OMB Circular A-11, Budget Submission, former Section 57.2.[1]

The Direct Loan, FFEL, and Pell Grant Programs were identified as risk susceptible to improper payments, and are described in the next section. The ACG, SMART, TEACH, FSEOG, LEAP/SLEAP, and IASG Grant Programs, Perkins Loan Program, and the Federal Work-Study Program were deemed to be low-risk programs.

- The ACG and SMART programs are budgeted together and had a five-year life, which will end with the academic school year 2010–2011.
- For TEACH Grants in FY 2011, approximately 45,000 grants were disbursed for almost $125 million, which is relatively low in volume and dollar amount.
- For the LEAP/SLEAP Grant Program 2010–11 award year, approximately $162 million in grants were disbursed to approximately 162,000 students. The 2010–2011 award year was the last award year in which states will be able to apply for SLEAP funding.
- The IASG Program began in the 2010–2011 award year, and is very small with approximately $181,995 in total awards and 37 recipients.
- The Federal Perkins Loan Program and Work-Study Programs are campus-based programs and funds are provided directly to eligible institutions. These programs had a larger number of awards and disbursement amounts, but resulted in a low risk rating for improper payments.

No further information on these low risk programs is included herein.

[1] The four original programs identified in OMB Circular A–11, Section 57, were Student Financial Assistance (now Federal Student Aid), ESEA, Title I, Special Education Grants to States, and Vocational Rehabilitation Grants to States. Subsequently, after further review of the program risk, OMB removed Special Education Grants to States and Vocational Rehabilitation Grants to States from the list. OMB considers Section 57 programs susceptible to significant improper payments regardless of the established thresholds.

Risk-Susceptible Programs

The Title IV programs that were deemed to be potentially susceptible to the risk of significant improper payments based on OMB criteria described above include Pell Grant Direct Loan, and FFEL.

Pell Grant Program. The Pell Grant Program includes the drawdown of funds by schools and the disbursement of aid from the school to the student; year-end closeout and the return of unsubstantiated funds; return to Title IV collections from schools; and collections on overpayments from recipients.

An estimated improper payment rate calculation was completed for the Pell Grant Program in FY 2011. There were no changes to the sampling process from prior years. The overall improper payment rate, based on this analysis, was 2.72 percent.

In FY 2011, OMB designated Pell a “high-priority” program per Executive Order 13520 and OMB Circular A-123, Appendix C (as updated by OMB Memo M-10-13), because estimated FY 2010 Pell improper payments of $1,005 million exceeded the OMB FY 2010 high-priority program threshold of $750 million. The Department is coordinating with OMB to establish and execute a plan to implement all applicable high priority program requirements. These include, in FY 2011, the designation of accountable officials, the establishment of supplemental measures, and new reporting on program measures on PaymentAccuracy.gov.

Direct Loan Program. The Direct Loan Program includes the drawdown of funds by schools, the origination of a loan and disbursement of funds from the school to the student (or their account); consolidations; servicing of the loan and collections from borrowers; and return to Title IV collections from schools.

An estimated improper payment rate calculation was completed for the Direct Loan Program in FY 2011. There were no changes to the sampling process from prior years. The overall improper payment rate, based on this analysis, was 0.22 percent.

FFEL Program. During FY 2011, the FFEL Program made no new loan originations. FY 2011 payment types and cash flows associated with loans originated in prior years (i.e., the existing FFEL portfolio) include: Special Allowance (SAP), Interest Benefits, Lender Fees, Origination Fees, Consolidation Loan Rebate Fees, Reinsurance, Account Maintenance Fee, and Loan Processing and Issuance Fees.

Starting with 2008, the FFEL program also included the Loan Purchase Commitment Program, Loan Participation Purchase Program, and the Asset Backed Commercial Paper (ABCP) Conduit Program authorized in the *Ensuring Continued Access to Student Loans Act* (ECASLA). The Loan Purchase Commitment Program and Loan Participation Purchase Program ended on 10/15/2010. The Conduit Program is scheduled to end in 2014. These programs resulted in the purchase of significant volumes and amounts of FFEL loans from 2008 to 2010. The on-going servicing of these FFEL loans acquired through ECASLA is a part of the FFEL Program.

Beginning in FY 2009 and ending in FY 2010, Federal Student Aid initiated FFEL SAP risk analyses in lieu of a measurement. As described in the Department’s FY 2010 *Agency Financial Report* (AFR), these analyses did not yield any result that could help inform decisions on improper payment measurement and were suspended. Accordingly, Federal Student Aid did not use these risk analyses to calculate an FY 2011 error rate and no estimate of FY 2011 improper payments is provided.

Estimation Methodology

The size and complexity of the student aid programs make it difficult to consistently identify "improper" payments. The legislation and OMB guidance use the broad definition: "Any payment that should not have been made or that was made in an incorrect amount under statutory, contractual, administrative, or other legally applicable requirement." Federal Student Aid has a wide array of programs, each with unique objectives, eligibility requirements, and payment methods. Consequently, each program has its own universe (or multiple universes) of payments that must be identified, assessed for risk, and, if appropriate, statistically sampled to determine the extent of improper payments.

Pell Grant Program. The Department conducts studies with the IRS using FAFSA data. Data provided by the IRS study are used to estimate improper payments for the Pell Grant Program. The methodology for the Pell Grant did not change in FY 2011 and additional details about the study can be found in the FY 2009 AFR, under Corrective Actions (http://www2.ed.gov/about/reports/annual/2009report/5-otherinfo.pdf).

Direct Loan Program. For the Direct Loan program, the estimation methodology considers the risk for each payment type within the program, and for each component, an independent error rate is determined, via sample or other process, so as to calculate an aggregate error rate.

The estimated improper payment rate for FY 2011 is 0.22 percent in the aggregate. Consistent with prior years, this percentage estimate is well below the historical threshold for risk susceptible programs of 2.5 percent. The FY 2011 estimated improper payment amount at $264 million, however, exceeds the new IPERA reporting threshold for risk susceptible programs effective this year of $100 million.

Historically, and in FY 2011, a significant percentage of the program's total outlays come from the origination and disbursement front end of the loan life cycle. In FY 2011, approximately 90 percent of the $116.1 billion in total outlays are from loan disbursements. Because of strong controls within the Common Origination and Disbursement system and supporting processes, and other factors, there is low risk of improper payment for these payment types and an estimated error rate of approximately $8 million or less than 0.01 percent. In FY 2011, approximately 10 percent of total program outlays are related to consolidations. Due to the nature of consolidations and timing of payments, we expect to see a small percentage of over and under payments annually, with some portion of the over/under payments having been caused by error, and most being attributable to the fact that loan consolidations are not performed with a date-certain settlement date. In FY 2011, the error rate estimate for consolidations is approximately $253 million or 2.1 percent. Last, a negligible percentage of total outlays (i.e., less than 0.1 percent in FY 2011) is composed of servicing and collection refunds. These too have a small expected percentage of over and under payments annually, mostly composed of cancellations. The FY 2011 error rate for refunds, on average, was approximately $3 million or 2.6 percent.

FFEL Program. Prior year risk analyses that were undertaken in lieu of a measurement did not yield any result that could help inform decisions on improper payment estimation. Accordingly, FSA did not use these risk analyses to calculate a FY 2011 error rate and no estimate of FY 2011 improper payments is provided. Federal Student Aid is in the process of assessing the feasibility of new assessment methodologies and is developing a comprehensive plan for implementation in FY 2012 to develop an estimate of FFEL improper payments to be reported in the FY 2012 AFR.

In FY 2009, Federal Student Aid worked with OMB to target their improper payment analysis using data mining techniques to identify potential improper payments, with particular focus on SAP to lenders. In past years, SAP has been among the largest categories of payments to lenders. However, the *College Cost Reduction Act of 2007* reduced SAP rates and combined with a historically low interest rate environment, has resulted in SAP amounts due to the Department beginning in FY 2007. This substantial decline, coupled with a significant increase in the Direct Loan Program versus FFEL and the move to 100 percent Direct Loans at the end of FY 2010, have resulted in an improving risk profile related to the potential for FFEL improper payments.

Root Causes and Corrective Actions

Pell Grant Program. Departmental analysis found that the inaccuracy of self-reported financial income on the Free Application for Federal Student Aid (FAFSA) was the most significant root cause of potential Pell improper payments. This root cause is considered a verification category error, as defined by OMB Circular A-123. As a result, one of the key actions aimed at addressing the issue has been the establishment of a data exchange process with the Internal Revenue Service (IRS). FSA in conjunction with the IRS implemented a pilot version of the IRS Data Retrieval Tool (IRS DRT) on January 28, 2010, for the remaining six months of the 2009–10 application cycle. The tool enables Title IV student aid applicants and, as needed, parents of applicants, to transfer certain tax return information from an IRS Web site directly to their online FAFSA.

The IRS DRT was made available to students for ten months in the 2010–11 cycle becoming available in September of 2010. For the 2011–12 cycle, the availability of the IRS DRT was aligned more closely with the beginning of the FAFSA cycle, becoming available on January 30, immediately after the IRS began processing tax returns for the year. For the 2011–12 cycle, 3,427,891 students and parents transferred their tax data from the IRS to the FAFSA using the IRS DRT. This usage represents approximately 21.2 percent of the 16,205,543 FAFSAs submitted for the 2011–12 academic year between January 30, 2011 through September 04 2011.

Another key action of note in addressing the inaccuracies on the FAFSA, are the changes in verification regulations. Verification is the process required by the Department that schools conduct to confirm specific information reported on the FAFSA by the applicant. Previously, the Department required postsecondary educational institutions to verify key items on up to 30 percent of their students' FAFSA forms, focusing on those individuals that qualify for Pell Grants. Beginning with the 2012–13 cycle, schools will be required to verify all applicants selected for verification.

Both actions contribute to fewer instances of inaccurate financial information and subsequently, reduce improper payments. FSA will continue to explore ways to facilitate the detection of error, based on the results of the FAFSA/IRS Data Statistical Study. Additionally, FSA continues to simplify the application process and promote the real-time use of the IRS DRT. These enhancements, coupled with improved error detection, should allow FSA to further reduce improper payments.

Direct Loan Program. The root causes for improper payments within the Direct Loan program vary by payment type, and are considered administrative category errors, as defined by OMB Circular A-123, Appendix C. As noted in the preceding section, most of the Direct Loan estimated improper payment amount relates to the consolidation process. Departmental analysis has found that the most significant root cause for consolidation payoff errors is erroneous manual processing of information received from borrowers and lenders. Examples are manual errors of data entry, inclusion of student loans that the borrower desired to exclude, or failure to cancel a consolidation upon the borrower's request. Given that the loan consolidation process does not make payoffs on a prearranged date certain, an improper payment (for example to buy one loan too many) has the same characteristics as an overpayment (for example a borrower made a payment the day before consolidation). In either case, the lender is required to return the funds to the Direct Loan Consolidation program. The program conducts sampling of returned funds so as to determine the root cause, and conduct continuous process improvement.

FSA has a number of existing internal controls integrated into its Direct Loan systems and activities to prevent and detect errors and continually evaluates how to improve these controls. These include:

- System Edits and data matches—The front end student eligibility and origination and disbursement systems include edits and data matches with external data sources to prevent erroneous information from being entered into the system and prevent potential improper payments.

- Certification—In the Loan Consolidation Program, the key control is FSA's usage of lender certified loan balances and FSA's ability to compare borrower and lender provided information to the National Student Loan Data System (NSLDS) data set. A recent enhancement completed in March 2011 has been to lengthen the time between borrower final notice and lender payment so as to give the borrower additional time to respond in the event of the rare erroneous data. Another recent enhancement completed in December 2010 was the automation of a computer interface between COD and the FSA federal loan servicers. The result of this action was to reduce the potential for human error. The prior process used the Treasury's IPAC system for inter-governmental funds transfers, and usage of that system involved manual transaction processing, subject to error.

- Servicer Oversight—Management and oversight of Title IV Additional Servicers includes: process monitoring, financial data reconciliations, NSLDS reporting, operational and finance meetings and oversight activities, program compliance reviews, SAS70/SSAE16 assessments of servicer controls performed by independent public accountants (IPAs), and A-123A assessments of internal controls over financial reporting performed by FSA.

FFEL Program. Past experiences with managing the FFEL program have shown that the highest risk areas with the potential to lead to improper payments reside in the accurate and timely reporting of borrower status to calculate interest benefits and SAP. These are considered administrative category errors, as defined by OMB Circular A-123.

FSA has a number of existing internal controls integrated into its systems and activities. Program reviews, independent audits, and Inspector General audits of guaranty agencies, lenders, and servicers are some of its key oversight controls. Other control mechanisms include the following:

- System Edits—The system used by guaranty agencies, lenders, and servicers to submit bills and remit payments includes “hard” and “soft” edits to prevent erroneous information from being entered into the system and prevent potential improper payments. The hard edits require correction before proceeding with payment processing. The soft edits alert the user and FSA to potential errors. FSA reviews these warnings prior to approval of payment.
- Reasonability Analysis—Data reported by guaranty agencies to the NSLDS are used to determine payment amounts for account maintenance and loan issuance processing fees. FSA also performs trend analysis of previous payments to guaranty agencies and lenders as a means of evaluating reasonableness of changes in payment activity and payment levels.
- Focused Monitoring and Analysis—FSA targets specific areas of FFEL payment processing that are at an increased risk for improper payments as areas of focus for increased monitoring and oversight. In FY 2009, FSA completed a series of reviews of guaranty agencies’ establishment of the federal and operating funds in 1998 in response to an Office of Inspector General (OIG) recommendation. Those reviews and resulting corrective actions have been completed.

Federal Student Aid Improper Payment Reporting Summary

The following table presents the improper payments outlook for the primary Federal Student Aid programs.

Federal Student Aid Improper Payment Reduction Outlook ($ in millions)									
Year	Pell[1,2]			Direct Loan[3]			FFEL[4,5,6]		
	Outlays $	IP %	IP $	Outlays $	IP %	IP $	Outlays $	IP %	IP $
FY 2010	32,215	3.12	1,005	99,428	0.30	298	94,875	N/A	N/A
FY 2011	36,515	2.72	993[7]	116,098	0.22	255[8]	42,616	N/A	N/A
FY 2012	37,090	2.72	1,009	190,266	0.22	419	15,561	N/A	N/A
FY 2013	38,505	2.72	1,047	207,179	0.22	456	14,619	N/A	N/A
FY 2014	35,199	2.72	957	220,474	0.22	485	14,517	N/A	N/A

1) The source of FY 2010 Pell outlays is the FY 2010 AFR. The source of FY 2011 estimated Pell outlays is supporting documentation for the FY 2012 President’s Budget request. The source of the FY 2012–14 estimated Pell outlays is the Mid-Session Review update to the FY 2012 President’s Budget Request.

2) The chart above uses a preliminary Pell improper payment (IP) percentage for FY 2011. The improper payment amount is considered an estimate because the Pell rate is preliminary. The FY 2011 IP percentage is scheduled to be finalized after issuance of the Department’s AFR. The final Pell error rate for FY 2010 was

3.12 percent. This 3.12 percent rate was reported as "preliminary" in the FY 2010 AFR; however, it did not change.

3) The source of FY 2010 Direct Loan outlays is the FY 2012 President's Budget request. The source of FY 2011 estimated Direct Loan outlays is supporting documentation for the FY 2012 President's Budget request. The source of the FY 2012–14 estimated Direct Loan outlays is the Mid-Session Review update to the FY 2012 President's Budget Request.

4) As noted in the preceding "Estimation Methodology" section, FSA will continue to work with OMB in FY 2012 to develop improper payment estimation methodology for the FFEL program. Accordingly, improper payment estimates for the FFEL program are not provided.

5) The source for the FY 2010 FFEL outlays is FY2012 President's Budget request. The source for the FY 2011 FFEL outlays is the supporting documentation for the FY 2012 President's Budget request. The source for the FY 2012–14 estimated outlays is the Mid-Session Review update to the FY 2012 President's Budget request.

6) The annual Guaranty Agency Financial report provides information on transfers from the Federal Fund to Operating Fund for default aversion fees that are received in the winter of the current fiscal year for prior fiscal year activity. The amount of FY 2010 default aversion fees transferred from the Federal Fund was $166 million (non-cash transaction) and is not included in the FY 2011 outlay number. The FY 2011 default aversion fee will not be available until approximately the second quarter of the next fiscal year (FY 2012) and is not included in the FY 2011 outlays.

7) The FY 2011 Pell overaward improper payment rate estimate is 1.84 percent or $672 million and the underaward improper payment rate estimate is 0.88 percent or $321 million.

8) The FY 2011 Direct Loan overpayment improper payment rate estimate is 0.19 percent or $220 million and the underpayment improper payment rate estimate is 0.03 percent or $35 million.

The final FY 2010 improper payment rate estimate for Pell of 3.12 percent was lower than the FY 2010 reduction target of 3.5 percent as reported in the FY 2009 AFR. The preliminary FY 2011 improper payment rate estimate for Pell of 2.72 percent was lower than the FY 2011 reduction target of 3.3 percent as reported in the FY 2010 AFR. The target Pell 2.72 IP percentage used for 2012–2014 is base-lined from the FY 2011 preliminary estimate. Analysis of the FY 2011 data will be performed through early 2012 to determine whether the decrease from prior years is statistically significant, and if so, what caused it (e.g., ongoing efforts to expand and improve IRS DRT usage and recipient verification).

FY 2011 is the base year IP measurement for Direct Loan. No reduction targets were reported in the FY 2009 or FY 2010 AFRs. The target Direct Loan 0.22 IP percentage used for 2012–2014 is base-lined from the FY 2011 estimate.

Internal Control, Human Capital, Information Systems and Infrastructure

Federal Student Aid has the internal controls, human capital, and information systems and other infrastructure it needs in order to reduce improper payments to the levels the agency has targeted.

Manager Accountability

The Federal Student Aid offices, managers, and staff responsible for these programs are accountable for establishing and maintaining sufficient internal controls, including a control environment that prevents improper payments from being made, and promptly detects and recovers any improper payments that may occur. Offices and managers are held accountable through a variety of mechanisms and controls, including annual performance measures aligned to the strategic plan, organizational performance review criteria, and individual annual performance appraisal criteria. Federal Student Aid contractors are held accountable through various contract management and oversight activities and functions, control assessments, and audits. All relevant Federal Student Aid key controls are assessed annually for design and operating effectiveness to support management's FMFIA and A-123A assurance statements.

Important controls to prevent and detect improper payments are administered at the school level. For example, schools are responsible and held accountable for recipient verification for need based aid. Federal Student Aid certifies a school's eligibility for participation in Title IV programs, conducts periodic program reviews of schools to verify compliance, and evaluates school financial statement and compliance audits to ensure any potential compliance issues or control weaknesses are resolved.

Statutory and Regulatory Barriers

There are currently no identified barriers which may limit Federal Student Aid's corrective actions in reducing improper payments.

Elementary and Secondary Education Act of 1965, Title I, Part A Program

The Department performed a risk assessment of the *Elementary and Secondary Education Act of 1965* Title I Grants to Local Educational Agencies, during FY 2011. The assessment, based on FY 2010 audit data (the most recent available), yielded an estimated improper payment rate of 0.05 percent. This is consistent with previously reported data indicating that Title I does not meet the statutory threshold for susceptibility to improper payments.

The risk assessment was conducted by analyzing the questioned costs reflected in A-133 single audits and OIG audits for both grant recipients and sub-recipients. Questioned costs were identified in 91 of the total 10,455 Title I audits included in the review. Only 33 of these 91 audits included questioned costs greater than 2.5 percent of expenditures.

Questioned costs are a reasonable, upper-bound estimate of improper payments. Some questioned costs are not sustained during the audit resolution process and, as such, are not considered improper; however, additional improper payments, to a lesser extent, are identified during audit resolution. We also note that questioned costs may not include all questionable payments to a recipient given that audits generally review only a small sample of transactions. Yet this is difficult to estimate given that most individual audit findings cannot be projected with statistical confidence to 100 percent of an entity's payments.

The Department's assessment of these factors and estimate of improper payments result in the conclusion that Title I is not susceptible to significant improper payments. All previous risk assessments have similarly indicated there is not a significant risk of improper payments in the Title I program. Recoveries of improper payments in Title I are discussed in the next section. The following table presents an estimate of the improper payment outlook for Title I. No reduction targets are proposed since the Department's risk assessments have not identified Title I as a program susceptible to significant improper payments. This table is presented because Title I was previously required to report improper payments under Section 57 of OMB Circular A-11 (2002).

Title I Improper Payment Reduction Outlook ($ in millions)			
	Outlays $[1]	IP %	IP $[2]
FY 2010	18,141	.04	7.3
FY 2011	17,926	.05	9.0
FY 2012	14,825	.05	7.4
FY 2013	14,487	.05	7.2
FY 2014	14,492	.05	7.2

1) The sources of Title I outlays are FACTS II reports and the FY 2012 President's Budget request. These include ARRA outlays.

2) The estimated amount of improper payments has been increased from the amount reported in the FY 2010 AFR due to the inclusion of ARRA totals.

Other Grant Programs

Risk Assessments

The Department's approach to the risk assessment process for other non-Federal Student Aid grant programs is the same as for Title I. The intent is to use the same methodology across all non-Federal Student Aid grant programs to establish a level of quality control for all programs and, at the same time, produce a cost-effective measure. Risk assessments for programs other than Title I are conducted on a three-year cycle. None of these programs were deemed susceptible to significant improper payments in the most recent risk assessment included in the *FY 2010 Agency Financial Report.* Despite this determination, the Department is concerned about the risk of improper payments in grant programs, especially at the sub-recipient level and for programs for which audits have identified higher rates of questioned costs. The Department is working to identify root causes of improper grantee expenditures to improve grant monitoring and technical assistance to reduce improper payments.

Recovery Auditing

IPERA requires agencies to conduct recovery audits for programs that expend one million dollars or more annually if conducting such audits would be cost-effective.

Contract Payment Recapture Audits. The Department's findings from payment recapture audits of contracts have been consistently insignificant. For FY 2004–2006, the Department hired an independent CPA firm to conduct payment recapture audits for the Department's contracts and purchase orders, which total approximately $1.5 billion annually. Due to the amount the firm recovered, which is less than one percent (.0025 percent) for the entire contract period, the Department decided not to continue the work for FY 2007. Therefore, the Department has been conducting payment recapture audits of contracts since FY 2007 as part of the A-123 review process. The findings from these reviews have consistently demonstrated the low risk of improper payments in contracts.

The following chart presents the results of the Department's contract payment recapture auditing program.

Contract Payment Recapture Audit Reporting ($ in millions)	
Amount Subject to Review for Current Year (2011) Reporting	$1,571
Actual Amount Reviewed and Reported (2011)	$20.6
Amounts Identified for Recovery (2011)	$0
Amounts Recovered (2011)	$0
% of Amount Recovered out of Amount Identified (2011)	NA
Amount Outstanding (2011)	$0
% of Amount Outstanding out of Amount Identified (2011)	NA
Amount Determined Not to be Collectable (2011)	$0
% Amount Determined Not to be Collectable out of Amount Identified (2011)	NA
Amounts Identified for Recovery Prior Years (2004–2010)	$0
Amounts Recovered (2004–2010)	$0
Cumulative Amounts Identified for Recovery (2004–2011)	$0
Cumulative Amounts Recovered (2004–2011)	$0
Cumulative Amounts Outstanding (2004–2011)	$0
Cumulative Amounts Determined Not to be Collectable (2004–2011)	$0

The Department has not established formal recovery targets for contract payments given the consistently insignificant findings. Since FY 2004, the Department's audits have found no improper payments for recovery, and there are no outstanding overpayments to report. Should future contract payments be identified for recovery, the Department will establish recovery targets, taking into consideration the nature of the overpayments and any potential barriers to recovering funds.

Federal Student Aid Post-Award Audits. Audits and reviews of Title IV program participants identify potential improper payments within these programs and assess liabilities that are recovered through the Department's accounts receivable process and are included in the chart below. Federal Student Aid will continue to explore recovery audit methods, as defined by IPERA, during fiscal year 2012 and determine if they are cost beneficial.

For the Pell Grant Program, recoveries also occur when overpayments to students are assigned to Federal Student Aid for collection. Pell amounts recovered through student Debt Collection were approximately $8.7 million in FY 2011, $6.7 million in FY 2010, and $81.5 million cumulative from FY 2011 to FY 2004. While all programs may have student debts transferred to debt collection, the categorization of resulting collections as an improper payment recovery is unique to Pell. Unlike loans, Pell grant payments transferred to debt collection commonly indicate a potential improper payment at time of disbursement.

Overpayments Recaptured Outside of Payment Recapture Audits. The Department works with grantees to resolve amounts identified in A-133 Single Audits, OIG Audits and Department conducted Program Reviews as potential improper payments. The Department published a Request for Information (RFI) on February 17, 2011, to seek information from potential contractors to conduct more formal recovery audits in accordance with IPERA. The results of the RFI and an analysis of Department audit recoveries suggest that grant payment recapture audits would not be cost-effective.

The Department is exploring the possibility of leveraging IPERA to create incentives for State governments that administer Education-funded programs to conduct payment recapture audits to identify and recover overpayments, payments for ineligible goods or services, excess interest earned on advances, and other improper payments. In 2005, the Department's OIG noted that, for programs where the funds are substantially passed-through the state, in general there is a lower risk of improper payments at the state level than at the local level where the services are delivered. Under OMB Circular A-133 and other Federal grants management requirements, states are responsible for conducting programmatic and fiscal monitoring of sub-grantees at the local level. States are also responsible for addressing most Single Audit findings pertaining to sub-grantees. The Department will provide additional details as our plans progress.

The following chart provides estimates of the amounts identified and recovered through A-133 Single Audits, OIG Audits, and Program Reviews.

Overpayments Recaptured Outside of Payment Recapture Audits ($ in millions)

Agency Source	Amount Identified (FY 2011)	Amount Recovered (FY 2011)*	Amount Identified (FY 2010)	Amount Recovered (FY2010)*	Cumulative Amount Identified (FY 2010-2011)	Cumulative Amount Recovered (FY 2010-2011)
Single Audit Reports	28.7	4.2	16.9	9.3	45.6	13.5
OIG Audit Reports	13.5	3.4	.5	.6	14.0	4.0
Program Reviews	38.3	9.8	21.0	7.1	59.3	16.9

*Includes all amounts recovered during the year, not just the recoveries of amounts identified during the year.

Manager Accountability. Program staff must assess grantee risk and determine whether new or continuing grants should include "special conditions" (including grantees designated "high-risk" pursuant to EDGAR at 34 CFR §80.12). Program staffs work with the Department's Risk Management Service (RMS) to use the Decision Support System (DSS) to assess grantee risk and assist in the determination of special conditions for grant awards. DSS is a suite of software tools and support services used to perform risk analysis and reveal to the Department information that can be used to effectively administer grants. Appropriate uses of the information are to inform the work of (1) identifying fiscal or performance risks with ED's applicants or grant recipients; (2) determining if special conditions are needed for the award; and (3) developing risk-based monitoring and technical assistance plans. For more information on DSS see page 22 in the Management Discussion Analysis section of this report.

Additionally, post-audit follow-up courses have been developed to associate audit corrective actions with monitoring to minimize future risk and audit findings. Managerial compliance with monitoring procedures is reviewed and tested during the assurance process under OMB Circular A-123.

Information Systems and Infrastructure. The Department recently acquired continuous monitoring software to help detect anomalies and potential issues in agency financial data prior to payment, staff follow-up when anomalies are identified, aggressively investigate root causes of improper payments when they do occur, and develop corrective action plans to address the systemic weaknesses. This new technological tool will be used to examine payment records and identify challenges such as duplicate payments, payments for services not rendered, overpayments, and fictitious vendors before payments are actually made. This software will allow the Department to shift our focus from traditional retrospective/detective activities to proactive/preventive activities, thereby assisting the Department in reducing the risk of improper payments.

Statutory and Regulatory Barriers. The high burden of proof in the requirements of the General Education Provisions Act (GEPA) is a significant reason why the Department generally recovers a small percentage of the original questioned costs in audits. The GEPA, 20 U.S.C. 31 Subchapter IV § 1234a, requires the Department to establish a prima facie case for the recovery of funds, including an analysis reflecting the value of services obtained. In accordance with 20 U.S.C. 31 Subchapter IV § 1234b, any amount returned must be proportionate to the extent of harm the violation caused to an identifiable Federal interest.

Summary

The Department is enhancing its efforts for identifying and reducing the potential for improper payments to comply with the IPERA. Although there are still challenges to overcome, the Department is committed to ensuring the integrity of its programs.

The Department is focused on identifying and managing the risk of improper payments and mitigating the risk with adequate control activities. In FY 2012, we will continue to work with OMB and the OIG to explore additional opportunities for identifying and reducing potential improper payments and to ensure compliance with the IPERA.

Summary of Financial Statement Audit and Management Assurances

The following tables provide a summarized report on the Department's financial statement audit and its management assurances. For more details the auditor's report can be found on pages 87–104 and the Department's management assurances on pages 32–33.

Summary of Financial Statement Audit

Audit Opinion: Unqualified
Restatement: No

Material Weaknesses	Beginning Balance	New	Resolved	Consolidated	Ending Balance
Total Material Weaknesses	**0**	**0**	**0**	**0**	**0**

Summary of Management Assurances

Effectiveness of Internal Control over Financial Reporting—*Federal Managers' Financial Integrity Act* (*FMFIA*) 2

Statement of Assurance: Unqualified

Material Weaknesses	Beginning Balance	New	Resolved	Consolidated	Reassessed	Ending Balance
Total Material Weaknesses	**0**	**0**	**0**	**0**	**0**	**0**

The Department had no material weaknesses in the design or operation of the internal control over financial reporting.

Effectiveness of Internal Control over Operations—*FMFIA* 2

Statement of Assurance: Unqualified

Material Weaknesses	Beginning Balance	New	Resolved	Consolidated	Reassessed	Ending Balance
Total Material Weaknesses	**0**	**0**	**0**	**0**	**0**	**0**

Conformance with Financial Management System Requirements—*FMFIA* 4

Statement of Assurance: The Department systems conform to financial management system requirements.

Non-Conformance	Beginning Balance	New	Resolved	Consolidated	Reassessed	Ending Balance
Total Non-Conformance	**0**	**0**	**0**	**0**	**0**	**0**

Compliance with Federal Financial Management Improvement Act

	Agency	Auditor
Overall Substantial Compliance	Yes	No
1. System Requirements	Yes	No
2. Federal Accounting Standards	Yes	Yes
3. United States Standard General Ledger at Transaction Level	Yes	Yes

UNITED STATES DEPARTMENT OF EDUCATION
OFFICE OF INSPECTOR GENERAL

The Inspector General

Date OCT - 3 2011

MEMORANDUM

TO: Secretary Arne Duncan

FROM: Kathleen S. Tighe Kathleen S. Tighe
Inspector General

SUBJECT: Management Challenges for Fiscal Year 2012

The Reports Consolidation Act of 2000 requires the U.S. Department of Education (Department), Office of Inspector General (OIG), to identify and report annually on the most serious management challenges the Department faces. The Government Performance and Results Modernization Act of 2010 requires the Department to include in its agency performance plan information on its planned actions, including performance goals, indicators, and milestones, to address these challenges. To identify management challenges, we routinely examine past audit, inspection, and investigative work, as well as issued reports where corrective actions have yet to be taken; assess ongoing audit, inspection, and investigative work to identify significant vulnerabilities; and analyze new programs and activities that could pose significant challenges because of their breadth and complexity. We provided our draft challenges report to Department officials and considered all comments received.

Last year we presented four management challenges: implementation of new programs/statutory changes, oversight and monitoring, data quality and reporting, and information technology security. All of the prior management challenges remain challenges for FY 2012. The first FY 2011 challenge, implementation of new programs/statutory changes, which incorporated aspects of the American Recovery and Reinvestment Act of 2009 (Recovery Act), and the Ensuring Continued Access to Student Loans Act of 2008, has been incorporated into the oversight and monitoring challenge. In addition, we have added a new challenge related to improper payments.

The FY 2012 management challenges are:

(1) Improper Payments,
(2) Information Technology Security,
(3) Oversight and Monitoring, and
(4) Data Quality and Reporting.

We look forward to working with the Department to address the FY 2012 management challenges in the coming year. If you have any questions or would like to discuss these issues, please contact me at (202) 245-6900. You may also contact either Keith West, Assistant Inspector General for Audit, at (202) 245-7041, or William Hamel, Assistant Inspector General for Investigations, at (202) 245-6922.

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

Office of Inspector General's (OIG) Management Challenges for Fiscal Year 2012 Executive Summary

The Office of Inspector General (OIG) works to promote efficiency, effectiveness, and integrity in the programs and operations of the U.S. Department of Education (Department). Through our audits, inspections, investigations, and other reviews, we continue to identify areas of concern within the Department's programs and operations and recommend actions the Department should take to address these weaknesses. The Reports Consolidation Act of 2000 requires the OIG to identify and report annually on the most serious management challenges the Department faces. The Government Performance and Results Modernization Act of 2010 requires the Department to include in its agency performance plan information on its planned actions, including performance goals, indicators, and milestones, to address these challenges.

Last year we presented four management challenges: implementation of new programs/statutory changes, oversight and monitoring, data quality and reporting, and information technology security. All of the prior management challenges remain challenges for FY 2012. The first FY 2011 challenge, implementation of new programs/statutory changes, which incorporated aspects of the American Recovery and Reinvestment Act of 2009 (Recovery Act), and the Ensuring Continued Access to Student Loans Act of 2008, has been incorporated into the oversight and monitoring challenge. In addition, we have added a new challenge related to improper payments.

The FY 2012 management challenges are:

(1) Improper Payments,

(2) Information Technology Security,

(3) Oversight and Monitoring, and

(4) Data Quality and Reporting.

Improper Payments. A significant challenge for management in FY 2012 is the prevention, identification, and recapturing of improper payments. Across the Federal Government, agencies reported an estimated $125.4 billion in improper payments for FY 2010. The Department estimated that it had more than $1 billion in improper payments in the Pell Grant program alone in FY 2010. The Department, as well as other agencies, must be able to ensure that the billions of dollars entrusted to it are reaching the intended recipients. The President has established an aggressive goal to reduce government-wide improper payments by $50 billion by FY 2012. To meet these goals, various pieces of legislation were enacted and implementing guidance was issued. The Department will be challenged to take actions to meet all the new requirements, and to intensify its efforts to prevent, identify, and recapture improper payments.

Information Technology Security. The Department collects, processes, and stores a large amount of personally identifiable information regarding employees, students, and other program participants. OIG has identified repeated problems in Information Technology (IT) security and noted increasing threats and vulnerabilities to Department systems and data. For the last several years, OIG's IT audits and Investigative Program Advisory Reports have identified management, operational, and technical security controls that need improvement to adequately protect the confidentiality, integrity, and availability of Department systems and data. We have identified security weaknesses in the incident handling process and procedures, personnel security controls, and configuration management. Compromise of the Department's data would cause substantial harm and embarrassment to the Department and could lead to identity theft or other fraudulent use of the information.

Oversight and Monitoring. Effective oversight and monitoring of the Department's programs and operations are critical to ensure that funds are used for the purposes intended, programs are achieving goals and objectives, and the Department is obtaining the products and level of services for which it has contracted. This is a significant responsibility for the Department given the numbers of different entities and programs requiring monitoring and oversight, the amount of funding that flows through the Department, and the impact that ineffective monitoring could have on the students and taxpayers. Five areas are included in this management challenge—student financial assistance (SFA) program participants, distance education, Recovery Act programs, grantees, and contractors.

- **Student Financial Assistance Program Participants.** The Department must provide effective oversight and monitoring of participants in the SFA programs under Title IV of the Higher Education Act of 1965 as amended to ensure that the programs are not subject to fraud, waste, abuse, and mismanagement. Under the President's budget, the Department expects to provide more than $189 billion in grants, loans, and work-study assistance for these programs in FY 2012. An estimated 15.9 million students and their families will rely on the SFA programs to help fund their postsecondary educations. Participants in the SFA programs include postsecondary institutions, lenders, guaranty agencies, and third-party servicers. Our work has identified weaknesses in the Department's oversight and monitoring of these participants. The Department has taken corrective actions to address many of the recommendations contained in our prior reports. However, the Department needs to continue to assess and improve its oversight and monitoring of program participants and take effective actions when problems are identified.

- **Distance Education.** Distance education refers to courses or programs offered through telecommunication, such as through Internet connection with a postsecondary institution. The flexibility offered is popular with students pursuing education on a non-traditional schedule. Many institutions offer distance education programs as a way to increase their enrollment. Management of distance education programs presents a challenge for the Department and school officials because of limited or no physical contact to verify the student's identity or attendance. OIG audit work has found that for distance education programs, schools face a challenge in determining when a student attends, withdraws from school, or drops a course. Attendance is critical because it is used to determine the student's eligibility for Federal student aid and to calculate the return of funds if the student withdraws or drops out. Our investigative work has also identified numerous instances of fraud involving distance education programs. These cases involved the exploitation of vulnerabilities in distance education programs to fraudulently obtain Federal student aid. Also, some requirements for residential programs do not translate clearly for distance education programs, and guidance is not available to address these issues. The Department needs to develop requirements specific to distance education and to increase its oversight of schools providing programs through distance education.

- **Recovery Act Programs.** The Recovery Act provided significant additional funding to help improve the economy and enhance education reforms. This included funding for new educational programs and existing programs. Over the last year, the challenge for the Department has moved from implementing the programs to monitoring the programs to ensure that program funds are expended for the purposes intended and that the goals and objectives of the programs are being met. In FY 2012, the Department will also be providing oversight of the winding down of the programs and funding provided. The OIG and the Government Accountability Office have conducted significant amounts of work at the Department, State agencies, and local educational agencies (LEAs). This work identified a number of control weaknesses related to the use of funds, cash management, subrecipient monitoring, and impacts on maintaining levels of funding for education programs. We made recommendations to improve implementation and monitoring of Recovery Act programs. The Department has taken proactive measures to coordinate the effective implementation and oversight of the Recovery Act and to provide technical assistance to recipients. Additional oversight and monitoring could enhance the Department's ability to ensure that Federal funds are effectively managed and that deficiencies noted in audits and other reviews are corrected timely. The Department must continue to provide guidance and assistance to recipients on these programs, identify and obtain additional resources for program monitoring, and take timely corrective actions to address issues noted in audits and other reviews.

- **Grantees.** Effective monitoring and oversight are essential to ensure that grantees meet grant requirements and achieve program goals and objectives. In addition to our work on Recovery Act programs, our work on other grant programs has identified a number of weaknesses in grantee oversight and monitoring. We have identified pervasive fiscal control weaknesses at a number of grantees, weaknesses in a grant payback program, as well as fraud committed by LEA and charter school officials. The Department is responsible for monitoring the activities of grantees to ensure compliance with applicable Federal requirements and that performance goals are being achieved. The Department has taken corrective actions to address many of the recommendations contained in our reports. However, the Department needs to continue to assess and improve its oversight and monitoring of grantees and take effective actions when issues are identified.

- **Contractors.** The Department relies heavily on contractor support to accomplish its mission and to ensure the effective operations of its many systems and activities. The current value of the Department's active contracts is nearly $5.4 billion. Once a contract is awarded, the Department must effectively monitor performance to ensure that it receives the quality and quantity of products or services for which it is paying. OIG reports have included numerous deficiencies in the area of contract monitoring, and we have made recommendations for corrective action. The Department has taken action to address many of the issues noted. A critical issue hampering significant improvement, however, is the shortage of appropriately qualified staff to adequately monitor contractor performance. A concerted effort is needed to develop and implement an aggressive human capital plan to address this issue.

- **Data Quality and Reporting.** The Department, its grantees, and its subrecipients must have controls in place and effectively operating to ensure that accurate, reliable data are reported. Data are used by the Department to make funding decisions, evaluate program performance, and support a number of management decisions. State education agencies (SEAs) annually collect data from LEAs and report various program data to the Department. The Recovery Act places a heavy emphasis on accountability and transparency, including reporting requirements related to the awarding and use of funds. All recipients and subrecipients are mandated to provide information about their awards on a publicly available Web site authorized by the statute. The new reporting requirements required Federal, State, and local agencies to develop the systems and infrastructure quickly to collect and report the required information. The Department must educate recipients about the reporting requirements, assess the quality of the reported information, and use the collected information effectively to monitor and oversee Recovery Act programs and performance. Our work has identified a variety of weaknesses in the quality of reported data and recommended improvements at the SEA and LEA level, as well as actions the Department can take to clarify requirements and provide additional guidance. Establishing more consistent definitions for data terms will enhance reporting accuracy and comparability. For Recovery Act programs, our work noted weaknesses in controls over data quality and reporting, both externally at SEAs and LEAs, and internally at the Department. Ensuring that accurate and complete data are reported is critical to achieving the transparency goals of the Recovery Act, as well as supporting effective management decisions.

The FY 2012 Management Challenges report is published by the Department's Office of Inspector General. To view the full report, go to: http://www2.ed.gov/about/offices/list/oig/managementchallenges.html.