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/erroneous payments made by the federal government. OMB also has established specific reporting requirements for agencies with programs that possess a significant risk of erroneous payments and for reporting on the results of recovery auditing activities. Agencies are required to 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 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; *Elementary and Secondary Education Act of 1965* Title I, Part A Program; Other Grant Programs; and Recovery Auditing.

Student Financial Assistance Programs

Risk-Susceptible Programs

As required by the OMB Circular A-123, Appendix C, Federal Student Aid (FSA) inventoried all its programs during FY 2011 (the year after IPERA's enactment) and, for each program, assessed the risk of improper payments. The result of the FY 2011 assessment is found in the FY 2011 AFR. OMB Circular A-123, Appendix C, requires all programs not deemed risk susceptible to improper payments to be reviewed at least once every three years. Thus, FSA did not perform a risk assessment during FY 2012.

As a result of the FY 2011 risk assessment, the Direct Loan Program, Federal Family Education Loan (FFEL) Program, and Pell Grant Program were identified as potentially susceptible to the risk of significant improper payments based on the OMB Circular A-123, Appendix C criteria described above.

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 of undisbursed funds to Title IV collections from schools; and collections by the school on overpayments from recipients.

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 loan holders; and return of Title IV collections (undisbursed funds or overpayments) from schools.

FFEL Program. During FY 2012, the FFEL Program made no new loan originations. FY 2012 payment types and cash flows associated with the guarantees on 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, and Account Maintenance Fees.

Beginning 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 October 15, 2010, and 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 ongoing servicing of these FFEL loans acquired through ECASLA is a part of the FFEL Program.

Estimation Methodology

The size and complexity of the student aid programs make it difficult to define "improper" payments in the context of Title IV funds. 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.

For FY 2012, FSA implemented new estimation methodologies for all risk-susceptible programs reported (i.e., Pell, Direct Loan, and FFEL); however, these new methodologies have not been approved by OMB and are provided here as supplemental information only. As of the publication date of this FY 2012 AFR, FSA is working with OMB to obtain approval of the new estimation methodologies. The new estimation methodologies produce statistically valid estimates with a higher level of confidence than the prior methodologies (as defined by OMB Circular A-123, Appendix C) for each program. FSA contracted with statisticians to develop the overall approach for each program. These statisticians designed and executed the statistical samples, and they compiled the results and calculated the rates for each program. FSA will consider the results of the FY 2012 process and input from OMB in making improvements to the methodologies in FY 2013 and subsequent years. Information is presented below for both the previously approved methodologies and the new unapproved FY 2012 methodologies for all programs reported.

Pell Grant Program

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 program threshold of $750 million. The Department coordinated with OMB to establish and execute a plan to implement applicable high-priority program requirements including the designation of accountable officials and the establishment of supplemental measures to be reported on PaymentAccuracy.gov.

As in previous years, the Department conducted a statistical study with the Internal Revenue Service (IRS) using FAFSA data to calculate an improper payment rate for the

Pell Grant program. The FY 2011 Pell Grant improper payment rate of 2.72 percent was based on the results of the study. The preliminary rate FY 2012 from the study is 2.49 percent which results in estimated improper payments of $829 million. In the most recent completed study, which compared 2011–12 FAFSA data with 2010 IRS data (the tax year that was used to calculate 2011-12 Pell Grant eligibility), a sample was drawn from the Title IV Central Processing system that included 3,299,819 applicants to be used in various studies. A match with the SSNs of the parents and students was sought from the IRS database. Two files were provided to the IRS. The first contained the social security numbers (SSNs) of the sample records along with a sampling program designed to select the desired analysis sample for the baseline analysis from the larger file. This was done to preserve IRS confidentiality requirements. This file was used to match against the main IRS database and select the matching records. IRS data for these records was then used with the second file provided by the Department which contained other applicant data specific to the filer that could be used, along with the relevant IRS data, to calculate an EFC and Federal Pell Grant award amount for each applicant in the sample, to explain discrepancies, and to identify the types of applicants who over- and under-reported their income information on the FAFSA.

The IRS matched student SSN, and parent SSN (if the student was dependent), in this file against SSNs in the IRS master file. If a match occurred, the IRS extracted adjusted gross income (AGI), taxes paid, type of return filed, earned income credit, exemptions, and itemized deductions for the tax filer and compared this information to FAFSA-reported data. Using a program supplied by the Department, the IRS calculated the EFC and Pell awards for matching records by substituting the IRS income information for the FAFSA income information. The IRS provided aggregated statistical tables to the Department that showed the results of these comparisons. Data provided by the IRS as a result of the match were analyzed and used to model projections for income, EFC, and Pell award discrepancies.

The IRS statistical study used application and disbursement level data to recalculate student awards where income figures were mismatched between tax returns and aid applications. The IRS study was based on interim data where not all of the applications expected to be processed for the cycle had been processed and moreover, additional corrections were still to be made by applicants to their original data. Therefore, the IRS data did not reflect subsequent corrections that were made nor did it reflect applicants for summer school of the second year who applied late. These limitations in the study resulted in changes to the Pell methodology for FY 2012. In contrast to the methodology used in the study, the new methodology for Pell is based on onsite reviews used disbursement level data and tested actual payments that were made. The Pell improper payment rate going forward will be based on the new Pell methodology.

A new estimated improper payment rate calculation was completed for the Pell Grant Program in FY 2012 to quantify precision of the estimate and to consider additional root causes and corrective actions. This estimation methodology is pending OMB approval and was based on onsite reviews conducted at a sample of schools. FSA conducts onsite program reviews at schools to assess a variety of compliance requirements of the Pell Grant program. FSA identified individual transaction points of the Pell Grant program that were deemed to pose the highest risk of improper payments. The program review schedule of schools is focused on high-risk institutions as determined by an annual risk assessment.

In FY 2012, the Pell payment error rates for 802 students sampled across 61 institutions, with program reviews conducted between October 1, 2011, and May 31, 2012, were used to estimate a statistical confidence interval range of rates, representing the likely range of error rate in the population. Any error rate in that range may be chosen, and potentially complemented by the supplemental compliance audit estimate covering 96 schools, considering the impact on the estimated range of the risk-based selection methodology. Student file records for a sample of payments made to Pell recipients at each selected school were verified for overall eligibility, or subsequent events that would disqualify all or a portion of the payment made. The ratio of the errors identified to the total payments reviewed for all sampled students was extrapolated using a 90 percent confidence interval to estimate the improper payment rate for the Pell Grant Program. Based on this analysis, the error rate was 2.10 percent, or $699 million, at a 90 percent confidence level and 1.26 percent precision.

FSA also reviewed compliance audits as a supplemental estimate of improper payments. Public and private schools that receive more than $500,000 of Title IV funds must submit compliance audits in accordance with OMB Circular A-133, *Audits of States, Local Governments and Non-Profit Organizations*. Proprietary institutions must submit compliance audits in accordance with the Department of Education's Office of Inspector General Audit Guide, *Audits of Federal Student Financial Assistance Programs at Participating Institution Servicers (2000)*. Thus, both A-133 audits and annual compliance audits of proprietary schools were used as the basis for the supplemental estimates. The Department randomly sampled 96 A-133 compliance audits of the total population of schools participating in the Pell Program. Since the sampling methodology is rarely reported in A-133 compliance audits, it was assumed that 15 students were sampled in each compliance audit with a disbursement value that is equal to the average disbursement amount for the Pell program. The assumption of 15 students was made to compare to the sample methodology used in the general assessment program reviews conducted by FSA. Findings related to improper payments were logged from these audits and divided by an estimated sample value computed based on the assumed sample size and disbursement values. This result was used to provide an alternate, supplemental estimate to the one computed based on the onsite reviews discussed above. This resulting estimate was 1.47 percent.

Additionally, FSA performed analytical procedures on its internal disbursement system to include transactional rule sets to assess whether any control deficiencies exist that result in systemic improper payments for the Pell program for schools that recorded disbursements for the 2010–11 award year as of September 30, 2011. The conclusion of this analysis was that no material deficiencies exist.

Direct Loan Program

The Direct Loan Program improper payment rate is composed of estimates of improper payments from the following activities: loan disbursements from institutions to students, loan consolidations, and refunds. In FY 2011, an estimated improper payment rate calculation, similar to the calculation used in years prior to FY 2011, was completed resulting in an overall improper payment rate of 0.22 percent. As noted below, improvements to this methodology can be made and, in accordance with instruction from OMB, FSA does not provide a rate for the Direct Loan Program under the FY 2011

methodology. As noted in the data tables in the improper payment summary section, no approved FY 2012 rate is reported.

A new estimated improper payment rate calculation was completed for the Direct Loan Program in FY 2012 to quantify precision of the estimate and to consider additional root causes and corrective actions. The new FY 2012 methodology is pending OMB approval. This estimate was based on tests of the three components of the Direct Loan program: 1) onsite reviews conducted at a sample of schools for disbursements to students, 2) tests of loan consolidation overpayment and underpayment activity, and 3) tests of loan refund activity.

For the first component test of onsite program reviews, FSA identified individual transaction points of the Direct Loan Program that were deemed to pose the highest risk of improper payments. The ratio of the high-risk improper payment errors identified to the total payments reviewed for all sampled students was computed to estimate the overall error rate for Direct Loan disbursement of funds from the school to students. The estimate of improper payments from institutions to students uses the same methodology as used in the Pell Grant Program where the error rates of Direct Loan payments for 747 students sampled at 56 institutions with program reviews conducted between October 1, 2011, and May 31, 2012, were used to estimate a statistical confidence internal range of rates. Again, any error rate in that range may be chosen, and complemented by the supplemental compliance audit estimate covering 97 schools, considering the impact on the estimate range of the risk-based selection methodology. Based on this analysis, the overall extrapolated loan disbursement error rate was 0.6 percent at a 90 percent confidence level and 0.7 percent precision.

The second component test of loan consolidation activity was computed based on the same source data as in FY 2011, but the sample design was modified to measure precision and demonstrate representativeness to the past estimation methodology. The loan consolidation improper payment estimate was computed by sampling five overpayments and five underpayments, from the universe of all underpayment and overpayment activities for each of the 12 months from July 2011 through June 2012 for a total sample size of 120. Any improper payments found in the sample were extrapolated to create a 90 percent statistical confidence interval range of the overall improper payment rate for loan consolidation activity. Note that the sample selection methodology for loan consolidations was representative versus risk-based. Based on this analysis, the program review extrapolated loan consolidation component error rate was 0.39 percent at a 90 percent confidence level and 0.14 percent precision.

The third component test is the test of loan refund activity. A refund on a borrower's account can occur when a payment is received for more than the amount due, resulting in a credit balance. In the case that the credit balance is less than $5, the account is closed out and written up to zero, unless the borrower requests a refund. A refund can also occur when a payment resides in an unapplied state in suspense and cannot be matched to a borrower's account. The calculation of the loan refunds improper payment estimate was computed by sampling 15 refunds, from the universe of all refund activity for each of the 12 months from July 2011 through June 2012 for a total sample size of 180. No improper payments were found in the sample, resulting in a loan refund component error rate of 0 percent. The sample selection was not risk-based.

The loan disbursement, consolidation, and refund rates were then applied to their representative FY 2012 balances. The aggregate estimated improper payment amount for all three components was then applied to the total disbursement activity for the Direct Loan program to come up with the overall Direct Loan improper payment rate of 0.58 percent, or $614 million, at a 90 percent confidence level and 0.63 percent precision.

A supplemental estimate based on A-133 Compliance Audits for public and private institutions and compliance audits for proprietary institutions was conducted in the same fashion as the Pell supplemental estimate. Findings related to improper payments were logged from a sample of 97 compliance audits and divided by an estimated sample value computed based on the assumed sample size and disbursement values. The resulting estimate was 0.36 percent.

FSA also performed analytical procedures on its internal disbursement system to include transactional rule sets to assess whether any control deficiencies exist that result in systemic improper payments for the Direct Loan program for a sample set of 66 institutions for the Direct Loan program disbursements recorded for the 2010–11 award year as of September 30, 2011. The conclusion of this analysis was that no material deficiencies exist.

FFEL Program

In past years, Special Allowance Payment (SAP) has been among the largest categories of payments to lenders or guarantors. However, the *College Cost Reduction Act of 2007* reduced SAP rates and, combined with a historically low interest rate environment, changed this trend and resulted in SAP amounts due to the Department beginning in FY 2007. A significant increase in the Direct Loan Program from the transition to 100 percent Direct Loans at the end of FY 2010 has also resulted in a lower risk related to the potential for FFEL improper payments.

Federal Student Aid performed a FFEL Special Allowance Payment (SAP) risk analysis in lieu of an improper payment measurement in FY 2009 and FY 2010. The results determined through the FY 2009 and FY 2010 SAP risk analyses could not conclude in an informed measurement of improper payments; therefore, the SAP analysis was suspended after FY 2010 and no estimate of improper payments was calculated in FY 2011. For FY 2012, FSA does not report an improper payment rate for the FFEL program under this old methodology.

In FY 2012, an estimated improper payment rate calculation was completed for the FFEL Program based on new methodology which is pending OMB approval. This estimate was based on onsite reviews conducted at a sample of financial institutions holding or servicing commercially held FFEL loans. FSA developed an improper payment measurement for the FFEL program in FY 2012 that estimated improper payments based on transaction points posing the highest risk of improper payments. FSA identified the high risk areas for improper payment as SAP and Interest Benefit (IB) payments for lenders, and reinsurance claims paid for Guaranty Agencies (GAs). A component of SAP is Negative SAP, which represents the net amount due to a Lender. In the last few years, Negative SAP has outpaced regular SAP, and this resulted in negative net SAP amounts due to lenders. Therefore, the FY 2012 sampling methodology included consideration for this shift in SAP balances. The results from program reviews at seven servicers and two lenders, where loan accounts were tested, were used to estimate improper payments for the FFEL program.

The sample represents 362 loan accounts where average daily balances were tested for the purpose of estimating potentially erroneous SAP and IB payments. The ratio of lender-reported average daily balances to correctly calculated average daily balances in the sample population was computed to estimate improper SAP and IB payments to come up with the overall improper payment rate of 1.93 percent, or $552 million, at a 90 percent confidence level and 0.53 percent precision.

Although the sample selection methodology was risk-based, the improper payment rate was conservatively chosen since an estimate for the FFEL program was not previously reported. Additionally, no actual payments were tested. Errors in reported average daily balances were used as a proxy for payments. Reinsurance claims paid to GAs were tested on a limited basis due to scheduling/timing issues and limited data available from the program reviews sampled. There were insufficient data points collected to produce a statistically valid estimate for this population. Furthermore, the result of the limited review of GA payments suggests that the error rate for GAs would be lower than the FFEL error rate calculated. FSA will work to adjust the FFEL methodology in FY 2013 to integrate these payment types in the overall FFEL improper payment estimate.

Similar to the review of A-133 compliance audits used in the Pell and Direct Loan estimates, supplemental estimates were calculated based on A-133 compliance audit findings of 53 for-profit FFEL lenders and servicers and the lender accounting system reconciliation results of 101 lenders conducted by FSA and its financial partners. While there were both SAP and IB findings logged when completing these supplemental procedures, the effective error rate was less than 0.01 percent and hence the supplemental estimates did not influence the estimates based on program reviews.

Root Causes and Corrective Actions

During the FY 2012 improper payment assessment, the root causes of improper payments were categorized under the following two of three error categories, as defined by OMB Circular A-123, Appendix C:

- ***Documentation and Administrative Errors:*** Errors caused by the absence of supporting documentation necessary to verify the accuracy of a payment; or errors caused by incorrect inputting, classifying, or processing of applications or payments by a relevant federal agency, state agency, or third party who is not the beneficiary; and
- ***Verification Errors:*** Errors caused by the failure or inability to verify recipient information, including earnings, income, assets, or work status, even though verifying information does exist in third-party databases or other resources (in this situation, as contrasted with “authentication” errors, the “inability” to verify may arise due to legal or other restrictions that effectively deny access to an existing database or resource), or errors due to beneficiaries failing to report correct information to an agency.

The category of Authentication and Medical Necessity Errors, as defined by OMB Circular A-123, Appendix C, was not applicable to the Pell, Direct Loan, or FFEL programs in FY 2012. A summary of the root causes of improper payments identified for each program are outlined in the sections below.

Pell Grant and Direct Loan Programs—Root Causes

The root causes of improper payments identified through improper payment testing for both the Pell Grants and Direct Loan Programs were distributed across the major risk areas identified, and are outlined in the chart below:

IPIA Error Category	Root Causes of Improper Payments Identified for Pell Grants and Direct Loans
Documentation and Administrative Errors	Incorrect Awards based on Expected Family Contribution (EFC)
	Incorrect Processing of Student Data During Normal Operations
	Student Account Data Changes Not Applied or Processed Correctly
Verification Errors	Ineligibility for a Pell Grant/Direct Loan (e.g., validity of high school attended, history of degrees obtained)
	Satisfactory Academic Progress (SAP) Not Achieved
	Incorrectly Calculated Return Record

Direct Loan Consolidations—Root Causes

As reported in the FY 2011 AFR, many Direct Loan improper payments relate to the loan consolidation component. Additional departmental analysis has found that the most significant root cause for FFEL-to-Direct Loan consolidation pay-off errors relates to the erroneous processing of loan consolidations. Examples include funds returned due to duplicate funding or multiple Loan Verification Certificates (LVCs), inclusion of student loans that the borrower desired to exclude or were determined to be ineligible, and payoffs sent to the wrong address.

In FY 2012, six root causes of improper payments were identified through testing for the Direct Loan Consolidation Program and are outlined in the chart below:

IPIA Error Category	Root Causes of Improper Payments Identified for Direct Loan Consolidations
Documentation and Administrative Errors	Incorrect Processing of Loan Verification Certificate (LVC) (e.g., LVC not certified)
	Processing of Duplicate LVCs
	Incorrect Information Submitted on the LVC and Processed
	Loan Not Intended for Consolidation Processed
	Consolidation Processed for Loans Sold to Other Lenders
Verification Errors	Ineligibility for Direct Loan Consolidation

FFEL Program—Root Causes

Three root causes of improper payments were identified for the FFEL Program and are outlined in the chart below:

IPIA Error Category	Root Causes of Improper Payments Identified for FFEL
Documentation and Administrative Errors	Manual Entries Processed Erroneously (e.g., as failure to apply the 3-day delay, or to adjust the Lender Report System (LaRS) billing date, or to use only one payment code during the billing quarter)
	Incorrect Calculation of the Average Daily Balance due to Erroneous Manual Entries
	Incorrect Calculation of the Average Daily Balance due to Software Formula Errors
	Incorrect calculation of Guaranty Agency reinsurance claims

Root Cause Summary

In FY 2012, the results of the root cause analysis of improper payments across all risk-susceptible programs highlighted that the underlying root cause was due to the processing errors which occur at the institution level.

Further analysis of the improper payment findings identified through testing and associated root causes resulted in the following percentages of improper payment findings in dollars, attributed to Documentation and Administrative Errors (i.e., the absolute dollar amount of improper payments identified within the category proportional to the total dollar amount in the sample reviewed) and Verification Errors (i.e., the absolute dollar amount of improper payments identified within the category proportional to the total dollar amount in the sample reviewed), as follows:

IPIA Error Category	Pell Grants	Direct Loans	Direct Loan Consolidations	FFEL
Documentation and Administrative Errors	36%	39%	61%	100%
Verification Errors	64%	61%	39%	0%

Corrective Actions

Corrective actions as described in the FY 2011 AFR are ongoing efforts and have continued to be refined during FY 2012. Additional actions are being planned to address other root causes identified during FY 2012. FSA will continue to evaluate corrective actions for these root causes in FY 2013 and refine our Program Compliance initiatives and other corrective actions. Corrective actions for each program and corrective actions applicable to all programs are described below.

The discussion below on program reviews is applicable to all the risk-susceptible programs. In addition, Federal Student Aid addresses audit findings from Department of Education OIG audits such as the OIG audit of the Department of Education's Compliance with the *Improper Payments Elimination and Recovery Act of 2010* for Fiscal Year 2011 (ACN: A03M0001, issued March 15, 2012). In an effort to address the improper payment findings from that audit and root causes noted during the FY 2012 improper payments testing, Federal Student Aid is currently working toward resolving the findings with corrective actions which are scheduled for completion on November 21, 2012. Federal Student Aid is

also working to complete corrective actions for the OIG's Investigative Program Advisory Report (IPAR) on Distance Education Fraud Rings (L42L0001, issued September 26, 2011). Corrective actions taken by FSA for the IPERA audit findings include replacing or modifying the existing improper payment estimation methodology in FY 2012 for the Pell, Direct Loan, and FFEL programs. The new FY 2012 estimation methodology addresses issues identified in findings, such as including a detailed description of all estimation methodology in the AFR, excluded populations in the Pell program, and incorporating the use of Program Compliance reviews and OIG audits and investigations. Corrective actions taken by FSA for the Distance Education Fraud Rings IPAR include steps toward promulgating new regulations over institutions that enroll students exclusively in distance education programs and publishing a Dear Colleague Letter (GEN-11-17) that provides guidance to institutions that offer distance education programs.

Pell Grant Program. Federal Student Aid continues to utilize the Internal Revenue Service Data Retrieval Tool (IRS DRT), which enables Title IV student aid applicants and, as needed, parents of applicants, to transfer certain tax return information from an IRS website directly to their online FAFSA. For the 2012–13 cycle, 4,842,207 students and parents transferred their tax data from the IRS to the FAFSA using the IRS DRT between February 5, 2012 and September 23, 2012. This usage translates to approximately 26 percent of the 18,621,335 FAFSAs submitted including IRS data for the 2012–13 academic year.

In addition, customized verification processes have been implemented in FY 2012. Verification is the process required by the Department that schools conduct to confirm specific information reported on the FAFSA by the applicant. As noted in the FY 2011 AFR, for the 2012–13 award year, schools are required to verify all applications selected for verification. For the 2013–14 award year, the Department has begun transitioning to a customized selection approach where students are selected based on an analysis of applicant data and require verification of only the data element(s) that caused the selection. Enhanced system edits within NSLDS have also been implemented to flag students with unusual enrollment history to assist in identifying applications for verification.

Institutions administering the Pell Grant Program are also subject to corrective actions through program reviews. Please see the section on program review below.

Direct Loan Program. To address the findings noted during the FY 2012 improper payments testing of Direct Loan Consolidations, Federal Student Aid will work to reevaluate the current procedures of processing Loan Verification Certificate LVCs and will consider improvements in system edits to prevent the processing of duplicate LVCs and ineligible loans. Additionally, management will consider additional trainings on processing LVCs to ensure the correct account, lender, and loan information is processed in an effort to reduce the risk of potential improper payments.

As reported in the FY 2011 AFR, 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.

- Servicer oversight—Management and oversight of Title IV Additional Servicers includes: process monitoring, financial data reconciliations, NSLDS reporting, 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.
- Internal reporting—FSA's Business Operations works with the Servicers to track overpayments and/or underpayments that occur during the course of business, through an internal reporting process. Using internal reporting methods allows FSA to identify the causes of the overpayments and/or underpayments, track the progress of resolution, and, make necessary adjustments to correct them.
- Program reviews—Institutions administering the Direct Loan Program are also subject to corrective actions through program reviews. Please see the section on program review below.

FFEL Program. The FFEL program continues to have a number of existing internal controls integrated into its systems and activities including program reviews. Some of these are described below:

- 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.
- Program reviews—Institutions administering the FFEL Program are also subject to corrective actions through program reviews. Please see the section on program review below.

All Risk-Susceptible Programs. In addition to the control activities and corrective actions identified above for each individual risk-susceptible program, the following activities and related corrective actions (both internally at FSA and at the institution level) mitigate the risk of improper payments and facilitate identification and recovery for all programs.

Program Review Process

As mentioned in the Estimation Methodology section, the improper payment rate calculations for FY 2012 were partially based upon the results of onsite program reviews conducted at a sample of schools or financial institutions for the Pell Grant, Direct Loan and FFEL Programs. FSA's Program Compliance office works to promote accountability in the administration of Title IV student financial aid through institutional oversight and

enforcement. As part of its ongoing enforcement activities, Program Compliance issues loss of eligibility determinations to schools, closes main campuses and additional locations, assesses millions of dollars in Program Review final determinations and final audit determinations, and debars individuals from receiving assistance or benefits from any federal agency as a result of financial aid fraud or other criminal convictions.

For each program review completed, Federal Student Aid Program Compliance review teams issue a Program Review Report (PRR), a preliminary report of the findings identified during the program reviews which includes statutes and regulations applicable to each finding identified per school or financial institution. To address each finding identified, the PRR includes corrective actions required by the school/financial institution to resolve the findings of noncompliance. The review team may optionally include recommendations in the PRR regarding actions the institution should consider that are not necessarily related to identified findings; but, may improve the process of administering student aid or address certain matters in the PRR that can potentially affect the administration of Title IV program at the school/financial institution. These requirements and recommendations contribute to fewer future instances of inaccurate processing of financial aid at the institutional level and subsequently, the reduction of improper payments.

The school/financial institution is required to respond to the initial PRR within a specified timeframe and, if available, provide additional supporting detail on the findings. Federal Student Aid receives a response from the school/institution, the information and any supporting documentation provided is reviewed to determine if the institution has included adequate information required by the report for the identified finding or if further follow-up with the school/financial institution is required prior to issuing the Final Program Review Determination.

Once the PRR response is considered complete, a Final Program Review Determination (FPRD) is issued to: (1) inform the institution of the liabilities identified based on the findings reported in the PRR, (2) provide instructions for payment of liabilities, (3) notify the school/financial institution of the right to appeal, and (4) close the program review process. Furthermore, the FPRD may address requirements for subsequent A-133 Compliance Audits (see detail on corrective actions related to the A-133 Compliance Audits in the section below). The findings and final determinations are detailed within the FPRD and include the corrective actions taken by the school/financial institution to either resolve the finding or finding(s) that contain liabilities or detail the ongoing corrective actions from the school/ financial institution.

Overall, Federal Student Aid necessitates that all findings identified during the program reviews are tracked through the Postsecondary Education Participants System (PEPS). Tracking practices allow FSA to increase the focus on monitoring findings identified through program reviews and alert FSA to potential future errors related to improper payments.

Specifically related to FFEL improper payments, Federal Student Aid engages stakeholder offices to share issues and to identify relevant risk areas in the FFEL program. The results of this collaboration brings these risk areas into focus in their program review and compliance audits conducted over financial institutions that participate in the FFEL program, and include testing areas related to improper payments. For instance, FSA works closely with the OIG in updating the audit guides for Guaranty Agencies, Lender and Lender Servicers, and also exerts considerable influence in establishing the scope of the

Common Review Initiative (CRI), which are peer reviews conducted by Guaranty Agency staff on a biennial basis, where tests are performed on lender portfolios for which the Guaranty Agency holds the loan guarantees.

A-133 Compliance Audits and Other External Assessments

Independent public accountants and the Inspector General perform audits of guaranty agencies, lenders, and servicers. Such audits include A-133 Compliance Audits (i.e., Single Audit Act Audits) that are required to be performed at schools and financial institutions. Furthermore, for-profit entities holding more than $5 million in FFEL loans during their fiscal year must submit an independent annual compliance audit for that year conducted by a qualified independent organization or person. Please refer to the Estimation Methodology section for further information related to A-133 Compliance Audits. The Department requires external auditors to work with the auditee's management to develop corrective action plans as part of the audit report package to assist in resolving instances of noncompliance, reportable conditions, and material weaknesses in the internal controls of the school/financial institution.

The corrective action plans developed by the external auditor must describe the corrective action taken or planned in response to findings identified. Additionally, the Department requires the school/financial institution to develop a separate corrective action plan based on the findings identified by the external auditor that includes projected dates for completion of corrective activities. The external auditor will report on the status of the findings and corrective actions annually until the finding is resolved by the school/financial institution.

Other Activities to Improve Institutional Level Administration of Title IV Aid

As noted in the sections above, the underlying source for the majority of the root causes of improper payments identified for FY 2012 are due to the processing errors which occur at the institutional level, and do not reside within controls at Federal Student Aid. In addition to the corrective actions described in the preceding section, including institutional program reviews, Federal Student Aid makes available information, resources, and tools to institutions to facilitate efforts to improve institutional control. These include, but are not limited to, the following:

- **Annual FSA Conferences:** A (no registration fee) conference is held annually in November to provide the most up-to-date information on Title IV programs and the evolving federal policies and procedures affecting FSA customers and partners. Topics generally covered range from the technologies associated with information systems to improved practices for supporting aid applicants and recipients. This conference hosted almost 7,000 financial aid community members in 2011. One of the highlights of this conference is the "Top 10 Audit & Program Review Findings" presentation, which is updated annually. The presentation for FY 2012 identified many of the root causes of improper payments.
- **FSA Assessments:** FSA designed this online tool to help schools with compliance and improvement activities by performing self-assessments.
- **Information for Financial Aid Professionals (IFAP) Website:** This website consolidates guidance, resources, and information related to the administration and processing of Title IV federal student aid into one online site for use by the entire

financial aid community and includes training resources, as well as worksheets, schedules, and table templates to be used for day-to-day operations.

- **Federal Student Aid Call Centers:** The Research and Customer Care Center (RCCC) is a call center that assists schools with questions about the Title IV federal student aid programs, policies, and regulations.
- **Dear Colleague Letters:** Announcements sent from FSA Management to disseminate pertinent information and guidance on changes or updates in policies and procedures, create awareness and provide comment to common issues identified, and share information about tools and trainings that are becoming available. There were 60 Dear Colleague Letters publicized during the fiscal year.
- **FSA COACH:** A free, comprehensive, introductory course on school requirements for administering the Federal Student Aid programs, which spans 37 lessons.

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 Payment Outlook ($ in millions)									
Year	Pell			Direct Loan			FFEL		
	Outlays $[1][2]	IP%	IP $[5]	Outlays $[1][2]	IP%	IP $	Outlays/ Collections $[1][3][4]	IP%	IP $
FY 2011	36,515[1]	2.72	993	116,098[1]	0.22	255	42,616[1]	N/A	N/A
FY 2012	33,299[2]	2.49	829[5]	105,810[2]	N/A	N/A	28,620[3]	N/A	N/A
FY 2013	35,463[2]	2.49	883	171,075[2]	N/A	N/A	9,180[4]	N/A	N/A
FY 2014	36,419[2]	2.49	907	179,440[2]	N/A	N/A	8,363[4]	N/A	N/A
FY 2015	37,924[2]	2.49	944	186,367[2]	N/A	N/A	8,267[4]	N/A	N/A

[1] The source of FY 2011 outlays for all programs is the FY 2012 President's Budget request at the Mid-Session Review as presented in the FY 2011 AFR. The FY 2011 FFEL outlays include projected ECASLA put transactions related to participation and purchase agreements and the conduit.

[2] The source of the FY 2012 Pell and Direct Loan outlays amount is FMS. The source of FY 2013–2015 Pell and Direct Loan outlay amounts is the supporting documentation for the FY 2013 President's Budget request at the Mid-Session Review.

[3] FY 2012 FFEL outlays include related disbursements (e.g., Special Allowance Payments [SAP]) and collections (e.g., Negative SAP). The source of data for these 2012 FFEL disbursements and collections is FMS.

[4] The source of FY 2013–2015 FFEL outlays is supporting documentation for the FY 2013 President's Budget request at the Mid-Session Review. These amounts exclude ECASLA put transactions, which are anticipated to drop off significantly with the end of the participation and purchase agreements in 2010.

[5] The FY 2011 Pell overaward improper payment rate estimate is 1.80 percent or $599 million and the underaward improper payment rate estimate is 0.69 percent or $230 million.

The target IP percentage used for FY 2012–15 is baselined from the FY 2012 preliminary estimate.

Federal Student Aid presents below the outlook table for FY 2012 under the new methodology which is pending OMB approval.

Federal Student Aid Payment Outlook ($ in millions)									
Year	Pell			Direct Loan			FFEL		
	Outlays $[1][2]	IP%	IP $	Outlays $[1][2]	IP%	IP $	Outlays/ Collections $[1][3][4]	IP%	IP $
FY 2011	36,515[1]	2.72	993	116,098[1]	0.22	255	42,616[1]	N/A	N/A
FY 2012	33,299[2]	2.10	699	105,810[2]	0.58	614	28,620[3]	1.93	552
FY 2013	35,463[2]	2.10	745	171,075[2]	0.58	992	9,180[4]	1.93	177
FY 2014	36,419[2]	2.10	765	179,440[2]	0.58	1,041	8,363[4]	1.93	161
FY 2015	37,924[2]	2.10	796	186,367[2]	0.58	1,081	8,267[4]	1.93	160

[1] The source of FY 2011 outlays for all programs is the FY 2012 President's Budget request at the Mid-Session Review as presented in the FY 2011 AFR. The FY 2011 FFEL outlays include projected ECASLA put transactions related to participation and purchase agreements and the conduit.

[2] The source of the FY 2012 Pell and Direct Loan outlays amount is FMS. The source of FY 2013–2015 Pell and Direct Loan outlay amounts is the supporting documentation for the FY 2013 President's Budget request at the Mid-Session Review.

[3] FY 2012 FFEL outlays include related disbursements (e.g., Special Allowance Payments [SAP]) and collections (e.g., Negative SAP). The source of data for these 2012 FFEL disbursements and collections is FMS.

[4] The source of FY 2013–2015 FFEL outlays is supporting documentation for the FY 2013 President's Budget request at the Mid-Session Review. These amounts exclude ECASLA put transactions, which are anticipated to drop off significantly with the end of the participation and purchase agreements in 2010.

Although FSA is able to disclose the dollar value of overpayments and underpayments observed in the samples tested in our new methodology, a limitation to the approach is that we were not able to separately extrapolate overall program over and underpayment rates and dollars with the same precision as the gross estimate. The dollar value of Pell overpayments and underpayments that were observed in the sample of schools and students for tests of improper payments were $81,764 in overpayments and $21,151 in underpayments. The dollar value of Direct Loan overpayments and underpayments that were observed in the sample of schools and students for tests of improper payments were $93,362 in overpayments and $1,481 in underpayments. The dollar value of loan consolidation overpayments and underpayments observed in the sample of loan consolidation activity were $264,309 in overpayments and $277,914 in underpayments. The dollar value of FFEL overpayments and underpayments that were observed in the sample of lenders and lender servicers for tests of improper payments were $2,867 in overpayments and $15,268 in underpayments.

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 2012. The assessment, based primarily on FY 2011 audit data (the most recent available), yielded an estimated improper payment rate of 0.186 percent. This is consistent with previously reported data indicating that Title I does not meet the statutory 2.5 percent of expenditures threshold for susceptibility to improper payments.

The Department continues to rely on questioned cost data in audit reports to assess susceptibility by calculating a reasonable estimate of improper payments. The Department notes that questioned costs may not capture all potential improper payments to a recipient given that audits generally review only a small sample of transactions. However, it is difficult to estimate how findings from a sample may reflect a larger problem given that most individual audit findings cannot be projected with statistical confidence to 100 percent of an entity's payments.

On April 23, 2012, the OIG issued its first annual report on the Department's compliance with IPERA. The report found the Department to be in compliance. The report also noted that procedures for estimating improper payments for grant programs including Title I could be strengthened. As a result of the OIG report, the Department has undertaken several initiatives to address improper payments and strengthen its processes, one of which was to modify the methodology for calculating the estimated improper payment rate for Title I.

To develop this estimate for FY 2012, the Department conducted an analysis of audit data, including findings of questioned costs and sustained questioned costs from OIG audits, and their relationship to A-133 single audits. Following is a detailed discussion of the revised methodology.

As the nature and frequency of the OIG audits are different from that of the A-133 single audits, and the rate of questioned costs on average are higher in OIG audits, the Department conducted an analysis to determine how the statistically representative A-133 questioned cost data could be combined with the OIG data to produce a more accurate improper payment estimate. In the FY 2011 estimate, all questioned costs from FY 2010 A-133 and OIG audits were applied to the improper payment estimate with equal weight. However, a limited number of OIG audits were available to include in the estimate at the time of reporting.

For the FY 2012 estimate, based on the differences between the two types of audits, the Department developed a weighting system for the audit data. To determine these weights, a trending analysis of sustained questioned costs for the OIG audits for grant recipients and sub-recipients was conducted for the last five audit cycles. The analysis indicated that *sustained* question costs from OIG audits, weighted as a percentage of all A-133 and OIG audit findings in a given fiscal year, adjusted for the differences between the two types of audits and provided a more accurate estimate. Those differences included the OIG's authority to make audit assumptions that resulted in questioned costs beyond the sampled data, its focus on high-risk grantees and its judgmental sampling approaches, and the inclusion of a larger scale of payment records in their samples. The trend of sustained costs in OIG audits were compared to all questioned costs identified in A-133 audits for the same grantees over the same period of time. The differences identified in these rates served as the basis for weighting the data to estimate improper 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 is a Section 57 program.

Title I Improper Payment Reduction Outlook ($ in millions)			
	Outlays $[1]	**IP %**	**IP $**
FY 2011	17,926	.05	9.0
FY 2012	15,208	.186[2]	28.3
FY 2013	14,546	.186	27.1
FY 2014	14,511	.186	27.0
FY 2015	14.516	.186	27.0

[1] The sources of Title I outlays are FACTS II reports and the FY 2013 President's Budget request. These include ARRA outlays.
[2] The estimated amount of improper payments has been increased due to greater inclusion of OIG audit findings.

Other Grant Programs

Risk Assessments

The Department's approach to the risk assessment process for other non-Federal Student Aid grant programs has been the same as for Title I. The Department intends to continue using 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 findings from payment recapture audits of contracts have been consistently insignificant. For FY 2004–11, the Department relied on several different approaches to conduct payment recapture audits for the Department's contracts and purchase orders, which total approximately $1.5 billion annually. The amount recovered has consistently been insignificant, less than one percent (.0025 percent). Between 2007 and 2011 the Department conducted payment recapture audits of contract payments as part of its A-123 review process. The findings from these reviews, which are based on a random sample of contract payments, consistently demonstrated the low risk of improper payments in contract administration. In 2011, the quantitative results of these reviews (which found minimal improper payments) were combined with the Department's qualitative A-123 risk assessments of procurement management processes to determine that Department contracts are not susceptible to significant improper payments, as defined by OMB Circular A-123, Appendix C. The Department will continue to rely on the cyclical A-123 risk assessments and annual recapture audit activities to determine the susceptibility of contracts to improper payments.

In 2012, the Department refocused its resources and took the initiative to strengthen and expand its payment recapture efforts by leveraging recent advances in data mining technologies. The Department is in the final stages of awarding a contingency-based contract; proposals are currently being paneled with an anticipated award date of December 2012. The awarded contractor will conduct a payment recapture audit of all Department contract payments for fiscal years 2007–12 beginning with the most recent fiscal years. The audit will focus on identifying improper payments including overpayments, duplicate payments, payments to the wrong recipient, and payments for ineligible goods or services. Further, the data yielded will be used to investigate and report the root causes of all identified improper payments so corrective actions can be implemented. The Department anticipates the use of new data mining approaches may identify a small but significant number of improper payments that were previously undetected. A payment recapture audit of this kind supports the Department's strategic goal to improve its organizational capacity by increasing the efficient and effective use of contract resources.

The following chart presents the results of previous recapture efforts:

Contract Payment Recapture Audit Reporting ($ in millions)	
Amount Subject to Review for Current Year (2012) Reporting	$0
Actual Amount Reviewed and Reported (2012)	$0
Amounts Identified for Recovery (2012)	$0
Amounts Recovered (2012)	$0
% of Amount Recovered out of Amount Identified (2012)	NA
Amount Outstanding (2012)	$0
% Amount Outstanding out of Amount Identified (2012)	NA
Amount Determined Not to be Collectable (2012)	$0
% Amount Determined Not to be Collectable out of Amount Identified (2012)	NA
Amounts Identified for Recovery Prior Years (2005–12)	$0
Amounts Recovered (2005–12)	$0
Cumulative Amounts Identified for Recovery (2005–12)	$0
Cumulative Amounts Recovered (2005–12)	$0
Cumulative Amounts Outstanding (2005–12)	$0
Cumulative Amounts Determined Not to be Collectable (2005–12)	$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.

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 $6.2 million in FY 2012, $8.7 million in FY 2011, and $87.8 million cumulative from FY 2012 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.

Grant Reviews and 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 continues to explore the possibility of leveraging IPERA to create incentives for state governments that administer Department-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 all Department A-133 Single Audits, OIG Audits, and program reviews.

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

Agency Source	Amount Identified (FY 2012)	Amount Recovered (FY 2012)*	Amount Identified (FY 2011)	Amount Recovered (FY 2011)*	Cumulative Amount Identified (FY 2011–12)	Cumulative Amount Recovered (FY 2011–12)
Single Audit Reports	21.7	4.3	28.7	4.2	50.4	8.5
OIG Audit Reports	2.7	.2	13.5	3.4	16.2	3.6
Program Reviews	30.7	6.7	38.3	9.8	69	16.5

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

Information Systems and Infrastructure. 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) Entity Risk Review (ERR) 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 the Department'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 ERR see page 28 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.

The Department recently implemented continuous controls monitoring software to help detect anomalies and potential issues in agency payment-related data. These include all Department and FSA payments made through the G5 system. 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 any systemic weaknesses. This new automated tool is used to examine payment records and identify problems such as duplicate payments, unduly large payments, overpayments, and potential fictitious vendors. This software enhances the Department's analytical capacity to monitor potential improper payments, 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 2013, 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.

Department of Education
Schedule of Spending
For the Years Ended September 30, 2012 and 2011
(Dollars in Millions)

	FY 2012		FY 2011	
	Budgetary	Non-Budgetary Credit reform Financing Accounts	Budgetary	Non-Budgetary Credit reform Financing Accounts
What Money is Available to Spend?				
Total Resources	$ 104,710	$ 270,274	$ 103,494	$ 262,887
Less Amount Available but Not Agreed to be Spent	10,480	1	3,036	634
Less Amount Not Available to be Spent	2,142	18,992	2,398	14,768
Total Amounts Agreed to be Spent	**$ 92,088**	**$ 251,281**	**$ 98,060**	**$ 247,485**
How was the Money Spent?				
Increase College Access, Quality, and Completion				
Credit Program Loan Disbursements and Claim Payments	$ 56	$ 154,449	$ 99	$ 146,686
Credit Program Subsidy Transfers	8,337	40,650	3,081	50,202
Federal Interest Payments		26,629		20,181
Other Credit Program Payments	4	2,581	4	4,296
Federal Student Loan Reserve Fund Valuation	419		2,166	
Grants	39,364		42,926	
Personnel Compensation and Benefits	258		256	
Contractual Services	1,073	474	962	343
Other [1/]	37	8	38	16
	49,548	**224,791**	**49,532**	**221,724**
Improve Preparation for College and Career from Birth Through 12th Grade, Especially for Children with High Need				
Grants	22,154		21,786	
Personnel Compensation and Benefits	74		78	
Contractual Services	114		103	
Other [1/]	14		16	
	22,356		**21,983**	
Ensure Effective Educational Opportunities for All Students				
Grants	16,889		16,055	
Personnel Compensation and Benefits	168		166	
Contractual Services	64		65	
Other [1/]	25		23	
	17,146		**16,309**	
Enhance the Education System's Ability to Continuously Improve				
Grants	1,179		1,276	
Personnel Compensation and Benefits	88		88	
Contractual Services	399		423	
Other [1/]	16		15	
	1,682		**1,802**	
American Recovery and Reinvestment Act and Education Jobs Fund				
Grants	7,787		28,840	
Personnel Compensation and Benefits	4		6	
Contractual Services	10		22	
	7,801		**28,868**	
Total Spending	**98,533**	**224,791**	**118,494**	**221,724**
Amounts Remaining to be Spent[2/]	(6,445)	26,490	(20,434)	25,761
Total Amounts Agreed to be Spent	**$ 92,088**	**$ 251,281**	**$ 98,060**	**$ 247,485**

[1/] Other primarily consists of building rental payments, equipment purchases and transportation.
[2/] The "Amounts remaining to be spent" line item shown in the schedule above represents the difference between spending and amounts agreed to be spent during the given fiscal year. Actual spending during a particular fiscal year may include spending associated with amounts agreed to be spent during previous fiscal years, which may result in negative amounts shown for the "Amounts Remaining to be Spent" line item.

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 93–116 and the Department's management assurances on pages 33–36.

Summary of Financial Statement Audit

Audit Opinion: Unqualified
Restatement: No

Material Weaknesses	Beginning Balance	New	Resolved	Consolidated	Ending Balance
Total Material Weaknesses	**0**	**1**	**0**	**0**	**1**

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**	**1**	**1**	**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: Qualified

Material Weaknesses	Beginning Balance	New	Resolved	Consolidated	Reassessed	Ending Balance
Total Material Weaknesses	**0**	**1**	**0**	**0**	**0**	**1**

Conformance with Financial Management System Requirements—FMFIA 4

Statement of Assurance: The Department systems do not conform to financial management system requirements.

Non-Conformance	Beginning Balance	New	Resolved	Consolidated	Reassessed	Ending Balance
Total Non-Conformance	**0**	**1**	**0**	**0**	**0**	**1**

Compliance with *Federal Financial Management Improvement Act*

	Agency	Auditor
Overall Substantial Compliance	No	No
1. System Requirements	No	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

October 11, 2012

MEMORANDUM

TO: The Honorable Arne Duncan
Secretary of Education

FROM: Kathleen S. Tighe
Inspector General

SUBJECT: Management Challenges for Fiscal Year 2013

The Reports Consolidation Act of 2000 requires the U.S. Department of Education (Department), Office of Inspector General, 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.

Last year we presented four management challenges: improper payments, information technology security, oversight and monitoring, and data quality and reporting. While we noted some progress by the Department in addressing these areas, each remains as a management challenge for Fiscal Year (FY) 2013.

The FY 2013 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 2013 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 Patrick Howard, Assistant Inspector General for Audit, at (202) 245-6949, William Hamel, Assistant Inspector General for Investigations, at (202) 245-6922, or Charles Coe, Assistant Inspector General for Information Technology Audits and Computer Crime Investigations, at (202) 245-7033.

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 and Performance Challenges for Fiscal Year 2013 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: improper payments, information technology security, oversight and monitoring, and data quality and reporting. While we noted some progress by the Department in addressing these areas, each remains as a management challenge for Fiscal Year (FY) 2013.

The FY 2013 management challenges are:

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

Improper Payments. In FY 2010, the President established a goal to avoid $50 billion in improper payments government-wide by the end of FY 2012. Legislation was enacted and implementing guidance was issued to assist in meeting this goal. While PaymentAccuracy.gov reported that the Federal Government avoided over $20 billion in improper payments in FYs 2010 and 2011 combined, Federal agencies still reported an estimated $115 billion in improper payments for FY 2011. The Department estimated its Pell Grant program had more than $1 billion in improper payments in FY 2011, making it one of 14 programs identified as "high-error" at PaymentAccuracy.gov. A recent OIG audit identified weaknesses in the methodologies and data used to calculate the estimated improper payment rates for the Title I, Pell, and Direct Loan programs. In addition, OIG audit and investigative work over the past several years have identified improper payments in the Student Financial Assistance (SFA) programs, to or by State educational agencies (SEA) and local educational agencies (LEA), to other grantees, and to contractors. 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. Overall, the Department remains challenged to meet new requirements and to intensify its efforts to successfully prevent, identify, and recapture improper payments.

Information Technology Security. Recent audit work performed by the Department's financial statement auditor and OIG continue to identify control weaknesses within Information Technology (IT) security and systems that need to be addressed. The Department's financial statement auditor has identified IT controls as a significant deficiency for the past 3 years based on weaknesses related to access controls,

noncompliant passwords, configuration management, and administrator account monitoring. The OIG has found similar issues through its own work and identified additional weaknesses in operational, managerial, and technical security controls. Recent OIG reports identified weaknesses in compliance with configuration management, identity and access management, incident response and reporting, risk management, security training, remote access management, and contingency planning. Compromise of the Department's data or systems could cause substantial harm to the Department, negatively impact operations, and lead to identity theft or other fraudulent use of information. The Department provided corrective action plans to address the recommendations in our audits and has reported that some corrective actions are completed. However, vulnerabilities continue to exist and the Department needs to effectively address and eliminate IT security deficiencies where possible, continue to provide mitigating controls for vulnerabilities, and implement remaining planned actions to correct system weaknesses.

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 stakeholders. Four areas are included in this management challenge—SFA program participants, distance education, grantees, and contractors.

- **SFA 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. The Department estimated $193.5 billion will be used for SFA programs in FY 2013. This level of funding will provide an estimated 15.2 million students with assistance in paying the cost of their postsecondary education. 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 and our external audits of individual SFA program participants frequently identified noncompliance, waste, and abuse of SFA program funds. 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 an 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. The OIG also reported that the control weaknesses in distance education programs increase their susceptibility to "fraud rings"—large, loosely affiliated groups of criminals that seek to exploit distance education programs in order to fraudulently obtain Federal student aid. The Department has taken corrective actions to address many of the recommendations contained in our reports. However, the Department needs to increase its monitoring and oversight of schools providing distance education and develop requirements specifically to address potential problems inherent in distance education.

- **Grantees.** Effective monitoring and oversight are essential to ensure that grantees meet grant requirements and achieve program goals and objectives. Our work on Recovery Act and other grant programs has identified a number of weaknesses in grantee oversight and monitoring. These include LEA and SEA fiscal control issues; internal control weaknesses in the Department's oversight processes; and fraud perpetrated by LEA, SEA, 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 value of the Department's active contracts as of April 2012 was approximately $6.3 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. The OIG has identified issues relating to the lack of effective oversight and monitoring of contracts and contractor performance, primarily related to the appropriateness of contract prices and payments, and the effectiveness of contract management. OIG investigations have noted inappropriate activities by contractor employees that resulted in improper billings and payments. The Department has taken action to address many of the issues noted. However, because the Department relies on its contractors to help run its various programs and operations, effective contract management is critical for ensuring effective performance, that the Department receives the specified level and quality of products or services, and that payments made are appropriate. The Department still needs to work to ensure that it has an appropriately qualified staff in place and in sufficient numbers to provide effective oversight of its contracts.

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. SEAs annually collect data from LEAs and report various program data to the Department. 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. Ensuring that accurate and complete data are reported is critical to support effective management decisions.